SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for January 2008, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57102 / January 4, 2008

INVESTMENT ADVISERS ACT OF 1940
Release No. 2691 / January 4, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2766 / January 4, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12924

In the Matter of **SANTO C. MAGGIO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Santo C. Maggio ("Maggio" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

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herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Maggio, age 56, a resident of Naples, Florida, was a registered representative associated with Refco Securities, LLC, a registered broker-dealer, from May 1985 to October 2005. From 1991 to October 2005, Maggio was the President and Chief Executive Officer of Refco Securities. From May 1999 to August 2005, Maggio was a director of Forstmann-Leff Associates LLC and FLA Asset Management LLC, both of which were registered as investment advisers with the Commission. At all relevant times, Maggio held a Series 7 general securities license as well as Series 3, 4, 24, and 63 licenses. He is not currently associated with any regulated entity.

2. On December 28, 2007, a final judgment was entered by consent against Maggio, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 13(b)(5) of the Exchange Act, and Exchange Act Rules 10b-5, 13b2-1, and 13b2-2(a) and from aiding and abetting violations of Sections 13(b)(2)(A) and 15(d) of the Exchange Act and Exchange Act Rules 15d-2 and 15d-13, in the civil action entitled United States Securities and Exchange Commission v. Santo C. Maggio, Civil Action Number 07-cv-11388, in the United States District Court for the Southern District of New York.

3. The Commission's complaint in that action alleged, among other things, that from at least 1998 to October 2005, Maggio engaged in fraudulent conduct that repeatedly concealed, at the end of Refco fiscal periods, hundreds of millions of dollars of related party receivables owed to Refco Group Ltd. or its successor entity Refco Inc. (together "Refco"). The receivables were owed to Refco by an entity controlled by Refco's Chairman and Chief Executive Officer. In addition, the complaint alleged that, in 2004 and 2005, Maggio engaged in conduct that artificially inflated Refco's results of operations. As a result of this conduct, Refco provided false and materially misleading information in registration statements and other reports it filed with the Commission and provided to investors.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Maggio's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Maggio be, and hereby is barred from association with any broker, dealer, or investment adviser;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for January 2008, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ANNETTE L. NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

September 12, 2007

IN THE MATTER OF Terax Energy, Inc. File No. 500-1	:	CORRECTED ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Terax Energy, Inc. ("Terax," trading symbol TEXG.OB), because of questions regarding the accuracy of assertions by Terax and by others, in reports filed with the Commission and in press releases to investors concerning, among other things: (1) the status of Terax's oil and gas operations, (2) Terax's purported financing agreements, (3) Terax's supposed acquisition of a controlling interest in a foreign oil and gas firm, (4) the existence, terms and status of a purported share exchange agreement between Terax and Westar Oil, Inc., and (5) the identity of the persons in control of the operations and management of Terax.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed company is suspended for the period from 9:30 a.m. EDT, September 12, 2007 through 11:59 p.m. EDT, on September 25, 2007.

By the Commission.

Nancy M. Morris
Secretary

Florence E Harmon

By: Florence E. Harmon
Deputy Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57085 / January 2, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12917

In the Matter of **JAMES T. GARRETT, JR.,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against James T. Garrett, Jr. ("Garrett" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Garrett, 53 years old, is a resident of Charlotte, North Carolina. He was the president, general securities principal and FINOP of Carolinas First Investments, Inc. ("Carolinas First").

2. Carolinas First was a broker dealer registered with the Commission and with its principal place of business in Charlotte, North Carolina. The firm derived approximately 90% of its revenue from sales of subordinated notes issued by a South Carolina consumer loan company and from providing management services related to the note sales. On November 26, 2003, Carolinas First filed a Form BDW to withdraw its broker dealer registration. The withdrawal became effective in January 2004.

3. On June 15, 2007, Garrett pled guilty to nine counts of securities fraud in violation of Sections 35-1-1210(2), 35-1-1210(3) and 35-1-1590 of the South Carolina Code of Laws, before the Circuit Court of Charleston County, South Carolina, in State v. James T. Garrett, Jr., Case No. 2005-GS-47-31. On June 15, 2007, Garrett was sentenced to eight years in prison, suspended to five years of probation on the condition that he pay restitution of $75,500 to eight investors named in his indictment. Garrett's sentence further provided that his probation period would be decreased to two years once the restitution was paid. He was also barred from selling securities. Garrett has paid the restitution and is now serving his two years of probation.

4. The counts of the indictment to which Garrett pled guilty alleged, inter alia, that Garrett defrauded investors and obtained money by means of materially false and misleading statements or omissions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Garrett's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent Garrett be, and hereby is barred from association with any broker or dealer.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 3, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12918

In the Matter of vFinance Investments, Inc., Nicholas Thompson and Richard Campanella, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against vFinance Investments, Inc. ("vFinance"), Nicholas Thompson ("Thompson") and Richard Campanella ("Campanella") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. These proceedings involve the failure of a registered broker-dealer to maintain all documents pertinent to its business and provide those documents to the Commission in a prompt fashion for inspection and review.

2. The broker-dealer in this case, vFinance, violated the federal securities laws by failing to preserve and produce the customer correspondence of its registered representative, Thompson. Thompson repeatedly failed to produce records and deliberately deleted data from his hard drive relating to a matter under investigation by the Commission. Campanella failed to respond promptly to the Commission's document requests and failed to address Thompson's non-compliance with the firm's document retention policies.

B. RESPONDENTS

3. vFinance is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the NASD. vFinance is a Florida corporation with its principal executive offices in Boca Raton, Florida, and is a wholly-owned subsidiary of vFinance, Inc., a Delaware corporation whose securities are registered with the Commission pursuant to

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Section 12(g) of the Exchange Act. During 2004 and 2005, vFinance had about 25 branch offices and 125 registered representatives nationwide. On April 12, 2005, the Commission entered an Order Instituting Administrative Proceedings *In the Matter of vFinance Investments, Inc.*, Admin. Proc. File No. 3-11895, finding that vFinance had failed reasonably to supervise a trader through the inadequate implementation of supervisory procedures for preventing market manipulation. In settlement of that proceeding, vFinance retained an independent consultant who provided vFinance in early July 2005 with a preliminary report of the need to improve its supervision of traders.

4. Thompson was a registered representative associated with vFinance and the manager of a small vFinance branch in Flemington, New Jersey from 2002 until 2006. During 2004 and 2005, Thompson supervised one other registered representative (his father) and an administrative assistant in the Flemington branch. Thompson is 41 years old and resides in Kintnersville, Pennsylvania. While at vFinance, Thompson was authorized by vFinance's head trader to serve as a market maker of a microcap oil and gas firm, the shares of which were quoted on the OTC Bulletin Board, which became the subject of a Commission investigation into potential violations of the federal securities laws.

5. Campanella has been affiliated with vFinance as a registered representative since 2001 and was vFinance's Chief Operating Officer and Chief Compliance Officer during 2004 and 2005. Campanella became President of vFinance in January 2006 and then President and CEO of vFinance in July 2006. Campanella also is a director of vFinance, Inc. Campanella is 56 years old and resides in Boca Raton, Florida.

C. vFINANCE HAD A DUTY TO RETAIN AND PRODUCE DOCUMENTS

6. Section 17(a) of the Exchange Act mandates that broker-dealers "shall make and keep for prescribed periods such records, furnish copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title." Pursuant to its authority under Section 17(a), the Commission promulgated Rule 17a-4(b)(4), which requires broker-dealers to preserve for at least three years (the first two in an easily accessible place) "originals of all communications received and copies of all communications sent ... relating to its business as such." The Commission also promulgated Rule 17a-4(j), which requires broker-dealers to "furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the [broker-dealer] that are required to be preserved under [Rule 17a-4], or any other records of the [broker-dealer] subject to examination under Section 17(b) of the [Exchange Act] that are requested by the representative of the Commission." The Commission has made clear that it is of "overriding importance" that broker-dealers comply with the requests of regulatory authorities during investigations. *See In the Matter of Wedbush Securities, Inc.*, 48 S.E.C. 963, 971-72 (1988).

7. vFinance had in place certain procedures and policies with respect to document retention, but failed to develop reasonable systems to implement them. vFinance's policies required Thompson to retain copies of all correspondence in his branch in correspondence files.

8. In his role as Chief Operating Officer, Campanella was responsible for vFinance's document retention practices.

9. vFinance had an unwritten policy prohibiting the use of non-vFinance email accounts for work purposes. vFinance adopted a policy in August 2003 requiring that instant messages be printed and saved in paper files. vFinance's systems did not retain instant messages or emails in non-vFinance email accounts.

10. Campanella prepared the vFinance instant message policy citing the July 2003 NASD Notice to Members entitled "Instant Messaging," which said "[m]embers that permit instant messaging must use a platform that enables the member to monitor, archive, and retrieve message traffic."

11. vFinance executives knew the firm was required to monitor and maintain customer correspondence in branch offices. On March 22, 2004, the chairman of vFinance, Inc. sent Campanella and vFinance's then-President an email with a link to SEC Staff Legal Bulletin No. 17. The bulletin said, "if firms permit communications with customers from employees' home computers or personal computers not connected to the firm's network, SRO rules require firms to employ systems to monitor those communications." The bulletin specifically cited firms' obligation "to maintain copies of incoming and outgoing correspondence" in branch offices under Section 17(a) of the Exchange Act and Rule 17a-4.

D. vFINANCE, AIDED AND ABETTED BY CAMPANELLA AND THOMPSON, FAILED TO RETAIN DOCUMENTS

12. Since at least 2003, Thompson used non-vFinance email accounts and instant messages to communicate with customers and for other business purposes. As previously described, vFinance policies required Thompson to retain in correspondence files copies of all work-related emails and instant messages, including paper copies of all instant messages. Nonetheless, Thompson deleted numerous work-related emails and instant messages from his computer, and did not print out and retain the emails and messages in hard-copy correspondence files. Thompson also periodically deleted all documents from his computer by reformatting the hard drive and wiping it clean.

13. Campanella relied on annual office inspections and branch manager questionnaires to monitor the firm's document retention practices in branch offices. The vFinance employee who visited Thompson's branch office sent notes and reports to Campanella that discussed Thompson's document retention practices. The notes from his first visit to Thompson's office in December 2003 said Thompson had "no written correspondence," which was highly unusual because Thompson was engaged in extensive retail trading and market making activities while at vFinance. In 2003, 2004 and 2005, he reported to Campanella and vFinance that Thompson was using an instant message program for business purposes and not retaining messages in paper files as required. He reported to Campanella and vFinance again in 2005 that his review of Thompson's "incoming and outgoing correspondence, faxes and e-mails revealed very little correspondence with clients" (which was inexplicable given Thompson's extensive retail trading and market making activities).

14. Campanella was separately on notice as early as March 2004 that Thompson was not complying with the firm's policy against using non-vFinance email for work purposes. In March 2004, he received a work-related email from Thompson's personal blast.net account. In

August 2004, Campanella received an email from Thompson's personal account discussing trading in the issuer's stock.

15. On September 1, 2005, vFinance's head trader, whom Campanella directed to collect documents from Thompson in response to the staff's request, copied Campanella on an email he sent to Thompson stating that "the firm definitely captures all emails, except the ones from a personal account like [your blast.net] account ... **you** are required to retain the ones from your personal account."

16. No one at vFinance ever reprimanded Thompson or told him to stop using personal email and instant message accounts to communicate with customers or to print and save instant messages.

E. vFINANCE, AIDED AND ABETTED BY CAMPANELLA AND THOMPSON, FAILED TO PRODUCE DOCUMENTS PROMPTLY

17. In mid-2005, the staff of the Commission was conducting an investigation into possible securities law violations involving a microcap oil and gas company (the "issuer"). On July 18, 2005, the Commission's staff sent a letter to Campanella asking vFinance to preserve all documents relating to the issuer and to produce documents – including trading records and correspondence – regarding the issuer. Only an incomplete and tardy production of documents was made by vFinance in response to that July 18th request, and vFinance failed (through Campanella) to address whether Thompson preserved and produced all documents relating to the issuer.

18. In August 2005, the Commission's staff asked vFinance (through Campanella) for the contents of Thompson's computer hard drive and made the same request of Thompson's legal counsel in September 2005. vFinance and Campanella failed to take any action at that time to provide the Commission with Thompson's computer hard drive. Additionally, rather than producing and saving all materials relating to the issuer, Thompson deleted from his computer, files and correspondence relating to the issuer and other companies for which Thompson's firm was a market maker. Furthermore, in or around November 2005, Thompson ran a special disk wiping program designed to eliminate all traces of the erased files on his hard drive. Thompson then loaded specially selected emails and messages that he had set aside back onto his computer before producing it to the Commission's staff on February 14, 2006, without telling the Commission staff about his deletions.

19. Campanella was the person at vFinance responsible for responding to the staff's document requests on behalf of vFinance, first as Chief Compliance Officer and Chief Operating Officer, and then as President. Campanella repeatedly told the staff that vFinance would not physically go to Thompson's vFinance branch office to look for documents because Thompson's employment status was that of an independent contractor rather than an employee. In fact, Thompson's independent contractor agreement required Thompson to give vFinance access to all business records in his office upon request.

20. In response to the staff's July 2005 document request, Campanella sent the staff some records electronically stored at vFinance's headquarters office for some (but not all) of the accounts that traded in the issuer's stock, and told the staff that Thompson had no correspondence

related to the issuer. vFinance produced a small number of additional documents in September and October 2005 in response to the staff's request, but the documents still did not include any of Thompson's customer correspondence. On November 18, 2005, Campanella incorrectly certified that vFinance's document production was complete.

21. After the Commission issued a formal order of investigation relating to the issuer in May 2006, the staff issued subpoenas to Thompson and vFinance covering the same documents that had been requested in July 2005 and extending the relevant time period to the date of the subpoenas. Thompson produced no additional documents. When Thompson resigned from vFinance in August 2006, vFinance did not attempt to retrieve his vFinance documents.

22. vFinance ultimately produced additional documents, but not until December 2006, after the staff told vFinance that the staff had learned from other sources that there were at least three additional vFinance accounts that had traded in the issuer's securities during the relevant time period. In February 2007, nineteen months after the staff's first document request, vFinance produced account records for all accounts that had traded the issuer's stock. At the same time, vFinance also produced a small number of Thompson's instant messages that it claimed to have recently discovered – nineteen months after the staff's initial document request – and told the staff these were the only instant messages of Thompson's it had retained.

23. In March 2007, Campanella finally searched Thompson's office for documents. Campanella located additional responsive documents from Thompson's paper customer files, but could not find Thompson's emails and instant messages.

F. VIOLATIONS

24. As a result of the conduct described above, vFinance willfully violated Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(j) thereunder when it failed to retain for at least three years (the first two in an easily accessible place) Thompson's electronic communications relating to vFinance's business as such, and failed to furnish promptly to the staff upon request records that vFinance was required to maintain.

25. As a result of the conduct described above, Thompson willfully aided and abetted and caused vFinance's violations of Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(j) thereunder. Thompson knowingly provided substantial assistance to vFinance in furtherance of vFinance's violations by communicating with customers using accounts outside the vFinance network, only keeping copies of those communications on his computer, and periodically deleting all documents from his computer by reformatting and wiping it clean. Thompson delayed producing his hard drive for six months, and never provided any documents from his paper customer files to vFinance or the staff in response to the staff's requests.

26. As a result of the conduct described above, Campanella willfully aided and abetted and caused vFinance's violations of Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(j) thereunder. Campanella, who as Chief Operating Officer was responsible for vFinance's document retention practices, knowingly provided substantial assistance to vFinance in furtherance of vFinance's violations by taking no action to retain Thompson's electronic communications after learning that Thompson was using accounts outside the vFinance network for business purposes and

failing to retain copies of the communications. Campanella never instructed Thompson to stop using email and instant message accounts outside the vFinance network for work purposes, nor did he ensure that vFinance had a system or procedures for retaining Thompson's work-related communications in those accounts. Campanella, who as Chief Operating Officer/Chief Compliance Officer and then as President was responsible for vFinance's prompt production of documents requested by the staff, knowingly provided substantial assistance to vFinance in furtherance of its failure promptly to furnish the requested documents by insisting that vFinance was not responsible for producing documents from Thompson's office and failing to produce account records and paper customer files relating to the issuer for nineteen months.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act; and

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(j) thereunder.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57092 / January 3, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2765 / January 3, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12920

In the Matter of **GREG A. GADEL (CPA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Greg A. Gadel ("Respondent" or "Gadel") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Gadel has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3. below, which are admitted, Gadel consents to the entry of this

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Gadel's Offer, the Commission finds that:

1. Gadel, age 47, is and has been a certified public accountant who has never been licensed to practice in any state. He served as Chief Financial Officer and Senior Vice President of Buca, Inc ("Buca") from 1997 until his resignation in February 2005.

2. Buca was, at all relevant times, a Minnesota corporation with its principal place of business in Minneapolis, Minnesota. Buca is the holding company for the Buca di Beppo restaurant chain. Buca conducted an initial public offering of its stock in 1999. Since Buca's initial public offering, its common stock has been registered pursuant to Section 12(g) of the Exchange Act and traded on NASDAQ.

3. On June 7, 2006, the Commission filed a complaint against Gadel in the civil action entitled Securities and Exchange Commission v. Greg A. Gadel and Daniel J. Skrypek, Civil Action Number 06-cv-2320, in the United States District Court for the District of Minnesota. On December 21, 2007, the court entered a final judgment against Gadel, permanently enjoining him from future violations of Section 17(a) of the Securities Exchange Act of 1933 ("Securities Act") and Sections 10(b), 13(b)(5), and 14(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 13a-14, 13b2-1, 13b2-2, 14a-3, and 14a-9 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Gadel was also prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

4. The Commission's complaint alleged, among other things, that Gadel engaged in a fraudulent scheme which resulted in Buca filing materially false and misleading financial statements in the company's annual reports on Form 10-K for the years ended 2000 to 2003, and in the company's quarterly reports for every quarter in fiscal years 2000 to 2003 and the first three quarters of fiscal year 2004. The complaint alleged that Gadel engaged in improper accounting practices that materially increased Buca's pre-tax income, in a departure from Generally Accepted Accounting Principles ("GAAP"). These practices included improperly capitalizing expenses. The complaint also alleged that Gadel failed to ensure disclosure of two related party transactions involving Buca's Chief Executive Officer and a series of related party transactions in which Gadel was involved. The complaint further alleged that Gadel provided false and misleading information to Buca's auditors concerning Buca's financial statements and falsely certified the accuracy of Buca's 2002 and 2003 Forms 10-K. The complaint further alleged that Gadel was involved in drafting and approving proxy statements that materially understated his compensation and the compensation of Buca's Chief Executive Officer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Gadel's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

Gadel is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57091 / January 3, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2764 / January 3, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12919

In the Matter of DANIEL J. SKRYPEK, CPA, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Daniel J. Skrypek ("Respondent" or "Skrypek") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Skrypek has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3. below, which are admitted, Skrypek consents to the entry of

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Skrypek, age 34, is and has been a certified public accountant licensed to practice in the State of Minnesota. From 1999 until his termination on March 14, 2005, he served as Controller of Buca, Inc. ("Buca"). From 2001 until 2005, Skrypek also acted as a vice president of Buca. In addition, Skrypek was Buca's interim CFO from February 15, 2005 until March 14, 2005.

2. Buca was, at all relevant times, a Minnesota corporation with its principal place of business in Minneapolis, Minnesota. Buca is the holding company for the Buca di Beppo restaurant chain. Buca conducted an initial public offering of its stock in 1999. Since Buca's initial public offering, its common stock has been registered pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on NASDAQ.

3. On June 7, 2006, the Commission filed a complaint against Skrypek in the civil action entitled Securities and Exchange Commission v. Greg A. Gadel and Daniel J. Skrypek, Civil Action Number 06-cv-2320, in the United States District Court for the District of Minnesota. On December 21, 2007, the court entered a final judgment against Skrypek, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b), 13(b)(5), and 14(a) of the Exchange Act and Rules 10b-5, 13b2-1, 13b2-2, 14a-3, and 14a-9 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. The final judgment also prohibited Skrypek from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, for a period of five years after entry of the final judgment.

4. The Commission's complaint alleged, among other things, that Skrypek participated in a course of conduct which resulted in Buca filing materially false and misleading financial statements in the company's annual reports on Form 10-K for the fiscal years ended 2000, 2001, 2002, and 2003, and in the company's quarterly reports for all four quarters in fiscal years 2000 through 2003 and the first three quarters of fiscal year 2004. The complaint alleged that Skrypek facilitated Buca's engaging in improper accounting practices that materially increased its pre-tax income, which was a departure from Generally Accepted Accounting Principles ("GAAP"), including improperly capitalizing expenses. The complaint also alleged that Skrypek failed to ensure the disclosure of two related party transactions involving Buca's Chief Executive Officer and a series of related party transactions in which Buca's Chief Financial Officer was involved. The complaint further alleged that Skrypek signed management representation letters on behalf of Buca that provided false and misleading information to Buca's auditors concerning the

company's financial statements. In addition, the complaint alleged that Skrypek was involved in drafting proxy statements that materially understated the compensation of Buca's Chief Executive Officer and Chief Financial Officer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Skrypek's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Skrypek is suspended from appearing or practicing before the Commission as an accountant.

B. After five (5) years from the date of this Order, Skrypek may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Skrypek's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Skrypek, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Skrypek, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in his or the firm's quality control system that would indicate that he will not receive appropriate supervision;

(c) Skrypek has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Skrypek acknowledges his responsibility, as long as he appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Skrypek to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Skrypek's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 4, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12922

In the Matter of Accent Color Sciences, Inc., ActFit.com, Inc. (n/k/a Telum International Corp.), AdPads, Inc., Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.), Aero Group, Inc., and Alford Refrigerated Warehouses, Inc., Respondents.	ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Accent Color Sciences, Inc., ActFit.com, Inc. (n/k/a Telum International Corp.), AdPads, Inc., Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.), Aero Group, Inc., and Alford Refrigerated Warehouses, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Accent Color Sciences, Inc. ("Accent") (CIK No. 921898) is a Connecticut corporation located in East Hartford, Connecticut with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Accent is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 30, 2001, which reported a net loss of $770,586 for the prior three months. On June 29, 2001, Accent filed a Chapter

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7 petition with the U.S. Bankruptcy Court for the District of Connecticut that is still pending. As of December 21, 2007, the company's common stock (symbol "ACLR") was quoted on the Pink Sheets, had nine market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

2. ActFit.com, Inc. (n/k/a Telum International Corp.) ("ActFit") (CIK No. 1055364) is an Ontario corporation located in Woodbridge, Ontario, Canada with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). ActFit is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a $12 million (Canadian) deficit for fiscal year 2001. As of December 21, 2007, the company's common stock (symbol "TLMIF") was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

3. AdPads, Inc. ("AdPads") (CIK No. 1100362) is a Colorado corporation located in Neptune, New Jersey with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). AdPads is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $1.3 million for the prior nine months. As of December 21, 2007, the company's common stock (symbol "APAD") was quoted on the Pink Sheets, had twelve market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

4. Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.) ("Advanced Products") (CIK No. 1096154) is a Delaware corporation located in Landenberg, Pennsylvania with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Products is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2000. As of December 21, 2007, the company's common stock (symbol "CLDH") was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

5. Aero Group, Inc. ("Aero Group") (CIK No. 891705) is a Utah corporation located in Jacksonville, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Aero Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001. As of December 21, 2007, the company's common stock (symbol "AROU") was quoted on the Pink Sheets, had ten market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

6. Alford Refrigerated Warehouses, Inc. ("Alford") (CIK No. 1078006) is a forfeited Texas corporation located in Dallas, Texas with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Alford is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which

reported a net loss of $214,046 for the prior three months. As of December 21, 2007, the company's stock (symbol "ALFO") was quoted on the Pink Sheets, had two market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K, 10-KSB, or 20-F), and Rule 13a-13 requires domestic issuers to file quarterly reports (Forms 10-Q or 10-QSB). Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Appendix 1

Chart of Delinquent Filings
Accent Color Sciences, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Accent Color Sciences, Inc.					
	10-Q	06/30/01	08/14/01	Not filed	76
	10-Q	09/30/01	11/14/01	Not filed	73
	10-K	12/31/01	04/01/02	Not filed	68
	10-Q	03/31/02	05/15/02	Not filed	67
	10-Q	06/30/02	08/14/02	Not filed	64
	10-Q	09/30/02	11/14/02	Not filed	61
	10-K	12/31/02	03/31/03	Not filed	57
	10-Q	03/31/03	05/15/03	Not filed	55
	10-Q	06/30/03	08/14/03	Not filed	52
	10-Q	09/30/03	11/14/03	Not filed	49
	10-K	12/31/03	03/30/04	Not filed	45
	10-Q	03/31/04	05/17/04	Not filed	43
	10-Q	06/30/04	08/16/04	Not filed	40
	10-Q	09/30/04	11/15/04	Not filed	37
	10-K	12/31/04	03/31/05	Not filed	33
	10-Q	03/31/05	05/16/05	Not filed	31
	10-Q	06/30/05	08/15/05	Not filed	28
	10-Q	09/30/05	11/14/05	Not filed	25
	10-K	12/31/05	03/31/06	Not filed	21
	10-Q	03/31/06	05/15/06	Not filed	19
	10-Q	06/30/06	08/14/06	Not filed	16
	10-Q	09/30/06	11/14/06	Not filed	13
	10-Q	12/31/06	02/14/07	Not filed	10
	10-Q	03/31/07	05/15/07	Not filed	7
	10-Q	06/30/07	08/14/07	Not filed	4
	10-Q	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	26				
ActFit.com, Inc. (n/k/a Telum International Corp.)					
	20-F	12/31/02	06/30/03	Not filed	47
	20-F	12/31/03	06/30/04	Not filed	42
	20-F	12/31/04	06/30/04	Not filed	42
	20-F	12/31/05	06/30/06	Not filed	18

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
ActFit.com, Inc. (n/k/a Telum International Corp.)					
	20-F	12/31/06	07/02/07	Not filed	5
Total Filings Delinquent	5				
AdPads, Inc.					
	10-KSB	12/31/02	03/31/03	Not filed	57
	10-QSB	03/31/03	05/15/03	Not filed	55
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	20				
Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.)					
	10-QSB	03/31/01	05/15/01	Not filed	79
	10-KSB	06/30/01	09/28/01	Not filed	75
	10-QSB	09/30/01	11/14/01	Not filed	73
	10-QSB	12/31/01	02/14/02	Not filed	70
	10-QSB	03/31/02	05/15/02	Not filed	67
	10-KSB	06/30/02	09/30/02	Not filed	63

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.)					
	10-QSB	09/30/02	11/14/02	Not filed	61
	10-QSB	12/31/02	02/14/03	Not filed	58
	10-QSB	03/31/03	05/15/03	Not filed	55
	10-KSB	06/30/03	09/29/03	Not filed	51
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-QSB	12/31/03	02/17/04	Not filed	46
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-KSB	06/30/04	09/28/04	Not filed	39
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-QSB	12/31/04	02/14/05	Not filed	34
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-KSB	06/30/05	09/28/05	Not filed	27
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-QSB	12/31/05	02/14/06	Not filed	22
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-KSB	06/30/06	09/28/06	Not filed	15
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-QSB	12/31/06	02/14/07	Not filed	10
	10-QSB	03/31/07	05/15/07	Not filed	3
	10-QSB	06/30/07	09/28/07	Not filed	3
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	27				
Aero Group, Inc.					
	10-KSB	12/31/01	04/01/02	Not filed	68
	10-QSB	03/31/02	05/15/02	Not filed	67
	10-QSB	06/30/02	08/14/02	Not filed	64
	10-QSB	09/30/02	11/14/02	Not filed	61
	10-KSB	12/31/02	03/31/03	Not filed	57
	10-QSB	03/31/03	05/15/03	Not filed	55
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Aero Group, Inc.					
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	24				
Alford Refrigerated Warehouses, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	80
	10-QSB	03/31/01	05/15/01	Not filed	79
	10-QSB	06/30/01	08/14/01	Not filed	76
	10-QSB	09/30/01	11/14/01	Not filed	73
	10-KSB	12/31/01	04/01/02	Not filed	68
	10-QSB	03/31/02	05/15/02	Not filed	67
	10-QSB	06/30/02	08/14/02	Not filed	64
	10-QSB	09/30/02	11/14/02	Not filed	61
	10-KSB	12/31/02	03/31/03	Not filed	57
	10-QSB	03/31/03	05/15/03	Not filed	55
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Alford Refrigerated Warehouses, Inc.					
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1

Total Filings Delinquent 27

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 4, 2008

IN THE MATTER OF **ABC Dispensing Technologies, Inc.** **(n/k/a Ka Wang Holding, Inc.)** **Accent Color Sciences, Inc.,** **Access Tradeone.com, Inc.,** **ActFit.com, Inc.** **(n/k/a Telum International Corp.),** **Addison-Davis Diagnostics, Inc.,** **Aden Enterprises, Inc.,** **AdPads, Inc.,** **Advanced Products Group, Inc.** **(n/k/a Cloudtech Sensors, Inc.)** **Advanced Recycling Sciences, Inc.,** **Advanced Systems** **International, Inc.,** **Aero Group, Inc., and** **Alford Refrigerated Warehouses, Inc.,** **File No. 500-1**	:	**ORDER OF SUPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ABC Dispensing Technologies, Inc. (n/k/a Ka Wang Holding, Inc.) because it has not filed any periodic reports since the period ended July 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Accent Color Sciences, Inc. because it has not filed any periodic reports since the period ended June 29, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Access Tradeone.com, Inc. because it has not filed any periodic reports since November 2, 1999.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ActFit.com, Inc. because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Addison-Davis Diagnostics, Inc. because it has not filed any periodic reports since the period ended March 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Aden Enterprises, Inc. because it has not filed any periodic reports since the period ended January 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of AdPads, Inc. because it has not filed any periodic reports since September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Advanced Products Group, Inc. (n/k/a Cloudtech Sensors, Inc.) because it has not filed any periodic reports since December 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Advanced Recycling Sciences, Inc. because it has not filed any periodic reports since the period ended March 31, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Advanced Systems International, Inc. because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Aero Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Alford Refrigerated Warehouses, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed companies is suspended for the period from 9:30 a.m. EST on January 4, 2008, through 11:59 p.m. EST on January 17, 2008.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 4, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12921

In the Matter of **ABC Dispensing Technologies, Inc.** **Access Tradeone.com, Inc.,** **Addison-Davis Diagnostics, Inc.,** **Aden Enterprises, Inc.,** **Advanced Recycling Sciences, Inc., and** **Advanced Systems International, Inc.,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents ABC Dispensing Technologies, Inc., Access Tradeone.com, Inc., Addison-Davis Diagnostics, Inc., Aden Enterprises, Inc., Advanced Recycling Sciences, Inc., and Advanced Systems International, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. ABC Dispensing Technologies, Inc. ("ABC") (CIK No. 748103) is an inactive Florida corporation located in Akron, Ohio with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). ABC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2001, which reported a net loss of $416,000 for the prior three months. ABC was purportedly acquired by a Chinese clothing company and renamed Ka Wang Holding, Inc. As of December 20, 2007, the common stock of Ka Wang Holding, Inc. (symbol "KWGI") was traded on the Pink Sheets, had fifteen market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-

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11(f)(3). However, Ka Wang Holding, Inc. has failed to establish that it is a legitimate successor to ABC.

2. Access Tradeone.com, Inc. ("Access") (CIK No. 1096018) is a defaulted Nevada corporation located in Las Vegas, Nevada with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Access is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on November 2, 1999. As of December 20, 2007, the company's common stock (symbol "ACST") was quoted on the Pink Sheets, had four market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

3. Addison-Davis Diagnostics, Inc. ("Addison-Davis") (CIK No. 932127) is a Delaware corporation located in Westlake Village, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Addison-Davis is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2006, which reported a net loss of $2.7 million for the prior nine months. On October 5, 2006, Addison-Davis filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which is still pending. On August 6, 2007, at a status conference in the bankruptcy case, Addison-Davis's president advised the Commission's bankruptcy counsel that he had received the Division of Corporation Finance's delinquency letter, but that until the reorganization plan's funding came through, the company did not have the money to bring its periodic filings current. As of December 20, 2007, the company's common stock (symbol "ADSD") was quoted on the Pink Sheets, had twelve market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

4. Aden Enterprises, Inc. ("Aden") (CIK No. 798538) is a suspended California corporation located in Omaha, Nebraska with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Aden is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2000, which reported a net loss of $9.3 million for the prior nine months. As of December 20, 2007, the company's common stock (symbol "ADEN") was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

5. Advanced Recycling Sciences, Inc. ("Advanced Recycling") (CIK No. 921450) is a Nevada corporation located in Irvine, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Recycling is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended March 31, 2003, which reported a net loss of $1.69 million for fiscal year 2002. As of December 20, 2007, the company's common stock (symbol "ARYC") was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

6. Advanced Systems International, Inc. ("Advanced Systems ") (CIK No. 1070497) is a defaulted Nevada corporation located in Southfield, Michigan with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of $1.9 million for the prior nine months. As of December 20, 2007, the company's common stock (symbol "ADSN") was quoted on the Pink Sheets, had eight market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Appendix 1

Chart of Delinquent Filings
ABC Dispensing Technologies, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
ABC Dispensing Technologies, Inc.					
	10-Q	10/31/01	12/17/01	Not filed	72
	10-Q	01/31/02	03/18/02	Not filed	69
	10-K	04/30/02	07/29/02	Not filed	65
	10-Q	07/31/02	09/16/02	Not filed	63
	10-Q	10/31/02	12/16/02	Not filed	60
	10-Q	01/31/03	03/17/03	Not filed	57
	10-K	04/30/03	07/29/03	Not filed	53
	10-Q	07/31/03	09/15/03	Not filed	51
	10-Q	10/31/03	12/15/03	Not filed	48
	10-Q	01/31/04	03/16/04	Not filed	45
	10-K	04/30/04	07/29/04	Not filed	41
	10-Q	07/31/04	09/14/04	Not filed	39
	10-Q	10/31/04	12/15/04	Not filed	36
	10-Q	01/31/05	03/17/05	Not filed	33
	10-K	04/30/05	07/29/05	Not filed	29
	10-Q	07/31/05	09/14/05	Not filed	27
	10-Q	10/31/05	12/15/05	Not filed	24
	10-Q	01/31/06	03/17/06	Not filed	21
	10-K	04/30/06	07/31/06	Not filed	17
	10-Q	07/31/06	09/14/06	Not filed	15
	10-Q	10/31/06	12/15/06	Not filed	12
	10-Q	01/31/07	03/19/07	Not filed	9
	10-K	04/30/07	07/30/07	Not filed	5
	10-Q	07/31/07	09/14/07	Not filed	3
	10-Q	10/31/07	12/17/07	Not filed	0
Total Filings Delinquent	25				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Access Tradeone.com, Inc.					
	10-QSB	03/31/00	05/15/00	Not filed	91
	10-QSB	06/30/00	08/14/00	Not filed	88
	10-QSB	09/30/00	11/14/00	Not filed	85
	10-KSB	12/31/00	04/02/01	Not filed	80
	10-QSB	03/31/01	05/15/01	Not filed	79
	10-QSB	06/30/01	08/14/01	Not filed	76
	10-QSB	09/30/01	11/14/01	Not filed	73
	10-KSB	12/31/01	04/01/02	Not filed	68
	10-QSB	03/31/02	05/15/02	Not filed	67
	10-QSB	06/30/02	08/14/02	Not filed	64
	10-QSB	09/30/02	11/14/02	Not filed	61
	10-KSB	12/31/02	03/31/03	Not filed	57
	10-QSB	03/31/03	05/15/03	Not filed	55
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1

Total Filings Delinquent 31

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Addison-Davis Diagnostics, Inc.					
	10-KSB	06/30/06	09/28/06	Not filed	15
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-QSB	12/31/06	02/14/07	Not filed	10
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-KSB	06/30/07	09/28/07	Not filed	3
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	6				
Aden Enterprises, Inc.					
	10-KSB	04/30/00	07/31/00	Not filed	89
	10-QSB	07/31/00	09/14/00	Not filed	87
	10-QSB	10/31/00	12/15/00	Not filed	84
	10-QSB	01/31/01	03/19/01	Not filed	81
	10-KSB	04/30/01	07/30/01	Not filed	77
	10-QSB	07/31/01	09/14/01	Not filed	75
	10-QSB	10/31/01	12/17/01	Not filed	72
	10-QSB	01/31/02	03/18/02	Not filed	69
	10-KSB	04/30/02	07/29/02	Not filed	65
	10-QSB	07/31/02	09/16/02	Not filed	63
	10-QSB	10/31/02	12/16/02	Not filed	60
	10-QSB	01/31/03	03/17/03	Not filed	57
	10-KSB	04/30/03	07/29/03	Not filed	53
	10-QSB	07/31/03	09/15/03	Not filed	51
	10-QSB	10/31/03	12/15/03	Not filed	48
	10-QSB	01/31/04	03/16/04	Not filed	45
	10-KSB	04/30/04	07/29/04	Not filed	41
	10-QSB	07/31/04	09/14/04	Not filed	39
	10-QSB	10/31/04	12/15/04	Not filed	36
	10-QSB	01/31/05	03/17/05	Not filed	33
	10-KSB	04/30/05	07/29/05	Not filed	29
	10-QSB	07/31/05	09/14/05	Not filed	27
	10-QSB	10/31/05	12/15/05	Not filed	24
	10-QSB	01/31/06	03/17/06	Not filed	21
	10-KSB	04/30/06	07/31/06	Not filed	17
	10-QSB	07/31/06	09/14/06	Not filed	15
	10-QSB	10/31/06	12/15/06	Not filed	12
	10-QSB	01/31/07	03/19/07	Not filed	9

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Aden Enterprises, Inc.					
	10-KSB	04/30/07	07/30/07	Not filed	5
	10-QSB	07/31/07	09/14/07	Not filed	3
	10-QSB	10/31/07	12/17/07	Not filed	0
Total Filings Delinquent	31				
Advanced Recycling Sciences, Inc.					
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	18				
Advanced Systems International, Inc.					
	10-KSB	12/31/01	04/01/02	Not filed	68
	10-QSB	03/31/02	05/15/02	Not filed	67
	10-QSB	06/30/02	08/14/02	Not filed	64
	10-QSB	09/30/02	11/14/02	Not filed	61
	10-KSB	12/31/02	03/31/03	Not filed	57
	10-QSB	03/31/03	05/15/03	Not filed	55

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Advanced Systems International, Inc.					
	10-QSB	06/30/03	08/14/03	Not filed	52
	10-QSB	09/30/03	11/14/03	Not filed	49
	10-KSB	12/31/03	03/30/04	Not filed	45
	10-QSB	03/31/04	05/17/04	Not filed	43
	10-QSB	06/30/04	08/16/04	Not filed	40
	10-QSB	09/30/04	11/15/04	Not filed	37
	10-KSB	12/31/04	03/31/05	Not filed	33
	10-QSB	03/31/05	05/16/05	Not filed	31
	10-QSB	06/30/05	08/15/05	Not filed	28
	10-QSB	09/30/05	11/14/05	Not filed	25
	10-KSB	12/31/05	03/31/06	Not filed	21
	10-QSB	03/31/06	05/15/06	Not filed	19
	10-QSB	06/30/06	08/14/06	Not filed	16
	10-QSB	09/30/06	11/14/06	Not filed	13
	10-KSB	12/31/06	04/02/07	Not filed	8
	10-QSB	03/31/07	05/15/07	Not filed	7
	10-QSB	06/30/07	08/14/07	Not filed	4
	10-QSB	09/30/07	11/14/07	Not filed	1
Total Filings Delinquent	24				

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 4, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12925

In the Matter of Euro Capital Incorporated, Respondent.	ORDER TEMPORARILY SUSPENDING EXEMPTION PURSUANT TO SECTION 3(b) OF THE SECURITIES ACT OF 1933 AND REGULATION A THEREUNDER, STATEMENT OF REASONS FOR ENTRY OF ORDER, AND NOTICE OF AND OPPORTUNITY FOR HEARING

I.

The public official files of the Securities and Exchange Commission ("Commission") show that:

Euro Capital Incorporated ("Euro Capital" or the "company"), a Delaware corporation with its principal office in Athens, Texas, filed with the Commission on December 17, 2007, a document styled "Regulation A Offering Statement under the Securities Act of 1933" ("Offering Statement"). The document was apparently intended as a Regulation A Offering Statement submitted to obtain an exemption from the registration requirements of the Securities Act of 1933, as amended ("Securities Act"), pursuant to Section 3(b) of the Securities Act and Regulation A thereunder. The Offering Statement was submitted for a proposed offering of 5,000,000 shares of Euro Capital common stock.

II.

The Commission has reason to believe, on the basis of information reported to it by its staff, that:

A. The Offering Statement filed by Euro Capital contains untrue statements of material facts and omits to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning, among other things:

1. The Offering Statement reports $175,000 of unproven mineral claims as an asset, when they should have been recorded as an expense. The claims were acquired from the

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president of Euro Capital. As Euro Capital is in the exploration stage and has not yet determined whether its reserves are commercially minable, under generally accepted accounting principles, its mineral claims are not considered to be recoverable assets and the acquisition costs should have been expensed upon acquisition.

2. Euro Capital's statement of operations incorrectly presents revenue in the amount of $10,000. Specifically, Euro Capital incorrectly reports in its financial statements $10,000 of revenue from the November 9, 2007 issuance of ten million shares of stock to its founder for $10,000 in cash. Accounting Principles Board Opinion No. 9, "Reporting the Results of Operation," prohibits recognizing revenue or expense from transactions in the company's own stock. Euro Capital should have reported $10,000 of contributed capital as a part of equity on the balance sheet rather than reporting such amount as revenue.

3. Euro Capital's financial statements, which are included in the Offering Statement, are deficient because the balance sheet has omitted the required stockholders equity section. As a result, the balance sheet does not balance.

B. Euro Capital has not complied with the terms and conditions of Regulation A because its Offering Statement omits essential information required by Regulation A and Commission Form 1-A as follows:

1. The Offering Statement does not include a legal opinion as required by Form 1-A, Part III, Item 2(11).

2. The Offering Statement contains no account of the order of priority in which the proceeds it raises will be used.

3. The Offering Statement contains no disclosure as to how the implementation of its business plan would be impacted if it fails to raise in its proposed offering the maximum $2,500,000.

4. Euro Capital states on page 10 of the Offering Statement that the company "has confidence that these [New Mexico] properties contain valuable minerals." However, the Offering Statement fails to set forth a basis for the assertion that the minerals are "valuable."

5. Two of the exhibits filed with Euro Capital's Offering Statement concerning a mining claim and a quitclaim deed contain inconsistent and confusing references to sellers and owners of the property rights. For example, the appended "Offer to Purchase Mining Claim," references Steve Karolyi as the seller, although the bottom signature references John Petros, the president of Euro Capital, as the seller. An appended quitclaim deed grants property rights to the minerals to a company called Phoenix Gold Mining, not Euro Capital.

6. The Offering Statement fails to set forth specific details about Petros's work experience over the previous five years.

C. The offering, if made, would be in violation of Section 17 of the Securities Act for the reasons stated in Section II.A above.

III.

It appearing to the Commission that it is in the public interest and for the protection of investors that the exemption of Euro Capital Incorporated under Regulation A be temporarily suspended,

IT IS ORDERED, pursuant to Rule 258(a) of the General Rules and Regulations under the Securities Act, that the exemption of Euro Capital Incorporated under Regulation A be, and hereby is, temporarily suspended.

NOTICE IS HEREBY GIVEN that any person having an interest in this matter may, within thirty calendar days after the entry of this Order, file with the Secretary of the Commission a written request for a hearing; that within twenty days after the receipt of such request the Commission will, or at any time upon its own motion the Commission may, set the matter for hearing at a place to be designated by the Commission, for the purpose of determining whether this order should be vacated or made permanent, without prejudice, however, to the presentation and consideration of additional matters at the hearing; and that notice of the time and place of the hearing will be promptly given by the Commission. If no hearing is requested and none is ordered by the Commission, this Order shall become permanent on the thirtieth day after its entry, and will remain in effect unless and until it is modified or vacated by the Commission.

By the Commission.

Nancy M. Morris
Secretary

J Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57124 / January 10, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12928

In the Matter of JOSEPH M. MALONE, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph M. Malone ("Malone" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From the summer of 2000 through at least the summer of 2002, Malone was associated with Renaissance Asset Fund, Inc ("Renaissance"). Renaissance, which sold investments during the relevant time period, has never been registered with the Commission, nor has it registered any offerings or class of securities under either the Securities Act of 1933 ("Securities Act") or the Exchange Act.

2. On September 4, 2007, a final judgment was entered by consent against Malone, permanently enjoining him from future violations of Sections 5(a), 5(c), 17(a)(2) and 17(a)(3) of the Securities Act as well as Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Renaissance Asset Fund, Inc., Ronald J. Nadel and Joseph M. Malone, Civil Action Number SAC 06-661-JVS(ANx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that Malone solicited investments and supervised the solicitation of investments in Renaissance. Further, the Commission's complaint alleged that Malone's responsibilities while he was Renaissance's investor relations representative included, among other things, accepting investment agreements and signing off on the suitability of investments, overseeing salesmen who solicited investors, determining commission payments to them for their sales, and attending board meetings. Additionally, the Commission's complaint alleged that Malone received at least $230,000 in salary or other compensation from entities controlled by Renaissance's president Ronald J. Nadel.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Malone's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Malone be, and hereby is barred from association with any broker or dealer with the right to reapply for association after three years to the appropriate self-regulatory organization, or if there is none, to the Commission;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57123 / January 10, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12927

In the Matter of **RONALD J. NADEL,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Ronald J. Nadel ("Nadel" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. During the relevant time period, Ronald J. Nadel was the president, owner, and manager of Renaissance Asset Fund, Inc ("Renaissance") and other affiliated entities. As Renaissance's president, owner and manager, Nadel personally offered and sold investments in Renaissance. Renaissance is a Delaware corporation located in San Clemente, California. Renaissance has never been registered with the Commission, nor has it registered any offerings or class of securities under either the Securities Act of 1933 ("Securities Act") or the Exchange Act. During the relevant time period, Nadel was not registered with the Commission as a broker or dealer.

2. On September 4, 2007, a final judgment was entered by consent against Nadel, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Renaissance Asset Fund, Inc., Ronald J. Nadel and Joseph M. Malone, Civil Action Number SAC 06-661-JVS(ANx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, from at least March 1999 through April 2004, Ronald Nadel, through Renaissance, operated various investment programs as a Ponzi scheme. The complaint further alleges that Nadel, individually and through a network of other solicitors raised at least $16 million by selling promissory notes. At least 190 individuals, many elderly, invested in Nadel's programs. According to the complaint, Renaissance made numerous misrepresentations when selling these investments, including promising returns ranging from 10% to 75% annually and claiming that the investments would be used to provide loans or other financing to promising businesses. As investors began requesting the return of their money, Nadel engaged in a series of stalling tactics, including soliciting "rollovers" of investors' purported returns into other investment programs and making partial repayments from funds contributed by other investors. The Commission's complaint alleged that Renaissance invested approximately $1 million of the funds it raised in business projects, but Nadel spent most of the investors' money operating his Ponzi scheme. Nadel also diverted at least $2.3 million to himself.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Nadel's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Nadel be, and hereby is barred from association with any broker or dealer with the right to reapply for association after five years to the appropriate self-regulatory organization, or if there is none, to the Commission;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

January 10, 2008

IN THE MATTER OF AAMPRO GROUP, INC. File No. 500-1	: : : :	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Aampro Group, Inc. ("Aampro") because of questions regarding the adequacy and accuracy of information in Aampro's public filings concerning, among other things: (1) the company's business operations, (2) the company's business combinations, and (3) the company's current financial condition.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed company is suspended for the period from 9:30 a.m. EST January 10, 2008, through 11:59 p.m. EST on January 24, 2008.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57138 / January 14, 2008

Admin. Proc. File No. 3-12618

In the Matter of the Application of

WEDBUSH MORGAN SECURITIES, INC.
c/o Jerry S. Phillips, Esq.
Loeb & Loeb LLP
10100 Santa Monica Boulevard, Suite 2200
Los Angeles, CA 90067-4120

For Review of Disciplinary Action Taken by

NASD

ORDER DISMISSING PROCEEDINGS

I.

Wedbush Morgan Securities, Inc. ("Wedbush" or "the Firm"), an NASD member firm and a registered broker-dealer, appeals from a March 15, 2007 decision by an NASD Hearing Officer (the "Decision") finding that Wedbush had failed to make full payment of all post-award interest due under an arbitration proceeding against the Firm. 1/ On May 26, 2006, an NASD arbitration panel awarded forty-three claimants compensatory damages and attorneys' fees totaling $3,801,933.00 against Wedbush, plus fees and administrative costs (the "Award"). Under the Decision, the Hearing Officer ordered that Wedbush's NASD membership be suspended effective at the opening of business on March 23, 2007, until the Firm provided

1/ On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 72 FR 42190 (Aug. 1, 2007) (SR-NASD-2007-053). Because the NASD action here was taken before that date, we continue to use the designation NASD.

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documentary evidence that it had paid the full Award, including all post-award interest, settled the Award with the Firm's arbitration claimants, or declared bankruptcy. Wedbush paid the amount due under the Decision on March 22, 2007. Thus, the suspension never took effect. Wedbush then appealed the Decision to the Commission asserting, as the bases for its appeal, that the Decision was flawed and based on erroneous facts and that Wedbush was denied due process in its proceeding before the NASD Hearing Officer. We base our findings on an independent review of the record.

II.

A. Background At issue in the proceeding below was the proper construction of Rule 10330(h) of NASD's Code of Arbitration Procedure with respect to the portion of the Award and the number of days for which Wedbush owed post-Award interest. 2/ In a letter dated May 26, 2006 (the "May 26 NASD Letter"), NASD transmitted the Award to Wedbush's counsel. The May 26 NASD Letter stated, "Pursuant to Rule 10330(h) of the [NASD Arbitration] Code, the responsible party must pay any monetary awards within 30 days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. If an award is not paid within 30 days, the responsible party must pay post-judgment interest at the legal rate or as provided in the award by the arbitrator(s)." The May 26 NASD Letter went on to say, "The 30-day period ends on: June 28, 2006."

On June 26, 2006, Wedbush filed a Petition to Vacate Arbitration Award or, in the Alternative, to Correct Arbitration Award in the United States District Court for the Central District of California (the "Petition") that challenged $2,351,635.00 of the Award. It sent claimants' counsel a copy of the Petition and a check for $1,450,298.00, "the amount of the Award the enclosed Petition does not challenge." Although Wedbush's letter transmitting this check to claimants' counsel is dated June 26 and marked "VIA MESSENGER," the record suggests that claimants' counsel may not have received the check until June 27. On August 3, 2006, Wedbush's Petition was dismissed, and on November 7, 2006, Wedbush hand-delivered a check issued by Wedbush to claimants' counsel in the amount of $2,351,635.00, the principal amount of the Award at issue in the Petition. On November 8, 2006, claimants' counsel requested that NASD suspend or cancel Wedbush's NASD membership for failure to pay the Award in full, claiming that, after the November 7 payment, Wedbush still owed an additional $118,503.69 in interest. This amount purportedly reflected $32,290.53 in interest that had accrued on the full amount of the Award during the period prior to Wedbush's June 27 payment, plus $86,213.16 in interest on the portion of the Award disputed in the Petition through

2/ Rule 10330(h) of NASD's Code of Arbitration Procedure states, in relevant part, "All monetary awards shall be paid within thirty (30) days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. An award shall bear interest from the date of the award: (1) if not paid within thirty (30) days of receipt, (2) if the award is the subject of a motion to vacate which is denied, or (3) as specified by the arbitrator(s) in the award."

Wedbush's November 7 payment. Claimants' counsel asserted that the interest would continue to accrue going forward.

On November 9, 2006, NASD informed Wedbush that it intended to suspend the Firm's NASD membership because of its "failure to comply with the award." The suspension would take effect on November 30, 2006, unless the Firm first paid the Award in full or requested a hearing. On November 16, 2006, Wedbush responded to NASD, disputing claimants' counsel's calculation of the interest Wedbush owed on the Award and stating, "Wedbush is making its own calculation of interest on the Award and will pay that calculated amount once those efforts have been completed." Soon thereafter, Wedbush delivered to claimants' counsel a check in the amount of $104,373.94, together with a letter stating that this amount reflected "the correct calculation of interest due." Claimants' counsel challenged Wedbush's calculation of the interest due and requested that NASD suspend Wedbush's membership for failure to pay the Award in full. Wedbush requested the NASD hearing that produced the Decision.

B. <u>NASD Proceeding</u> At the hearing, NASD and Wedbush disputed the amount of interest Wedbush owed on the Award. NASD claimed that Wedbush's partial payment of $1,450,298.00 on June 27 did not relieve Wedbush of the obligation to pay interest on that partial payment because, NASD argued, NASD Arbitration Rule 10330(h) does not permit partial payments within thirty days of receipt of an award. Wedbush responded that NASD's calculation of interest on the entire amount of the Award was improper because Wedbush's partial payment of $1,450,298.00 on June 27 occurred within the 30-day period set forth under NASD Arbitration Rule 10330(h). According to Wedbush, it only ever owed interest on the $2,351,635.00 challenged in the Petition.

The Decision rejected NASD's position, stating, "Giving credit to such partial payments [as Wedbush made on June 27] encourages the losing party to pay the undisputed amount of an award, which benefits the prevailing party. If [NASD] Enforcement's construction is applied, there is less incentive for the losing party to pay the undisputed portion of an award promptly."

However, on its own motion, the Decision found that Wedbush's June 27 partial payment was not timely because it was not made within thirty days of the date on "which Wedbush's attorney received" the Award, which the Decision stated was May 26, 2006. The Decision dismissed the significance of the June 28 due date specified in the May 26 NASD Letter on the grounds that the thirty-day requirement in NASD Rule 10330(h) is unambiguous and cannot be superseded by an NASD staff letter. The Decision did not state the basis for its finding that Wedbush's attorney received the Award on May 26, 2006, but stated that the thirty days concluded on June 25, 2006. The Decision found that the pendency of the Petition stayed Wedbush's obligation to pay interest on the challenged portion of the Award. The Decision accordingly calculated that Wedbush owed $16,620.70 in unpaid interest, after accounting for all of the payments made by Wedbush through November 30, 2006. The Decision ordered Wedbush's NASD membership to be suspended unless it made payment of this interest before

March 23, 2007. On March 22, 2007, Wedbush paid all amounts due under the Decision, and the suspension thus did not take effect.

III.

On appeal, Wedbush requests that we: "(a) reverse the Decision, (b) find that no interest or costs were due from Wedbush, (c) order NASD to pay all costs attendant to this and the underlying proceeding, and (d) order [claimants' counsel] to return all monies paid by Wedbush to it under the Decision." According to Wedbush, the NASD Hearing Officer's Decision was based on what Wedbush asserts was an erroneous assumption that the Award was due on June 25, 2006. Wedbush argues that NASD itself had conceded before the Hearing Officer that the May 26 NASD Letter stated that the Award was due on June 28 and that, as a result, Wedbush did not argue this point before the Hearing Officer.

NASD responds that Wedbush's appeal requests relief that the Commission is unable to order. According to NASD, the Commission lacks authority to order the arbitration claimants to return monies they received under the Award to Wedbush. As a result, according to NASD, Wedbush's appeal is moot. 3/

Section 19 of the Securities Exchange Act of 1934 authorizes NASD members or persons associated with such members to seek review by us of action taken by NASD. Wedbush does not cite any basis for Commission jurisdiction over this proceeding. Under Section 19(d) of the Exchange Act, NASD action is subject to review by the Commission if it: (i) imposes a final disciplinary sanction on an NASD member; (ii) denies membership or participation to an applicant; (iii) prohibits or limits any person with respect to access to services offered by NASD or an NASD member; or (iv) bars any person from becoming associated with an NASD member. 4/ Exchange Act Section 19(e), which applies to disciplinary actions, authorizes us to "set aside" a sanction imposed in such a disciplinary action and, "if appropriate, remand to the self-regulatory organization for further proceedings." 5/

3/ In the alternative, NASD argues that, if the Commission reaches the merits of Wedbush's appeal, the Commission should affirm NASD's action because Section 19(f) of the Securities Exchange Act of 1934 requires the Commission to uphold NASD actions when: (i) the specific grounds upon which NASD based its action exist in fact; (ii) NASD conducted the proceeding in accordance with its rules; and (iii) NASD applied its rules consistently with the purposes of the Exchange Act. 15 U.S.C. § 78s(f). NASD argues that its actions in connection with these matters satisfy each of these conditions.

4/ 15 U.S.C. § 78s(d).

5/ 15 U.S.C. § 78s(e).

If NASD's order imposing a suspension on the Firm had taken effect, Wedbush would have been subject to a final disciplinary sanction. However, as noted above, the Decision ordered Wedbush's membership to be suspended effective March 23, 2007, only if Wedbush did not pay the full amount due under the Decision by that date. Because Wedbush made full payment on March 22, the suspension never took effect. In addition, NASD did not deny Wedbush membership, prohibit or limit Wedbush's access to services, or bar any person from becoming associated with Wedbush, nor has Wedbush argued that the Decision did any of these things. Therefore, NASD took no action within the meaning of Section 19(d) of the Exchange Act that is subject to review by the Commission, and Wedbush's appeal must be dismissed for lack of jurisdiction. 6/ Under the circumstances, we have determined to dismiss Wedbush's appeal. 7/

Notwithstanding this determination, we are concerned that the parties had no opportunity to develop evidence or legal arguments concerning the Decision's finding that Wedbush's June 27 payment was not made within thirty days of the date on which Wedbush received the Award. We also note that the Decision does not identify the basis for its finding that Wedbush received the Award on May 26 and does not address issues relating to the discrepancy between the thirty-day requirement in Rule 10330(h) and the June 28 due date for paying the Award stated in the May 26 NASD Letter. NASD may wish to consider these matters as part of its ongoing administration of its arbitration program.

Accordingly, it is ordered that Wedbush Morgan Securities, Inc.'s application for review be, and it hereby is, dismissed.

By the Commission.

Nancy M. Morris
Secretary

6/ See, e.g. Allen Douglas Secs., Inc., Exchange Act Rel. No. 50513 (Oct. 12, 2004), 83 SEC Docket 3570 (dismissing for lack of jurisdiction an appeal of NASD's determination to disapprove certain proposed subordinated loan agreements on the grounds that the NASD action was not reviewable under Section 19(d) of the Exchange Act); Russell A. Simpson, 53 S.E.C. 1042 (1998) (dismissing for lack of jurisdiction an appeal of NASD's dismissal of a customer complaint on the grounds that the NASD action was not reviewable under Section 19(d) of the Exchange Act).

7/ Exchange Act Section 19 does not appear to authorize the setting aside of NASD's assessment of interest on the Award, nor does it authorize the Commission to order claimants to return to Wedbush monies received under the Decision.

Chairman Cox
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2693 / January 14, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12931

In the Matter of MARC A. FREEDMAN, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Marc A. Freedman ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From 1993 to May 2006, Respondent Freedman was a shareholder in TriCapital Advisors, Inc. ("TriCapital"), an investment adviser registered with the Commission. During that time, he was TriCapital's president, chief compliance officer and operations manager, and managed his own client accounts. Freedman, age 49, is a resident of Gaithersburg, Maryland.

2. On December 21, 2007, a final judgment was entered by consent against Freedman, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Marc A. Freedman, Civil Action Number 07-CV-3263, in the United States District Court for the District of Maryland.

3. The Commission's complaint alleged that between 1999 and 2005, Freedman misappropriated approximately $2,380,000 from three TriCapital clients. In order to perpetrate his fraud, Freedman, among other things, falsely told the clients that he was purchasing legitimate investments with their funds, and then created false account statements and other documents purportedly reflecting the purchases. The complaint further alleged that Freedman used the misappropriated funds both for his personal benefit and to repay funds earlier taken from at least two of the clients.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Freedman's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Freedman be, and hereby is, barred from association with any investment adviser.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57159; File No. SR-CBOE-2006-106)

January 15, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to an Interpretation of Paragraph (b) of Article Fifth of its Certificate of Incorporation

I. Introduction

On December 12, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change to adopt an interpretation of the rules of CBOE in response to the acquisition of the Board of Trade of the City of Chicago, Inc. ("CBOT") by Chicago Mercantile Exchange Holdings, Inc. ("CME Holdings"). On January 17, 2007, the Exchange filed Amendment No. 1 to the proposed rule change which replaced and superseded the filing. The proposed rule change, as modified by Amendment No. 1, was published for notice and comment in the Federal Register on February 6, 2007.[3] The Commission received 174 comment letters from 134 separate commenters on the proposed rule change, including comment letters from CBOT members and legal counsel to CBOT and CBOT members. The CBOE submitted its response to comments on June 15, 2007.[4] On June

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55190 (January 29, 2007), 72 FR 5472 (SR-CBOE-2006-106) ("Notice").

4 See Letter from Michael L. Meyer, Schiff Hardin, to Nancy M. Morris, Secretary, Commission, dated June 15, 2007 ("CBOE Response to Comments").

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29, 2007, CBOE filed Partial Amendment No. 2 to the proposal.[5] This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

II. Description of the Proposed Rule Change

A. Background

As compensation for the "special contribution" of time and money that the CBOT expended in the development of the CBOE in the early 1970s, an "Exercise Right" was granted to each "member of [the CBOT]" entitling him or her to become a member of the CBOE without having to acquire a separate CBOE membership.[6] This right, established in Article Fifth(b) of the CBOE Certificate of Incorporation ("Article Fifth(b)"), provides, in relevant part:

> In recognition of the special contribution made to the organization and development of the [CBOE] by the members of [the CBOT] . . . every present and future member of [the CBOT] who applies for membership in the [CBOE] and who otherwise qualifies shall, so long as he remains a member of said Board of Trade, be entitled to be a member of the [CBOE] notwithstanding any such limitation on the number of members and

5 The CBOE submitted an opinion of counsel as Exhibit 3f to Amendment 1 to its proposal. See Letter from Wendell Fenton, Esq., Richards, Layton & Finger, to Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated January 16, 2007 ("First Opinion of Counsel"). CBOE subsequently submitted an updated legal opinion via Partial Amendment No. 2, which opines that the proposed rule change embodied in SR-CBOE-2006-106 constitutes an interpretation of Article Fifth(b), and not an amendment of Article Fifth(b), consistent with the conclusions reached in the opinion letters of Delaware counsel that CBOE submitted to the Commission in connection with CBOE rule filings SR-CBOE-2004-16 and SR-CBOE-2005-19. See Letter from Wendell Fenton, Esq., Richards, Layton & Finger, to Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated June 28, 2007 ("Second Opinion of Counsel"). The Commission believes that because Partial Amendment No. 2 raises no new or novel issues, it is technical in nature and not subject to separate notice and comment.

6 As CBOE explained in the notice of its proposal, the "special contribution" of the members of CBOT referred to in Article Fifth(b) consisted primarily of CBOT's providing the seed capital for the start-up of CBOE in the early 1970s by means of direct cash expenditures, CBOT's guarantee of a bank loan to CBOE to fund additional CBOE start-up costs, and CBOT's contribution of intellectual property. See Notice, supra note 3, 72 FR at 5473.

without the necessity of acquiring such membership for consideration or value from the [CBOE], its members or elsewhere.

Article Fifth(b) states that no amendment may be made to it without the approval of at least 80% of those CBOT members who have "exercised" their right to be CBOE members and 80% of all other CBOE members.

Since Article Fifth(b) does not define what a "member of [the CBOT]" means, on several occasions in the past, the CBOE has interpreted the meaning of Article Fifth(b), in particular the term "member of [the CBOT]," in response to changes in the ownership structure of the CBOT. On each such occasion, the CBOE and CBOT ultimately reached a mutual agreement on the particular interpretation at issue, and those interpretations are reflected in various agreements and letter agreements between CBOE and CBOT. CBOE filed these interpretations of Article Fifth(b) with the Commission, reflected in amendments to CBOE Rule 3.16(b) ("Special Provisions Regarding Chicago Board of Trade Exerciser Memberships"), as proposed rule changes pursuant to Section 19(b)(1) of the Exchange Act.[7] The Commission approved each such interpretation.

1. <u>1992 Agreement</u>

In 1993, the Commission approved the CBOE's proposed interpretation of the meaning of the term "member of [the CBOT]" as used in Article Fifth(b) that was embodied in an agreement dated September 1, 1992 (the "1992 Agreement") and reflected in CBOE Rule 3.16(b).[8] The 1992 Agreement addressed, among other things, the effect on the Exercise Right of CBOT's plans to divide the membership interests of the then-existing 1,402 member-owners

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7 15 U.S.C. 78s(b)(1).

8 <u>See</u> Securities Exchange Act Release No. 32430 (June 8, 1993), 58 FR 32969 (June 14, 1993) (SR-CBOE-92-42).

of CBOT into parts. That interpretation provided that all such parts, together with the trading rights appurtenant thereto, must be in the possession of an individual in order for that individual to be eligible to utilize the Exercise Right.[9] CBOE Rule 3.16(b) reflects this interpretation in stating that "[f]or the purpose of entitlement to membership on the [CBOE] in accordance with... [Article Fifth(b)]... the term 'member of [the CBOT],' as used in Article Fifth(b), is interpreted to mean an individual who is either an 'Eligible CBOT Full Member' or an 'Eligible CBOT Full Member Delegate,' as those terms are defined in the [1992 Agreement]...."[10]

2. **<u>2001 Agreement, as Modified By the 2004 and 2005 Letter Agreements</u>**

In connection with CBOT's proposed restructuring, CBOE took the position that the effect of such a transaction would be to eliminate entirely the concept of CBOT "membership" as it existed when the Exercise Right was created as a right held by members of CBOT, and therefore would result in the termination of the Exercise Right.[11] CBOE and CBOT eventually compromised and entered into an agreement dated August 7, 2001 ("2001 Agreement") under which CBOE agreed to interpret Article Fifth(b) such that the Exercise Right was only available to a CBOT member that held all of the trading rights of a full member of CBOT as well as the same number of shares of stock of CBOT Holdings, Inc. ("CBOT Holdings") originally issued to CBOT members in the restructuring.[12] CBOE agreed, in the 2001 Agreement, to interpret Article Fifth(b) in this way, only "in the absence of any other material changes to the structure or

9 <u>See</u> 1992 Agreement, Section 2(b).

10 CBOE Rule 3.16(b). In the 1992 Agreement, an "Eligible CBOT Full Member" is defined as an individual who at the time is the holder of one of 1,402 existing CBOT full memberships ("CBOT Full Memberships"), and who is in possession of all trading rights and privileges of such CBOT Full Memberships. An "Eligible CBOT Full Member Delegate" is defined as the individual to whom a CBOT Full Membership is delegated (<u>i.e.</u>, leased) and who is in possession of all trading rights and privileges appurtenant to such CBOT Full Membership.

11 <u>See</u> Notice, <u>supra</u> note 3, 72 FR at 5473.

12 <u>See</u> <u>id.</u>

ownership of the CBOT … not contemplated in the CBOT [restructuring]."[13]

CBOE and CBOT subsequently agreed to modify the 2001 Agreement by a Letter Agreement among CBOE, CBOT, and CBOT Holdings dated October 7, 2004 ("October 2004 Letter Agreement"), which was intended to represent the agreement of the CBOE and CBOT concerning the nature and scope of the Exercise Right following the restructuring of the CBOT and in light of the expansion of the CBOE and CBOT's electronic trading systems. The CBOE, CBOT, and CBOT Holdings entered into another letter agreement on February 14, 2005 ("February 2005 Letter Agreement") in which CBOE confirmed that CBOT's restructuring was consistent with CBOE's interpretation of Article Fifth(b) as set forth in the 2001 Agreement.

The CBOE's interpretation of Article Fifth(b) through interpretations of "Eligible CBOT Full Member" as used in CBOE Rule 3.16 were approved by the Commission.[14] As set forth in the 2001 Agreement, as amended by the letter agreements, the CBOE interprets Article Fifth(b) such that an individual is deemed to be an "Eligible CBOT Full Member" under CBOE Rule 3.16 if the individual: (1) is the owner of the requisite number of Class A Common Stock of CBOT Holdings, the requisite number of Series B-1 memberships of the CBOT, and the Exercise Right Privilege; (2) has not delegated any of the rights or privileges appurtenant to such ownership; and (3) meets applicable membership and eligibility requirements of the CBOT.[15] An individual is deemed to be an "Eligible CBOT Full Member Delegate," under that Agreement, if the individual: (1) is in possession of the requisite number of Class A Common Stock of CBOT Holdings, the requisite number of Series B-1 memberships of the CBOT, and the Exercise Right Privilege; (2) holds one or more of the items listed in (1) by means of delegation

[13] See id. at 5473-74 (citing the 2001 Agreement).

[14] See Securities Exchange Act Release No. 51733 (May 24, 2005), 70 FR 30981 (May 31, 2005) (SR-CBOE-2005-19).

[15] See id. at 30983 (footnote 14).

rather than ownership; and (3) meets applicable membership and eligibility requirements of the CBOT.[16]

B. CBOE's Current Proposal

1. Interpretation of Article Fifth(b)

The CBOE is again proposing an interpretation of the term "member of [the CBOT]" as used in Article Fifth(b). CBOE believes that its proposed interpretation is necessary to address the effect on the Exercise Right of the then-proposed (and now completed) acquisition of the CBOT by CME Holdings.[17] Specifically, CBOE believes that the acquisition of the CBOT by CME Holdings effected "substantial changes to the structure and ownership of CBOT, as well as to the rights represented by CBOT membership," in a way that creates a substantive ambiguity with respect to whether a person who formerly qualified under Article Fifth(b) as a "member of [the CBOT]" for purposes of the Exercise Right still possesses sufficient attributes of CBOT membership following the acquisition by CME Holdings.[18]

In response to the acquisition of the CBOT by CME Holdings, the CBOE Board of Directors found it necessary to determine whether the substantive rights of a former CBOT member would continue to qualify that person as a "member of [the CBOT]" pursuant to Article Fifth(b), as that term was contemplated when Article Fifth(b) was adopted, after the acquisition of the CBOT by CME Holdings. CBOE determined that it would not, because former CBOT

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16 See id.

17 That acquisition was accomplished by the merger of CBOT Holdings, of which CBOT was a subsidiary, with and into CME Holdings, with CME Holdings continuing as the surviving corporation and as the parent company of CBOT, as well as of its existing wholly-owned subsidiary, the Chicago Mercantile Exchange, Inc. ("CME"). CBOT Holding's shareholders approved the acquisition on July 9, 2007. See Form 8-K submitted by CME Holdings on July 9, 2007. The transaction was completed on July 12, 2007. See Form 25-NSE submitted by the New York Stock Exchange, Inc. (regarding notification of the removal of listing of CBOT Holdings).

18 CBOE Response to Comments, supra note 4, at 17.

members "lose in the CME acquisition the few remaining membership rights they retained following the [CBOT's] 2005 restructuring," such that "persons who had formerly been the full members of CBOT will simply be the holders of trading permits and will not possess any of the other rights commonly associated with membership in an exchange."[19]

Thus, CBOE's proposed interpretation concludes that, following the acquisition, there no longer are any individuals who qualify as "members of [the CBOT]" within the meaning of Article Fifth(b). Consequently, no person would qualify under Article Fifth(b) to utilize the Exercise Right to become and remain a member of CBOE without having to obtain a separate CBOE membership. This interpretation is based on CBOE's view that the concept of a member-owner of CBOT, as CBOE believes that concept was understood when Article Fifth(b) was first adopted in CBOE's Certificate of Incorporation and when it was subsequently interpreted in the 1992 Agreement, has been abolished following the restructuring of CBOT and its subsequent acquisition by CME Holdings. In this respect, the CBOE's proposal does not extinguish the Exercise Right or delete Article Fifth(b) from its Certificate of Incorporation, but rather interprets Article Fifth(b) in a manner than means no CBOT member is eligible to utilize that right following the acquisition of CBOT.

With respect to the prior agreements concerning the interpretation of Article Fifth(b) with CBOT, CBOE believes that, because the change in structure effectuated by the acquisition of CBOT by CME Holdings was not contemplated as part of the 2005 restructuring of CBOT, the acquisition constitutes a change to the ownership of CBOT that is inconsistent with a condition to the interpretation embodied in the 2001 Agreement, as amended, that there not be any change

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19 Id. at 28.

to the ownership of CBOT not contemplated in its 2005 restructuring.[20] Accordingly, CBOE believes that the 2001 Agreement, as amended, no longer governs whether and to what extent the Exercise Right will remain in existence, with the result being that CBOE and CBOT are back in the position they faced before the 2001 Agreement.[21]

With the 2001 Agreement no longer controlling, CBOE looks to the 1992 Agreement, in particular Section 3(d), which addresses the possibility that CBOT, among other things, may merge or consolidate with, or be acquired by, another entity. Section 3(d) establishes three conditions that all must be satisfied for the Exercise Right to remain available following any such transaction. Those three conditions are:

> 1. … the survivor of such merger, consolidation or acquisition ("survivor") is an exchange which provides or maintains a market in commodity futures contracts or options, securities, or other financial instruments, and …
>
> 2. the 1,402 holders of CBOT Full Memberships are granted in such merger, consolidation or acquisition membership in the survivor ("Survivor Membership"), and …
>
> 3. such Survivor Membership entitles the holder thereof to have full trading rights and privileges in all products then or thereafter traded on the survivor (except that such trading rights and privileges need not include products that, at the time of such merger, consolidation or acquisition, are traded or listed, designated or otherwise authorized for trading on the other entity but not on the CBOT) ….[22]

CBOE believes that none of these conditions are satisfied following the acquisition of CBOT by CME Holdings. Specifically, with respect to Condition 1, CBOE notes that the survivor of the acquisition (i.e., the acquiring entity that survives the transaction) is CME Holdings, which is not an exchange.[23]

20 See Notice, supra note 3, 72 FR at 5474.

21 See id.

22 See id.

23 See id.

Further, CBOE believes that Condition 2 is not satisfied because the former 1,402 holders of CBOT Full Memberships have not been granted "membership" in the survivor.[24] Rather, CBOE's position is that there are not any holders of CBOT Full Memberships as they existed in 1992, because all of these memberships were stripped of their ownership attributes in the 2005 restructuring of CBOT.[25] Likewise, CBOE argues that CME Holdings is not an exchange and therefore is not capable of granting "membership" interests in itself to anyone.[26] CBOE further states that, even if CBOT is considered to have survived the acquisition, Condition 2 still would not be satisfied because, except for trading rights, former CBOT members no longer have most of the other rights in the surviving entity that they formerly held when they were full members of CBOT as the term "member" was commonly understood when Article Fifth(b) was adopted in 1972 and later interpreted in 1992.[27] Accordingly, following the acquisition, CBOE believes that former CBOT members will simply be the holders of trading permits and will not be granted any of the other rights commonly associated with membership in an exchange.[28]

Finally, CBOE believes that Condition 3 of Section 3(d) of the 1992 Agreement is not satisfied following the acquisition of CBOT by CME Holdings because that condition contemplates an acquisition where the surviving acquirer is an exchange, and it requires CBOT

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24 See id.

25 See id. Although CBOE has previously interpreted Article Fifth(b) to permit the Exercise Right to continue in existence following the 2005 restructuring of CBOT, subject to stated conditions, as discussed above, CBOE believes that those earlier interpretations, contained in the 2001 Agreement, as amended, are no longer controlling because those provisions applied only so long as there was no further change to the structure or ownership of CBOT not then in contemplation. See id.

26 See Notice, supra note 3, 72 FR at 5474.

27 See id. at 5475. For example, CBOE states that, following the acquisition by CME Holdings, CBOT's former Series B-1 members will be stripped, among other things, of their right to elect directors or nominate candidates for election as directors. See id.

28 See id.

members to have essentially the same full trading rights on that surviving exchange as they had on CBOT prior to the acquisition.[29] As CME Holdings is not an exchange, CBOE believes that it is not possible for CBOT members to have any trading rights on the survivor.[30] Further, CBOE believes that to be the case even if it were to look through CME Holdings to its two subsidiary exchanges, CME and CBOT.[31] CBOE states that, in respect of any new products to be introduced on CME after the acquisition, the trading rights of CBOT members will be diluted by the trading rights granted to other persons (i.e., CME members) to trade these same products, in which case the trading rights inherent in CBOT membership will be reduced from what they were prior to the acquisition.[32]

Consequently, CBOE's proposed interpretation concludes that the conditions contained in Section 3(d) of the 1992 Agreement are not satisfied following the acquisition of CBOT by CME Holdings, and that the terms of Section 3(d) therefore provide that "Article Fifth(b) shall not apply" following the acquisition. Hence, for the reasons discussed in its notice, as summarized above, CBOE's proposed interpretation is that the Exercise Right is no longer available as a means of acquiring membership in CBOE because there no longer are any individuals who qualify as "members of [the CBOT]" within the meaning of Article Fifth(b).

2. Transition Plan

In addition to its proposed interpretation of Article Fifth(b), CBOE has separately proposed a transition plan in order to avoid a sudden disruption to its marketplace as a result of no persons any longer being eligible to utilize the Exercise Right on account of the acquisition of

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29 See id.

30 See id.

31 See id.

32 See Notice, supra note 3, 72 FR at 5474.

CBOT by CME Holdings.[33] Specifically, CBOE submitted a separate proposed rule change interpreting CBOE Rule 3.19, which is a rule that authorizes the Exchange, when the Exchange determines that there are extenuating circumstances, to permit a member "to retain the member's status for such period of time as the Exchange deems reasonably necessary" to enable the member to address specified problems that caused the membership status to terminate.

Interpretation .01 to CBOE Rule 3.19, allows certain "grandfathered" Exerciser Members who had been trading on CBOE to continue to have uninterrupted access to CBOE until such time as the Commission takes action on SR-CBOE-2006-106. Under Interpretation .01 to CBOE Rule 3.19, persons who were Exerciser Members in good standing as of July 1, 2007 and who remain Exerciser Members as of the close of business on the day before the consummation of the acquisition of CBOT by CME Holdings temporarily retained their membership status, including their trading access to CBOE, for a limited period of time. Such persons were not required to hold or maintain any securities, memberships or other interests in order to maintain that status, but are required to pay a monthly access fee to the Exchange.[34] Temporary Members are required to remain in good standing and must pay all applicable fees, dues, assessments and other like charges assessed against CBOE members.

On September 4, 2007, CBOE filed a subsequent interpretation of CBOE Rule 3.19 to extend this temporary membership beyond any Commission approval of SR-CBOE-2006-106 until the earlier of: (1) the voluntary termination of a person's temporary membership; (2) any Commission approval of a subsequent proposed rule change to terminate temporary membership

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33 See Securities Exchange Act Release Nos. 56016 (July 5, 2007), 72 FR 38106 (July 12, 2007) (SR-CBOE-2007-77) and 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

34 See Securities Exchange Act Release No. 56197 (August 3, 2007), 72 FR 44897 (August 9, 2007) (SR-CBOE-2007-91) (adopting the access fee).

status; or (3) the demutualization of the Exchange.[35]

III. Comment Letters

The Commission received 174 comment letters on the proposed rule change from 134 different commenters.[36] Legal counsel for CBOT, legal counsel for CBOT Holdings, and legal counsel for the putative class of CBOT members from the Delaware litigation (collectively referred to as "CBOT") all submitted comment letters[37] in which they characterized the

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35 See Securities Exchange Act Release No. 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

36 Thirteen letters, including three letters from CBOE's legal counsel, explicitly supported the proposed rule change. See Letter from Robert H. Bloch, dated February 16, 1007 ("Bloch Letter"); Letter from Michael J. Post to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 16, 2007 ("Post Letter"); Letter from Steven G. Holtz, dated February 17, 2007; Letter from Dan Frost, dated February 19, 2007 ("Frost Letter"); Letter from Steve Fanady to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 20, 2007 ("Fanady Letter"); Letter from Lawrence J. Blum to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 25, 2007 ("Blum Letter"); Letter from Norman S. Friedland, dated February 27, 2007 ("Friedland Letter"); Letter from R. Kent Hardy to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 ("Hardy Letter"); Letter from Robert Silverstein to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 27, 2007 ("Silverstein Letter"); Letter from Marshall Spiegel, dated April 12, 2007 (referencing attached materials); Letter from Michael L. Meyer, Schiff Hardin, to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated January 12, 2007 ("Schiff Hardin Letter 1"); Letter from Michael L. Meyer, Schiff Hardin, to Nancy M. Morris, Secretary, Commission, dated March 19, 2007; and CBOE Response to Comments, supra note 4. The remainder of the letters either opposed the proposal or did not clearly communicate a position.

37 See Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated December 22, 2006 ("Mayer Brown Letter 1"); Letter from Gordon B. Nash, Jr., Gardner, Carton & Douglas, to Nancy M. Morris, Secretary, Commission, dated December 22, 2006 (on behalf of the putative class members) ("Gardner Letter"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated January 31, 2007 ("Mayer Brown Letter 2"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 ("Mayer Brown Letter 3"); Letter from Scott C. Lascari, Drinker Biddle Gardner Carton, to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 (on behalf of the putative class members); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated March 15, 2007 ("Mayer Brown Letter 4"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated July 9, 2007 ("Mayer Brown Letter 5"); and Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated August 9, 2007 ("Mayer Brown Letter 6").

proposed rule change as an attempt by CBOE to eliminate one group of Exchange members (Exerciser Members) for the benefit of another group of members (CBOE regular members), therein depriving Exerciser Members and those eligible to become Exerciser Members of a valuable property right.[38] CBOT asked the Commission to institute proceedings to disapprove CBOE's proposed rule change on the basis that the proposal is an improper use of CBOE's self-regulatory authority to resolve in its favor a private property dispute that is being litigated in the Delaware court, fails to meet the requirements of the Exchange Act, and was adopted without due process.[39]

Other commenters supplemented the concerns expressed by CBOT with criticism that the Commission lacked jurisdiction to consider the CBOE's proposal on the basis that the proposal implicated a contractual dispute subject to the jurisdiction of a state court.[40]

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38 See, e.g., Mayer Brown Letter 3, supra note 37, at 6.

39 See Mayer Brown Letter 3, supra note 37, at 1. See also Letter from Alton B. Harris, Ungaretti & Harris LLP, to Nancy M. Morris, Secretary, Commission ("Ungaretti Letter"), at 9-10 (arguing that the CBOE impermissibly and unilaterally interpreted a provision in a bilateral contract and filed this interpretation with the Commission in an attempt to invoke federal preemption). That commenter opined that the outcome of this matter could affect the future willingness of third parties to enter into contracts that may be subject to unilateral interpretation by a self-regulatory organization. See id. at 2-3.

40 See Letter from Gordon Gladstone, dated February 9, 2007; Letter from Glenn Hollander, dated February 9, 2007; Letter from Lance R. Goldberg, dated February 10, 2007 ("Goldberg Letter"); Letter from Mark Mendelson, dated February 12, 2007 ("Mendelson Letter"); Letter from John Simms, dated February 12, 2007 ("Simms Letter"); Letter from Charles W. Bergstrom to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Letter from Mike P. Darraugh, dated February 13, 2007 ("Darraugh Letter"); Letter from Edward E. Kessler, dated February 13, 2007 ("Kessler Letter"); Letter from Stephen L. O'Bryan, dated February 13, 2007 ("O'Bryan Letter"); Letter from Mark D. Hellman to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Hellman Letter"); Letter from J. Alexander Stevens to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Stevens Letter"); Letter from Allen Mitzenmacher to Nancy M. Morris, Secretary, Commission, dated February 15, 2007 ("Mitzenmacher Letter"); Letter from Benjamin Nitka, dated February 15, 2007; Letter from Jerome Israelov, dated February 16, 2007; Letter from Susie McMurray, submitted February 16, 2007 ("McMurray Letter"); Letter from Stuart Reif to Nancy M. Morris, Secretary, Commission, dated February 16, 2007 ("Reif Letter"); Letter from Doug Riccolo, dated February 16, 2007; Letter from Burt Gutterman and Noel Moore to Nancy M. Morris, Secretary, Commission, dated February 17, 2007; Letter from Charles B. Cox III, dated February 19, 2007 ("C. Cox Letter");

Commenters also opposed the proposal as without foundation, believing that the CBOT's acquisition by CME Holdings should be irrelevant to the continued validity of the Exercise Right.[41] Other commenters argued that CBOE's proposal violates the rights of CBOT members

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Letter from Michael J. Crilly, dated February 19, 2007 ("Crilly Letter 1"); Letter from Ronald E. Komo to Nancy M. Morris, Secretary, Commission, dated February 19, 2007 ("Komo Letter"); Letter from Thomas M. Myron to Nancy M. Morris, Secretary, Commission, dated February 19, 2007 ("T.M. Myron Letter"); Letter from Kyle A. Reed, dated February 20, 2007 ("Reed Letter"); Letter from Thomas F. Cashman to Nancy M. Morris, Secretary, Commission, dated February 21, 2007 ("Cashman Letter"); Letter from Richard Jaman, submitted February 22, 2007 ("Jaman Letter"); Letter from Lawrence D. Israel to Nancy M. Morris, Secretary, Commission, dated February 22, 2007 ("Israel Letter"); Letter from Gerald A. McGreevy, submitted February 22, 2007 ("McGreevy Letter"); Letter from David P. Baby to Nancy M. Morris, Secretary, Commission, dated February 23, 2007 ("Baby Letter"); Letter from Stephen Cournoyer to Nancy M. Morris, Secretary, Commission, dated February 24, 2007 ("S. Cournoyer Letter"); Letter from Wayne Goodman to Nancy M. Morris, Secretary, Commission, submitted February 24, 2007 ("Goodman Letter"); Letter from Cary Chubin, dated February 25, 2007 ("Chubin Letter"); Letter from John Halston, dated February 25, 2007 ("Halston Letter"); Letter from Veda Kaufman Levin, dated February 25, 2007 ("Levin Letter"); Letter from Robert J. Griffin to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Griffin Letter"); Letter from Harlan R. Krumpfes, dated February 26, 2007 ("Krumpfes Letter"); Letter from Nickolas J. Neubauer to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Neubauer Letter"); Letter from Ronald Bianchi, dated February 26, 2007 ("Bianchi Letter"); Letter from William Terman to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Terman Letter"); Letter from Robert E. Otter, dated February 27, 2007; and Letter from Paul L. Richards to Nancy M. Morris, Secretary, Commission, dated August 1, 2007 ("Richards Letter 2"). Cf. Comment Letters cited in note 36, supra (Bloch Letter, Post Letter, Friedland Letter, Frost Letter, Fanady Letter, Blum Letter (arguing that the proposal falls within the Commission's jurisdiction)).

41 See, e.g., Letter from Lawrence C. Dorf, dated February 9, 2007 ("Dorf Letter"); Goldberg Letter, supra note 40; Letter from Peter M. Todebush to Nancy M. Morris, Secretary, Commission, dated February 13, 2007 ("Todebush Letter"); Letter from Thomas M. Shuff Jr., dated February 13, 2007 ("Shuff Letter"); Letter from Norm Friedman, dated February 16, 2007 ("N. Friedman Letter"); C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Ungaretti Letter, supra note 39; Letter from Brian Cassidy, dated February 20, 2007 ("Cassidy Letter"); Letter from Gregory J. Ellis, dated February 20, 2007 ("Ellis Letter"); Letter from Paul R.T. Johnson, Jr. to Nancy M. Morris, Secretary, Commission, submitted February 20, 2007 ("Johnson Letter"); Reed Letter, supra note 40; Letter form Michael E. Stone, submitted February 22, 2007 ("Stone Letter 1"); Letter from Robert C. Sheehan, Electronic Brokerage Systems, LLC, to Nancy M. Morris, Secretary, Commission, dated February 23, 2007 ("Sheehan Letter"); Letter from Carolyn J. Davis to Nancy M. Morris, Secretary, Commission, dated February 24, 2007; Goodman Letter, supra note 40; Letter from David G. Northey, M&N Trading, submitted February 24, 2007 ("Northey Letter"); Letter from Kevin A. Ward, submitted February 24, 2007; Chubin Letter, supra note 40; Halston Letter, supra note 40; Letter from Michael E. Stone, dated February 25, 2007 ("Stone Letter 2"); Letter from Edward A. Cox and Cynthia R. Cox to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("E. Cox Letter"); Krumpfes Letter, supra note 40; Letter from John L. Pietrzak to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Pietrzak Letter"); Letter from Robert Salstone to Nancy M. Morris, Secretary,

with respect to the Exercise Right and violates the agreements between the CBOT and CBOE,[42] and complained about the economic impact of the proposed rule change on CBOT members,

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Commission, dated February 26, 2007.

42 See Letter from Peter W. Aden, dated February 9, 2007; Dorf Letter, supra note 41; Letter from Michael C. Rothman, dated February 9, 2007 ("Rothman Letter"); Goldberg Letter, supra note 40; Letter from Clint Gross, dated February 11, 2007 ("Gross Letter"); Letter from Richard D. Lupori, dated February 12, 2007; Mendelson Letter, supra note 40; Letter from Adam Rich to Nancy M. Morris, Secretary, Commission, dated February 12, 2007 ("Rich Letter"); Simms Letter, supra note 40; Letter from Frank J. Aiello to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Darraugh Letter, supra note 40; Letter from Michael Forester to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Letter from Richard Friedman, dated February 13, 2007 ("R. Friedman Letter"); Letter from Ronald F. Grossman, dated February 13, 2007 ("Grossman Letter"); Kessler Letter, supra note 40; Letter from Robert T. O'Brien to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; O'Bryan Letter, supra note 40; Shuff Letter, supra note 41; Todebush Letter, supra note 41; Letter from Arthur Arenson to Nancy M. Morris, Secretary, Commission, dated February 14, 2007; Letter from Michael Floodstrand to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Floodstrand Letter"); Hellman Letter, supra note 40; Letter from Pat Hillegass, dated February 14, 2007; Letter from Michael D. Morelli to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Morelli Letter"); Letter from Ira S. Nathan, dated February 14, 2007 ("Nathan Letter"); Letter from Glenn Beckert, dated February 15, 2007 ("Beckert Letter"); Letter from John V. Grimes, dated February 15, 2007 ("Grimes Letter"); Mitzenmacher Letter, supra note 40; Letter from Thomas E. Nelson to Nancy M. Morris, Secretary, Commission, dated February 15, 2007 ("Nelson Letter"); Letter from Young Chun, dated February 16, 2007 ("Chun Letter"); N. Friedman Letter, supra note 41; McMurray Letter, supra note 40; Reif Letter, supra note 40; Letter from Howard Tasner, dated February 16, 2007; Letter from Kelly A. Caloia to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Mark Feierberg, dated February 18, 2007 ("Feierberg Letter"); Letter from J. Patrick Hennessy to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Alan Matthew to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Nicholas M. McBride to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Richard H. Woodruff to Nancy M. Morris, Secretary, Commission, dated February 18, 2007 ("Woodruff Letter"); C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Komo Letter, supra note 40; T.M. Myron Letter, supra note 40; Letter from Patrick H. Arbor to Nancy M. Morris, Secretary, Commission, dated February 20, 2007 ("Arbor Letter"); Letter from John T. Brennan, dated February 20, 2007; Letter from Karl G. Estes to Nancy M. Morris, Secretary, Commission, dated February 20, 2007 ("Estes Letter"); Johnson Letter, supra note 41; Letter from Patrick A. Walsh, dated February 20, 2007 ("Walsh Letter"); Jaman Letter, supra note 40; Letter from Ronald G. Lindenberg to Nancy M. Morris, Secretary, Commission, dated February 21, 2007; McGreevy Letter, supra note 40; Baby Letter, supra note 40; Sheehan Letter, supra note 41; Letter from Bryan Cournoyer to Nancy M. Morris, Secretary, Commission, submitted February 24, 2007 ("B. Cournoyer Letter"); S. Cournoyer Letter, supra note 40; Goodman Letter, supra note 40; Northey Letter, supra note 41; Letter from Joyce Selander, submitted February 24, 2007; Chubin Letter, supra note 40; Letter from Neil Esterman, dated February 25, 2007 ("Esterman Letter"); Letter from Terry Myron, dated February 25, 2007; Letter from Martin Flaherty, dated February 25, 2007; Levin Letter, supra note 40; Letter from John F. McKerr, Celtic Brokerage, Inc., to Nancy M. Morris, Secretary, Commission, dated February 25, 2007 ("McKerr Letter"); Griffin Letter,

especially the fact that the CBOE's proposal would prohibit CBOT members from sharing in the CBOE's anticipated demutualization.[43] The main points raised by the comment letters, as well as the Commission's findings, are discussed below.

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supra note 40; Krumpfes Letter, supra note 40; Neubauer Letter, supra note 40; Letter from Sondra Brewer Pfeffer to Nancy M. Morris, Secretary, Commission, dated February 26, 2007; Bianchi Letter, supra note 40; Terman Letter, supra note 40; Letter from Judy Anne Parrish, dated February 27, 2007 ("Parrish Letter"); Letter from James Ryan, dated February 27, 2007; Letter from Rose G. Schneider, dated February 27, 2007 ("Schneider Letter"); Letter from Michael J. Crilly to Nancy M. Morris, Secretary, Commission, dated August 17, 2007 ("Crilly Letter 2"); Letter from Gary V. Sagui, Templar Securities LLC, to Nancy M. Morris, Secretary, Commission, dated August 20, 2007; and Letter from Paul L. Richards to Bill Brodsky, Chairman, CBOE, dated August 31, 2007.

43 See Dorf Letter, supra note 41; Goldberg Letter, supra note 40; Mendelson Letter, supra note 40; Rich Letter, supra note 42; Simms Letter, supra note 40; R. Friedman, Letter, supra note 42; Grossman Letter, supra note 42; Floodstrand Letter, supra note 42; Nathan Letter, supra note 42; Beckert Letter, supra note 42; Grimes Letter, supra note 42; Nelson Letter, supra note 42; Letter from Erskine S. Adam, Jr. to Nancy M. Morris, Secretary, Commission, dated February 16, 2007; Chun Letter, supra note 42; Letter from Angelo Dangles, dated February 18, 2007; Feierberg Letter, supra note 42; Woodruff Letter, supra note 42; C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Komo Letter, supra note 40; Arbor Letter, supra note 42; Ellis Letter, supra note 41; Estes Letter, supra note 42; Letter from Jay Homan, dated February 20, 2007; Walsh Letter, supra note 42; Cashman letter, supra note 40; McGreevy Letter, supra note 40; Stone Letter 1 and 2, supra note 41; Baby Letter, supra note 40; Richards Letter 2, supra note 40; Levin Letter, supra note 40; Letter from Robert M. Geldermann, dated February 26, 2007; Letter from Stephen R. Geldermann, dated February 26, 2007; Neubauer Letter, supra note 40; Parrish Letter, supra note 42; Schneider Letter, supra note 42; and Letter from Nancy Williams, dated February 27, 2007 ("Williams Letter").

Some commenters noted that the right to exercise to trade on the CBOE was priced into their CBOT memberships when they initially purchased them. See Rothman Letter, supra note 42; Goldberg Letter, supra note 40; Gross Letter, supra note 42; Williams Letter; Cassidy Letter, supra note 41; Johnson Letter, supra note 41; Walsh Letter, supra note 42; Letter from Robert Berry, dated February 21, 2007; Cashman Letter, supra note 40; Jaman Letter, supra note 40; McGreevy Letter, supra note 40; B. Cournoyer Letter, supra note 42; Chubin Letter, supra note 40; C. Cox Letter, supra note 40; Terman Letter, supra note 40; and Richards Letter 2, supra note 40. Cf. Hardy Letter, supra note 36 (noting that at some points in time a CBOE membership cost more than a CBOT membership, thus undercutting the argument that the CBOT membership reflected a premium for its attendant CBOE access right).

One commenter, a self-described founding member of CBOE, argued that the documents presented to the CBOT board of directors at the meeting where it decided to spin-off the CBOE do not mention equity rights to be retained in CBOE by CBOT members; rather, access rights, liquidation rights in CBOE in case of failure, and how to get back the initial investment of $750,000 were the main topics of discussion. See Blum Letter, supra note 36. The commenter notes that the $750,000 was eventually repaid to CBOT. See also Hardy Letter, supra note 36 (also noting that the $750,000 was repaid). One commenter argued that CBOT could have given each of its members a free seat on the CBOE if an equity position was desired, but instead they

IV. Discussion and Commission Findings

Before turning to the specific questions under consideration, it is appropriate to review the obligations that the Exchange Act imposes on the Commission in reviewing SRO proposed rule changes and the manner in which the Commission carries out those obligations. The Exchange Act specifically requires an exchange to file with the Commission all proposed rules and any proposed changes in, additions to, or deletions from its rules.[44] As noted below, "rules" of an exchange are defined broadly to include, in this case, interpretations of CBOE's Certificate of Incorporation.[45] Once an exchange files a proposed rule change with the Commission, the Exchange Act requires the Commission to approve any such proposed rule change if it finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the exchange.[46] Alternatively, if the Commission cannot so find, it must disapprove the rule proposal.[47] The Exchange Act requirements for Commission action are not conditioned upon the absence of issues arising under other federal or state laws.

The Commission considers proposed rule changes in accordance with the requirements applicable to national securities exchanges under Section 6 of the Exchange Act. In addition, because Section 6(b)(1) of the Exchange Act requires exchanges to enforce compliance by its

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chose to grant access through the Exercise Right. See Hardy Letter, supra note 36.

44 See 15 U.S.C. 78s(b)(1).

45 See infra note 70 and accompanying text.

46 See 15 U.S.C. 78s(b)(2). Section 19(b) of the Exchange Act requires the Commission to approve a proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved "[w]ithin thirty-five days of the date of publication of notice of the filing of a proposed rule change… or within such longer period as the Commission may designate up to ninety days of such date… or as to which the self-regulatory organization consents." Id. The CBOE consented to an extension of time for the Commission to consider its filing. See Item 6 of Amendment No. 1 to CBOE's Form 19b-4 filing, dated January 17, 2007.

47 See 15 U.S.C. 78s(b)(2).

members and persons associated with its members with the provisions of the Exchange Act, the Commission considers whether proposed rule changes are consistent with all other Exchange Act provisions and Commission rules adopted thereunder. Further, Sections 6(b)(1) and 19(g)(1) of the Exchange Act[48] require exchanges to comply with their own rules; as noted below, those rules are defined by the Exchange Act to include the exchange's certificate of incorporation and its bylaws.[49] Thus, the Commission cannot approve a proposed rule change if the exchange has failed to complete all action required under, or to comply with, its own certificate of incorporation or bylaws.

With respect to CBOE's proposal, the Commission has carefully reviewed the proposed rule change, all comment letters and attachments thereto, and the CBOE's response to the comment letters, and finds that, as a matter of federal law, the proposed rule change is consistent with the requirements of the Exchange Act, in particular Section 6 of the Exchange Act[50] and the rules and regulations applicable to a national securities exchange.[51]

In particular, the Commission finds that the proposed rule change is consistent with: (1) Section 6(b)(1) of the Exchange Act,[52] which requires the Exchange to be organized and have the capacity to comply, and to enforce compliance by its members and persons associated with its members, with, among other things, the rules of the Exchange; (2) Section 6(b)(5) of the Exchange Act,[53] which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade and not be unfairly discriminatory; (3) Section

48 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78s(g)(1), respectively.

49 See infra note 70 and accompanying text.

50 15 U.S.C. 78f(b).

51 In approving this rule, the Commission has considered the impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

52 See 15 U.S.C. 78f(b)(1).

53 See 15 U.S.C. 78f(b)(5).

6(b)(8) of the Exchange Act,[54] which requires that the rules of the Exchange not impose any burden on competition that is not necessary or appropriate in the furtherance of the purposes of the Exchange Act; (4) Section 6(c)(3)(A) of the Exchange Act,[55] which permits, among other things, an exchange to examine and verify the qualifications of an applicant to become a member, in accordance with the procedures established by exchange rules; and (5) Section 6(c)(4) of the Exchange Act,[56] which prohibits the Exchange from decreasing the number of memberships below the number of memberships in effect on May 1, 1975.[57] The Commission also finds that the proposed rule change complied with the requirements of Section 19(b) of the Exchange Act,[58] was complete and properly filed, and provided all of the requisite information specified in Form 19b-4.[59]

While we make these findings under the Exchange Act based on the record now before us, we discuss below possible reactions by the CBOE or the Commission to the eventual decision in a lawsuit now pending in Delaware state court. Depending upon that outcome, it may be appropriate for CBOE and the Commission to take further actions in light of the state court's findings and to assess whether they affect CBOE's compliance with the federal securities laws.[60]

A. <u>The Commission Has Jurisdiction to Consider the CBOE's Proposed Rule Change</u>

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54 <u>See</u> 15 U.S.C. 78f(b)(8).

55 <u>See</u> 15 U.S.C. 78f(c)(3)(A).

56 <u>See</u> 15 U.S.C. 78f(c)(4).

57 <u>See</u> <u>infra</u> Section IV.C. (discussing the Commission's findings in greater detail).

58 15 U.S.C. 78s(b).

59 <u>See</u> <u>infra</u> Section IV.C.2 (discussing the completeness of CBOE's proposed rule change on Form 19b-4).

60 <u>See</u> <u>infra</u> note 115.

Various commenters challenged the Commission's jurisdiction over the CBOE's proposed rule change, arguing that the Commission should not consider or approve the CBOE's proposal because the filing implicates a contractual dispute arising under state law and therefore is subject to the jurisdiction of a state court.[61] In particular, CBOT notes that the proposed rule change relates to a pending dispute in the Delaware court involving matters that are governed by state law, including the interpretation of private contracts between CBOE and CBOT involving a property right and claims regarding the proper exercise of authority and fiduciary obligations on the part of CBOE's Board of Directors.[62] CBOT expressed its view that the Commission's authority to consider the proposed rule change under the federal securities laws does not preempt the authority of the state court to determine whether the CBOE's actions comported with state corporate, fiduciary, and contract law.[63]

Accordingly, CBOT and certain commenters have asked the Commission to either disapprove the proposal or defer consideration of the proposed rule change until after the Delaware court has adjudicated the state law issues.[64] CBOT suggests that, since the state

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61 See Comment Letters cited in note 40, supra (questioning the Commission's jurisdiction over the proposed rule change).

62 See Mayer Brown Letter 3, supra note 37, at 6. Specifically, CBOT argues that CBOE's Board of Directors violated its fiduciary duty towards Exerciser Members and violated prior contractual agreements between the CBOE and CBOT by submitting a proposal that has the effect of not affording Exerciser Members equal treatment in the anticipated CBOE demutualization. See id. at 9-10.

63 See id. at 11.

64 See Gardner Letter, supra note 37, at 2; Mayer Brown Letter 1, supra note 37, at 1, 3-4; Mayer Brown Letter 2, supra note 37, at 1; Mayer Brown Letter 3, supra note 37, at 6-7, 10-11; Mayer Brown Letter 6, supra note 37, at 1-2. According to CBOT, the central question in the Delaware litigation – the status of the Exercise Right in light of CBOE's proposed demutualization and the acquisition of CBOT by CME Holdings – is fundamentally a state law question because it concerns an interpretation of the CBOE Certificate of Incorporation, which is treated as a contract under Delaware law. See Mayer Brown Letter 3, supra note 37, at 10.

See also, e.g., Kessler Letter, supra note 40; Reed Letter, supra note 40; Cashman Letter, supra note 40; McKerr Letter, supra note 42; and Letter from Marshall Spiegel, dated March 19, 2007 court's decision may inform the Commission's resolution of the proposed rule change, it may be more efficient for the Commission to defer its consideration of the proposal until after the Delaware litigation is resolved.[65] For similar reasons, CBOT claims that the proposed rule change is not a proper subject of SRO rulemaking because it does not implicate issues under the federal securities laws.[66]

The Commission believes the proposed rule change is a proper subject of SRO rulemaking and implicates issues under the federal securities laws. While the proposed rule change may relate to issues that are implicated in a lawsuit pending in Delaware court, it is also a proposal by a self-regulatory organization ("SRO") to interpret its rules. Section 19(b)(1) of the Exchange Act[67] requires CBOE to file with the Commission any proposed changes to, or interpretations of, its rules. Accordingly, the Exchange Act unambiguously places CBOE's proposal firmly within the Commission's authority and responsibility. Furthermore, the Commission is obligated to consider CBOE's proposal, as the Exchange Act does not give the

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(all requesting that the Commission wait for the Delaware court to rule before acting on the CBOE's proposal). One commenter urged the Commission to wait until the Delaware court decides the issue on the basis that if the Delaware court finds bad faith on the part of the CBOE Board under state law, then the proposed rule change will have been improperly filed. See Ungaretti Letter, supra note 39, at 5-6.

65 See Mayer Brown Letter 1, supra note 37, at 3-4. CBOT notes that, although the Commission has jurisdiction to review proposed rule changes to ensure that they are consistent with the Exchange Act, the Commission previously has indicated that it does not interpret state law to determine whether a rule change is also consistent with state laws. See Mayer Brown Letter 1, supra note 37, at 3; Mayer Brown Letter 5, supra note 37, at 5-6.

66 See, e.g., Mayer Brown Letter 5, supra note 37, at 5 ("In sum, this controversy, and the Proposed Rule Change, have nothing to do with 'membership issues', and everything to do with the ownership issues before the Delaware court."); Mayer Brown Letter 2, supra note 37, at 1 ("The Proposed Rule Change has no legitimate securities regulatory or self-regulatory purpose."); and Mayer Brown Letter 3, supra note 37, at 6-7

67 15 U.S.C. 78s(b)(1).

Commission authority to defer consideration of a proposed rule change that has been properly filed.[68]

As a federal law matter, Congress has given the Commission jurisdiction over SROs and has required "[e]ach self-regulatory organization [to] file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization…."[69] The "rules of a self-regulatory organization" include, among other things, "the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing, of an exchange… [and] the stated policies, practices, and interpretations of such exchange…."[70] Rule 19b-4(b) under the Exchange Act defines the term "stated policy, practice, or interpretation" broadly to include:

> (1) any statement made generally available to the membership of the SRO, or to a group or category of persons having or seeking access to facilities of the SRO, that establishes or changes any standard, limit, or guideline with respect to the rights, obligations, or privileges of such persons, or
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> (2) the meaning, administration, or enforcement of an existing SRO rule.[71]

Accordingly, because the CBOE's Certificate of Incorporation and the CBOE's interpretation thereof constitute "rules" of the Exchange, the Exchange Act clearly establishes

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68 The Commission notes that the pending lawsuit has been stayed pending Commission action on this proposed rule change. See CBOT Holdings, Inc. et al. v. Chicago Board Options Exchange Inc., et al., Memorandum of Opinion, decided August 3, 2007 (Del. Ch.) ("Memorandum of Opinion"); see also Letter Opinion, dated October 10, 2007 (denying Plaintiffs' Motion to Lift Stay to Allow for Filing of a Third Amended Complaint and the Commencement of Discovery).

69 15 U.S.C. 78s(b)(1).

70 See Sections 3(a)(27) and 3(a)(28) of the Exchange Act; 15 U.S.C. 77c(a)(27) and (28).

71 See 17 CFR 240.19b-4(b).

that CBOE's proposed rule change, an interpretation of Article Fifth(b) of its Certificate of Incorporation, was the proper subject of a rule filing under Section 19(b)(1) of the Exchange Act. Indeed, Section 19(b)(1) of the Exchange Act[72] requires CBOE to file with the Commission any proposed changes to, or interpretations of, its Certificate of Incorporation.

In compliance with Section 19(b)(1), CBOE filed its proposed interpretation of its Certificate of Incorporation with the Commission on December 12, 2006. Once CBOE filed this proposed rule change, Section 19(b)(2) of the Exchange Act[73] required the Commission to publish notice of the proposed rule change and either approve it or institute proceedings to determine whether the proposed rule change should be disapproved.[74] Accordingly, the Commission has the obligation under the Exchange Act to consider and affirmatively dispose, by either approving or disapproving, of the CBOE's proposal. The existence of a contractual dispute arising under state law subject to pending litigation in state court does not in any way displace or supplant the Commission's jurisdiction to consider a proposed rule change submitted by an SRO.[75]

Moreover, Article Fifth(b), which entitles "members of [the CBOT]" to be members of the CBOE, implicates several important Exchange Act issues. First, by its terms, this provision of the CBOE's Certificate of Incorporation relates to membership on the Exchange. The

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72 15 U.S.C. 78s(b)(1).

73 15 U.S.C. 78s(b)(2).

74 The CBOE consented to an extension of time for the Commission to consider its filing. See Item 6 of Amendment No. 1 to CBOE's Form 19b-4 filing, dated January 17, 2007.

75 CBOE asserts that the proposed rule change was not an attempt to undercut the Delaware court's authority to resolve the litigation initiated by the CBOT and the putative class, because, at the time the proposed rule change was filed, the Delaware litigation dealt only with the valuation issues arising from the CBOE demutualization, whereas the proposed rule change addresses the impact of the change in the CBOT corporate structure on the eligibility to be, and remain, an Exercise Member. See Schiff Hardin Letter 1, supra note 36, at 2; and CBOE Response to Comments, supra note 4, at 17-18.

Exchange Act clearly establishes the Commission's oversight responsibility with regard to matters of exchange membership,[76] which includes access to trading on the exchange. For example, Section 6(b)(2) of the Exchange Act requires that "[s]ubject to the provisions of subsection (c) . . ., the rules of the exchange provide that any registered broker or dealer or natural person associated with a broker or dealer may become a member of such exchange . . . "[77] Section 6(c) of the Exchange Act further specifies when a national securities exchange may deny membership to, or condition the membership of, a registered broker or dealer.[78] An exchange's rules are also required, among other things, to provide a fair procedure for the denial of membership to any person seeking membership and the prohibition or limitation by the exchange of any person's access to services offered by the exchange.[79] Further, the Commission has authority under Sections 19(d) and (f) of the Exchange Act to, among other things, review denials of membership by a national securities exchange.[80]

Second, the Exchange Act manifests a strong federal interest in the governance of national securities exchanges.[81] Section 6(b)(3) of the Exchange Act requires the rules of the

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76 CBOE notes that state courts have previously recognized the Commission's exclusive authority over membership rules and membership decisions, including CBOE's interpretations of Article Fifth(b), and have noted that the Commission's authority preempts direct judicial consideration of exchange membership issues. See CBOE Response to Comments, supra note 4, at 6-8; Schiff Hardin Letter 1, supra note 36, at 5-6. CBOE opined that the preeminence of federal law with respect to membership issues is critical to avoid having inconsistent standards imposed on exchanges by competing judicial authorities, which CBOE believes would undermine the federal regulatory scheme. See CBOE Response to Comments, supra note 4, at 8-10.

77 15 U.S.C. 78f(b)(2).

78 See 15 U.S.C. 78f(c).

79 See 15 U.S.C. 78f(b)(6).

80 See 15 U.S.C. 78s(d) and (f), respectively.

81 See, e.g., Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003) (SR-NYSE-2003-34) (approving NYSE's governance proposal to establish a new board of directors composed wholly of independent directors; an advisory board of executives that would be representative of the exchange's various constituencies; independent board committees with specific oversight authority for compensation, audit functions, the

exchange to assure "a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall. . . not be associated with a member of the exchange, broker, or dealer."[82] By giving members a voice in the governance of an SRO, this requirement "serves to ensure that an exchange is administered in a way that is equitable to all market members and participants,"[83] and helps to preserve the integrity of an exchange's self-regulatory functions. Effective governance of an exchange is also important to an exchange's ability to satisfy the requirement under Section 6(b)(1) of the Exchange Act that an exchange be organized and have the capacity to carry out the purposes of the Exchange Act and to comply and enforce compliance with the Exchange Act, the rules and regulations thereunder, and exchange rules.[84]

The CBOE's interpretation of Article Fifth(b) affects who is entitled to be a member of the CBOE. Because of the role that CBOE members have in the governance of the Exchange, including the election of the CBOE Board of Directors,[85] the Commission has an interest in who

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nominations process and regulatory matters; and an autonomous regulatory unit that would report directly to the regulatory oversight committee).

82 15 U.S.C. 78f(b)(3). The Exchange Act requires that at least one director be representative of issuers and investors because of the public's interest in ensuring the fairness and stability of significant markets. See id.

83 Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70882 (December 22, 1998) (S7-12-98).

84 See, e.g., Securities Exchange Act Release No. 21439 (October 31, 1984), 49 FR 44577 (November 7, 1984) (SR-CBOE-84-15 and SR-CBOE-84-16). This order instituted proceedings to disapprove two CBOE proposals to change certain of its rules related to governance. The first proposal would have increased the number of floor directors on the Board of Directors. The Commission subsequently disapproved this proposal because it could not find that it was consistent with the Act, particularly Sections 6(b)(1), 6(b)(3), and 6(b)(5). See Securities Exchange Act Release No. 22058 (May 21, 1985), 50 FR 23090 (May 30, 1985) (SR-CBOE-84-15 and SR-CBOE-84-16). The second proposal provided that, in the event there is more than one candidate for Chairman of the CBOE Executive Committee, the Chairman would be elected by a plurality of CBOE members voting at an annual meeting of the membership. This proposal was later approved. See id.

85 See CBOE Constitution, Section 6.1.

is entitled to be a member of the Exchange, because it affects how the Exchange is governed and how it fulfills its regulatory responsibilities consistent with Section 6(b) of the Exchange Act.

B. Compliance with Its Own Rules

National securities exchanges are required under Sections 6(b)(1) and 19(g)(1) of the Exchange Act to comply with their own rules.[86] In this case, commenters and the CBOT present two questions of the CBOE's compliance with its rules, which are (1) whether the CBOE should have treated the rule as an amendment instead of an interpretation and (2) whether the Board of Directors of the CBOE breached duties under state law when approving the proposed rule. We begin with a discussion of the way the Commission evaluates arguments such as these in the course of reviewing a proposed SRO rule and then turn to the two specific issues the CBOT and commenters present.

Both of the issues concerning the CBOE's compliance with its own rules raise state law questions. Typically, the Commission does not consider matters outside the scope of the federal securities laws, except to the extent that consideration of a matter of state law is necessary to inform a Commission finding on a federal matter arising under the Exchange Act. Generally, the analysis of whether an SRO has complied with its own rules is straightforward and does not require consideration of disputed areas of state law. For instance, the question might involve whether an SRO complied with requirements relating to a particular time period or some other readily ascertainable procedural step. In those cases, the Commission has a straightforward task in determining whether the SRO complied with its own rules. Other cases, however, might present a more nuanced question of compliance that turns on a difficult or novel issue of state law. In those cases, the Commission generally looks for expert guidance and reaches a decision

[86] 15 U.S.C. 78f(b)(1) and 78s(g)(1).

based on the submissions and sufficiency of the basis of the action of the SRO. However, the Commission is not the final arbiter on questions of state law. If an authoritative decision by a court reaches a conclusion about the relevant state law in a dispute concerning the SRO's actions that differs from the position the Commission relied on, the Commission expects the SRO promptly to propose changes to its rules necessary to comply with the outcome of any such litigation.

In other words, when a proposed rule change raises a difficult or novel question of SRO compliance with its certificate of incorporation or bylaws, the Exchange Act requires the Commission to determine whether the SRO has so complied, even though the question of compliance turns on the interpretation and application of state law. In that situation, the Commission relies on the conclusions of experts or other authorities as to the content and application of state law.[87]

1. <u>Interpretation vs. Amendment of Article Fifth(b)</u>

CBOT argues that CBOE deviated from its own rules and procedures in failing to obtain the necessary vote when it "amended" Article Fifth(b) to eliminate the property right created therein.[88] In response, CBOE states that a vote of its membership was not necessary because the proposed rule change constituted an interpretation of, rather than an amendment to, Article Fifth(b), and thus is not subject to a vote pursuant to the terms of Article Fifth(b).[89] Based on the record before it, the Commission agrees with CBOE.

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87 <u>Cf.</u> Fed. R. Civ. P. 44.1 (in determining foreign law, a court may consider any relevant material or source).

88 <u>See</u> Mayer Brown Letter 3, <u>supra</u> note 37, at 26 and 33. CBOT notes that the terms of Article Fifth(b) require an 80% class vote to amend that provision. <u>See</u> <u>id.</u> at 26.

89 <u>See</u> CBOE Response to Comments, <u>supra</u> note 4, at 19-20 and 22-23.

The proposal interprets who qualifies as a "member of [the CBOT]" under Article Fifth(b) in light of circumstances external to the proposed rule change (i.e., CBOT's decision to be acquired by CME Holdings). CBOT argues that the proposed rule change is an unreasonable interpretation[90] that violates CBOE's Certificate of Incorporation and breaches the 1992 Agreement because it is based on the faulty premise that, following the acquisition by CME Holdings, former CBOT members will no longer be "members" within the meaning of Article Fifth(b).[91] Rather, CBOT asserts that its former members continue to qualify as "CBOT Full Members" and continue to have all the same trading rights they had in the past.[92] In addition, CBOT argues that the provisions in the 1992 Agreement regarding the effect of a potential merger involving CBOT do not adversely affect the continued availability of the Exercise Right in this case.[93] CBOT believes that members of CBOT after the acquisition continue to hold sufficient indicia of CBOT membership to qualify for CBOE membership under Article Fifth(b).[94]

In particular, CBOT points out that the CBOT itself did not merge with any entity and

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90 One commenter criticizes the CBOE's proposal on the basis that it ignores the CBOT's "reasonable alternative interpretation." See Ungaretti Letter, supra note 39, at 9. The Commission, however, is not required to find that the interpretation proposed is the most reasonable, but only that the one proposed is consistent with the Exchange Act.

91 See Mayer Brown Letter 3, supra note 37, at 34. CBOT also notes CBOE's (now expired) arrangement with the Intercontinental Exchange ("ICE") when ICE was attempting to acquire the CBOT in which ICE and CBOE would have paid $665.5 million to compensate, in part, for the loss of the Exercise Right. See Mayer Brown Letter 5, supra note 37, at 2. CBOT believes that this arrangement undercut CBOE's claim that after the acquisition by CME Holdings, the Exercise Right will have no value and the rights of Eligible CBOT Full Members will be extinguished. See id. The Commission disagrees. An offer of settlement in which compensation is to be paid does not necessarily suggest that the underlying matter in dispute has any particular validity or value. An offer to settle a disputed matter has value it its own right, for example the savings associated with the avoidance of protracted legal proceedings and the ability to bring a dispute to a final conclusion.

92 See Mayer Brown Letter 3, supra note 37, at 34-36.

93 See id.

94 See id. at 37.

will survive the transaction with CME Holdings.[95] CBOT affirms that the acquisition by CME Holdings is "precisely the kind of transaction that CBOE has already agreed would have no effect on the Exercise Right under the 1992 Agreement."[96] CBOT asserts that as part of its 2005 restructuring it split full memberships into three components: the Exercise Right Privilege, a Series B-1 membership, and stock in CBOT Holdings, and possession of all three components qualifies a person as an "Eligible CBOT Full Member" within the meaning of the 1992 Agreement (therefore qualifying such person for the Exercise Right).[97] CBOT argues that the Exercise Right should survive because the only change after the acquisition by CME Holdings is that "the 27,338 shares of Class A common stock of CBOT Holdings that Exercise Right holders held before the merger was consummated will be converted into 8,217.80 shares of CME Holdings Class A common stock."[98]

In response, CBOE argues that the concept of a CBOT "member" was eliminated by the acquisition of CBOT, and the only reason persons had continued to qualify as "members" of CBOT for purposes of Article Fifth(b) after CBOT's restructuring is because under the 2001 Agreement, CBOE interpreted Article Fifth(b) so that persons would qualify as "members" of CBOT if they held all of three specified interests in CBOT and CBOT Holdings following CBOT's restructuring.[99] CBOE points out that Article Fifth(b) was designed to recognize

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95 See id. at 35. Rather, CBOT Holdings (of which CBOT is a subsidiary) was acquired by CME Holdings.

96 See id.

97 See id. at 36.

98 See id. at 34.

99 See CBOE Response to Comments, supra note 4, at 26 and 29. The Commission notes that there is support for this position in the Memorandum of Opinion: "The CBOE agreed, albeit with some reluctance, that the restructuring of the CBOT into CBOT Holdings would not render the Exercise Right inapplicable, a circumstance that would likely have been the case if a provision under the parties' agreement in 1992 had been strictly interpreted." Memorandum of Opinion, supra note 68, at 3.

contributions made by CBOT members in their capacities as owners, and so an ownership stake in CBOT is essential to the definition of "member."[100] However, after the CME/CBOT transaction, the concept of CBOT "members" as originally contemplated in Article Fifth(b) no longer exists because CBOT is now owned by CME Holdings.[101] Similarly, after the acquisition, persons who were former members of the CBOT only hold trading permits and no longer possess any of the other rights commonly associated with membership in an exchange.[102] In particular, according to CBOE, a former CBOT member no longer has a right to elect directors, the right to nominate candidates for director, or the right to amend or repeal the bylaws of CBOT.[103] In addition, CBOE notes that one of the conditions in the 1992 Agreement for Exercise Rights to continue after an acquisition is that "the survivor" entity of any merger be an exchange, a condition that is no longer satisfied since the survivor of the transaction is not an exchange, but rather a holding company.[104] CBOE states that ownership of shares of CME Holdings is not enough to support Exercise Right eligibility because the interpretation of Article Fifth(b) embodied in the 2001 Agreement was that "persons remain 'members' of CBOT only if they continue to hold all of three specified interests in CBOT and CBOT Holdings following the 2005 demutualization of CBOT – namely, one Class B, Series B-1 membership in CBOT, one [Exercise Right Privilege] and 27,338 shares of Class A stock of CBOT Holdings."[105] However, as CBOE notes, after CBOT is acquired by CME Holdings, "there no longer will be any persons who could hold all three of these interests – because CBOT Holdings Class A stock will cease to

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100 See CBOE Response to Comments, supra note 4, at 26-27.

101 See id. at 26.

102 See id. at 28.

103 See id.

104 See id.

105 Id. at 29.

exists and instead will be converted into either cash or shares of CME Holdings."[106] Further, CBOE notes that the 2001 Agreement states that the provisions applicable to the Exercise Right would continue to apply only "in the absence of any other material changes to the structure or ownership of the CBOT...not contemplated in the CBOT [restructuring]."[107]

Additionally, in response to the assertion that issues raised in the proposed rule change are governed by state contract law, CBOE responds that the 1992 Agreement was not a contract in which new rights were created, but was rather an interpretation serving to clarify the term "Exercise Member" and what is required to qualify as such.[108] Specifically, according to CBOE, any contractual grant of exercise rights that added or detracted from those afforded by Article Fifth(b) would have represented an amendment of Article Fifth(b), which under its own terms would have required an affirmative vote of at least 80% of Exercise Members and CBOE Seat Owners, voting as separate groups.[109] Thus, CBOE concludes that, since no vote was taken, the 1992 Agreement cannot be construed as a contractual source of new exercise rights, and, at most, must be construed to be a mutually shared interpretation of Article Fifth(b).

The Commission believes that the record provides a sufficient basis on which the Commission can find that the CBOE complied with its own Certificate of Incorporation in determining that the proposed rule change is an interpretation of, not an amendment to, Article Fifth(b).[110] After considering the materials on this issue submitted by both the CBOE and CBOT, the Commission is persuaded by CBOE's analysis of the difference between "interpretations" and "amendments." In particular, the Commission notes that the CBOT's

106 CBOE Response to Comments, supra note 4, at 29.

107 Id. at 27.

108 See id. at 13-15.

109 See id.

110 See 15 U.S.C. 78f(b)(1).

letter of counsel was based on an error of fact with respect to the composition of the CBOE Board at the time of the interpretation of Article Fifth(b), and, in fact, the CBOE's Board of Directors was composed of a majority of disinterested public directors at the time. This issue is discussed below.[111]

In approving this proposal, the Commission is relying on the CBOE's representation that its approach is appropriate under Delaware state law. The Commission is also relying on CBOE's letter of counsel that concludes that the Board's interpretation of Article Fifth(b) does not constitute an amendment to the CBOE's Certificate of Incorporation and that it is within the general authority of the CBOE's Board of Directors to interpret Article Fifth(b) when questions arise as to its application under certain circumstances, so long as the interpretation adopted by the Exchange's Board of Directors is made in good faith, consistent with the terms of the governing documents themselves, and not for inequitable purposes.[112] Without opining on the merits of any claims arising solely under state law, the Commission finds that CBOE has articulated a sufficient basis to support its proposed rule change and for the foregoing reasons finds that it is consistent with the Exchange Act.

Further, the Commission agrees that the actions of the CBOT necessitated CBOE's interpretation of Article Fifth(b) to clarify whether the substantive rights of a former CBOT member would continue to qualify that person as a "member of [the CBOT]" pursuant to Article

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111 See infra note 120 (citing to CBOT's opinion letter from Frederick H. Alexander, Morris, Nichols, Arsht & Tunnell LLP, to Erik R. Sirri and Elizabeth K. King, Division of Market Regulation, Commission, dated August 20, 2007) and note 124 (citing to CBOE's opinion letter from Michael D. Allen, Richards, Layton & Finger, to Nancy M. Morris, Secretary, Commission, dated August 31, 2007).

112 See Second Opinion of Counsel, supra note 5, at 5. The Commission's evaluation of CBOE's interpretation of Delaware law rests solely on the materials in the record before it.

Fifth(b) in response to changes in the ownership of the CBOT.[113] While CBOE could have interpreted Article Fifth(b) in any number of ways following that transaction, its proposed interpretation is one that the Commission may find, and herein has found, to be consistent with the Exchange Act. In particular, the Commission finds that CBOE's proposed interpretation is consistent with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, because the proposal interprets CBOE's rules fairly and reasonably with respect to eligibility for the Exercise Right following the acquisition of CBOT by CME Holdings.[114]

Except to the extent necessary to make these findings under the Exchange Act, the Commission is not purporting to decide a question of state law. Rather, the Commission's approval of the CBOE's proposal under federal law leaves undisturbed any aspects arising solely under state law for the consideration and disposition by the competent state authorities. The currently pending Delaware state court action may result in authoritative decisions on some of the issues we have addressed and could make some of the conclusions reached here infirm. If that occurs, the Commission expects CBOE to propose appropriate amendments to its rules. Should CBOE fail to take the required steps, the Commission has the authority to act.[115]

2. <u>Independence of CBOE Directors Voting on the Matter</u>

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113 See CBOE Response to Comments, supra note 4, at 24.

114 15 U.S.C. 78f(b)(5). See also Securities Exchange Act Release No. 51733 (May 24, 2005), 70 FR 30981, 30983 (May 31, 2005) (SR-CBOE-2005-19) (finding CBOE's proposal to be consistent with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, because it interpreted CBOE's rules fairly and reasonably with respect to the eligibility of a CBOT full member to become a member of the CBOE following the CBOT's restructuring).

115 See, e.g., Section 19(c) of the Exchange Act; 15 U.S.C. 78s(c) (authorizing the Commission to abrogate, add to, and delete from exchange rules as necessary or appropriate to conform those rules to the requirements of the Exchange Act).

When filing a proposed rule change with the Commission, an SRO is required to state that the proposal was validly approved pursuant to the SRO's governing documents.[116] If the CBOE Board's action in approving the proposal for filing with the Commission was invalid, the consequence would be that the CBOE's proposal would not satisfy the Exchange Act requirements, specified in Form 19b-4, regarding the necessity of valid approval by the SRO's governing body to authorize the filing of the proposal with the Commission.

CBOT argues that the proposal was approved by a conflicted board of directors that had a financial interest in the status of the Exercise Right.[117] Further, CBOT argues that, while the CBOE Board of Directors may interpret the CBOE Certificate of Incorporation "in good faith, consistent with the terms of [Article Fifth(b)], and not for inequitable purposes,"[118] in this particular instance, the CBOE Board "acted in bad faith, for inequitable purposes, inconsistently with the clear terms of the CBOE Charter, and in breach of its fiduciary duties" and was "dominated by members with personal financial interests in expropriating the rights of CBOT members."[119]

The Commission notes that the CBOT submitted an opinion of counsel opining that the CBOE Board breached its fiduciary duties in determining to extinguish the rights of Exerciser

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116 See Item 2 of Form 19b-4 (requiring an SRO to "[d]escribe action on the proposed rule change taken by members or board of directors....") and General Instruction E (specifying that the Commission will not approve a proposal before the SRO has completed all action required to be taken under its governing documents with respect to the submission of such proposal to the Commission).

117 See Mayer Brown Letter 3, supra note 37, at 11.

118 Id. (citing CBOE's Second Opinion of Counsel).

119 Id. One commenter asserts that if the CBOT's allegations are correct that the CBOE Board of Directors lacked corporate authority in filing the proposed rule change in so much as they acted in bad faith and for inequitable purposes, then the issue of whether the proposal had the requisite corporate authority is a central question that can only be resolved by the Delaware state court. See Ungaretti Letter, supra note 39, at 7.

Members.[120] That opinion letter concludes that "[a] majority of the directors serving on the CBOE Board and interpreting Article Fifth(b) are either regular members of CBOE (who stand to benefit financially from the proposed rule change) or are affiliated with, or beholden to, such regular members."[121] Specifically, the opinion letter notes that "11 of the 23 members of the CBOE Board" are regular CBOE members or affiliated with or employed by such members.[122] Together with the Chairman and CEO of CBOE, the letter opines that "12 of CBOE's 23 Board members are not independent" with respect to the decision on how to treat Exerciser Members.[123] The letter also criticized the CBOE Board's failure to appoint a special committee to interpret Article Fifth(b), as it had done before CBOT announced its planned acquisition, in connection with the determination regarding how to treat Exerciser Members in connection with CBOE's planned demutualization.[124]

CBOE responds to the CBOT's comment by stating that it is based on factual errors with respect to the CBOE Board's deliberations.[125] CBOE affirms that its Board of Directors followed deliberative procedures designed to ensure that the interpretation of Article Fifth(b) was considered and agreed upon by directors who did not have a personal or financial interest in the

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120 See Letter from Frederick H. Alexander, Morris, Nichols, Arsht & Tunnell LLP, to Erik R. Sirri and Elizabeth K. King, Division of Market Regulation, Commission, dated August 20, 2007 ("Morris Nichols Opinion Letter") (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Jerrold E. Salzman, Skadden, Arps, Slate, Meagher & Flom LLP, dated August 20, 2007).

121 See id. at 3-4.

122 See id. at 4.

123 See id.

124 See id.

125 See CBOE Response to Comments, supra note 4, at 15-23. See also Letter from Michael D. Allen, Richards, Layton & Finger, to Nancy M. Morris, Secretary, Commission, dated August 31, 2007 ("Richards Layton August Opinion Letter") (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Patrick Sexton, Associate General Counsel, CBOE, dated August 31, 2007).

issue and who were not subject to improper influence from those who might have such an interest.[126] Specifically, according to CBOE, although interested directors were permitted to participate in the general discussion of the interpretation, the disinterested public directors' vote was conducted independently under procedures that ensured that the vote was free from any undue influence.[127]

CBOE also responded to the Morris Nichols Opinion Letter by submitting a subsequent opinion letter from its own counsel.[128] In particular, the CBOE's opinion letter states that, contrary to the Morris Nichols Opinion Letter's assertion that the CBOE Board was composed of 23 members, 12 of whom had a material interest in the interpretation, the CBOE Board in fact had a majority of disinterested directors at the time of the December 21, 2006 meeting of the CBOE's Board of Directors when the Board considered the proposed rule change.[129] Specifically, the opinion letter states that the Board was comprised of 21 members, 11 of whom had no membership interest in CBOE, possessed no right to acquire a membership interest in CBOE, and had no affiliation with an entity that owned any CBOE membership (i.e., they were CBOE's "Public Directors").[130] The opinion letter notes that an additional director was an Exerciser Member (the "Exerciser Director"), and therefore did not have a personal interest in favor of regular full CBOE members.[131]

In an affidavit provided by CBOE's General Counsel, CBOE affirms that at the December 21, 2006 meeting of the CBOE's Board of Directors, seven of the Public Directors

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126 See CBOE Response to Comments, supra note 4, at 19-20.

127 See id. at 19-22. See also Richards Layton August Opinion Letter, supra note 125.

128 See Richards Layton August Opinion Letter, supra note 125.

129 See id. at 2.

130 See id.

131 See id. at 3.

were present (in person or by telephone).[132] The four Public Directors who were members of a Special Committee of the Board that previously had been convened to consider certain issues related to CBOE's planned demutualization were present at the meeting but recused themselves from the discussion and vote on the proposed interpretation.[133] In a separate meeting, all seven Public Directors voted unanimously in favor of the interpretation.[134] Following the separate meeting of the Public Directors, the entire CBOE Board met to discuss the interpretation.[135] At that time, six Industry Directors were present and voted unanimously in favor of the interpretation, one of whom was an Exerciser Member.[136] The seven Public Directors also voted in favor of the proposal.[137] The remaining three Industry Directors abstained from the vote.[138] In addition, the Chairman of the Board was present and voted for the proposal.[139]

Accordingly, the opinion letter notes that "a majority of the members of the Board voting when the full Board considered the Exercise Right Interpretation were also Public Directors or Exerciser Directors" and the proposed interpretation was unanimously approved by the seven voting Public Directors, who also had met and unanimously approved the proposal in closed session, as well as the one Exerciser Director and the remaining six voting directors.[140]

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132 See Affidavit of Joanne Moffic-Silver, dated August 30, 2007, at 1-2 (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Paul E. Dengel, Schiff Hardin LLP, dated August 30, 2007) ("Moffic-Silver Affidavit").

133 See id. at 2. See also Richards Layton August Opinion Letter, supra note 125, at footnote 3.

134 See Moffic-Silver Affidavit, supra note 132, at 2.

135 See id.

136 See id.

137 See id.

138 See id.

139 See id.

140 See Richards Layton August Opinion Letter, supra note 125, at 3.

CBOT also asserts that the proposal is inconsistent with the requirements of Section 6(b)(3) of the Exchange Act, which requires fair representation of CBOE members in the administration of the exchange's affairs, because the fact that the proposal would eliminate the Exercise Right without compensation demonstrates per se that Exerciser Members were not represented in the administration of CBOE's affairs.[141] However, in response, CBOE notes that the presence of an Exerciser Member representative on CBOE's Board demonstrates that CBOE provided fair representation to Exerciser Members in satisfaction of Section 6(b)(3) of the Exchange Act.[142]

The Commission believes that the CBOE has adequately responded to these commenters' contentions, and believes, based on the record before it, that the CBOE Board's approval of the interpretation filed in this proposed rule change was proper and that the CBOE has provided a sufficient basis on which the Commission, as a federal matter under the Exchange Act, can find that the CBOE's proposed rule change was properly authorized and validly filed. In this regard, the Commission approved CBOE's rules establishing the composition of its board of directors, including the number of public directors.[143] In 2002, the Commission found that CBOE's proposal to increase the number of public directors from 8 to 11 is consistent with the requirements of Section 6(b)(5) of the Exchange Act "because it is designed to promote just and equitable principles of trade and to protect investors and the public interest by increasing public representation on the Exchange's Board and certain committees so that the Board and those committees will be balanced between industry (member) and public directors."[144]

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141 See Mayer Brown Letter 3, supra note 37, at 19.

142 See Richards Layton August Opinion Letter, supra note 125, at 2.

143 Section 6.1(a) of CBOE's Constitution defines "public directors" as persons who are not members and who are not broker-dealers or persons affiliated with broker-dealers.

144 See Securities Exchange Act Release No. 46718 (October 24, 2002), 67 FR 66186 (October 30,

The Commission is persuaded by CBOE's letter of counsel affirming that, at the time of the CBOE Board's consideration of the Exercise Right interpretation, a majority of the CBOE Board was disinterested and independent.[145] The Commission is relying on the CBOE's representations and its letter of counsel, which conclude that a majority of the CBOE Board's directors during the consideration of the interpretation did not have a personal interest to favor the regular CBOE members, which, counsel concludes, entitles the Board to the presumption of the business judgment rule.[146]

C. Additional Concerns Expressed by the CBOT and Commenters

As stated above, the Commission herein finds that CBOE's proposed interpretation of Article Fifth(b) is consistent with the Exchange Act. In particular, the Commission would like to address CBOT's contentions that: (1) due process was not given; (2) the proposal does not comply with the requirements of Form 19b-4; (3) the proposal unfairly discriminates among classes of CBOE members by revoking the memberships of a defined group for reasons that do not apply to all CBOE members or potential members; (4) the proposal fails to allocate fairly fees and dues by increasing the value of one group's CBOE membership and forcing another group to purchase new memberships at an added cost; (5) the proposal does not promote free and open markets because it reduces the number of members of the CBOE and therefore negatively impacts liquidity and depth of the markets; (6) the proposal places an unnecessary burden on competition by eliminating the membership rights of current Exerciser Members and eligible Exercise Members and thus reduces the number of people who are able to trade on the Exchange;

2002) (SR-CBOE-2002-48).

145 See Richards Layton August Opinion Letter, supra note 125, at 3.

146 See id. at 2-3.

and (7) that the proposal is inconsistent with Section 6(c)(4) of the Exchange Act.[147] The CBOT also argues that the proposal is an unreasonable interpretation and breach of contract under state law.[148] Each of these points is addressed in turn, below.

1. Due Process and Sufficiency of Notice

CBOT contends that there were failures of due process in the CBOE Board's approval of the proposal.[149] In particular, CBOT believes that CBOE did not provide Exerciser Members or eligible Exercise Members sufficient notice or an opportunity to be heard "at a meaningful time" prior to filing the proposal with the Commission, which consequently deprived CBOT members of valuable property rights without due process.[150]

In response, CBOE notes that it has complied with the requirements of the Exchange Act in proposing its interpretation of Article Fifth(b) and believes that there is no basis to argue that the fulfillment of its filing obligations under the Exchange Act constitutes a deprivation of due process.[151]

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147 See Mayer Brown Letter 3, supra note 37, at 17-26. CBOT's contention that the proposal was improperly adopted in so far as CBOE failed to comply with its own rules in promulgating the proposed rule change is addressed above. See supra Section IV.B.

148 See Mayer Brown Letter 3, supra note 37, at 34.

149 See Mayer Brown Letter 3, supra note 37, at 27-34. See also Stevens Letter, supra note 40. CBOT argues that CBOE, as a state actor endowed with quasi-governmental authority, was obligated to set rules that provide fair procedures when taking actions that deny membership or limit a person's access to the services of the Exchange. See Mayer Brown Letter 3, supra note 37, at 27-29.

150 See Mayer Brown Letter 3, supra note 37, at 30-34. CBOT notes that CBOE stated in its Form 19b-4 submission that it did not solicit or receive comments on the proposed rule change, and uses this fact to support its contention that the CBOE's process for consideration of the proposal was flawed. See id. at 32. Item 5 of Form 19b-4 directs an SRO to summarize any written comments it may have received on a proposal prior to filing such proposal with the Commission. The requirement to solicit written comments, however, is not a prerequisite to filing a proposal with the Commission. Rather, the act of filing a proposal with the Commission initiates a public notice and comment procedure in which the Commission provides notice of and solicits comments on an SRO's proposed rule change.

151 CBOE Response to Comments, supra note 4, at 18 (footnote 28).

The Commission is not persuaded that the CBOE should be considered a government actor subject to constitutional due process requirements in the context of its decision to file with the Commission a proposed rule change pursuant to Section 19 of the Exchange Act. Even if the CBOE were found to be a state actor when proposing an interpretation of its rules, we do not believe that the CBOE, in fulfilling its filing obligations, has deprived CBOT members of any process they are due. Based on the record before it, the Commission finds that the CBOE has satisfied all requirements prerequisite to filing a proposed rule change with the Commission and in so doing has complied with the applicable requirements of the Exchange Act, which are designed to provide interested parties with notice and an opportunity to express their views. CBOE filed its proposal with the Commission and the Commission then promptly published it for notice and comment in the Federal Register. The proposal was posted on the Commission's Web site as well as the CBOE's Web site. This process, required by the Exchange Act, provided the public with a meaningful opportunity to be heard and afforded an opportunity for interested persons to alert the Commission to facts or reasons that may indicate why a proposed rule change may not satisfy the requirements for a proposed rule change under Section 19(b) of the Exchange Act. If in fact the Commission believes that a proposal may not be consistent with the Exchange Act and the rules and regulations thereunder applicable to the exchange, the consequence would be that the Commission would institute disapproval proceedings and, if the proper findings were made, would not allow an SRO to proceed with its proposal. In the present case, the Commission does not believe that any commenters have raised facts or reasons indicating that the CBOE's proposal is not consistent with the Exchange Act and the rules thereunder applicable to CBOE.

The Commission is confident that the public and all affected entities have received ample notice of CBOE's proposed rule change, and commenters, including the CBOT members, have availed themselves of this opportunity to provide their views to the Commission.[152] Further, because CBOE filed its proposal in December 2006, a full six months before CBOT Holdings shareholders voted on the acquisition, and CBOE granted the Commission an extension of time to consider the proposal, affected entities were put on notice of the CBOE's position and were afforded an extended opportunity to be heard before the Commission considered the proposal.

Finally, the Commission disagrees with the CBOT's argument that CBOE was required to provide due process to the Exerciser Members prior to filing the proposal with the Commission pursuant to Section 19(b), because CBOE's act of filing a rule change for Commission consideration does not deprive the Exerciser Members of property interests requiring prior due process.[153] The CBOT argues that "the CBOT members who hold Exercise Rights are holding a valuable property interest with an ascertainable pecuniary value" and that the "value of an Exercise Right is also reflected in the total value of a CBOT Full Membership, which in itself is fully transferable."[154] In essence, the CBOT appears to argue that the CBOE has deprived the Exerciser Members of a valuable property right simply by filing the proposal with the Commission for consideration pursuant to the Exchange Act.[155]

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152 As noted previously, the Commission received 174 comment letters on this proposal from 134 different commenters. See supra note 36 and accompanying text.

153 See, e.g., Mathews v. Eldridge, 424 U.S. 319, 332 (1976) (noting that "procedural due process imposes constraints on governmental decisions which deprive individuals of "liberty" or "property.")

154 Mayer Brown Letter 3, supra note 37, at 30.

155 See id. (stating that "the Proposed Rule Change affects the current value of the Exercise Rights and the CBOT memberships regardless of whether the Merger ever occurs.")

This argument is not persuasive. Any diminution of the value of the CBOT memberships is not a deprivation of a property interest that would compel the provision of due process by the CBOE. The proposal is simply that, a proposal. At the time it was filed with the Commission, it had not taken effect. Further, the proposal could not take effect before the provisions of Section 19(b) of the Exchange Act had been satisfied, which, in this case, include a determination by the Commission that the proposed rule change complies with the requirements of the Exchange Act. Although the rule filing might have caused a decreased value in an Exercise Right, in the way the filing of litigation can affect a company's stock price, the rule filing process mandated by the Exchange Act affords due process. Therefore, the CBOE did not deprive the Exerciser Members of any due process that would warrant additional process in advance of CBOE's filing a proposed rule change with the Commission.

2. <u>Completeness of CBOE's Form 19b-4 Submission</u>

Item 3(b) in Form 19b-4 requires the SRO to "explain why the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization."[156] CBOT argues that the proposed rule change is inconsistent with the requirements of the Exchange Act because Item 3 of CBOE's Form 19b-4 submission was incomplete.[157] In response, CBOE states that it satisfied the requirements of Form 19b-4 by providing a detailed history behind the proposed interpretation, explained the need for the interpretation, stated the purpose served by the interpretation, and noted why the interpretation is fair and reasonable.[158] Furthermore, CBOE submits that it provided a full explanation in Item 3 of why its proposed interpretation is consistent with the Exchange Act and then simply stated the

156 <u>See</u> Item 3(b) in Form 19b-4.

157 <u>See</u> Mayer Brown Letter 3, <u>supra</u> note 37, at 17; Mayer Brown Letter 5, <u>supra</u> note 37, at 6-7.

158 <u>See</u> CBOE Response to Comments, <u>supra</u> note 4, at 23-24.

conclusion in Section II.A(2) of the Notice.[159] The Commission finds that the proposed rule change was complete and properly filed in that it provided all of the requisite information specified in Form 19b-4.

3. <u>Unfair Discrimination</u>

CBOT argues that the proposed rule change discriminates among classes of CBOE members (i.e., Exerciser Members vs. "regular" CBOE full members) by impermissibly applying "different membership rules to Regular [CBOE] Members and Exerciser Members without justification…."[160] In response, CBOE states that equal treatment is not required in this case because it is not relevant to the validity of the proposed interpretation whether persons who previously would have qualified as Exerciser Members will not be treated the same as regular members under the interpretation.[161] According to CBOE, the argument that Exerciser Members are entitled to the same treatment as regular CBOE members presumes that persons are still eligible to become and remain Exerciser Members, and is consequently flawed because the CBOT/CME transaction resulted in no persons being eligible to remain Exercise Members.[162]

In other words, CBOE asserts that its proposed interpretation does not "terminate" or "extinguish" the Exercise Right for persons who otherwise would be entitled thereto. Rather, it is the actions of the CBOT that has resulted in no persons being able to qualify as "members"

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159 See id.

160 See Mayer Brown Letter 3, supra note 37, at 18.

161 See CBOE Response to Comments, supra note 4, at 30-32.

162 See id. at 30-32. In addition, CBOE notes that Exerciser Members and regular CBOE members were treated differently in one respect – Exerciser Members were not permitted to transfer their CBOE Exercise Membership. See id. at 30.

of the CBOT for purposes of Article Fifth(b).[163] In addition, CBOE notes that the proposal does not delete Article Fifth(b) or the Exercise Right contained therein, but rather addresses whether anyone will continue to be eligible to utilize that right after the acquisition of CBOT by CME Holdings.[164] CBOE notes that the express terms of Article Fifth(b) state that the Exercise Right will remain available for a person only for "so long as he remains a member of [CBOT],"[165] and, as explicitly contemplated in the 1992 Agreement, CBOE believes that CBOT was well aware that the consequence of a merger or acquisition of the CBOT might be to eliminate the eligibility of persons to utilize the Exercise Right.[166]

The Commission believes that the CBOE's proposed interpretation of Article Fifth(b) is consistent with Section 6(b)(5) of the Exchange Act,[167] which requires, among other things, that exchange rules not be unfairly discriminatory. The CBOE is interpreting an existing rule that allows certain persons to become members without buying a seat on the exchange. These persons must satisfy all other prerequisites to membership.[168] Article Fifth(b) only relates to members of the CBOT. It entitled such members to membership on CBOE under certain circumstances, which have been interpreted over many years by CBOE, including specifically in the 1992 and 2001 Agreements, which addressed the status of Exerciser Members in the event that significant changes in the ownership structure of the CBOT occurred. The interpretation proposed by the CBOE applies equally to all persons similarly situated.

4. Allocation of Fees and Dues/ Economic Impact of Proposal

163 See id. at 24.

164 See id. at 24-25.

165 See id. at 25.

166 See id.

167 15 U.S.C. 78f(b)(5).

168 See, e.g., CBOE Rule 3.3 (Qualifications and Membership Statuses of Member Organizations).

CBOT argues that the proposal fails to provide for a reasonable allocation of dues, fees, and other charges in that it could have the effect of increasing the value of a CBOE membership while requiring former Exerciser Members to "pay twice" for access to CBOE.[169] Further, CBOT argues that the proposal will result in a windfall enrichment of regular CBOE members in connection with CBOE's proposed demutualization.[170] Additionally, one commenter argued that the potential economic impact of the proposal presented a reason for the Commission to disapprove the proposed rule change.[171]

In response, CBOE states that former Exerciser Members have no claim to any value derived from their former rights for which they no longer qualify.[172] According to CBOE, the value of the Exercise Right was lost, not because of action taken by the CBOE, but rather because of the CME's acquisition of CBOT.[173]

The Commission notes that the CBOE's proposed rule change does not propose any new or modified fees, dues, or other charges. Further, the Commission is not required to consider the potential effect on the value of a CBOE or CBOT membership that arises as a consequence of the CBOE's proposed rule change. Section 6 of the Exchange Act does not establish standards regarding the impact of exchange rules on the value of an exchange's membership or the value of a membership in a separate entity.

5. Market Impact

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169 See Mayer Brown Letter 3, supra note 37, at 22.

170 See Mayer Brown Letter 3, supra note 37, at 25. See also Ungaretti Letter, supra note 39, at 11.

171 See Ungaretti Letter, supra note 39, at 2 and 10.

172 See CBOE Response to Comments, supra note 4, at 32.

173 See id.

CBOT argues that the proposed rule change will adversely affect the liquidity and depth of CBOE's market because it would reduce the number of CBOE members as Exerciser Members lose their ability to trade on the CBOE.[174] In response, CBOE notes that the proposal contemplates that CBOE will provide temporary interim trading access to allow former Exerciser Members to continue to have uninterrupted access to CBOE in order to avoid a sudden disruption to CBOE's market.[175] The CBOE has since filed its temporary membership plan for former Exerciser Members, which will become operative following today's approval of the interpretation.[176] In addition, CBOE believes that a negative impact on the quality of CBOE's markets is unlikely, given the number of people who currently provide liquidity as market makers on CBOE's market.[177]

The Commission agrees. The CBOE's proposed temporary membership plan was filed on September 13, 2007 under Section 19(b)(3)(A) and was immediately effective upon filing. The Commission did not, and is not today, approving that proposed rule change. This temporary membership plan, however, does preserve the status quo in existence prior to the acquisition of CBOT by CME Holdings with respect to those individuals that had utilized the Exercise Right to trade on the CBOE. Because of these temporary memberships, the Commission believes that its approval of this proposed rule change will not impact the quality

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174 See Mayer Brown Letter 3, supra note 37, at 24-25. See also Ungaretti Letter, supra note 39, at 11-12; Morelli Letter, supra note 42; Crilly Letter 1, supra note 40; Cashman Letter, supra note 40; Israel Letter, supra note 40; Chubin Letter, supra note 40; Esterman Letter, supra note 42; Pietrzak Letter, supra note 41; Bianchi Letter, supra note 40; Todebush Letter, supra note 41; Richards Letter 2, supra note 40; and Crilly Letter 2, supra note 42.

175 See CBOE Response to Comments, supra note 4, at 33.

176 See Securities Exchange Act Release No. 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

177 See CBOE Response to Comments, supra note 4, at 33.

or fairness of CBOE's market and is, therefore, consistent with Section 6(b)(5) of the Exchange Act.[178]

6. **Burden on Competition**

CBOT asserts that the proposal imposes an unnecessary burden on competition, which CBOE has failed to justify, because it drastically reduces the number of people who are able to trade on CBOE.[179] CBOE's position is that the effect on the Exercise Right is a consequence of former CBOT members' approval of the acquisition of CBOT by CME Holdings, in which case the failure to qualify as a "member of [the CBOT]" under Article Fifth(b) is a self-imposed consequence of substantial changes to the structure and ownership of the CBOT.[180]

The Commission agrees that the CBOE's proposal does not impose an inappropriate burden on competition, and is therefore consistent with Section 6(b)(8) of the Exchange Act.[181] In particular, following Commission approval of CBOE's proposal, CBOE's existing full members, as well as former Exerciser Members who access the Exchange pursuant to temporary memberships, will continue to have uninterrupted access to CBOE's markets. Accordingly, the Commission believes that CBOE will continue to accommodate a membership pool that provides for vigorous competition on CBOE's markets. Furthermore, CBOE's proposal is an application of existing rules and interpretations to a new set of facts arising from the CME's acquisition of CBOT. Accordingly, the Commission finds that CBOE's proposed interpretation does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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178 15 U.S.C. 78f(b)(5).

179 See Mayer Brown Letter 3, supra note 37, at 24.

180 See CBOE Response to Comments, supra note 4, at 33.

181 15 U.S.C. 78f(b)(8).

7. **The Proposed Interpretation is Consistent with Section 6(c)(4) of the Exchange Act**

One commenter urged the Commission to disapprove the proposal on the basis that it would violate Section 6(c)(4) of the Exchange Act,[182] which requires that an exchange not "decrease the number of memberships in such exchange" below the number of memberships "in effect on May 1, 1975."[183] CBOE argues that the proposed interpretation does not "terminate" or "extinguish" the Exercise Right for persons who otherwise would be entitled thereto, and therefore it has not taken any action that would violate Section 6(c)(4) of the Exchange Act.[184] Rather, CBOE states, that it is the actions of the CBOT to enter into the CME Holdings acquisition that has resulted in no persons being able to qualify as "members of the [CBOT]" for purposes of Article Fifth(b).[185]

The Commission finds that the proposed rule change is not an attempt on the part of CBOE to decrease the number of CBOE memberships in violation of Section 6(c)(4) of the Exchange Act. Rather, CBOE's proposal was to address the status of the Exercise Right following the acquisition of CBOT by CME Holdings.

In addition, the CBOE's temporary access plan allows former Exerciser Members to maintain their temporary memberships on CBOE and continue, on an uninterrupted basis, to have access to CBOE's markets. To change or terminate its temporary access plan, CBOE would be required to file a proposed rule change with the Commission and any such proposal would have to be consistent with the Exchange Act, including Section 6(c)(4) thereof.

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182 15 U.S.C. 78f(c)(4).

183 See Ungaretti Letter, supra note 39, at 12.

184 See CBOE Response to Comments, supra note 4, at 33.

185 See id.

Even if the Commission were to view the CBOE's proposal as an effort on the part of CBOE to decrease the number of exchange memberships below the 1975 level, the Commission finds that the number of CBOE memberships in effect on November 2, 2007 exceeds the number of CBOE memberships in effect in 1975. Specifically, the CBOE has represented that as of June 30, 1975,[186] the number of CBOE memberships was 1,025.[187] CBOE has represented that the number of CBOE memberships in effect on November 2, 2007 was 1,179.[188] The 222 Temporary Members are "members" under Section 3(a)(3) of the Exchange Act with the same rights "to effect transactions on [the CBOE] without the services of another person acting as broker."[189] Accordingly, the current number of CBOE memberships exceeds the number of CBOE memberships in effect in 1975 for purposes of Section 6(c)(4) of the Exchange Act.

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186 CBOE has informed the Commission that it is unable to locate historical records from May 1, 1975, but has located financial statements from June 30, 1975 that contain a full count of memberships then in effect. See Letter from Joanne Moffic-Silver, General Counsel, CBOE, to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 2, 2007.

187 See id. Of those, 774 were transferable memberships and 251 were exerciser memberships. See id. Cf. Letter from Peter B. Carey to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 9, 2007 (arguing that the number of CBOE memberships in 1975 should include all 1,402 exerciser memberships both active and inactive). Under the Exchange Act, a "member" of a national securities exchange is defined as a person permitted to effect transactions on an exchange without the services of another person acting as broker. See 15 U.S.C. 78c(a)(3)(A). Thus, only those persons who affirmatively exercised their rights under Article Fifth(b) to trade on CBOE would have been considered members of the CBOE because only those persons were permitted to effect transactions on the exchange without the services of another person acting as broker.

188 See Letter from Joanne Moffic-Silver, General Counsel, CBOE, to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 2, 2007, at 2. Of those, 930 are transferable memberships, 222 are temporary members (i.e., former Exerciser Members), and 27 are CBOE Stock Exchange permits. See id.

189 See 15 U.S.C. 78c(a)(3)(A). See also Securities Exchange Act Release Nos. 56016 (July 5, 2007), 72 FR 38106 (July 12, 2007) (SR-CBOE-2007-77) and 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

Accordingly, based on the record before us, the Commission finds that the proposal is consistent with Section 6(c)(4) of the Exchange Act and does not constitute an effort by CBOE to decrease the number of CBOE members.

V. Pending State Court Litigation

The Commission wants to emphasize the limited nature of our position on the state law issues we have addressed. The Commission is aware of the state court litigation between the CBOE and members of the CBOT and the state court's decision to stay the litigation until the Commission acts on the CBOE rule proposal. We stress that our consideration of the state law questions in this matter should in no way prejudice or affect the state court's consideration of those questions. As we explained, the state law questions played a role in our analysis of the federal law considerations the Commission is charged with deciding under the Exchange Act. To carry out our responsibilities under the Exchange Act (and also to avoid an endless cycle of our deference to the state court on the state law issues and the state court's deference to us on the federal law issues) we have proceeded to review the CBOE rule proposal. Our decisions about state law matters, however, are only those required to serve as a basis for carrying out our Exchange Act responsibilities.

We also recognize that our review of the CBOE proposed rule involves procedures different from those the state court uses in the pending litigation. This review process is not a forum to litigate state law issues that may arise regarding an SRO's rule proposal. Rather, our review of a proposed rule of an SRO employs public notice and comment, the receipt of written submissions from the SRO and the public, and the possibility of a proceeding to determine whether it should be disapproved. To this process, we bring familiarity with SROs and their rules and extensive knowledge and experience with the relevant provisions of the Exchange Act.

The state court applies the range of procedures used in traditional adversarial litigation, including discovery, rules of evidence, witnesses, cross-examination, motions, and the like. It has deep and specialized knowledge of Delaware corporate law.

The state court thus is free to find the relevant facts and determine and apply the relevant state law in its normal fashion without according weight to our evaluation of the state law questions, which was done employing different procedures and for different purposes.[190] And, as we have explained, if the state law decision calls into question the basis on which our decision here with respect to these state law issues or any other relevant state law issues was made, we would expect CBOE to respond appropriately, or we will act on our own as necessary.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[191] that the proposed rule change (SR-CBOE-2006-106), as amended, be, and hereby is approved.

By the Commission.

Nancy M. Morris
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

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[190] The Delaware court discussed possible ways in which the Commission's jurisdiction and the court's state law authority might interact. As the court emphasized, the court "has jurisdiction to consider the 'economic rights' issues by the Complaint because those claims emerge from and are governed by state contract or fiduciary duty law." See Memorandum of Opinion, supra note 68, at 29. The court also noted that "even if it turns out that the SEC's mandate requires that CBOT Full Members be excluded from trading on the CBOE," then "it does not ineluctably follow that, in these unique circumstances, they are also divested of whatever economic (or contractual) rights they hold as a result of that status." Id. at note 48. We agree with the Delaware court and welcome its expert determination of these issues.

[191] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2694 / January 16, 2008

Admin. Proc. File No. 3-12357

In the Matter of

WARWICK CAPITAL MANAGEMENT, INC.

and

CARL LAWRENCE

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud violations

Reporting and registration violations

Investment adviser and its president reported false information about adviser's assets under management and performance in Forms ADV filed with the Commission and to database services that published the false information to their subscribers. Investment adviser also maintained its Commission registration when it was not eligible to do so. Held, it is in the public interest to bar president from association with any investment adviser and to impose cease-and-desist orders against Respondents.

APPEARANCES:

Carl Lawrence, pro se and on behalf of Warwick Capital Management, Inc.

Jack Kaufman and Howard S. Kim, for the Division of Enforcement.

Document 16 of 38

Appeal filed: February 26, 2007
Last brief received: May 21, 2007

I.

Warwick Capital Management, Inc., an investment adviser, and its president, Carl Lawrence (collectively, "Respondents"), appeal from an administrative law judge's initial decision. The law judge found that Warwick willfully violated, and that Lawrence willfully aided and abetted and was a cause of Warwick's violations of, Section 203A of the Investment Advisers Act of 1940 by maintaining Warwick's Commission registration while having less than $25 million of assets under management. 1/ The law judge found that Respondents willfully violated Advisers Act Section 207 by falsely representing in Commission filings that Warwick had assets under management in excess of $25 million. 2/ The law judge found that Respondents willfully violated Advisers Act Sections 206(1) and 206(2), and that Warwick willfully violated, and Lawrence willfully aided and abetted and was a cause of Warwick's violations of, Advisers Act Section 206(4) by falsely representing Warwick's assets under management and 2003 total performance returns to database services that published the misrepresentations to subscribers in the securities industry. 3/ The law judge concluded that it was in the public interest to bar Lawrence from association with any investment adviser and to enter cease-and-desist orders against Lawrence and Warwick. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

1/ 15 U.S.C. § 80b-3A(a)(1) (generally prohibiting an investment adviser with less than $25 million of assets under management from registering with the Commission). Advisers Act Section 203A defines "assets under management" as "the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services." 15 U.S.C. § 80b-3A(a)(2). A "securities portfolio" is an account at least 50% of the total value of which consists of securities. See Advisers Act Form ADV, Schedule I, Instruction 7(a); Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Rel. No. 1633 (May 15, 1997), 64 SEC Docket 1524, 1527.

2/ 15 U.S.C. § 80b-7 (prohibiting an investment adviser from willfully making material misstatements and omissions in applications and reports filed with the Commission).

3/ 15 U.S.C. §§ 80b-6(1), (2), and (4) (prohibiting fraudulent conduct by an investment adviser). Respondents were charged with violating Advisers Act Section 204 and Rules 204-2(a)(11), 204-2(a)(16), and 206(4)-1(a)(5), but the law judge found that the charges had not been established. 15 U.S.C. § 80b-4; 17 C.F.R. §§ 275.204-2(a)(11), 275.204-2(a)(16), and 275.206(4)-1(a)(5). That determination was not appealed.

II.

Lawrence is Warwick's founder, president, and sole control person. He and his wife own Warwick, and they are its only employees. Lawrence makes Warwick's investment decisions while his wife performs the administrative work. Lawrence has operated Warwick's business from his home since 2001. At all relevant times, Warwick, through Lawrence, met the definition of an "investment adviser" because it was engaged for compensation in the business of advising clients on investing in securities. 4/ As discussed below, Respondents inflated Warwick's assets under management in Forms ADV filed with the Commission between 1997 and 2000 and in data supplied during 2004 and earlier to database services that published the data to subscribers. Additionally, Respondents supplied inflated 2003 performance returns to the database services.

A. Respondents Report Inflated Assets Under Management in Forms ADV

Warwick first registered with the Commission as an investment adviser on March 15, 1996. A Form ADV dated March 29, 1996, reported that, as of year end 1995, Warwick had \$5 million of assets under management on a discretionary basis. The \$5 million figure was repeated in a Form ADV amendment dated November 1, 1996.

Beginning on July 8, 1997, pursuant to Advisers Act Section 203A, 5/ an investment adviser that was subject to state authorities like Warwick was not permitted to be registered with the Commission unless it had at least \$25 million in assets under management. From July 1997 forward, Warwick's Forms ADV represented that it had over \$25 million of assets under management. The values reported rose precipitously from \$5 million in 1996 to \$26.55 million in 1997, and higher in subsequent years, as set forth in the chart below:

Form ADV Date	Assets Under Management
March 29, 1996	\$5 million
November 1, 1996	\$5 million
July 3, 1997	\$26.55 million
March 25, 1998	\$28.9 million
November 17,1999	\$28.9 million
January 28,1999	\$28.9 million

4/ See 15 U.S.C. § 80b-2(a)(11) (defining "investment adviser").

5/. Advisers Act Section 203A was added to the Advisers Act by Title III of the National Securities Markets Improvement Act of 1996.

June 3, 1999	$29.4 million
March 18, 1999	$29.4 million
March 23, 2000	$37.2 million

Each of the Forms ADV represented that Warwick did not manage any securities portfolios on a non-discretionary basis. 6/ All were signed by Lawrence as Warwick's president.

Respondents ceased filing annual Forms ADV, including amendments, after March 23, 2000. Respondents assert that Warwick withdrew its registration with the Commission in 2000. We take official notice, pursuant to Rule of Practice 323, 7/ that the Commission's files do not include a Form ADV-W to withdraw Warwick's registration. 8/ By order dated January 31, 2002, the Commission cancelled Warwick's registration under Advisers Act Section 203(h). 9/

6/ A non-discretionary account is one in which an investor must give prior approval to all transactions. See Hotmar v. Lowell H. Listrom & Co., 808 F.2d 1384, 1385 (10th Cir. 1987); Scott E. Wiard, Securities Exchange Act Rel. No. 50393 (Sept. 16, 2004), 83 SEC Docket 2752, 2756 & n.12.

7/ 17 C.F.R. § 201.323 (official notice may be taken of any matter in the Commission's public official records).

8/ Filing Form ADV-W is mandatory for an investment adviser to withdraw from Commission registration. 17 C.F.R. § 275.203-2; Electronic Filing by Investment Advisers; Amendments to Form ADV; Technical Amendments, Advisers Act Rel. No. 1916 (Dec. 21, 2000), 73 SEC Docket 3934. The only Form ADV-W contained in the record was filed in 1996 for Warwick's predecessor.

9/ To cancel an adviser's registration, we must find that the adviser is "no longer in existence, is not engaged in business as an investment adviser, or is prohibited from registering as an investment adviser under section 203A." 15 U.S.C. § 80b-3(h). We have stated that "an adviser will be given notice and an opportunity to show why its registration should not be cancelled." Rules Implementing Amendments to the Investment Advisers Act of 1940, 64 SEC Docket at 1529 n.47. The record does not indicate why the cancellation order was issued. In the past, the Commission has cancelled the registration of investment advisers based on the absence of amendments to Forms ADV or annual filings. See Notice of Intention to Cancel Registrations of Certain Investment Advisers, Advisers Act Rel. No. 1705 (Mar. 9, 1998), 66 SEC Docket 2136, 2137. By 2002, Warwick had not filed any amendments to Forms ADV or annual filings for nearly two years.

(continued...)

However, after January 31, 2002, Respondents continued to hold themselves out to the database services as Commission-registered investment advisers, as recently as 2004.

B. Respondents Report Inflated Assets Under Management to Database Services

During 2004 and earlier, Respondents provided information about Warwick, primarily to three database services: Nelson MarketPlace ("Nelson's"); Mobius Group, Inc. ("Mobius"); and Plan Sponsor Network, Inc. ("PSN"). The database services obtained information about, among other things, assets and performance from investment managers, compiled the information, and sold it to subscribers for a fee. 10/ The database services relied on the investment managers for the accuracy of the information they submitted. The subscribers -- consultant firms, pension plan sponsors, brokerage firms, banks, investors, and investment managers -- used the information to evaluate and select managers and to determine what comparable firms were doing.

Lawrence testified at the hearing that he knew that the database services published the information he reported to their subscribers. He stated that "the purpose of [reporting data] was to try to get clients [for Warwick] through the database services." He also stated that he "depended a lot" on the database services for client referrals. Lawrence affirmed that some of Warwick's clients retained Warwick because of its database service listings.

From 2000 through 2004, Respondents reported to Nelson's, and Nelson's published to subscribers, that Warwick had the following assets under management:

Year	**Assets Under Management**
2000	$35.2 million
2001	$26.9 million
2002	$54.5 million

9/ (...continued)
Although Lawrence claimed at the hearing that he was not aware that Warwick's registration had been cancelled, the law judge generally found that his hearing testimony was not credible. We have repeatedly stated that a law judge's credibility findings are entitled to considerable weight and deference, absent substantial evidence to the contrary. See, e.g., Leslie A. Arouh, Exchange Act Rel. No. 50889 (Dec. 20, 2004), 84 SEC Docket 1880, 1893 n.40; Anthony Tricarico, 51 S.E.C. 457, 460 (1993).

10/ Respondents claim that the witnesses representing the database services did not give credible testimony. The law judge, who observed the witnesses' demeanor, did not suggest that the database service witnesses gave anything but credible testimony. She relied on their testimony in reaching her conclusions.

2003	$95.2 million
2004 (1st quarter)	$94.2 million

From 1995 through 2003, Respondents reported to Mobius, and Mobius published to subscribers, that Warwick had the following assets under management:

Year	**Assets Under Management**
1995	$40.5 million
1996	$25 million
1997	$31.6 million
1998	$35.8 million
1999	$47.2 million
2000	$35.5 million
2001	$26.86 million
2002	$64.5 million
2003	$95.2 million

From 1999 to 2002, Respondents reported to PSN, and PSN published to subscribers, that Warwick had the following assets under management:

Year	**Assets Under Management**
1999	$47.2 million
2000	$35 million
2001	$28 million
2002 (3rd quarter)	$58.2 million

Respondents reported to a fourth database service, Money Manager Review ("MMR"), that Warwick managed $36 million of assets as of year end 2000.

C. Respondents Report Significantly Smaller Asset Values to Commission Staff

In June 2000, Commission staff conducted an examination of Warwick. Lawrence produced records reflecting a total of $3 million of assets under management. He stated that clients with assets under management of approximately $37.5 million terminated their accounts with Warwick between October 1999 and February 2000, but that the records of the terminated clients were unavailable due to a fire.

In June 2004, Lawrence gave sworn investigative testimony to the staff during which he testified that Warwick had the following assets under management:

Year	Assets Under Management
1998	$15 million
1999	$2 million
2000	$4 million
2001	$6 million
2002	$6 million
2003	$10.5 million

The chart below compares the asset values described in Lawrence's June 2004 sworn investigative testimony with those reported in Forms ADV and to the database services:

Date	June 2004 testimony	Forms ADV	Nelson's	Mobius	PSN	MMR
1995				$40.5 M		
1996		$5 M		$25 M		
1997		$26.5 M		$31.6 M		
1998	$15 M	$28.9 M		$35.8 M		
1999	$2 M	$28.9 & $29.4 M		$47.2 M	$47.2 M	
2000	$4 M	$37.2 M	$35.2 M	$35.5 M	$35 M	$36 M
2001	$6 M		$26.9 M	$26.86 M	$28 M	

2002	$6 M		$54.5 M	$64.5 M	$58.2M (3rd Quarter)	
2003	$10.5 M		$95.2 M	$95.2 M		

At the October 2006 hearing before the law judge, Lawrence testified that the asset values reported in Forms ADV and to the database services included certain non-discretionary accounts that Warwick "indirectly" controlled and for which it made investment "recommendations" in return for "compensatory business." However, the values reported in Warwick's Forms ADV were for discretionary accounts only. All of the Forms ADV stated that Warwick did not maintain any assets on a non-discretionary basis. Furthermore, the record contains no evidence that any "indirect" or "recommendation" accounts existed. Lawrence claimed that he had such arrangements with New York University ("NYU"), Merrill Lynch, and Morgan Stanley (although he could not recall a contact at Morgan Stanley). However, the testimony of the Division of Enforcement's ("Division") witnesses from NYU and Merrill Lynch did not support his claim. 11/

At one point during the 2006 hearing, Lawrence testified that the asset values reported in Forms ADV and to the database services actually understated Warwick's assets, to protect the privacy of clients. Lawrence claimed that Respondents managed $300 million of assets of the Mellon family of Pittsburgh. 12/ He also claimed that Respondents managed $150 to $300

11/ NYU's chief investment officer, Maurice Maertens, testified that he spoke with Lawrence numerous times between 1999 and 2002, but that he never recommended or hired Lawrence as an investment adviser, and that Lawrence did not perform any investment services for, or receive payment from, NYU.

Former Merrill Lynch financial advisor John Toomey testified that one of his clients wanted Warwick to manage a portion of his portfolio because the client had seen Warwick listed in Nelson's World's Best Money Managers. According to Toomey, Respondents managed the client's portfolio for seven to eight months, after which the relationship was terminated. Toomey denied paying Lawrence for any recommendations or referring any clients to Lawrence, and stated that he was unaware of any relationship by which Lawrence would make stock recommendations to Merrill Lynch in return for a fee or client referrals.

12/ Before us, Respondents submit a May 2006 UBS Financial Services account statement that purports to show that Warwick managed $6 million for a James R. Mellon. We find that the May 2006 account statement is not material evidence because it refers to transactions after the events at issue. Moreover, while we are permitted under Rule of Practice 452 to admit additional evidence on motion of a party, the motion must show

(continued...)

million of assets of an entity called "First Deposit." The law judge rejected these claims as unsupported and incredible. 13/ As noted, the law judge generally found Lawrence's hearing testimony to be not credible. 14/ The law judge determined that Warwick's actual assets under management did not exceed the values described in Lawrence's investigative testimony. 15/ She found that those values were "not inconsistent" with the values established in connection with the June 2000 examination. She also found that, because Lawrence himself supplied the values in his sworn investigative testimony, there was no unfairness to him in finding them to be the assets under management as of the dates indicated.

D. Respondents Report Inflated 2003 Performance to Database Services

In a February 19, 2004, letter to Nelson's, Respondents reported that Warwick's total 2003 performance returns were "gross – 57.3%" and "net – 56.3%." In April 2004, Respondents reported to Mobius that Warwick's total 2003 performance return was 57.680% and its equity only return was 77.065%. Respondents reported monthly performance returns to PSN that resulted in a total 2003 performance return of 60.37% on its database. Relying on Respondents' representations, the database services published Warwick's 2003 performance returns to their subscribers and used those returns to rank Warwick as a top investment manager in industry publications, including Nelson's World's Best Money Managers and PSN's "Top Gun" quarterly rankings. Lawrence admitted that he was solely responsible for calculating Warwick's performance figures.

12/ (...continued)
with particularity that, among other things, there were reasonable grounds for the failure to adduce such evidence previously. See 17 C.F.R. § 201.452. Respondents have not provided such a motion.

13/ Respondents now allege that an unnamed person formed a joint venture with Warwick, that Warwick had a recommendation-type arrangement with NYU six years before the hearing, and that there were external portfolios under Warwick's control from 1997 to 2000. However, Respondents have adduced no evidence to support any of these allegations. Nor have they explained their failure to raise these matters before the law judge, as required under Rule 452.

14/ See supra note 9.

15/ Respondents assert that Lawrence was not advised that his investigative testimony was voluntary. The investigative transcript belies this assertion and shows that Division of Enforcement staff informed Lawrence that his appearance was voluntary, that he was not required to answer any questions, and that he was free to leave at any time. Lawrence affirmed that he understood this.

E. Respondents Report Significantly Smaller Performance Values to Commission Staff

In May 2004, during the investigation of this matter, Respondents produced to Division staff an undated marketing brochure that reported a 2003 total performance of 25.6%. In his June 2004 sworn investigative testimony, Lawrence testified that Warwick's 2003 total performance was no greater than the 25.6% reported in the marketing brochure. He also sought to disavow his February 19, 2004, letter to Nelson's reporting inflated 2003 performance returns for Warwick, stating, "I don't recognize it. This is impossible." In the days after his investigative testimony, Lawrence mailed to Division staff a copy of a document that purported to be a letter to Nelson's dated February 26, 2004, correcting 2003 performance returns reported in his February 19 letter downward from 57.3% "gross" and 56.3% "net" to 25.6% "gross" and 24.6% "net." However, a Nelson's witness testified that Nelson's never received this letter. The record shows that Nelson's continued to publish the inflated 2003 performance to subscribers as late as 2006. 16/

At the October 2006 hearing, Lawrence claimed that the 2003 performance reported to the database services was the result of an inadvertent error in a single month in the year 2003 for which he reported performance of positive 9.77% when it was actually negative 9.77%. The law judge did not believe Lawrence's claim of error. Division witness Anthony Fiduccia calculated that Warwick's actual 2003 performance return was 18.65% and actual equity only performance return was 21.68%. The law judge found that Warwick's actual 2003 performance was no more than 25.6%. 17/ She also found that Lawrence never revised the inflated performance figures published by Nelson's, and that the February 26, 2004, letter to Nelson's was "part of a pattern of dubious mishaps and newly discovered exculpatory evidence that indicate[d] a lack of truthfulness."

F. Respondents Give Conflicting Explanations for Their Inability to Produce Records

In his June 2004 sworn investigative testimony, Lawrence testified that the records of Warwick's assets under management and performance from January 2000 forward had been destroyed by a fire in June 2002. He also testified that he called the fire department for service and filed an insurance claim for fire damage. However, at the October 2006 hearing, Lawrence testified that the records had been destroyed in June 2002, not by a fire, but by a flood. Lawrence stated that he was "confused" in his prior testimony, that shortly before the flood there was a

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16/ Lawrence also contacted Mobius and PSN to restate 2003 performance. As a result, Mobius published Warwick's 2003 performance as 26.54% and PSN published it as 26.28%.

17/ The law judge found that the difference between the 18.65% and 25.6% was due to an inadvertent error. In their brief, Respondents assert that the "favorable parts" of Fiduccia's testimony are missing from the transcript. Respondents fail to identify what exactly is missing from the transcript. Based on our review of the record, we find no gaps or deletions in Fiduccia's testimony.

"smoking condition" in his chimney, that he called the fire department, but then extinguished the "smoking condition," and told the fire department not to come. Lawrence also stated that he had filed an insurance claim for damages resulting from the "smoking condition." Lawrence's hearing testimony about the flood and "smoking condition" was contradicted by the testimony of Division witnesses that the fire department did not receive any calls for service at Lawrence's home and that no insurance claim for a fire or "smoking condition" was filed. The law judge rejected Lawrence's conflicting explanations for his failure to produce records. She found that there was no flood or fire at Lawrence's home which, in her view, strongly supported a finding that the records that he claimed were destroyed never existed.

III.

A. Advisers Act Section 203A

Advisers Act 203A generally prohibits an investment adviser that is subject to state authorities from registering with the Commission unless it has assets under management of at least $25 million. The record shows that Warwick maintained its Commission registration while having less than $25 million of assets under management. In seven reports filed between 1997 and 2000, Respondents represented that Warwick had between $26.55 and $37.2 million of assets under management. However, in June 2000, Lawrence was able to produce records reflecting a total of only $3 million of assets. In his June 2004 sworn investigative testimony, Lawrence stated that Warwick did not have more than $15 million of assets under management during the dates specified. Respondents were unable to substantiate the numbers provided in the reports. 18/ Their claims at the hearing of managing hundreds of millions of dollars more than reported were unsupported and deemed not credible. Like the law judge, we find that Warwick's assets under management were no greater than the values described in Lawrence's sworn investigative testimony 19/ and, at all relevant times, were substantially less than $25 million.

18/ See Donald T. Sheldon, 51 S.E.C. 59, 77 (1992) (stating that once the party having the burden of proof has come forward with evidence, the burden shifts to its opponent to refute that evidence), aff'd, 45 F.3d 1515 (5th Cir. 1995).

19/ Throughout the hearing, Lawrence disavowed numerous portions of his investigative testimony, stating that he did not give the answers attributed to him. As noted, the law judge generally did not credit Lawrence's hearing testimony. We have upheld a law judge's determination to accept prior sworn investigative testimony over conflicting hearing testimony. See, e.g., Michael J. Fee, 50 S.E.C. 1124, 1125 (1992), aff'd, 998 F.2d 1002 (3d Cir. 1993) (Table); Wheat First Sec., Inc., 56 S.E.C. 894, 899 n.8 (2003) (citing Fee); see also Bearcat, Inc., Exchange Act Rel. No. 49375 (Mar. 8, 2004), 82 SEC Docket 1336, 1343 n.16 (finding that investigative testimony, being earlier in time, was entitled to more weight than contrary hearing testimony).

The law judge found that Warwick ceased to be registered on August 31, 2000, and that no violations of Section 203A occurred after that date. We disagree. The law judge's finding was based primarily on Lawrence's hearing testimony that he filed for withdrawal of Warwick's registration in 2000 and believed that Warwick was not registered as of June 2000 or a few months later. The record fails to support this finding. Lawrence offered no evidence that he ever withdrew Warwick's registration and, as noted previously, our official files contain no Form ADV-W for Warwick. Moreover, as late as 2004, Lawrence continued to report to one or more database services that Warwick was Commission-registered. We conclude that Warwick willfully violated Advisers Act Section 203A by maintaining its registration with the Commission while having less than $25 million of assets under management from July 8, 1997, until January 31, 2002, when we cancelled Warwick's registration. 20/

We also conclude that Lawrence willfully aided and abetted Warwick's Advisers Act Section 203A violations. 21/ The elements of aiding and abetting liability are: (1) a securities law violation by another party; (2) substantial assistance by the aider and abettor in the conduct constituting the violations; and (3) a general awareness or knowledge by the aider and abettor that his actions are part of an overall course of conduct that is improper. 22/ Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." 23/ Recklessness satisfies the scienter requirement. 24/ Recklessness is "an extreme departure from the standards of ordinary care . . . present[ing] a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." 25/

Warwick's primary violations of Section 203A have been established. Lawrence, as Warwick's president, substantially assisted those violations by signing Warwick's Forms ADV

20/ Willfulness under the federal securities laws "means intentionally committing the act which constitutes the violation," and not, as Respondents suggest, an intent to violate the laws or rules. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000).

21/ Our finding that Lawrence aided and abetted Warwick's violations necessarily makes him a "cause" of those violations. See Sharon M. Graham, 53 S.E.C. 1072, 1085 n.35 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000)

22/ See, e.g., Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000). A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws. See Graham, 53 S.E.C. at 1084 n.33.

23/ Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

24/ See, e.g., SEC v. McNulty, 137 F.3d 732, 741 (2d Cir.), cert. denied, 525 U.S. 931 (1998); SEC v. Steadman, 967 F.2d 967 F.2d 636, 641-42 (D.C. Cir. 1992).

25/ Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-45 (7th Cir.), cert. denied, 434 U.S. 875 (1977).

and amendments thereto. The evidence demonstrates Lawrence's scienter. Lawrence was Warwick's control person and solely responsible for its filings. Lawrence must have known that his description of Warwick's assets greatly exaggerated the amounts actually under management, or he was at least reckless in his description of those assets. Lawrence repeatedly reported values that could not be confirmed and which contradicted his sworn investigative testimony. We find it telling that Warwick's reported assets increased precipitously from $5 to $26.55 million in 1997, the year that Section 203A's $25 million minimum asset requirement became effective. Lawrence testified at the hearing that Warwick's Commission registration bolstered its reputation with clients and potential clients. Lawrence therefore had a pecuniary motive for misrepresenting Warwick's data, which provides additional circumstantial evidence that he deliberately inflated Warwick's assets in order to maintain its Commission registration. 26/ Accordingly, we find that Lawrence knew of the wrongdoing and his role in furthering it.

B. Advisers Act Section 207

Advisers Act Section 207 makes it unlawful for any person willfully to make an untrue statement of material fact or to omit to state a material fact required to be stated in applications or reports to the Commission. 27/ Scienter is not required. 28/ In Forms ADV filed between 1997 and 2000, Respondents falsely stated that Warwick had assets under management in excess of $25 million when, in fact, they were unable to substantiate the values reported, those values were refuted at the hearing, and Lawrence's sworn investigative testimony supported asset values substantially less than $25 million during that time. Respondents made false statements about Warwick's assets under management in order improperly to qualify Warwick for Commission registration. Respondents' false statements were material because they gave an erroneous impression of Warwick's size and asset base, qualities that would be important to clients and prospective clients in selecting an investment adviser. 29/ For the reasons set forth in connection with the Section 203A violations, we find that Respondents' conduct was willful. By making untrue statements of material fact in reports filed with the Commission, Respondents willfully violated Advisers Act Section 207.

26/ See Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2511 (2007) (stating that "motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference").

27/ A fact is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); see supra note 20 (definition of willfulness).

28/ IMS/CPAs & Assocs., 55 S.E.C. 436, 455 (2001), petition denied, 327 F.3d 851 (9th Cir. 2003).

29/ See, e.g., The Barr Fin. Group, Inc., 56 S.E.C. 1243, 1255 (2003).

C. Advisers Act Sections 206(1), 206(2), and 206(4)

Advisers Act Section 206(1) makes it unlawful for an investment adviser to employ any device, scheme, or artifice to defraud any client or prospective client. Advisers Act Section 206(2) makes it unlawful for an investment adviser to engage in any transaction, practice, or course of business that operates as a fraud or deceit on any client or prospective client. Advisers Act Section 206(4) makes it unlawful for an investment adviser to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Scienter is required for violations of Section 206(1), but not for violations of Sections 206(2) or 206(4). 30/

As investment advisers, Respondents owed fiduciary duties to exercise good faith in dealing with clients and prospective clients and to employ reasonable care to avoid misleading them. 31/ Respondents breached those duties by making false and misleading statements to the database services about Warwick's assets and 2003 performance. 32/ Respondents' statements were false and misleading because they greatly exaggerated Warwick's assets and more than doubled its total 2003 performance, which we find was 18.65%. Their false and misleading statements were material because they made Warwick appear to be larger and more skillful at managing assets than it actually was. A reasonable investor would have wanted to know that the values reported to the database services overstated Warwick's actual assets and performance because investors routinely consider an adviser's past investment performance and attractiveness to other investors when making investment decisions.

The record shows Lawrence's scienter, which is attributed to Warwick. 33/ Lawrence admitted that he alone calculated Warwick's performance and provided those values, along with the values of Warwick's assets, to the database services. The accuracy of the values Lawrence supplied was contradicted by the values described in his sworn investigative testimony, certain of Warwick's Forms ADV, and documents, including Warwick's marketing brochure, that he

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30/ SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); Steadman, 967 F.2d at 641-43 & nn.3 & 5; Steadman v. SEC, 603 F.2d 1126, 1134 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

31/ See Capital Gains Research Bureau, 375 U.S. at 191-92,194; SEC v. Washington Inv. Network, 475 F.3d 392, 404 (D.C. Cir. 2007).

32/ Respondents also appear to have overstated the number of Warwick's clients to Nelson's database service. Because we believe that the evidence supporting the charge of inflated client numbers is weaker than the evidence supporting the charges of inflated assets and performance, we confine the findings of liability under Advisers Act Sections 206(1), 206(2), and 206(4) to the latter charges.

33/ A company's scienter is imputed from that of the individuals controlling it. Clarke T. Blizzard, Advisers Act Rel. No. 2253 (June 23, 2004), 83 SEC Docket 362, 374 & n.16.

provided to the staff. Lawrence also admitted that he knew the database services published the values he reported to the public, and that he relied on the database services for client referrals. In fact, he testified that he hoped the information about Warwick published by the database services would bring Warwick additional clients. 34/ Thus, as stated previously, Lawrence had a motive for overstating Warwick's assets and performance, which provides circumstantial evidence of his scienter. 35/ His self-interest in providing inaccurate information about Warwick is apparent. We find that Lawrence knew or was at least reckless in not knowing that the asset and 2003 performance values reported to the database services were materially false and misleading. 36/ We conclude that Respondents willfully violated Advisers Act Section 206(1) and Section 206(2), and that Warwick willfully violated, and Lawrence willfully aided and abetted and was a cause of Warwick's violation of, Advisers Act Section 206(4). 37/

34/ Courts have held that a misrepresentation communicated to a third party can support a fraud claim if the defendant intended or expected the misrepresentation to reach that particular plaintiff, or a class of persons including the plaintiff. See, e.g., Peerless Mills, Inc. v. AT&T, 527 F.2d 445, 450 (2d Cir. 1975) ("A third party can recover damages for a fraudulent misrepresentation if he can establish that he relied upon it to his detriment, and that the defendants intended the misrepresentation to be conveyed to him."); Chase Manhattan Bank, N.A. v. Fidata Corp., 700 F. Supp. 1252, 1261 (S.D.N.Y. 1988) ("A misrepresentation communicated to one person can support a claim for fraud by another person if the maker of the misrepresentation intends or has reason to expect that the statement will be repeated to the other person."). See generally Restatement (Second) of Torts § 533 (1977) (stating that maker of misrepresentation may be subject to liability for loss to third party if maker "intends or has reason to expect that its terms will be repeated or its substance communicated" to third party).

35/ See supra note 26.

36/ Lawrence's assertion that he did not know what numbers the database services were publishing was rejected by the law judge as not credible. We find no basis to disagree with that finding.

37/ Lawrence has not asserted that he was, at most, secondarily liable and should not have been charged as a primary violator under Advisers Act Section 206. The record shows that, at all times, Lawrence acted on Warwick's behalf. In addition, Lawrence has not disputed that he was an "investment adviser" as the term is defined under the Advisers Act. See supra note 4. We have held that an associated person may be charged as a primary violator under Section 206 where his activities cause him to meet the "broad" definition of "investment adviser." John J. Kenny, 56 S.E.C. 448, 485 & n.54 (2003).

IV.

We determine sanctions pursuant to a public interest standard under Advisers Act Sections 203(e) and 203(f). 38/ We consider such factors as the egregiousness of a respondent's actions, the isolated or recurrent nature of the infractions, the degree of scienter involved, the sincerity of any assurances against future violations, respondent's recognition of the wrongful nature of his conduct, and the likelihood that respondent's occupation will present opportunities for future violations. 39/ We also consider the extent to which a sanction will have a deterrent effect. 40/ In making a determination of appropriate sanctions, we have stated that conduct violating the antifraud provisions of the securities laws is "especially serious and subject to the severest of sanctions." 41/

A. Statute of Limitations

As an initial matter, we note that the Order Instituting Proceedings issued on July 6, 2006. The five-year statute of limitations in 28 U.S.C. § 2462 commenced on July 6, 2001. 42/ Some conduct violative of every provision charged, except for Section 207, occurred within the five-year limitations period and therefore is not time-barred. Section 2462 precludes consideration of Respondents' conduct occurring before July 6, 2001, in determining whether to impose an investment advisory bar or civil penalties. 43/ Such conduct may be considered, however, to establish Respondents' motive, intent, or knowledge in committing violations that are within the limitations period. 44/ Further, we may consider the entirety of Respondents' conduct in

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38/ 15 U.S.C. §§ 80b-3(e), 80b-3(f).

39/ Steadman, 603 F.2d at 1140.

40/ See, e.g., McCarthy v. SEC, 406 F.3d 179, 190 (2d Cir. 2005) (noting that deterrent value is a relevant factor in deciding sanctions); Ahmed Mohamed Soliman, 52 S.E.C. 227, 231 n.12 (1995) (stating that selection of an appropriate sanction involves consideration of several elements including deterrence).

41/ Marshall E. Melton, 56 S.E.C. 695, 713 (2003).

42/ See Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996) (holding that Section 2462 applies to Commission administrative proceedings).

43/ See Terry T. Steen, 53 S.E.C. 618, 623-25 (1998).

44/ Id. at 624; see also Joseph J. Barbato, 53 S.E.C. 1259, 1278 (1999); Graham, 53 S.E.C. at 1089 n.47.

deciding whether to impose cease-and-desist orders because such orders, like injunctions, operate prospectively and are not subject to Section 2462. 45/

B. Bar and Cease-and-Desist Orders

Lawrence's conduct on behalf of Warwick was egregious, recurrent, and prolonged. Lawrence maintained Warwick's Commission registration when it was not eligible to do so. In addition, Lawrence overstated Warwick's assets under management and 2003 performance in data reported to database services which published the information to subscribers in the securities industry. The false data that Lawrence reported to the Commission and the database services misled clients and prospective clients by making Warwick appear to be larger and more skillful at managing assets than it actually was, contrary to Respondents' fiduciary duties to exercise good faith and use reasonable care to avoid misleading clients and prospective clients. Lawrence's attempts to justify or conceal his actions in the days after his sworn investigative testimony underscore the seriousness of his conduct.

The degree of scienter was knowing and intentional, or at least reckless. Lawrence gave false information about Warwick to the database services knowing or recklessly disregarding that the information greatly exaggerated Warwick's actual assets and performance and intending that the false information be reported to the database service subscribers.

Lawrence has not acknowledged any wrongdoing. Rather, he continues to blame what the law judge described as a series of "dubious mishaps" for the absence of records -- records which remain unaccounted for to date. Nor has he offered assurances against future violations. In fact, the Nelson's witness testified that, as late as three weeks before the hearing, Lawrence called and asked Nelson's to report that Warwick managed $10 million of assets for the second quarter of 2006, even though the actual amount of its managed assets for that quarter was less than $10 million. The witness testified that he understood that Lawrence wanted him to falsely report and publish that Warwick had $10 million of assets in order to qualify it for listing in Nelson's World's Best Money Managers, which has a minimum asset requirement of $10 million. Lawrence's apparent persistence in providing false information about Warwick to the database services, and thereby to the public, despite the serious fraud charges against him for the same conduct, raises substantial uncertainty about Lawrence's willingness to comply with applicable regulatory requirements in the future. It also demonstrates his complete disregard for the fiduciary principles governing his conduct as an investment adviser.

Lawrence testified that he has been in the investment advisory business for nearly thirty years and wishes to continue serving clients as an adviser. His occupation presents opportunities for future violations. Absent a bar, Lawrence could return to association with an investment adviser. The record as a whole, including the evidence of the seriousness of the violations, the

45/ See Edgar B. Alacan, Exchange Act Rel. No. 49970 (July 6, 2004), 83 SEC Docket 842, 869-70.

degree of scienter involved, the lack of assurances against future violations, and the opportunity to commit future violations, warrants Lawrence's exclusion from the investment advisory business. We find it is appropriate in the public interest to bar Lawrence from association with any investment adviser for his violations of Advisers Act Sections 203A , 206(1), 206(2), and 206(4) that fall within the statute of limitations. 46/

As to the remedy of cease-and-desist orders, we look to whether there is some risk of future violations. 47/ The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. 48/ The existence of a violation raises an inference that the violation will be repeated, and where the misconduct resulting in the violation is egregious, the inference is justified. 49/ Here, Respondents engaged in not one but repeated instances of egregious violative behavior.

We also consider whether other factors demonstrate a need for cease-and-desist orders, including the seriousness of the violation, its isolated or recurrent nature, whether the violation is recent, the degree of harm to investors or the marketplace, the respondent's state of mind, the sincerity of assurances against future violations, the opportunity to commit future violations, and the remedial function to be served by cease-and-desist orders in the context of other sanctions sought in the proceeding. 50/

Respondents' conduct was egregious and recurrent, with a common thread of misrepresentation that continued for seven years. The violations were recent and involved at least recklessness. Although the law judge found no evidence of harm to Warwick's clients,

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46/ The Commission has authority to bar a person who violates the Advisers Act from associating or seeking to associate with unregistered investment advisers. Teicher v. SEC, 177 F.3d 1016, 1017-18 (D. C. Cir. 1999), cert. denied, 529 U.S. 1003 (2000). We reject Respondents' suggestion that there is no basis to impose a bar because no criminal acts were committed. We have stated previously, in reliance on United States Supreme Court precedent, that a bar is a civil rather than criminal penalty. See The Barr Fin. Group, 56 S.E.C. at 1258 n.29 (citing Hudson v. United States, 522 U.S. 93 (1997)); William F. Lincoln, 53 S.E.C. 452, 459-60 (1998) (same). We see no basis to reach a contrary conclusion here. Respondents have made no showing that this remedy is criminal. Lincoln, 53 S.E.C. at 462.

47/ KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185 (2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002).

48/ Id. at 1191.

49/ See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004).

50/ KPMG Peat Marwick LLP, 54 S.E.C. at 1192.

Respondents' conduct in inflating Warwick's assets under management and 2003 performance returns in Forms ADV and to the database services misled investors and potential investors about Warwick's size and the willingness of others to trust Respondents with their assets. We have long held that the "public interest determination extends beyond the consideration of particular investors to the public-at-large." 51/ An acknowledgment of the wrongful nature of the conduct and assurances against future violations are absent. As the law judge observed, Lawrence either believed that his conduct was justified or was ready to fabricate evidence in order to justify or conceal violative conduct. This lack of remorse demonstrates the need for cease-and-desist orders against future violations. In addition, cease-and-desist orders will serve the remedial purpose of encouraging Lawrence to take his responsibilities more seriously in the future, should his involvement in the securities industry recur. We conclude that Respondents pose a continuing risk of harm to investors. Therefore, in addition to a bar, 52/ it is in the public interest to impose cease-and-desist orders against Respondents from violating Advisers Act Sections 203A, 206(1), 206(2), 206(4), and 207.

C. Civil Money Penalties

Advisers Act Section 203(i) authorizes us to assess a civil penalty if we find that such penalty is in the public interest. 53/ Section 203(i) establishes three tiers of penalties, graduated according to the seriousness of the offense. 54/ The Division seeks second-tier penalties against Respondents. 55/ Although we find that second-tier penalties can be justified, we agree with the law judge that the combination of a bar and cease-and-desist orders are sufficient in the public interest. The record shows that Warwick had only two clients at the time of the hearing. Lawrence's claims of managing assets totaling in the hundreds of millions of dollars were

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51/ Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (8th Cir. 2003).

52/ We have stated that "injunctive and administrative remedies serve different purposes, one restrains further violative activity, the other seeks to determine whether it is in the public interest to exclude somebody from the securities industry or to limit his activities in it." Samuel H. Sloan, 45 S.E.C. 734, 738-39 (1975). We believe that the same rationale pertains to cease-and-desist orders.

53/ 15 U.S.C. § 80b-3(i)(2).

54/ The maximum penalty for each "act or omission" is \$5,500 for a natural person or \$55,000 for any other person in the first tier, \$55,000 for a natural person or \$275,000 for any other person in the second tier, and \$110,000 for a natural person or \$550,000 for any other person in the third tier. See 15 U.S.C. § 80b-3(i)(2)(A)-(C).

55/ A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. § 80b-3(i)(2)(B).

unsubstantiated and deemed not credible. As the law judge stated, without Lawrence as an associated person, Warwick will need to cease operations.

An appropriate order will issue. 56/

By the Commission (Chairman COX and Commissioners ATKINS, NAZARETH and CASEY).

Nancy M. Morris
Secretary

56/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2694 / January 16, 2008

Admin. Proc. File No. 3-12357

In the Matter of

WARWICK CAPITAL MANAGEMENT, INC.

and

CARL LAWRENCE

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Carl Lawrence be, and he hereby is, barred from association with any investment adviser; and it is further

ORDERED that Carl Lawrence and Warwick Capital Management, Inc. cease and desist from committing or causing any violations or future violations of Sections 203A, 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act of 1940.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57165 / January 17, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2768 / January 17, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12932

In the Matter of **MARK E. SULLIVAN,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Mark E. Sullivan ("Respondent" or "Sullivan") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III (3) below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Sullivan, age 46, was a certified public accountant licensed to practice in the Commonwealth of Massachusetts from 1986 to 1993. He served as Director of World-Wide operations for Applix , Inc. ("Applix") from 2001 to 2006.

2. Applix was, at all relevant times, a Massachusetts corporation with its principal place of business in Westborough, Massachusetts. Applix was engaged in the business of developing and distributing enterprise management software. At all relevant times, Applix's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ SmallCap Market.

3. On January 9, 2008, a final judgment was entered against Sullivan, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Alan C. Goldsworthy et. al, Civil Action Number 06 CV 10012 JGD, in the United States District Court for the District of Massachusetts. Sullivan was also ordered to pay a $25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Sullivan, with the former CEO and former CFO of Applix, engaged in a fraudulent scheme which resulted in Applix filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2001, in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal year 2002, in an S-8 registration statement filed on July 25, 2002 and a Form 8-K filed February 5, 2003. The Complaint alleged that Sullivan engaged in improper accounting practices that materially increased Applix's annual and quarterly revenue and decreased its net loss in a departure from generally accepted accounting principles ("GAAP"). These practices included, among other things, prematurely recognizing revenue on the sale of a not-yet available products and prematurely recognizing revenue on a sale as to which there was a right of return.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Sullivan's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Sullivan is suspended from appearing or practicing before the Commission as an accountant.

B. After three years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 249, 275, and 279

[Release Nos. 34-57166, IA- 2695]

Technical Amendments to Forms MSD, MSDW, BD-N, BD, BDW, ADV, and ADV-W and to Exchange Act Rules 15b1-1, 15b3-1, 15b6-1, 15Ba2-2, 15Bc3-1, 15Ca1-1, 15Ca2-1, 15Cc1-1, and 17a-3, and Advisers Act Rules 203-1, 203-3, and 204-1

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; technical amendments.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting technical amendments to Form MSD and Form MSDW (the application for registration as a municipal securities dealer and the notice of withdrawal from registration as a municipal securities dealer, respectively) primarily to add the Office of Thrift Supervision to the list of agencies with which Forms MSD and MSDW must be filed. The Commission is also adopting a technical amendment to Form BD-N (the notice of registration as a broker-dealer for the purposes of trading security futures products pursuant to Section 15(b)(11) of the Securities Exchange Act of 1934 ("Exchange Act")) to update the address of the National Futures Association. In addition, to reflect the formation of the Financial Industry Regulatory Authority, Inc. ("FINRA"), the Commission is adopting technical amendments to Forms BD and BDW (the uniform broker-dealer registration form and the uniform request for withdrawal from broker-dealer registration, respectively), related Exchange Act Rules, Forms ADV and ADV-W (the investment adviser registration form and the request for withdrawal from investment adviser registration, respectively), and related rules under the Investment Advisers Act of 1940 ("Advisers Act").

EFFECTIVE DATE: January 17, 2008.

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FOR FURTHER INFORMATION CONTACT: With respect to the amendments to Forms MSD, MSDW, BD-N, BD and BDW and rules adopted under the Exchange Act, Paula Jenson, Deputy Chief Counsel, Haimera Workie, Branch Chief, or Max Welsh, Attorney, at (202) 551-5550, Office of the Chief Counsel, Division of Trading and Markets, and, with respect to the amendments to Forms ADV and ADV-W and rules adopted under the Advisers Act, David W. Blass, Assistant Director, or Vivien Liu, Senior Counsel, at (202) 551-6787, Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

I. SUPPLEMENTARY INFORMATION

A. Forms MSD and MSDW

Form MSD is the application used by municipal securities dealers that are either banks or separately identifiable departments or divisions of banks, to register with the Commission. These entities use Form MSDW to provide notice of withdrawal from registration.[1] Bank municipal securities dealers use these forms both with the

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1 The Commission adopted forms MSD and MSDW in October 1975 and July 1976, respectively, pursuant to Section 15B of the Exchange Act. Section 15B of the Exchange Act provides that municipal securities dealers can register and withdraw from registration under procedures developed by the Commission. See Exchange Act Release Nos. 11742 (Oct. 15, 1975) and 12602 (Jul. 7, 1976).

Exchange Act Rule 15Ba2-1 requires an application for registration of a municipal securities dealer that is filed pursuant to Section 15B of the Exchange Act to be filed on Form MSD in accordance with the instructions on the form. Exchange Act Rule 15Bc3-1 requires a notice of withdrawal from registration as a municipal securities dealer to be filed pursuant to Section 15B of the Exchange Act be filed on Form MSDW in accordance with the instructions on the form.

Commission and with their "appropriate regulatory agency," as defined in Exchange Act Section 3(a)(34).[2]

The Financial Services Regulatory Relief Act of 2006 ("Regulatory Relief Act")[3] amended the definition of "appropriate regulatory agency" for a municipal securities dealer to include the Office of Thrift Supervision for entities that are federal savings associations, or departments or divisions of federal savings associations. The Commission is adopting technical amendments to Item K of the General Instructions of Form MSD and Item 2 of the General Instructions of Form MSDW to update the current list of agencies with which Forms MSD and MSDW must be filed to include the Office of Thrift Supervision and to update the addresses of the agencies listed on the forms.

B. Form BD-N

Form BD-N is used to provide notice of registration as a broker-dealer for purposes of trading security futures products pursuant to Section 15(b)(11) of the Exchange Act. The Form is filed with the National Futures Association ("NFA"), as the

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2 For example, Instruction K of Form MSD currently provides:

"Form MSD must be filed in triplicate with the Securities and Exchange Commission, Washington, D.C. 20549. The execution page of each copy shall contain an original manual signature. In addition, an original signed copy of the Form must be filed with the applicant's appropriate regulatory agency, determined in accordance with Section 3(a)(34) of the Act. Applicants which are national banks, or department or divisions of such banks, must file Form MSD with the Comptroller of the Currency, Washington D.C. 20219; applicants which are state member banks of the Federal Reserve System, or departments or divisions of such banks, must file Form MSD with the Federal Reserve Board, Washington, D.C. 20551; applicants which are banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), or departments or divisions of such banks, must file Form MSD with the Federal Deposit Insurance Corporation, Washington, D.C. 20429."

See also Instruction 2 of Form MSDW.

3 Pub. L. No. 109-351, 120 Stat. 1966 (2006).

Commission's designated agent.[4] During December 2007, the NFA moved from its prior address to 300 South Riverside Plaza, Suite 1800, Chicago, Illinois 60606. The Commission is adopting a technical amendment to Instruction 4 of Form BD-N to reflect the new address of the NFA.

C. Forms BD and BDW

Broker-dealers use Forms BD and BDW to register with the Commission and to withdraw from registration, respectively.[5] The Commission is adopting technical amendments to reflect the formation of FINRA as a result of the consolidation of the National Association of Securities Dealers, Inc. ("NASD") with NYSE Regulation, Inc., a wholly-owned subsidiary of New York Stock Exchange LLC.[6] Specifically, the Commission is amending Forms BD and BDW to replace references to NASD with references to FINRA. The Commission is also amending Item 5 of the General Instructions to Form BD and the Federal Information Law and Requirements section of Form BDW to add Section 15B of the Exchange Act to the list of statutory references authorizing the Commission to collect information on the forms to correctly reflect the Commission's authority.

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4 See Instruction 4 of Form BD-N.

5 Section 15(b) of the Exchange Act provides that broker-dealers can register and withdraw from registration under procedures developed by the Commission. Exchange Act Rule 15b1-1 requires that an application for registration of a broker or dealer that is filed pursuant to Section 15(b) of the Exchange Act be filed on Form BD in accordance with the instructions on the form. Exchange Act Rule 15b6-1 requires that a notice of withdrawal from registration as a broker or dealer filed pursuant to Section 15(b) of the Exchange Act be filed on Form BDW in accordance with the instructions on the form.

Forms BD and BDW are uniform forms that also are used to register and deregister with states, to become members, and to withdraw from membership with SROs.

6 See Exchange Act Rel. No. 56145 (Jul. 26, 2007), 72 FR 42190 (Aug. 1, 2007).

D. Exchange Act Rules 15b1-1, 15b3-1, 15b6-1, 15Ba2-2, 15Bc3-1, 15Ca1-1, 15Ca2-1, 15Cc1-1, and 17a-3

The Commission is adopting technical amendments to replace references to NASD with references to FINRA in Exchange Act Rules 15b1-1, 15b3-1, 15b6-1, 15Ba2-2, 15Bc3-1, 15Ca1-1, 15Ca2-1, 15Cc1-1, and 17a-3. The names of other self-regulatory organizations in Exchange Act Rule 15b6-1 are also being updated. In addition, paragraph (c) of Rule 15b3-1, paragraph (e) of Rule 15Ba2-2 and paragraph (c) of Rule 15Ca2-1 contain temporary re-filing instructions that are now obsolete. The Commission is adopting technical amendments to delete these paragraphs from these rules.

E. Forms ADV and ADV-W and Advisers Act Rules 203-1, 203-3, and 204-1

Investment advisers use Form ADV to register with the Commission and Form ADV-W to withdraw from registration.[7] Rules 203-1, 203-3, and 204-1 of the Advisers Act address issues relating to investment adviser registration and contain references to NASD. The Commission is adopting technical amendments to these forms and rules to replace references to NASD with references to FINRA.[8]

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7 Section 203 of the Advisers Act provides that investment advisers can register and withdraw from registration under procedures developed by the Commission. Advisers Act Rule 203-1 requires that an application for registration of an investment adviser that is filed pursuant to Section 203(c) of the Advisers Act be filed on Form ADV in accordance with the instructions on the form. Advisers Act Rule 203-2 requires that a notice of withdrawal from registration as an investment adviser pursuant to Section 203(h) of the Advisers Act be filed on Form ADV-W in accordance with the instructions on the form.

Investment advisers also use Forms ADV and ADV-W to register and withdraw from registration with states.

8 Part 1B of Form ADV is required by the state securities authorities for state-registered investment advisers. It is not a Commission form. At the request of the North American Securities Administrators Association, Inc., for informational

II. CERTAIN FINDINGS

Under the Administrative Procedure Act ("APA"), notice of proposed rulemaking is not required when the agency, for good cause, finds "that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[9] The Commission is making technical amendments to Item K of the General Instructions of Form MSD and Item 2 of the General Instructions of Form MSDW in response to the addition of the Office of Thrift Supervision to the Exchange Act Section 3(a)(34) definition of "appropriate regulatory agency" for a municipal securities dealer, by the Regulatory Relief Act and to update the addresses of the agencies listed on the forms.[10] Because these amendments will implement this statutory change by adding the Office of Thrift Supervision to the list of entities with which forms MSD and MSDW must be filed and also update the addresses of the agencies listed on the forms, the Commission finds that the amendments are technical in nature and that publishing the amendments for comment is unnecessary.[11]

The Commission is also adopting technical amendments to Form BD-N to update the address of the National Futures Association. Because this amendment will conform

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purposes the Commission notes that FINRA will replace a reference to NASD in the Part 1B, Arbitration Disclosure Reporting Page (ADV).

9 5 U.S.C. 553(b).

10 Pub. L. No. 109-351, 120 Stat. 1966 (2006).

11 For similar reasons, the amendments do not require analysis under the Regulatory Flexibility Act or analysis of major rule status under the Small Business Regulatory Enforcement Fairness Act. See 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility Act analyses, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking); 5 U.S.C. 804(3)(C) (for purposes of Congressional review of agency rulemaking, the term "rule" does not include any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties).

the address on the form with the new physical address of the National Futures Association, the Commission finds that the amendment is technical in nature and that publishing the amendment for comment is unnecessary.[12]

In addition, the Commission is adopting technical amendments to Forms BD and BDW to reflect the formation of FINRA and to correctly reflect the Commission's authority to collect the information on the forms. Similarly, the Commission is adopting technical amendments to Exchange Act Rules 15b1-1, 15b3-1, 15b6-1, 15Ba2-2, 15Bc3-1, 15Ca1-1, 15Ca2-1, 15Cc1-1, and 17a-3, as well as, to Forms ADV and ADV-W, and to Advisers Act Rules 203-1, 203-3, and 204-1 to reflect the formation of FINRA. Because these amendments will replace references to NASD with references to FINRA and, in the case of Forms BD and BDW, include Section 15B of the Exchange Act in the list of statutory references authorizing the Commission to collect the information on the forms, the Commission finds that the amendments are technical in nature and that publishing the amendments for comment is unnecessary.[13] In addition, the Commission is deleting obsolete temporary re-filing instructions in Rules 15b3-1, 15Ba2-2 and 15Ca2-1. Because these amendments will eliminate outdated instructions that include outdated references to NASD, the Commission finds that the amendments are technical in nature and that publishing the amendments for comment is unnecessary.[14]

Publication of a substantive rule not less than 30 days before its effective date is required by the APA except as otherwise provided by the agency for good cause.[15] For

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12 Id.

13 Id.

14 Id.

15 5 U.S.C. 553(d).

the same reasons described above with respect to notice and opportunity for comment, the Commission finds that there is good cause for making the technical amendments to each of the forms and rules effective on January 17, 2008.

III. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 3(f) of the Exchange Act,[16] and Section 202(c) of the Advisers Act,[17] provide that whenever the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the anticompetitive effects of such rules, if any, and to refrain from adopting a rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[18]

Because the amendments are limited to technical amendments, we do not anticipate that any competitive advantages or disadvantages would be created. We do not expect the amendments, as technical amendments, to have a significant effect on efficiency, or on capital formation or the capital markets resulting from any obligations imposed by the Commission.

IV. STATUTORY AUTHORITY

We are adopting the technical amendments to Forms MSD, MSDW, BD, BDW, and BD-N and to Exchange Act Rules 15b1-1, 15b3-1, 15b6-1, 15Ba2-2, 15Bc3-1,

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16 15 U.S.C. 78c(f).

17 15 U.S.C. 80b-2(c).

15Ca1-1, 15Ca2-1, 15Cc1-1, and 17a-3 under the authority set forth in the Exchange Act and, in particular, Sections 3(b), 15(a), 15(b), 15B, 17(a), and 23(a) therein.[19] We are adopting the technical amendments to Form ADV under the authority set forth in Section 19(a) of the Securities Act of 1933,[20] Sections 23(a) and 28(e)(2) of the Exchange Act,[21] Section 319 of the Trust Indenture Act of 1939,[22] Section 38(a) of the Investment Company Act of 1940[23] and Sections 203(c)(1), 204, and 211(a) of the Advisers Act.[24] We are adopting the technical amendments to Form ADV-W and Advisers Act Rule 203-1 under the authority set forth in Sections 203(c)(1), 204, and 211(a) of the Advisers Act.[25] We are adopting the technical amendments to Advisers Act Rule 203-3 under the authority set forth in Sections 203(c)(1) and 211(a) of the Advisers Act.[26] We are adopting the technical amendments to Advisers Act Rule 204-1 under the authority set forth in Sections 203(c)(1) and 204 of the Advisers Act.[27]

TEXT OF FORM AMENDMENTS

List of Subjects

17 CFR Parts 240 and 249

Broker-dealers, Reporting and recordkeeping requirements, Securities.

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18 15 U.S.C. 78w(a)(2).

19 15 U.S.C. 78o(a), 78o(b), 78o-4, 78q(a), and 78w(a).

20 15 U.S.C. 77s(a).

21 15 U.S.C. 78w(a), 78bb(e)(2).

22 15 U.S.C. 77sss.

23 15 U.S.C. 80a-37(a).

24 15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a).

25 15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a).

26 15 U.S.C. 80b-3(c)(1), 80b-11(a).

27 15 U.S.C. 80b-3(c)(1), 80b-4.

17 CFR Parts 275 and 279

Investment advisers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a– 20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 et seq., and 18 U.S.C. 1350, unless otherwise noted.

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2. Amend § 240.15b1-1 by revising paragraph (b) and removing the authority citation following the section to read as follows:

§ 240.15b1-1 Application for registration of brokers or dealers.

*****

(b) Every application for registration of a broker or dealer that is filed on or after January 25, 1993, shall be filed with the Central Registration Depository operated by the Financial Industry Regulatory Authority, Inc.

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3. Amend § 240.15b3-1 by revising paragraph (a) and removing paragraph (c) to read as follows:

§ 240.15b3-1 Amendments to application.

(a) If the information contained in any application for registration as a broker or dealer, or in any amendment thereto, is or becomes inaccurate for any reason, the broker or dealer shall promptly file with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) an amendment on Form BD correcting such information.

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4. Amend § 240.15b6-1 by revising paragraph (a) to read as follows:

§ 240.15b6-1 Withdrawal from registration.

(a) Notice of withdrawal from registration as a broker or dealer pursuant to Section 15(b) of the Act shall be filed on Form BDW (17 CFR 249.501a) in accordance with the instructions contained therein. Every notice of withdrawal from registration as a broker or dealer shall be filed with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) in accordance with applicable filing requirements. Prior to filing a notice of withdrawal from registration on Form BDW (17 CFR 249.501a), a broker or dealer shall amend Form BD (17 CFR 249.501) in accordance with §240.15b3-1(a) to update any inaccurate information.

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5. Amend § 240.15Ba2-2 by revising paragraph (a) and removing paragraph (e) to read as follows:

§ 240.15Ba2-2 Application for registration of non-bank municipal securities dealers whose business is exclusively intrastate.

(a) An application for registration, pursuant to section 15B(a) of the Act, of a municipal securities dealer who is not subject to the requirements of §240.15Ba2-1, that is filed on or after January 25, 1993, shall be filed with the Central Registration

Depository (operated by the Financial Industry Regulatory Authority, Inc.) on Form BD in accordance with the instructions contained therein.

*****

6. Amend § 240.15Bc3-1 by revising paragraph (b) to read as follows:

§ 240.15Bc3-1 Withdrawal from registration of municipal securities dealers.

*****

(b) Every notice of withdrawal from registration as a municipal securities dealer that is filed on Form BDW (17 CFR 249.501a) shall be filed with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) in accordance with applicable filing requirements. Every notice of withdrawal of Form MSDW (17 CFR 249.1110) shall be filed with the Commission.

*****

7. Amend § 240.15Ca1-1 by revising paragraph (c) to read as follows:

§ 240.15Ca1-1 Notice of government securities broker-dealer activities.

*****

(c) Any notice required pursuant to this section shall be considered filed with the Commission if it is filed with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) in accordance with applicable filing requirements.

8. Amend § 240.15Ca2-1 by revising paragraph (a) and removing paragraph (c) to read as follows:

§ 240.15Ca2-1 Application for registration as a government securities broker or government securities dealer.

(a) An application for registration pursuant to Section 15C(a)(1)(A) of the Act, of a government securities broker or government securities dealer that is filed on or after January 25, 1993, shall be filed with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) on Form BD in accordance with the instructions contained therein.

*****

9. Amend § 240.15Cc1-1 by revising paragraph (a) to read as follows:

§ 240.15Cc1-1 Withdrawal from registration of government securities brokers or government securities dealers.

(a) Notice of withdrawal from registration as a government securities broker or government securities dealer pursuant to Section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5(a)(1)(A)) shall be filed on Form BDW (17 CFR 249.501a) in accordance with the instructions contained therein. Every notice of withdrawal from registration as a government securities broker or dealer shall be filed with the Central Registration Depository (operated by the Financial Industry Regulatory Authority, Inc.) in accordance with applicable filing requirements. Prior to filing a notice of withdrawal from registration on Form BDW (17 CFR 249.501a), a government securities broker or government securities dealer shall amend Form BD (17 CFR 249.501) in accordance with 17 CFR 400.5(a) to update any inaccurate information.

*****

10. Amend § 240.17a-3, the undesignated paragraph following paragraph (a)(12)(i)(H) by:

a. Revising the phrase "National Association of Securities Dealers, Inc." to read "Financial Industry Regulatory Authority, Inc.";

b. Revising the phrase "New York Stock Exchange, Inc., the Pacific Exchange, Inc." to read "New York Stock Exchange LLC, NYSE Arca, Inc."; and

c. Revising the phrase "Chicago Board Options Exchange, Inc., the Cincinnati Stock Exchange, Inc. or the International Securities Exchange" to read "Chicago Board Options Exchange, Incorporated, the National Stock Exchange, Inc. or the International Securities Exchange, LLC".

PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934

11. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a, et seq., 7202, 7233, 7241, 7262, 7264, and 7265; and 18 U.S.C. 1350, unless otherwise noted.

*****

12. Form BD (referenced in § 249.501) is amended by:

a. In General Instruction A.1., second sentence, revising "the NASD" to read "FINRA";

b. In General Instruction A.5., FEDERAL INFORMATION LAW AND REQUIREMENTS,

i. In the second sentence, revising the phrase "Sections 15, 15c," to read "Sections 15, 15B, 15C,";

ii. In the third sentence, revising the phrase "See 15 U.S.C. §§ 78o," to read "See 15 U.S.C. 78o, 78o-4,"; and

iii. In the seventh sentence, revising the phrase "National Association of Securities Dealers, Inc." to read "Financial Industry Regulatory Authority, Inc.";

c. In Electronic Filing Instruction C.3., revising the phrase "NASAA/NASD" to read "NASAA/FINRA";

d. On page 2, Item 2, revising the box "NASD" to read "FINRA";

e. In Schedule E, Item 10, revising the phrase "NASD Rule 3010" to read "FINRA rules";

f. In Schedule E, Item 12, revising the phrase "the NASD" to read "FINRA"; and

g. In the boxes following Schedule E, Item 12, revising "NASD" to read "FINRA" each time it appears.

Note: The text of Form BD does not, and these amendments will not, appear in the Code of Federal Regulations.

13. Form BDW (referenced in § 249.501a) is amended by:

a. In General Instruction A.3., revising the phrase "the NASD" to read "FINRA";

b. In Partial Withdrawal C.2., revising the phrase "NASAA/NASD" to read "NASAA/FINRA";

c. In Explanation of Terms, under the term Investigation, first sentence, revising "NASD Regulation, Inc." to read "FINRA" and revising "The NASD By-Laws" to read "FINRA By-Laws";

d. Under Federal Information Law and Requirements – SEC's Collection of Information,

i. In the second sentence, revising the phrase "Sections 15, 15C," to read "Sections 15, 15B, 15C,";

ii. In the third sentence, revising the phrase "See 15 U.S.C. §§ 78o," to read "See 15 U.S.C. 78o, 78o-4,"; and

iii. In the seventh sentence, revising the phrase "National Association of Securities Dealers, Inc." to read "Financial Industry Regulatory Authority, Inc."; and

e. In Item 3, revising the box "NASD" to read "FINRA".

Note: The text of Form BDW does not, and these amendments will not, appear in the Code of Federal Regulations.

14. Form BD-N (referenced in § 249.501b) is amended by:

a. In Instruction 4, revising "200 West Madison Street, Suite 1600" to read "300 South Riverside Plaza, Suite 1800".

Note: The text of Form BD-N does not, and these amendments will not, appear in the Code of Federal Regulations.

15. Form MSD (referenced in § 249.1100) is amended by:

a. In General Instruction K, fourth sentence,

i. Revising the phrase "Comptroller of the Currency, Washington, D.C. 20219" to read "Comptroller of the Currency, Credit & Market Risk, 250 E Street, SW, MS 9-14, Washington, D.C. 20219";

ii. Revising the phrase "Federal Reserve Board, Washington, D.C. 20551" to read "Board of Governors of the Federal Reserve System, Market and Liquidity Risk Section, Mail Stop 185, 20th and C Streets, NW, Washington, D.C. 20551"; and

iii. Revising the phrase "Federal Deposit Insurance Corporation, Washington, D.C. 20429" to read "Federal Deposit Insurance Corporation, 550 17th St., NW, Washington, D.C. 20429; applicants which are federal savings associations, or departments or divisions of such savings associations, must file

Form MSD with the Office of Thrift Supervision, Managing Director, Examinations and Supervision Policy, 1700 G Street, NW, Washington, D.C. 20552".

Note: The text of Form MSD does not, and these amendments will not, appear in the Code of Federal Regulations.

16. Form MSDW (referenced in § 249.1110) is amended by:

a. In General Instruction 2, fourth sentence,

i. Revising the phrase "Comptroller of the Currency, Washington, D.C. 20219" to read "Comptroller of the Currency, Credit & Market Risk, 250 E Street, SW, MS 9-14, Washington, D.C. 20219";

ii. Revising the phrase "Federal Reserve Board, Washington, D.C. 20551" to read "Board of Governors of the Federal Reserve System, Market and Liquidity Risk Section, Mail Stop 185, 20th and C Streets, NW, Washington, D.C. 20551"; and

iii. Revising the phrase "Federal Deposit Insurance Corporation, Washington, D.C. 20429" to read "Federal Deposit Insurance Corporation, 550 17th St., NW, Washington, D.C. 20429; applicants which are federal savings associations, or departments or divisions of such savings associations, must file Form MSDW with the Office of Thrift Supervision, Managing Director, Examinations and Supervision Policy, 1700 G Street, NW, Washington, D.C. 20552".

Note: The text of Form MSDW does not, and these amendments will not, appear in the Code of Federal Regulations.

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

17. The authority citation for Part 275 continues to read, in part, as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

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18. Amend § 275.203-1 by revising paragraph (d) to read as follows:

§ 275.203-1 Application for investment adviser registration.

*****

(d) Filing fees. You must pay FINRA (the operator of the IARD) a filing fee. The Commission has approved the amount of the filing fee. No portion of the filing fee is refundable. Your completed application for registration will not be accepted by FINRA, and thus will not be considered filed with the Commission, until you have paid the filing fee.

19. Amend § 275.203-3 by revising paragraph (b)(3) and the Note to paragraph (b) to read as follows:

§ 275.203-3 Hardship exemptions.

*****

(b) ***

(3) Effective date – upon approval. You are not exempt from the electronic filing requirements until and unless the Commission approves your application. If the Commission approves your application, you may submit your filings to FINRA in paper format for the period of time for which the exemption is granted.

*****

Note to paragraph (b): FINRA will charge you an additional fee covering its cost to convert to electronic format a filing made in reliance on a continuing hardship exemption.

20. Amend § 275.204-1 by revising paragraphs (b)(2) and (d) to read as follows:

§ 275.204-1 Amendments to application for registration.

*****

(b) ***

(2) If you have received a continuing hardship exemption under § 275.203-3, you must, when you are required to amend your Form ADV, file a complete Part 1A of Form ADV on paper with the SEC by mailing it to FINRA.

*****

(d) Filing fees. You must pay FINRA (the operator of the IARD) an initial filing fee when you first electronically file Part 1A of Form ADV. After you pay the initial filing fee, you must pay an annual filing fee each time you file your annual updating amendment. No portion of either fee is refundable. The Commission has approved the filing fees. Your amended Form ADV will not be accepted by FINRA, and thus will not be considered filed with the Commission, until you have paid the filing fee.

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PART 279 -- FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

21. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

22. Form ADV (referenced in § 279.1) is amended by:

a. In General Instruction 1, third paragraph, revising "NASD" to read "FINRA";

b. In General Instruction 9,

i. In the first bullet, fourth sentence, revising “NASD” to read “FINRA”;

ii. In the second bullet, revising all references to “NASD” to read “FINRA” each time it appears; and

iii. In the fourth bullet, revising “NASD” to read “FINRA”;

c. In General Instruction 10,

i. In the first paragraph, fourth sentence, revising “NASD” to read “FINRA”; and

ii. In the second paragraph, revising “NASD” to read “FINRA”;

d. In General Instruction 14, second bullet, revising all references to “NASD” to read “FINRA” each time it appears;

e. In General Instruction 15, first bullet under “Where you submit your paper filing depends on why you are eligible to file on paper,” revising all references to “NASD” to read “FINRA” each time it appears;

f. Removing Glossary of Terms 23;

g. Redesignating Glossary of Terms 11 to 22, as Glossary of Terms 12 to 23;

h. Adding new Glossary of Terms 11;

i. In Glossary of Terms 32, Self-Regulatory Organization or SRO, second sentence, revising “NASD” to read “FINRA”; and

j. In Part 1A, Item 1.E., first sentence, revising “<u>NASD’s</u>” to read “<u>FINRA’s</u>”.

<u>Note</u>: The text of Form ADV does not, and these amendments will not, appear in the Code of Federal Regulations.

The addition of new Glossary of Terms 11 reads as follows:

Form ADV

*****

Glossary of Terms

*****

11. **FINRA's CRD or CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. [Used in: Part 1A, Item 1; Form ADV-W, Item 1]

*****

23. Form ADV-W (referenced in § 279.2) is amended by:

a. In Instruction 5, How should I file my Form ADV-W?, second paragraph, second sentence, revising "NASD," to read "FINRA,"; and

b. In Item 1.C., revising "NASD's" to read "FINRA's".

Note: The text of Form ADV-W does not, and these amendments will not, appear in the Code of Federal Regulations.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: January 17, 2008

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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57171; File No. 4-534)

January 18, 2008

Joint Industry Plan; American Stock Exchange LLC, Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, New York Stock Exchange LLC, and NYSE Arca, Inc.; Notice of Filing of Amendment No. 1 to the Proposed National Market System Plan for the Selection and Reservation of Securities Symbols

I. Introduction

On March 23, 2007, pursuant to Rule 608 of Regulation NMS under the Act[1] ("Rule 608"), American Stock Exchange LLC ("Amex"), New York Stock Exchange LLC ("NYSE"), and NYSE Arca, Inc. ("NYSE Arca") filed with the Commission a proposed plan for the purpose of the selection and reservation of securities symbols ("Three-Characters Plan"). On March 23, 2007, The Nasdaq Stock Market, Inc. ("Nasdaq"), National Association of Securities Dealers, Inc. ("NASD") (n/k/a Financial Industry Regulatory Authority, Inc. ("FINRA")),[2] National Stock Exchange, Inc. ("NSX"), and Philadelphia Stock Exchange, Inc. ("Phlx") also filed with the Commission a proposed plan for the purpose of the selection and reservation of securities symbols ("Five-Characters Plan"). On April 23, 2007, the Chicago Stock Exchange, Inc. ("CHX"), Nasdaq, NASD, NSX, and Phlx filed a supplement to the Five-Characters Plan.[3] The

1 17 CFR 242.608.

2 On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56146 (July 26, 2007), 72 FR 42190 (August 1, 2007).

3 In the Supplement, CHX joined as a party proposing the Five-Characters Plan. In addition, the Supplement contained a revised version of the Five-Characters Plan. The parties to the Five-Characters Plan revised the plan as follows: (i) changed the definition of securities for which an SRO must maintain facilities for the quoting and trade reporting of such securities in order to be party to the plan and corresponding changes

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proposed plans were published for comment in the Federal Register on July 17, 2007.[4]

On August 1, 2007, Amex, Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange, LLC ("ISE"), NYSE, and NYSE Arca filed Amendment No. 1 to the proposed Three-Characters Plan ("Amendment No. 1"). The Commission requests comment on Amendment No. 1 from interested persons.

II. Description of Amendment No. 1

Amendment No. 1 makes the following modifications to the proposed Three-Characters Plan: (1) adds two new parties to the proposed plan; (2) amends the symbol portability provision of the proposed plan with respect to three-character symbols; (3) clarifies that the Three-Characters Plan covers reservations of one-, two-, and three-character symbols for options under the OPRA Plan; and (4) minor, non-substantive, technical changes, including re-naming the plan administrator.

A. New Parties to the Plan

The Three-Characters Plan was originally submitted by Amex, NYSE, and NYSE Arca. The Three-Characters Plan would grant the plan participants the following symbol reservation rights: (1) NYSE and Amex each would receive the right to reserve 200 symbols without any time or other limitations or restrictions as "perpetual reservations" and 1,500 symbols for a limited time of 24 months as "limited-time reservations" (2) all other parties would receive the right to reserve 40 perpetual reservations, and (3) NYSE Arca would receive the right to reserve

throughout the plan and (ii) deleted the statement that new parties to the plan would pay an equal share of all development costs.

4 See Securities Exchange Act Release No. 56037 (July 10, 2007), 72 FR 39096 ("Joint Industry Plan Notice").

500 limited-time reservations.[5] Amendment No. 1 adds CBOE and ISE as signatories to, and participants in, the proposed Three-Characters Plan. In addition, Amendment No. 1 modified the proposed limited-time reservation provision of the plan to grant CBOE the right to reserve 500 limited-time reservations and ISE the right to reserve 200 limited-time reservations.[6]

The Commission requests commenters' views on the amended provisions to the proposed Three-Characters Plan that add CBOE and ISE as parties to the plan and that would grant them the limited-time reservation rights described above. The Commission also requests commenters' views on the number of symbols a self-regulatory organization ("SRO") should be permitted to reserve as perpetual reservations or limited-time reservations. In particular, the Commission requests commenters' view on any basis on which it would be appropriate for certain SROs to receive more reservations than other SROs. For example, should there be a distinction in the number of limited-time reservations that non-primary listing markets receive? If so, what factors should be taken into account in allotting the number of limited-time reservations? Finally, the Commission requests commenters' views on how these amended provisions would affect new listing markets.

B. Symbol Portability

The proposed Three-Characters Plan originally provided that, if an SRO lists a security that transferred from another SRO, the SRO from which the issuer delisted its security would have the right to the symbol for that security, unless it consents to the transfer of the symbol to the other SRO. If the SRO to which the issuer transferred its listing believes there is a compelling business reason why it should have the rights to the symbol (if it is a two- or three-

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5 See Joint Industry Plan Notice supra note 4, at 39099-100 for additional details regarding perpetual reservations and limited-time reservations.

6 See amended Section IV(b)(1)(B) of the Three-Characters Plan.

character symbol, but not a one-character symbol), such SRO could submit to the Processor the determination of which SRO shall have the rights in that symbol.[7] The Processor could only grant the rights in the symbol to the new SRO if the Processor determines that such SRO's business reasons for obtaining such rights substantially outweigh the business needs of the other SRO to that symbol. The Processor's decision would be final and not subject to appeal.

Amendment No. 1 modifies this proposed portability provision with respect to three-character symbols. Specifically, an SRO to which a security that uses a three-character symbol transfers its listing would have the rights to that three-character symbol,[8] unless, in the new SRO's discretion, it consents to allowing the former SRO to retain the symbol. The participants to the Three-Character Plan noted that Amendment No. 1 would comport the Three-Characters Plan with a Nasdaq rule recently approved by the Commission, which permits an issuer that has traded under a three-character symbol to continue to use that three-character symbol if the issuer moves its listing to Nasdaq.[9]

The Commission requests comment on the change in Amendment No. 1 regarding the portability of a three-character symbol to a new listing market when an issuer transfers its listing. When an issuer moves its listing to a new listing market, should either the former listing market or the new listing market retain the right to use the issuer's symbol? How would awarding the rights to the symbol to the former listing market affect competition? How would awarding such

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7 The Three-Characters Plan would not permit disputes over one-character symbols to be submitted to the Processor.

8 The new SRO would be required to use the three-character symbol to identify the security transferred to its market.

9 See Amendment No. 1, Cover Letter at 2. See also Securities Exchange Act Release No. 56028 (July 9, 2007), 72 FR 38639 (July 13, 2007) (SR-NASDAQ-2007-031) (approving a rule change to allow a company that transfers its listing to Nasdaq to retain its three-character symbol).

rights to the new listing market affect competition? Finally, the Commission requests comment on whether one- and two-character symbols should be subject to the same portability process as three-character symbols.

C. Covered Symbols

The proposed Three-Characters Plan originally stated that the plan was intended to be the exclusive means of allocating and using symbols of one-, two-, or three-characters, and none of such one-, two-, or three-character symbols were to be allocated or used for securities other than those reflected on "Network A" or "Network B" as those terms are defined in the Consolidated Tape Association Plan ("CTA Plan").[10] The original Three-Characters Plan also stated that its Symbol Reservation System would cover the allocation of all symbols used to common stocks, other securities or other information disseminated to the public through the facilities operated by, or pursuant to, among other plans, the Options Price Reporting Authority ("OPRA"). Amendment No. 1 amends Section I(b) of the proposed Three-Characters Plan to state that the proposed plan is intended to be the exclusive means of allocating and using symbols of one-, two-, or three-characters for, among other securities, options under OPRA. In addition, Amendment No. 1 revises Section I(b) of the Three-Characters Plan to state that, in the case of "listed equity securities" (as Rule 600(b)(34) of Regulation NMS defines that term) no one-, two-, or three-character symbols would be allocated or used other than for "Network A" or "Network B" "Eligible Securities."

The Commission requests comment on the amended provision regarding the proposed Three-Characters Plan's scope. In particular, the Commission requests comment on whether it is appropriate that the proposed scope of the Three-Characters Plan include options. Should the

10 See Section I(b) of the original Three-Characters Plan.

Commission approve a plan solely covering equity security symbols or should both equity and option security symbols be covered? Are there other matters with respect to the scope of the plans that commenters believe the Commission should consider? In particular, should only root symbols be covered or should suffixes be included as well?

D. Name of the Plan Administrator

Amendment No. 1 also made a number of minor, non-substantive technical changes, including modifying the name for the plan administrator. The proposed Three-Characters Plan originally referred to the plan administrator as the "International Symbols Reservation Authority ("ISRA")." Amendment No. 1 renamed the authority the "Intermarket Symbols Reservation Authority ("ISRA")." The Commission requests comment on the name of the plan administrator.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed Amendment No. 1 is consistent with the Act. The Commission invites comments on whether the foregoing assures fair competition among all parties, including new listing markets. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-534 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number 4-534. The file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro/nms.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed plans that are filed with the Commission, and all written communications relating to the proposed plans between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number 4-534 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-57172; IC-28124; File No. S7-16-07]

RIN 3235-AJ92

ELECTRONIC SHAREHOLDER FORUMS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the proxy rules under the Securities Exchange Act of 1934 to facilitate electronic shareholder forums. The amendments clarify that participation in an electronic shareholder forum that could potentially constitute a solicitation subject to the proxy rules is exempt from most of the proxy rules if all of the conditions to the exemption are satisfied. In addition, the amendments state that a shareholder, company, or third party acting on behalf of a shareholder or company that establishes, maintains or operates an electronic shareholder forum will not be liable under the federal securities laws for any statement or information provided by another person participating in the forum. Therefore, the amendments remove legal ambiguity that might deter shareholders and companies from energetically pursuing this mode of communication.

EFFECTIVE DATE: [Insert date 30 days after Federal Register Publication].

FOR FURTHER INFORMATION CONTACT: Lillian Brown, Tamara Brightwell, or John Fieldsend at (202) 551-3700, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3010.

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SUPPLEMENTARY INFORMATION: We are amending Rule 14a-2,[1] and adopting new Rule 14a-17,[2] under the Securities Exchange Act of 1934.[3]

I. BACKGROUND

On July 27, 2007, the Commission published for comment a release proposing, among other things, amendments to the proxy rules relating to electronic shareholder forums.[4] We are adopting new Rule 14a-17[5] and adding an exemption to Rule 14a-2 substantially as proposed in that release.

The purposes of new Rule 14a-17 and the Rule 14a-2 exemption are to facilitate experimentation, innovation, and greater use of the Internet to further shareholder communications. By facilitating such communications on the Internet among shareholders, and between shareholders and their companies, we hope to tap the potential of technology to better vindicate shareholders' state law rights, including their right to elect directors, in ways that are potentially both more effective and less expensive for shareholders and companies.

In a series of proxy roundtables that we sponsored in May 2007, several participants observed that recent technological developments hold promise in this

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1 17 CFR 240.14a-2.

2 17 CFR 240.14a-17.

3 15 U.S.C. 78a et al.

4 Release No. 34-56160 (July 27, 2007) [72 FR 43466] ("Proposing Release"). The instant release addresses only the electronic shareholder forum aspects of the Proposing Release. Comments received that addressed the comprehensive package of amendments to the proxy rules and related disclosure requirements are outside the scope of this adopting release.

5 New Rule 14a-17 was proposed as Rule 14a-18.

regard.[6] Those participants noted that these technological developments could provide a more effective and efficient means of communication than any that are currently available to shareholders.[7]

For example, the participants suggested that an online forum that would be for the exclusive use of shareholders of the company could protect the shareholders' privacy through encrypted unique identifiers,[8] while still permitting participants to know what voting percentage of the company was represented in discussions.[9] Participants in such a forum could, in addition, discuss a variety of important subjects that today are considered, if at all, only periodically and indirectly through the proxy process.[10] With the use of electronic shareholder forums, shareholder participation and communication could be extended throughout the year, rather than only during the period leading up to companies' annual shareholder meetings. Shareholders might also use such a forum as a

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6 See Rich Daly, Broadridge Financial Solutions, Inc.; Amy Goodman, Gibson, Dunn & Crutcher LLP; Stanley Keller, Edwards Angell Palmer & Dodge LLP; Cary Klafter, Intel Corporation; and Paul Neuhauser, The University of Iowa College of Law, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 152 to 171. See also, Russell Read, CalPERS; Amy Goodman, Gibson, Dunn & Crutcher LLP; Nell Minow, The Corporate Library; Bill Mostyn, Bank of America Corporation; and Gary Brouse, Interfaith Center on Corporate Responsibility, Transcript of Roundtable on Proxy Voting Mechanics, May 24, 2007, at 54 to 81.

7 Id.

8 See, e.g., Stanley Keller, Edwards Angell Palmer & Dodge LLP, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 152; Rich Daly, Broadridge Financial Solutions, Inc., Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 157; and Nell Minow, The Corporate Library, Transcript of Roundtable on Proxy Voting Mechanics, May 24, 2007, at 67.

9 See, e.g., Rich Daly, Broadridge Financial Solutions, Inc., Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 157.

10 See, e.g., Rich Daly, Broadridge Financial Solutions, Inc., Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 156 and Stanley Keller, Edwards Angell Palmer & Dodge LLP, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 160.

polling mechanism to elicit the sentiments of the company's managers or other shareholders on various potential actions.[11]

Technology now makes it feasible to establish such electronic shareholder forums to perform these functions. As one commenter indicated, technology is available to establish "secure, shareowner-to-shareowner communications, with access restricted to eligible shareowners, and using the Internet as a medium for efficient, ongoing interaction between shareowners and issuers."[12] These forums can be created so that operators and participants may exchange information electronically. Additionally, electronic shareholder forums can be designed to identify a participant's share ownership, as of a particular date, without disclosing that participant's name, address, or other identifying information.[13] Therefore, we think that participants' privacy can be protected while simultaneously providing for accountability for anyone making false or misleading statements.

If companies choose to participate in, or sponsor, electronic forums, they might find them of use in better gauging shareholder interest with respect to a variety of topics. A company-sponsored forum also could be used to provide a means for management to communicate with shareholders by posting press releases, notifying shareholders of record dates, and expressing the views of the company's management and board of

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[11] See, e.g., Stanley Keller, Edwards Angell Palmer & Dodge LLP and Rich Daly, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007, at 170 to 171 and Nell Minow, The Corporate Library, Transcript of Roundtable on Proxy Voting Mechanics, May 24, 2007, at 54 to 56.

[12] Comment letter from Broadridge Financial Solutions, Inc.

[13] Id.

directors.[14]

Despite these potential benefits of electronic shareholder forums, shareholders and companies alike have been reluctant to establish, maintain, or operate them due, in part, to uncertainty over liability for statements and information provided by those participating in the forum. In addition, potential forum participants have expressed concern regarding whether views and statements expressed through the forum would be considered proxy solicitations. Therefore, we proposed a new exemption from the proxy rules (other than from the shareholder list provisions in Rule 14a-7 and the antifraud provisions in Rule 14a-9) for any solicitation in an electronic shareholder forum that satisfies the conditions of the exemption. We also proposed new Rule 14a-17 to provide liability protection for a shareholder, company, or third party acting on behalf of a shareholder or company that establishes, maintains or operates an electronic shareholder forum regarding statements or information provided by another party participating in the forum.

As we discuss further in Section III, we are adopting new Rule 14a-17 and the amendments to Rule 14a-2 substantially as proposed. We are taking these steps to remove both real and perceived impediments to continued private sector experimentation with, and use of the Internet for, communication among shareholders, and between shareholders and the companies in which they invest. We intend for the amendments to facilitate communication and thereby encourage the creation of, and participation in, electronic shareholder forums.

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14 Of course, anyone posting information on an electronic shareholder forum should consider the requirements of Regulation FD. See 17 CFR 243.100 to 243.103.

II. COMMENTS ON THE PROPOSED AMENDMENTS TO FACILITATE ELECTRONIC SHAREHOLDER FORUMS

The majority of the public comment on the proposed amendments to facilitate electronic shareholder forums was favorable.[15] A substantial percentage of commenters remarking on the amendments, however, opposed substituting electronic shareholder forums for the current means of presenting non-binding shareholder proposals in the company's proxy statement pursuant to Rule 14a-8.[16] Although we solicited comment on this question, we did not propose any revisions to Rule 14a-8 that would cause the electronic shareholder forum to be a substitute for the Rule 14a-8 process. In the rule amendments that we are adopting today, we are making the electronic shareholder forum option an additional, rather than substitute, means of communication that could enhance and expand opportunities for participation and interaction.

In our proposing release, we requested comment on five basic issues related to electronic shareholder forums. The first issue was whether the proposed amendments would have their intended effect of providing sufficient flexibility under the federal securities laws to establish forums that permit interaction among shareholders and between shareholders and the company. In this regard, we solicited comment on whether shareholders and companies desire such flexibility, and if they do, whether the amended rules would provide it. We also solicited comment on whether any additional measures

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15 See, e.g., comment letters from The Allstate Corporation ("Allstate"); Business Roundtable ("BRT"); Capital Research and Management Company ("Capital Research"); GreenMachines.net ("GreenMachines"); and Investment Company Institute ("ICI").

16 17 CFR 240.14a-8.

are necessary to ensure that the federal securities laws do not hinder development of these forums. Finally, we asked whether the rules should provide more direction and guidance relating to the structure and purpose of the forums than we proposed.

The second issue on which we solicited comment concerned the potential liability under the federal securities laws associated with electronic shareholder forums. A primary purpose of the proposed amendments was to clarify that establishing, maintaining, or operating an electronic shareholder forum does not make one liable for statements or information provided by another person. We also asked commenters to identify any additional liability issues under the federal securities laws that we may not have addressed through the proposed amendments.

The third issue concerned the period of time during which electronic shareholder forums should be allowed to operate without being subject to most of the federal proxy rules. Under the proposed amendments, any solicitation in an electronic shareholder forum by or on behalf of a person that does not seek, directly or indirectly, the power to act as a proxy for a shareholder would be exempt from most of the proxy rules.

We proposed that such a person could avail himself or herself of the exemption provided that the solicitation was made more than 60 days before the date announced by the company for its next annual or special meeting, or not more than two days following the announcement of such a meeting if the announcement occurred fewer than 60 days before the meeting date. We solicited comment on whether an electronic shareholder forum could function effectively with this timing limitation. We also asked whether better alternatives exist to encourage free and open communication. Additionally, we solicited comment on whether we should require electronic shareholder forums to be closed down within 60 days of a scheduled shareholder meeting, whether shareholders whose communications remain posted inside the 60-day period should be required to file them with us, and how to best monitor these forums.

Fourth, we solicited comment regarding the use of electronic shareholder forums as a substitute for advancing referenda that otherwise would be presented in the form of non-binding shareholder proposals for inclusion in a company's proxy materials.

Finally, we solicited comment on the ways that an electronic shareholder forum might be used in connection with bylaw proposals regarding procedures for nominating candidates to the board of directors. In particular, we solicited comment on whether shareholders should be able to use an electronic shareholder forum to solicit other shareholders to join with them in submitting a bylaw proposal.

The vast majority of commenters supported the new exemption for electronic shareholder forums that we proposed to add to Rule 14a-2 and proposed new Rule 14a-17.[17] The commenters generally favored the continued development of electronic shareholder forums as a means of facilitating communication among shareholders and between shareholders and companies.[18]

Despite the generally favorable reaction, some commenters predicted that electronic shareholder forums might develop into the same types of shareholder chat

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[17] See, e.g., comment letters from Allstate; BRT; Capital Research; GreenMachines; and ICI.

[18] See, e.g., comment letters from Calvert Group, Ltd. ("Calvert"); Senator Carl Levin ("Senator Levin"); and Stephen R. Van Withrop ("Van Winthrop").

rooms that exist today.[19] Other commenters suggested that the issues related to electronic shareholder forums require more time to be fully analyzed and should be addressed only upon completion of a comprehensive study reviewing the shareholder communications process.[20] Finally, some commenters asserted that we did not adequately address whether the proposed 60-day, non-solicitation period prior to a proxy vote would provide sufficient protection against a coordinated proxy campaign waged on an electronic shareholder forum.[21]

Most of the commenters expressing concerns regarding non-binding shareholder proposals stated that they would oppose making the electronic shareholder forum a substitute for the current process under Rule 14a-8. Several of these commenters made it clear that they support electronic shareholder forums, provided that they are only a supplement to the current Rule 14a-8 process.[22]

Additionally, some commenters mentioned that keeping the identity of participants who post messages on these electronic forums private would threaten meaningful communications among shareholders and with the company.[23] These commenters asserted that participants' identities should be disclosed and that the

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19 See, e.g., comment letters from Bricklayers and Trowel Trades International Pension Fund ("Bricklayers"); Green Century Capital Management ("Green Century"); Social Investment Forum ("SIF"), and Walden Asset Management ("Walden").

20 See comment letters from American Bar Association ("ABA") and Society of Corporate Secretaries and Governance Professionals ("SCSGP").

21 See comment letters from ABA and SunTrust Banks, Inc. ("SunTrust").

22 See, e.g., comment letters from Christus Health ("Christus"); Domini Social Investments ("Domini"); and Trillium Asset Management ("Trillium").

23 See comment letters from ABA and Christian Brothers Investment Services, Inc. ("Christian Brothers").

participants' ownership interests in the company should be made known as well.

III. FINAL RULES TO FACILITATE ELECTRONIC SHAREHOLDER FORUMS

As stated above, the amendments that we are adopting in this release provide an additional means for shareholders to communicate, and do not in any manner restrict a shareholder's ability under Rule 14a-8 to submit a non-binding proposal to a company for inclusion in the company's proxy materials. Furthermore, the amendments neither mandate nor preclude private communications in electronic shareholder forums; instead, they allow for flexibility in different approaches and to allow innovation and experimentation.[24]

The amendments are designed to facilitate greater online interaction among shareholders by removing two major obstacles to the use of electronic shareholder forums.[25] The first major obstacle to the use of electronic shareholder forums is the concern that a statement made by a participant in an electronic shareholder forum will be construed as a solicitation under the proxy rules. Section 14(a) of the Exchange Act[26] requires that the solicitation of proxy voting authority be conducted in a fair, honest, and informed manner.[27] Any solicitation of proxies in connection with securities registered

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24 Because the antifraud provisions of Rule 14a-9 would apply to any postings, it could conceivably be necessary for a participant to identify itself in an otherwise anonymous forum if failure to do so in the circumstances would result in the omission of a "material fact necessary in order to make the statements therein not false or misleading." 17 CFR 240.14a-9.

25 17 CFR 240.14a-2(b)(6) and 17 CFR 240.14a-17.

26 15 U.S.C. 78n(a).

27 Release No. 34-31326 (October 16, 1992) [57 FR 48276 and 48277].

pursuant to Section 12 of the Exchange Act[28] is subject to the filing and disclosure requirements of the Commission's proxy rules.[29] In this regard, the Commission has broad authority to control the conditions under which proxies may be solicited so that it promotes "fair corporate suffrage."[30] A necessary element of this authority is to prevent solicitors from obtaining authorization for corporate action by means of "deceptive or inadequate disclosure in proxy solicitations."[31]

As defined by the Commission, the term "solicitation" encompasses not only a request that a shareholder execute a proxy, but also the "furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."[32] As such, the proxy rules apply to any person seeking to influence the voting of proxies, regardless of whether the person is seeking authorization to act as a proxy. Both the courts and the Commission have construed this necessarily fact-intensive test broadly to bring within the ambit of the proxy rules any communication that, under the totality of relevant circumstances, is considered "part of a continuous plan ending in a solicitation and which

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28 15 U.S.C. 78l.

29 See 15 U.S.C. 78n(a) and 17 CFR 240.14a-1 and 240.14a-2(b)(1).

30 17 H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934) at 14. The House Report indicated that the Commission was provided with this broad power "with a view to preventing the recurrence of abuses which...[had] frustrated the free exercise of the voting rights of stockholders." Id.

31 J.I. Case v. Borak, 377 U.S. 426, 431 (1964).

32 17 CFR 240.14a-1(l). Pursuant to Rule 14a-1(l)(2), the term "solicitation" does not include the furnishing of a form of proxy to a shareholder upon the latter's unsolicited request, the issuer's performance of acts mandated by 17 CFR 240.14a-7, the shareholder list requirement, or ministerial acts performed by any person on behalf of the soliciting party.

prepare(s) the way for its success."[33]

Therefore, we are adding a new exemption to Rule 14a-2 to state explicitly that Rules 14a-3 through 14a-6 (other than Rule 14a-6(g)), Rule 14a-8, and Rules 14a-10 through 14a-15 do not apply to any solicitation in an electronic shareholder forum if all of the conditions to the exemption are satisfied.[34] Rule 14a-2(b)(6) exempts from most of the proxy rules any solicitation by or on behalf of any person who does not seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent, or authorization in an electronic shareholder forum that is established, maintained or operated by a company, shareholder, or a third party acting on a company's or shareholder's behalf.[35]

A solicitation on an electronic shareholder forum will be exempt so long as it occurs more than 60 days prior to the date announced by the company for its annual or special meeting of shareholders. If the company announces the meeting less than 60 days before the meeting date, the solicitation may not occur more than two days following the company's announcement.[36] We are adopting the limitations to the exemption because, although an electronic shareholder forum should provide a medium for, among other things, open discussion, debate, and the conduct of referenda, the actual solicitation of

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33 Release No. 34-29315 (June 17, 1991) [56 FR 28987 and 28989]. See, e.g., Long Island Lighting Company v. Barbash, et al, 779 F. 2d 793 (2d Cir. 1985).

34 Id.

35 See Exchange Act Rule 14a-2(b)(6).

36 The proposal would not affect the application of any other exemptions under Regulation 14A. For example, a person could rely on the other applicable exemptions in Exchange Act Rule 14a-2 (17 CFR 240.14a-2).

proxy authority for an upcoming meeting should be conducted in full compliance with the proxy rules. Any proxies obtained prior to the application of our proxy rules will not benefit from the full and fair disclosure required under the regulations.

A person who participates in an electronic shareholder forum and makes solicitations in reliance on the Rule 14a-2(b)(6) exemption will be eligible to solicit proxies after the date that the exemption is no longer available, or is no longer being relied upon, provided that any such solicitation complies with Regulation 14A. In fact, it is for this reason that Rule 14a-2(b)(6) is necessary. Existing Rule 14a-2(b)(1)[37] provides that most of the proxy rules do not apply to "[a]ny solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization."

Therefore, statements on an electronic shareholder forum could be exempt under Rule 14a-2(b)(1), even if these amendments were not adopted. Once an exempt solicitation is made under Rule 14a-2(b)(1), however, the individual making the solicitation cannot later request proxy authority. Consequently, Rule 14a-2(b)(6) states that a person who participates in an electronic shareholder forum and makes a solicitation in reliance on this rule can later solicit proxies without threatening the exemption's validity.

We believe that exempting participation in an electronic shareholder forum only up until 60 days before an annual or special meeting will limit the potential for abuse, and

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[37] 17 CFR 240.14a-2(b)(1).

therefore we are adopting the 60-day limitation.[38] Communications within an electronic shareholder forum that occur less than 60 days prior to the annual or special meeting, or more than two days after the announcement of the meeting if the announcement is made less than 60 days prior to the meeting date, will continue to be treated as they were under the proxy rules prior to these amendments. We recognize the concern that, as one commenter noted, 60 days may not be "sufficient practical protection against the ability of a coordinated campaign to so color shareholder perceptions as to make the vote a likely, if not foregone, conclusion."[39]

We believe that the 60 day cut-off period will provide sufficient time for shareholders to consider the information disclosed to them about a planned shareholder meeting. We also believe that removing obstacles to shareholder participation in electronic forums outweighs the potential for such communications to impact a shareholder's vote. Of course, persons relying on Rule 14a-2(b)(6) who later solicit proxy authority will need to comply with other Commission rules as applicable.

Additionally, although commenters did not request specifically that we provide guidance on the potential proxy rule implications of stored communications available on a forum after the 60-day period, one commenter referenced this subject.[40] In this regard, shareholders who post communications on forums in reliance on Rule 14a-2(b)(6) and later solicit the power to act as a proxy for a shareholder will need to determine whether

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38 Sixty days corresponds with the maximum amount of time prior to a scheduled meeting that the company may fix the record date for determining the stockholders entitled to notice of, or to vote at, a meeting under the Delaware Code. See Del. Code title 8, §213 (2007).

39 See comment letter from ABA.

40 See comment letter from SunTrust.

the earlier postings must be filed as soliciting materials. For instance, it is possible that earlier postings remaining available to shareholders could be "reasonably calculated to result in the procurement, withholding or revocation of a proxy."[41] Therefore, any communications made, or that remain available, on the forum after the 60-day period must comply with the proxy rules if they constitute a solicitation, unless they fall within an existing exemption. One way that a forum might deal with this question is to give participants the opportunity to delete their postings as of the 60-day cut-off, or have the forum "go dark" during this period.[42]

The second major obstacle to the use of electronic shareholder forums is the concern that one who establishes, maintains, or operates the forum will be liable under the federal securities laws for statements made by forum participants. With respect to the establishment of such forums, which can be conducted and maintained in any number of ways, new Rule 14a-17 clarifies that a shareholder or company (or third party acting on behalf of a shareholder or company) that establishes, maintains, or operates an electronic shareholder forum is not liable for statements made by another person participating in the forum.[43]

The persons providing information to or making statements on an electronic shareholder forum, however, will remain liable for the content of those communications under traditional liability theories in the federal securities laws, such as those in Section

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[41] 17 CFR 240.14a-1(l)(1)(iii).

[42] Of course, if a person begins soliciting proxies earlier than the 60-day cut off period, that person would no longer have the benefits of the exemption and would therefore need to comply with the proxy rules, including perhaps by filing any available postings as soliciting materials or removing prior postings from the forum.

[43] 17 CFR 240.14a-17(b).

17(a) of the Securities Act and Section 10(b), Rule 10b-5, Rule 14a-9, and Section 20(e) of the Exchange Act. The prohibitions in the antifraud provisions against primary or secondary participation in fraud, deception, or manipulation will continue to apply to those supplying information to the site, and claims will not face any additional obstacles because of the new rule. Also, any other applicable federal or state law will continue to apply to persons providing information or statements to an electronic shareholder forum.

As adopted, new Rule 14a-17 provides liability protection for all shareholders, companies, and third parties acting on behalf of a shareholder or company that establish, maintain, or operate an electronic shareholder forum under the federal securities laws, provided that the forum is conducted in compliance with the federal securities laws, applicable state law and the company's charter and bylaws. The proposed rule would have applied only to companies and shareholders, but we believe it is appropriate to expand liability protections to other types of forum sponsors or operators, such as Internet service providers and shareholder or corporate associations, acting at the request, and on the behalf, of a shareholder or company.

As noted above, liability under the federal securities laws for statements made on an electronic shareholder forum is one area of concern for shareholders, companies, or third parties acting on behalf of a shareholder or company when making the decision about whether to establish such a forum. The main purpose of Rule 14a-17 is to protect the person establishing, maintaining, or operating an electronic shareholder forum from liability under the federal securities laws in much the same way that the federal telecommunications laws protect an interactive computer service.[44]

Commenters suggested certain other changes to the proposed rules. For instance, one commenter questioned whether statements made in reliance on Rule 14a-2(b)(6) are in fact solicitations as defined in Rule 14a-1(l),[45] and why the antifraud provisions of Rule 14a-9 and the filing requirements of Rule 14a-6 did not apply to such statements.[46] We believe that statements posted on an electronic shareholder forum may constitute a solicitation as defined in Rule 14a-1(l) and that is why we are adopting Rule 14a-2(b)(6) as an exemption from most of the proxy rules for such postings and specifically designating which proxy rules would apply to the postings.

We also considered whether certain persons who rely on the new Rule 14a-2(b)(6) exemption should be required to file a notification with the Commission. We concluded that filing such a notification would be unnecessary because the postings made in reliance on new Rule 14a-2(b)(6) will be limited to postings made in a shareholder forum by persons who are not seeking, directly or indirectly, the power to act as a proxy for a shareholder and to those made more than 60 days before any meeting of shareholders.

Further, one commenter highlighted the need for persons who may rely on the exemption in Rule 14a-2(b)(6) to give consideration to the impact of the postings under other Commission rules and regulations. In particular, the commenter cited the potential

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44 See Section 230(c)(1) of the Telecommunications Act of 1996 (47 U.S.C. 230(c)(1)) ("No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."). The protection against liability in Section 230(c)(1) would presumably also apply to providers and users of electronic shareholder forums.

45 17 CFR 240.14a-1(l).

46 See comment letter from SunTrust.

implications of electronic shareholder forum postings on Regulation 13D beneficial ownership reporting.[47] Again, we agree that any person relying on Rule 14a-2(b)(6) would need to assess whether compliance with other Commission rules and regulations is required. For instance, communications among shareholders in an electronic shareholder forum for the purpose of acquiring, holding, voting, or disposing of the equity securities of a company might result in the formation of a group for purposes of Regulation 13D.[48] Also, soliciting activities may impact the eligibility to file a Schedule 13G.[49]

In conclusion, we intend to remove legal ambiguity that might inhibit shareholders, companies, or third parties acting on behalf of a shareholder or company from the energetic pursuit of this mode of communication. We also intend that the amendments will encourage shareholders, companies, or third parties acting on behalf of a shareholder or company to take advantage of electronic shareholder forums to facilitate better communication among shareholders and between shareholders and companies.

IV. PAPERWORK REDUCTION ACT

The proxy rules constitute a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995, the PRA.[50] The amendments described in this release relate to a previously approved collection of information, "Proxy Statements – Regulation 14A (Commission Rules 14a-1 through 14a-16 and Schedule

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47 See comment letter from ABA.

48 17 CFR 240.13d-5.

49 See Release No. 34-39538 (January 12, 1998) [63 FR 2854], Section G (Shareholder Communications and Beneficial Ownership Reporting).

50 44 U.S.C. 3501 et seq.

14A (OMB Control No. 3235-0059)." Regulation 14A was adopted pursuant to the Exchange Act and sets forth the disclosure requirements for proxy statements filed by companies to help shareholders make informed voting decisions. We do not believe that the amendments to Rule 14a-2, or the creation of new Rule 14a-17, require any revision to our current burden estimates for Regulations 14A or impose any new recordkeeping or information collection requirements under the PRA that require approval of the Office of Management and Budget, the OMB.

V. COST-BENEFIT ANALYSIS

We are adopting amendments to the proxy rules under the Exchange Act to facilitate electronic shareholder forums by removing legal ambiguity under the federal securities laws that might deter shareholders, companies, or third parties acting on a shareholder's or company's behalf from establishing or contributing to such forums. These amendments clarify that participation in an electronic shareholder forum which potentially could constitute a proxy solicitation subject to the proxy rules, is exempt from most of the proxy rules if the conditions to the exemption are satisfied. In addition, these amendments state that a shareholder, company, or third party acting on a shareholder's or company's behalf that establishes, maintains, or operates an electronic shareholder forum generally will not be liable under the federal securities laws for any statement or information provided by another person participating in the forum.

A. Benefits

The most important benefit of the amendments that we are adopting is that they will eliminate a regulatory obstacle to electronic shareholder forums which hold the potential to significantly improve communications among shareholders and between shareholders and the companies they own. As a result of the amendments, shareholders and companies may be more willing to create or sponsor these forums, because the regulatory and liability regime will be more clearly defined.

Among the potential benefits to shareholders and companies are cheaper, more timely, and more relevant exchanges of information among shareholders and between shareholders and companies. Electronic shareholder forums could generate attention for sound proposals that could increase the value of share ownership, and they could filter out proposals not supported by other shareholders. They could also help disparate shareholders form stronger coalitions and coordinate their voices.[51] These forums can also better educate or otherwise inform shareholders with respect to the issues that will likely come up through proxy solicitations during the 60 days prior to an annual meeting.

In this regard, the majority of the amendments' benefits flow from the potential reduction in costs of collective action among shareholders and the potential reduction of costs in communications between shareholders and companies if there is more extensive use of electronic forums. For example, a shareholder who does not agree with a corporate policy and therefore is considering taking steps to have the company change that policy may not be able to easily and inexpensively survey other shareholders and determine their sentiments regarding the policy. Therefore, that shareholder presently has to decide whether to take the costly steps of opposing the company's action by

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51 Of course, communications among shareholders in an electronic shareholder forum for the purpose of acquiring, holding, voting, or disposing of the equity securities of a company might result in the formation of a group for purposes of Regulation 13D. 17 CFR 240.13d-5. Also, soliciting activities may impact the eligibility to file a Schedule 13G. See Release No. 34-39538 (January 12, 1998) [63 FR 2854], Section G (Shareholder Communications and Beneficial Ownership Reporting).

submitting a non-binding proposal or running a proxy contest without having the benefit of knowing whether the initiative is favored or will be supported by other shareholders.

Electronic shareholder forums may reduce communication and coordination costs among shareholders and also reduce companies' costs in replying if they choose to do so. A shareholder seeking to submit a non-binding proposal or conduct a proxy contest may be encouraged or discouraged from doing so in accordance with the better information that he or she will have acquired, at little or no cost, about the preference of other shareholders. And if a proposal is enthusiastically supported by a significant number of shares, the company might take notice and voluntarily adopt it; again, saving the shareholder considerable expense and benefiting the company and its shareholders overall.

Even if the company does not voluntarily adopt an initiative that reflects strong shareholder sentiment, knowledge of this fact by other shareholders will make it more likely that the initiative will be submitted and adopted. Shareholders may be encouraged to run successful proxy contests to pursue such changes, or management may be more responsive to the concerns in other ways. Thus, shareholders may benefit from a closer alignment between management and the interests of shareholders.

Another way that shareholders and companies may benefit from the amendments is that they could have more information to use in evaluating initiatives submitted for their consideration by other shareholders or by management. This information could be available at little or no incremental cost and could be readily accessible and searchable because it is in electronic form. Therefore, the amendments may reduce the cost of monitoring issues among shareholders.

Finally, more extensive use of electronic shareholder forums may be a step towards improving the informational efficiency of the market generally.

B. Costs

There are several potential costs to shareholders of implementing the amendments to the proxy rules, although all such costs would be voluntarily undertaken. One immediate cost of an electronic shareholder forum is that of maintaining and operating it. Although empirical data are not available for the exact costs of operating electronic shareholder forums, based on comparable costs of maintaining interactive websites, the costs of starting and maintaining a basic shareholder forum are not expected to be high. As more complicated features are included in a forum by its operators, such as eligibility verification procedures, anonymous accountability programs, and share ownership displays, costs could be expected to increase accordingly. Again, however, the decision to establish, operate, or maintain an electronic shareholder forum, and to add more expensive features, is voluntary.

Additionally, to the extent that the amendments to the proxy rules we are adopting result in an increase in the number of electronic forums, there could be increased costs related to the additional time that a shareholder or company chooses to spend monitoring, processing, and considering information that is posted on the forums. These costs will generally correspond to the number of shareholders using the forums, the frequency with which those shareholders post information on the forums, and the level of attention that shareholders or companies choose to pay to the ideas and opinions of the shareholders.

Should a company choose to sponsor or use an electronic shareholder forum, the company, and derivatively its shareholders, would bear the associated costs. If the company or its shareholders used the forum to conduct shareholder polls or surveys, the costs of the forums would be commensurately higher due to the time and effort necessary to accurately determine the results.

Moreover, because electronic shareholder forums may generally reduce the cost of communication among shareholders and between shareholders and companies, they may increase the frequency of that communication and thus, incidentally, the subset of that communication that constitutes misstatements, whether made intentionally or unintentionally. This could increase the costs of the forums to companies or shareholders. Although shareholders are held liable under the federal securities laws for fraudulent statements made on the forums, at least one commenter still expressed a concern that fraudulent information may lead to problems for a company, such as changes in stock prices,[52] which could increase costs to shareholders.

It should be noted, however, that the opportunity for online fraudulent misstatements is not new, as a number of shareholder forums exist online already, and there is nothing in the nature of electronic shareholder forums that should attract misstatements in greater numbers than other more public areas of the Internet. Regardless, it is possible that misstatements on an electronic shareholder forum could be taken more seriously in cases where the forum is restricted, for example, to only shareholders and the company. Even so, given the inevitability of occasional miscommunication, an electronic forum in which both the shareholders and the company participate may provide a means to quickly dispel any misleading information.

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52 See, e.g., comment letter from Domini.

Another potential cost is that shareholders may have less complete information with which to evaluate proposals than they would have otherwise because the amendment facilitates solicitation, outside the 60-day period prior to an annual or special meeting, without mandating extensive disclosure about the identity and the ownership of the participants that would occur otherwise. Because disclosures of this type may in some instances provide other shareholders with valuable information regarding possible motivations behind proposals that they would not otherwise receive, shareholders currently benefit from the proxy rules mandating such disclosure. Under the current rulemaking, some solicitations that would ordinarily be accompanied by these additional disclosures would proceed without them. The magnitude of this cost of lost information, however, depends on the extent to which shareholders have easy access to substitute sources of information and to the extent the information is material to the actions of shareholders and companies in the proxy voting process.

Finally, a shareholder that cannot, or chooses not to, use the Internet may be disadvantaged by not being able to fully participate in this form of dialogue among shareholders and between shareholders and the company. As a result, these shareholders may incur costs associated with adjusting to the use of electronic forums or in searching for the information being conveyed on the electronic forums in another medium. Alternatively, a shareholder who has never used the Internet but feels compelled to do so because of an electronic shareholder forum would incur the costs of obtaining Internet access. These costs, however, are similar to those that shareholders already must incur in to participate in existing electronic forums. Nonetheless, it is possible that if electronic shareholder forums are restricted to shareholders and companies, they will be considered more relevant and meaningful than existing forums that are available to any person. The costs to shareholders not willing or able to use electronic shareholder forums could be offset to some degree by the fact that other shareholders with whom they share a common financial interest may take advantage of the forums to propose initiatives and make their sentiments known to the company.[53]

VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act[54] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act[55] and Section 2(c) of the Investment Company Act of 1940[56] requires us, whenever we engage in rulemaking and are required to consider or determine if an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation.

By removing legal ambiguity, we anticipate the rules will promote efficiency in shareholder communications. Electronic shareholder forums may reduce communication costs and coordination costs among shareholders and also reduce companies' costs in replying if they choose to do so. Finally, more extensive use of electronic shareholder

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53 Also, a forum operator, or a forum participant, could choose to mail notice of important developments on the electronic shareholder forum to shareholders who are not willing or able to use the technology.

54 15 U.S.C. 78w(a)(2).

55 15 U.S.C. 78c(f).

56 15 U.S.C. 80a-2(c).

forums may be a step towards improving the informational efficiency of the market generally.

To the extent shareholders express interest in starting or participating in forums, competition among service providers to host or operate the forums may increase. We do not anticipate any effect on capital formation.

VII. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Act Analysis, the FRFA, has been prepared in accordance with the Regulatory Flexibility Act.[57] This FRFA relates to new Rule 14a-17 and the new Rule 14a-2 exemption, which will facilitate greater online interaction among shareholders and their companies by removing some obstacles to the use of electronic shareholder forums. These amendments to the proxy rules clarify that a shareholder, company, or third party acting on a shareholder's or company's behalf that establishes, maintains, or operates an electronic shareholder forum is not liable for statements made by another person or entity participating in the forum. Also, the amended rules exempt any solicitation in an electronic shareholder forum from the proxy rules, other than from the shareholder list provisions in Rule 14a-7 and the antifraud provisions in Rule 14a-9, if all of the conditions to the exemption are satisfied. An Initial Regulatory Flexibility Act Analysis was prepared in accordance with the Regulatory Flexibility Act and included in the Proposing Release.

A. Need for the Amendments

These amendments to the proxy rules are necessary to remove legal ambiguity that might deter shareholders, companies, and others from establishing or participating in

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[57] 5 U.S.C. 601.

electronic shareholder forums. New Rule 14a-17 and the new Rule 14a-2(b)(6) exemption will clarify the responsibilities of those who establish, maintain, operate, and contribute to electronic shareholder forums, with the purpose of stimulating experimentation, innovation, and greater use of the Internet to further shareholder communications. By facilitating such communications on the Internet among shareholders, and between shareholders and their companies, we hope to tap the potential of technology to better vindicate shareholders' state law rights, including their rights to elect directors, in ways that are potentially both more effective and less expensive.

Despite the potential benefits of electronic shareholder forums, shareholders and companies alike have been reluctant to establish, maintain, or operate them due, in part, to uncertainty over liability for statements and information provided by those participating in the forum. In addition, shareholders and companies have expressed concern regarding whether views and statements expressed through a forum would be considered proxy solicitations.

Therefore, we are adopting Rule 14a-17 to provide liability protection for a shareholder, company, or third party acting on behalf of a shareholder or company that establishes or maintains an electronic shareholder forum regarding statements or information provided by others participating in the forum. Also, we are adopting the new Rule 14a-2(b)(6) exemption from the proxy rules to explicitly state that Rules 14a-3 through 14a-6 (other than Rule 14a-6(g)), Rule 14a-8, and Rules 14a-10 through 14a-15 do not apply to any solicitation in an electronic shareholder forum. By taking these steps, we hope to remove both real and perceived impediments to continued private sector experimentation with, and use of, the Internet for communication among shareholders, and between shareholders and the companies in which they invest. We intend for the amendments to encourage the creation of, and participation in, electronic shareholder forums.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we published for comment a number of amendments to the proxy rules under the Exchange Act concerning shareholder proposals generally. The description of the proposed amendments regarding electronic shareholder forums constituted only one section of the release.[58] In this release, we are adopting only the proposed amendments to the proxy rules that relate to electronic shareholder forums and not the proposed amendments dealing with other aspects of shareholder proposals.

The majority of the public comment regarding electronic shareholder forums was favorable.[59] Generally, the commenters favored the exemption and new rule because they support the continued development of electronic shareholder forums as a means of facilitating communication among shareholders and between shareholders and companies.[60] A substantial percentage of the commenters opposed substituting electronic shareholder forums for the current means of presenting non-binding shareholder proposals in the company's proxy statement pursuant to Rule 14a-8. Although we solicited comment on the idea of using electronic shareholder forums as the sole means to present non-binding shareholder proposals to shareholders, several of the commenters made it clear that they supported electronic shareholder forums provided that the forums

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58 Proposing Release, Section II.B (Electronic Shareholder Forums).

59 See, e.g., comment letters from Allstate, BRT, Capital Research, GreenMachines, and ICI.

60 See, e.g., comment letters from Calvert, Senator Levin, and Van Winthrop.

were a supplement to, and not a replacement for, the current Rule 14a-8 process.[61] Under the final rules, electronic shareholder forums will be an additional, rather than substitute, means of communication.

Additionally, some commenters believed that keeping the identity of shareholders who post messages on these electronic forums anonymous would threaten meaningful communications among shareholders and the company.[62] These commenters asserted that shareholders' identities should be disclosed and that the shareholders' ownership interests in the company should be made known as well. The rule amendments that we are adopting today neither mandate nor preclude anonymous communications because we want to allow forum sponsors to have flexibility in creating electronic shareholder forums and to encourage innovation and experimentation.

Despite the generally favorable reaction, some commenters were concerned about possible negative consequences of the amendments. First, some commenters worried that the electronic shareholder forums could develop into shareholder chat rooms, which may not provide for meaningful communication.[63] Other commenters asserted that we did not adequately address whether shareholders and others could wage a successful, coordinated proxy campaign beyond the 60-day period during which the regular proxy rules would not apply.[64] Finally, some commenters suggested that we analyze the issue further and address electronic shareholder forums as part of a more comprehensive study reviewing

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61 See, e.g., comment letters from Christus, Domini, and Trillium.

62 See comment letters from ABA and Christian Brothers.

63 See, e.g., comment letters from Bricklayers, Green Century, SIF, and Walden.

64 See comment letters ABA and SunTrust.

the shareholder communications process.[65]

In the Proposing Release, we requested comment on many aspects of the proposed amendments to the proxy rules concerning shareholder proposals generally, including the number of small entities that would be affected by the proposed amendments, and the quantitative and qualitative nature of the impact. Commenters, including the Office of Advocacy of the Small Business Administration, addressed several aspects of the proposed rule amendments that potentially could have affected small entities. However, none of the commenters specifically discussed the effect of the proposed amendments regarding electronic shareholder forums on small businesses or entities. In particular, because the electronic shareholder forums authorized by the amendments that we are adopting are entirely voluntary, we believe that they will beneficially affect small businesses and entities in the same manner that they will beneficially affect larger businesses and entities. This is because presumably, only those businesses and entities that find them beneficial will choose to use them.

C. Small Entities Subject to the Final Amendments

The amendments that we are adopting in this release will affect only shareholders and companies that voluntarily establish, maintain, or operate electronic shareholder forums or that post information on, or provide information to, such forums. Some of the companies or shareholders may be small entities. Exchange Act Rule 0-10(a) defines an issuer, other than an investment company, to be a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent

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65 See comment letters from ABA and SCSGP.

fiscal year. We estimate that there are approximately 1,110 issuers, other than investment companies, that may be considered small entities.

We are adopting the amendments to the proxy rules to facilitate electronic shareholder forums by clarifying that participation in a forum, which could potentially constitute a proxy solicitation subject to the proxy rules, is exempt from most of the proxy rules if the shareholder or company satisfies all of the conditions to the exemption. Also, we are facilitating electronic shareholder forums by clarifying that any shareholder, company, or third party acting on behalf of a shareholder or company that establishes, maintains, or operates an electronic shareholder forum will not solely because of establishing, maintaining, or operating the forum be liable under the federal securities laws for any statement or information provided by another person participating in the forum. The amendments remove legal ambiguity that might deter shareholders and companies from relying on this mode of communication.

The amendments that we are adopting only apply to shareholders, companies, or third parties acting on their behalf if they choose to establish, maintain, operate, or participate in electronic shareholder forums. We are not requiring a small entity to have any involvement with electronic shareholder forums. We are only clarifying the liability provisions for establishing, maintaining, or operating such a forum and providing an exemption for forum communications that fall within the broad definition of a solicitation.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The amended rules do not impose any new reporting, recordkeeping, or compliance requirements on small entities. In fact, a small entity is not required to take any reporting or recordkeeping action or to comply with any other new requirements, unless it chooses to rely on the new Rule 14a-2(b)(6) exemption. If a small entity or shareholder posts information on a forum in reliance on Rule 14a-2(b)(6), and later solicits the power to act as a proxy for a shareholder, it will need to determine whether any earlier postings remaining on the forum after the Rule 14a-2(b)(6) exemption no longer is available must be filed as soliciting materials.[66] Regardless, if small entities choose to do nothing regarding electronic shareholder forums, the amended proxy rules have no additional reporting, recordkeeping, or other compliance requirements that they must follow.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. Our objective in adopting the amendments is to facilitate electronic shareholder forums by clarifying that participation in a forum is exempt from most of the proxy solicitation rules if the participant satisfies all of the exemption's conditions, and that forum operators are not liable for third-party statements on their forums. The amendments impact small entities only if the entities choose to involve themselves in the forums by establishing, maintaining, or operating them or by posting information on or providing information to the forums. We considered alternatives to accomplish our stated objective, but we could not think of one that would make electronic shareholder forums more useful to small entities because these amendments are voluntary and affect small entities only if they chose to participate in them.

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[66] See 17 CFR 240.14a-1(l)(1)(iii).

VIII. STATUTORY BASIS AND TEXT OF THE RULES AND AMENDMENTS

We are adopting amendments pursuant to Sections 14, 23(a), and 36 of the Exchange Act, as amended, and Sections 20(a) and 38 of the Investment Company Act of 1940, as amended.

List of Subjects

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission amends Title 17, chapter II of the Code of Federal Regulations as follows:

PART 240 – GENERAL RULES AND REGULATION, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; and 18 U.S.C. 1350, unless otherwise noted.

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2. Section 240.14a-2 is amended by adding paragraph (b)(6) to read as follows:

§ 240.14a-2 Solicitations to which § 240.14a-3 to § 240.14a-15 apply.

* * * * *

(b) * * *

(6) Any solicitation by or on behalf of any person who does not seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not furnish or otherwise request, or act on behalf of a person who

furnishes or requests, a form of revocation, abstention, consent, or authorization in an electronic shareholder forum that is established, maintained or operated pursuant to the provisions of § 240.14a-17, provided that the solicitation is made more than 60 days prior to the date announced by a registrant for its next annual or special meeting of shareholders. If the registrant announces the date of its next annual or special meeting of shareholders less than 60 days before the meeting date, then the solicitation may not be made more than two days following the date of the registrant's announcement of the meeting date. Participation in an electronic shareholder forum does not eliminate a person's eligibility to solicit proxies after the date that this exemption is no longer available, or is no longer being relied upon, provided that any such solicitation is conducted in accordance with this regulation.

3. Add § 240.14a-17 to read as follows:

§ 240.14a-17 Electronic shareholder forums.

(a) A shareholder, registrant, or third party acting on behalf of a shareholder or registrant may establish, maintain, or operate an electronic shareholder forum to facilitate interaction among the registrant's shareholders and between the registrant and its shareholders as the shareholder or registrant deems appropriate. Subject to paragraphs (b) and (c) of this section, the forum must comply with the federal securities laws, including Section 14(a) of the Act and its associated regulations, other applicable federal laws, applicable state laws, and the registrant's governing documents.

(b) No shareholder, registrant, or third party acting on behalf of a shareholder or registrant, by reason of establishing, maintaining, or operating an electronic shareholder forum, will be liable under the federal securities laws for any statement or information provided by another person to the electronic shareholder forum. Nothing in this section prevents or alters the application of the federal securities laws, including the provisions for liability for fraud, deception, or manipulation, or other applicable federal and state laws to the person or persons that provide a statement or information to an electronic shareholder forum.

(c) Reliance on the exemption in §240.14a-2(b)(6) to participate in an electronic shareholder forum does not eliminate a person's eligibility to solicit proxies after the date that the exemption in §240.14a-2(b)(6) is no longer available, or is no longer being relied upon, provided that any such solicitation is conducted in accordance with this regulation.

Nancy M. Morris

By the Commission.

Nancy M. Morris
Secretary

Dated: January 18, 2008

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57177 / January 22, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2769 / January 22, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12789

In the Matter of

CARL S. SANKO, CPA,

Respondent.

ORDER MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE

I.

On September 13, 2007, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, and Notice of Hearing against Carl S. Sanko, CPA ("Sanko" or "Respondent").

II.

Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. RESPONDENT

1. Sanko, 51, of Tehachapi, California, is a certified public accountant licensed in California since 1987. Sanko operates as a sole proprietorship. Sanko prepared and issued an audit report dated June 3, 2004, in connection with his audit of Platina Energy Group, Inc. ("Platina").

B. FACTS

1. Platina is a Delaware corporation based in New Orleans, Louisiana. During the relevant period, Platina's common stock traded on the OTC Bulletin Board. Its common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Platina reported $638 in revenue and total assets of $14,312 for its fiscal year ended 2003.

2. Platina has at all relevant times been an issuer as defined by the Sarbanes-Oxley Act of 2002 (the "Act"). Platina was known as Federal Protection Services, Inc. during the relevant period.

3. Sanko audited Platina's financial statements included in Platina's annual report for fiscal year 2003 on Form 10-KSB, filed with the Commission on June 29, 2004. Sanko prepared and issued an audit report dated June 3, 2004, which was included in Platina's Form 10-KSB.

4. Although Sanko was aware of the registration requirement, at no point was Sanko registered with the Public Company Accounting Oversight Board ("PCAOB").

5. Sanko received $7,500 for conducting an audit of Platina's financial statements for its fiscal year 2003, and for issuing an audit report on those financial statements.

C. VIOLATIONS

1. Section 4C(a) of the Exchange Act provides, in relevant part, that the Commission "may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission … (1) not to possess the requisite qualifications to represent others … or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder."

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2. Rule 102(e)(1) of the Commission's Rules of Practice provides that the Commission "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission ... (i) not to possess the requisite qualifications to represent others ... or (iii) to have willfully violated ... any provision of the Federal securities laws or the rules and regulations thereunder."

3. Section 102(a) of the Act provides that "it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer."[2]

4. The provisions of Section 102(a) of the Act became effective on October 22, 2003.[3]

5. Based on the conduct described above, Sanko willfully[4] violated Section 102(a) of the Act.

D. FINDINGS

Based on the foregoing, the Commission finds that Sanko did not possess the requisite qualifications to represent others and willfully violated Section 102(a) of the Sarbanes-Oxley Act of 2002.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately:

A. Sanko is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After one year from the date of this Order, Respondent may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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2 A violation of the Act or any rule that the PCAOB issues under the Act is treated for all purposes in the same manner as a violation of the Exchange Act, including with respect to penalties. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7202(b)(1) (West 2002).

3 Section 102(a) became effective "[b]eginning 180 days after the date of the determination of the Commission under Section 101(d)" of the Act that the PCAOB was prepared to undertake its statutory responsibilities. The Commission made the required determination on April 25, 2003. See Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8223, Exchange Act Release No. 47746, 2003 WL 1956164 (Apr. 25, 2003).

4 "Willfully" as used in this Order means intentionally committing the act that constitutes the violation. There is no requirement that the actor also be aware that he is violating a rule or statute. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in Respondent's practice before the Commission will be reviewed either by the independent audit committee of the public company for which Respondent works or in some other acceptable manner, as long as Respondent practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective. However, if registration with the PCAOB is dependent upon reinstatement by the Commission, the Commission will consider an application on its other merits;

(b) Respondent has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(c) Respondent acknowledges responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that Respondent's state CPA license is current and Respondent has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57180 / January 22, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2772 / January 22, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12796

In the Matter of STORY & COMPANY, P.C., AND BRIAN L. STORY, CPA, Respondents.	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE

I.

On September 13, 2007, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, and Notice of Hearing against Story & Company, P.C. ("the Firm") and Brian L. Story, CPA ("Story"). The Firm and Story will be referred to hereafter collectively as "Respondents."

II.

Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

A. RESPONDENTS

1. The Firm is a Colorado professional corporation and public accounting firm headquartered in Centennial, Colorado. The Firm prepared and issued an audit report dated February 11, 2004, in connection with its audit of Regatta Capital Partners, Inc. ("Regatta Capital").

2. Story, 68, of Littleton, Colorado, is a certified public accountant licensed in Colorado and Nebraska since 1974. As engagement partner on the Regatta Capital engagement, Story participated in the preparation and issuance of the February 11, 2004 Regatta Capital audit report.

B. FACTS

1. Regatta Capital is a Colorado corporation based in Denver, Colorado. During the relevant period, Regatta Capital's common stock traded on the OTC Bulletin Board. Its common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Regatta Capital reported $2,128 in revenue and total assets of $9,115 for its fiscal year ended 2003. During the relevant period, Regatta Capital was known as Monet Entertainment, Ltd.

2. Regatta Capital has at all relevant times been an issuer as defined by the Sarbanes-Oxley Act of 2002 (the "Act").

3. The Firm audited Regatta Capital's financial statements included in Regatta Capital's annual report for fiscal year 2003 on Form 10-KSB, filed with the Commission on March 29, 2004.

4. The Firm prepared and issued an audit report dated February 11, 2004, which was included in Regatta Capital's Form 10-KSB.

5. Story participated in auditing the financial statements included in Regatta Capital's annual report for fiscal year 2003 on Form 10-KSB, filed with the Commission on March 29, 2004.

6. Story participated in the preparation and issuance of an audit report dated February 11, 2004, which was included in Regatta Capital's Form 10-KSB.

7. Although Respondents were aware of the registration requirement, at no point was the Firm registered with the Public Company Accounting Oversight Board ("PCAOB").

[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

8. The Firm received $1,100 for conducting an audit of Regatta Capital's financial statements for its fiscal year 2003 and for issuing an audit report on those financial statements.

C. VIOLATIONS

1. Section 4C(a) of the Exchange Act provides, in relevant part, that the Commission "may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission … (1) not to possess the requisite qualifications to represent others … or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder."

2. Rule 102(e)(1) of the Commission's Rules of Practice provides that the Commission "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission ... (i) not to possess the requisite qualifications to represent others … or (iii) to have willfully violated … any provision of the Federal securities laws or the rules and regulations thereunder."

3. Section 102(a) of the Act provides that "it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer."[2]

4. The provisions of Section 102(a) of the Act became effective on October 22, 2003.[3]

5. Based on the conduct described above, the Firm willfully[4] violated Section 102(a) of the Act.

D. FINDINGS

1. Based on the foregoing, the Commission finds that the Firm and Story did not possess the requisite qualifications to represent others.

2. Based on the foregoing, the Commission finds that the Firm willfully violated Section 102(a) of the Sarbanes-Oxley Act of 2002.

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[2] A violation of the Act or any rule that the PCAOB issues under the Act is treated for all purposes in the same manner as a violation of the Exchange Act, including with respect to penalties. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7202(b)(1) (West 2002).

[3] Section 102(a) became effective "[b]eginning 180 days after the date of the determination of the Commission under Section 101(d)" of the Act that the PCAOB was prepared to undertake its statutory responsibilities. The Commission made the required determination on April 25, 2003. See Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8223, Exchange Act Release No. 47746, 2003 WL 1956164 (Apr. 25, 2003).

[4] "Willfully" as used in this Order means intentionally committing the act that constitutes the violation. There is no requirement that the actor also be aware that he is violating a rule or statute. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

1. Story & Company, P.C.

A. The Firm is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After one year from the date of this Order, the Firm may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Firm's work in the Firm's practice before the Commission will be reviewed either by the independent audit committee of the public company for which the Firm works or in some other acceptable manner, as long as the Firm practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) the Firm is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective. However, if registration with the PCAOB is dependent upon reinstatement by the Commission, the Commission will consider an application on its other merits;

(b) the Firm has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(c) the Firm acknowledges responsibility, as long as the Firm appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by the Firm to resume appearing or practicing before the Commission provided that the Firm's state CPA license is current and the Firm has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Firm's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

2. Brian L. Story, CPA

A. Story is censured.

B. Story may practice before the Commission as an independent accountant provided that:

1. The public accounting firm with which he is associated is registered with the PCAOB in accordance with the Act, and such registration continues to be effective; and

2. He has submitted to the Commission staff (Attention: Office of the Chief Accountant) the PCAOB's letter notifying the public accounting firm with which he is associated that its registration application has been approved.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57179 / January 22, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2771 / January 22, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12792

In the Matter of

HALT, BUZAS & POWELL, LTD., WAYNE A. POWELL, CPA, AND STEVEN R. HALT, CPA,

Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE

I.

On September 13, 2007, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, and Notice of Hearing against Halt, Buzas & Powell, Ltd. ("the Firm" or "Halt, Buzas & Powell"), Wayne A. Powell, CPA ("Powell"), and Steven R. Halt, CPA ("Halt"). The Firm, Powell, and Halt will be referred to hereafter collectively as "Respondents."

II.

Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

A. RESPONDENTS

1. The Firm is a Virginia corporation and public accounting firm headquartered in Alexandria, Virginia. The Firm prepared and issued audit reports dated August 11, 2004, and October 11, 2004, in connection with its audits of American Utilicraft Corp. ("American Utilicraft").

2. Powell, 40, of Odenton, Maryland, is a certified public accountant licensed in Maryland since 1989. As engagement partner on the American Utilicraft engagement, Powell participated in the preparation and issuance of the August 11, 2004 and October 11, 2004 American Utilicraft audit reports.

3. Halt, 55, of Fort Washington, Maryland, is a certified public accountant licensed in Virginia since 1976. As concurring partner on the American Utilicraft engagement, Halt participated in the preparation and issuance of the August 11, 2004 and October 11, 2004 American Utilicraft audit reports.

B. FACTS

1. American Utilicraft is a Delaware Corporation based in Lawrenceville, Georgia. During the relevant period, American Utilicraft's common stock traded on the Pink Sheets. Its common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). American Utilicraft reported $286,550 in revenue and total assets of $818,233 for its fiscal year ended 2003.

2. American Utilicraft has at all relevant times been an issuer as defined by the Sarbanes-Oxley Act of 2002 (the "Act").

3. Although Respondents were aware of the Public Company Accounting Oversight Board ("PCAOB") registration requirements, at no point did the Firm register with the PCAOB as a public accounting firm.

4. The Firm audited the financial statements included in American Utilicraft's annual report for fiscal years 2001, 2002, and 2003 on Forms 10-KSB, filed with the Commission on November 3, 2004 (for fiscal years 2001 and 2002) and on December 6, 2004 (for fiscal year 2003).

5. The Firm prepared and issued audit reports dated August 11, 2004, and October 11, 2004, which were included in American Utilicraft's Forms 10-KSB.

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

6. Powell and Halt participated in auditing the financial statements included in American Utilicraft's annual reports for fiscal years 2001 through 2003 on Forms 10-KSB, filed with the Commission on November 3, 2004 (for fiscal years 2001 and 2002) and on December 6, 2004 (for fiscal year 2003).

7. Powell and Halt participated in the preparation and issuance of audit reports dated August 11, 2004, and October 11, 2004, which were included in American Utilicraft's Form 10-KSB.

8. Respondents were aware of the registration requirements and the October 22, 2003 deadline for registration with the PCAOB when the Firm issued the August 11, 2004 and October 11, 2004 audit reports.

9. The Firm received $104,797 for conducting an audit of American Utilicraft's financial statements for its fiscal years 2001 through 2003, and for issuing an audit report on those financial statements.

C. VIOLATIONS

1. Section 4C(a) of the Exchange Act provides, in relevant part, that the Commission "may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission … (1) not to possess the requisite qualifications to represent others … or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder."

2. Rule 102(e)(1) of the Commission's Rules of Practice provides that the Commission "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission … (i) not to possess the requisite qualifications to represent others … or (iii) to have willfully violated … any provision of the Federal securities laws or the rules and regulations thereunder."

3. Section 102(a) of the Act provides that "it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer."[2]

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[2] A violation of the Act or any rule that the PCAOB issues under the Act is treated for all purposes in the same manner as a violation of the Exchange Act, including with respect to penalties. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7202(b)(1) (West 2002).

4. The provisions of Section 102(a) of the Act became effective on October 22, 2003.[3]

5. Based on the conduct described above, the Firm willfully[4] violated Section 102(a) of the Act.

D. FINDINGS

1. Based on the foregoing, the Commission finds that the Firm, Powell and Halt did not possess the requisite qualifications to represent others.

2. Based on the foregoing, the Commission finds that the Firm willfully violated Section 102(a) of the Sarbanes-Oxley Act of 2002.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

1. Halt, Buzas & Powell, Ltd.

A. The Firm shall cease and desist from committing or causing any violations and any future violations of Section 102(a) of the Act.

B. The Firm is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After one year from the date of this Order, the Firm may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Firm's work in the Firm's practice before the Commission will be reviewed either by the independent audit committee of the public company for which the Firm works or in some other acceptable manner, as long as the Firm practices before the Commission in this capacity; and/or

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[3] Section 102(a) became effective "[b]eginning 180 days after the date of the determination of the Commission under Section 101(d)" of the Act that the PCAOB was prepared to undertake its statutory responsibilities. The Commission made the required determination on April 25, 2003. See Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8223, Exchange Act Release No. 47746, 2003 WL 1956164 (Apr. 25, 2003).

[4] "Willfully" as used in this Order means intentionally committing the act that constitutes the violation. There is no requirement that the actor also be aware that he is violating a rule or statute. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

2. an independent accountant. Such an application must satisfy the Commission that:

(a) the Firm is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective. However, if registration with the PCAOB is dependent upon reinstatement by the Commission, the Commission will consider an application on its other merits;

(b) the Firm has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(c) the Firm acknowledges responsibility, as long as the Firm appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by the Firm to resume appearing or practicing before the Commission provided that the Firm's state CPA license is current and the Firm has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Firm's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. IT IS FURTHER ORDERED that Halt, Buzas & Powell shall, within 21 days of the entry of this Order, pay disgorgement of $83,837 and prejudgment interest of $17,874 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Halt, Buzas & Powell as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Christopher Conte, Division of Enforcement, Securities and Exchange Commission, 100 F Street N.E., Washington, D.C. 20549-4631.

2. **Wayne A. Powell, CPA**

A. Powell is censured.

B. Powell may practice before the Commission as an independent accountant provided that:

1. The public accounting firm with which he is associated is registered with the PCAOB in accordance with the Act, and such registration continues to be effective; and

2. He has submitted to the Commission staff (Attention: Office of the Chief Accountant) the PCAOB's letter notifying the public accounting firm with which he is associated that its registration application has been approved.

3. **Steven R. Halt, CPA**

A. Halt is censured.

B. Halt may practice before the Commission as an independent accountant provided that:

1. The public accounting firm with which he is associated is registered with the PCAOB in accordance with the Act, and such registration continues to be effective; and

2. He has submitted to the Commission staff (Attention: Office of the Chief Accountant) the PCAOB's letter notifying the public accounting firm with which he is associated that its registration application has been approved.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57178 / January 22, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2770 / January 22, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12791

In the Matter of **FREDERICK A. KADEN & CO., AND FREDERICK A. KADEN, CPA,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE**

I.

On September 13, 2007, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, and Notice of Hearing against Frederick A. Kaden & Co. ("the Firm") and Frederick A. Kaden, CPA ("Kaden"). The Firm and Kaden will be referred to hereafter collectively as "Respondents."

II.

Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

A. RESPONDENTS

1. The Firm is a New York company and public accounting firm headquartered in Brentwood, New York. The Firm prepared and issued an audit report dated March 17, 2004, in connection with its audit of Daxor Corporation ("Daxor").

2. Kaden has been a certified public accountant licensed in New York since 1982. As engagement partner on the Daxor engagement, Kaden participated in the preparation and issuance of the March 17, 2004 Daxor audit report.

B. FACTS

1. Daxor is a New York corporation based in New York, New York. During the relevant period, Daxor's common stock traded on the American Stock Exchange. Its common stock is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act").

2. Daxor has at all relevant times been an issuer as defined by the Sarbanes-Oxley Act of 2002 (the "Act").

3. Daxor reported $3,165,437 in revenue and total assets of $48,300,532 for its fiscal year ended 2003.

4. The Firm audited Daxor's financial statement included in Daxor's annual report for fiscal year 2003 on Form 10-K, filed with the Commission on March 30, 2004.

5. The Firm prepared and issued an audit report dated March 17, 2004, which was included in Daxor's Form 10-K.

6. Kaden participated in auditing the financial statements included in Daxor's annual report for fiscal year 2003 on Form 10-K, filed with the Commission on March 30, 2004.

7. Kaden participated in the preparation and issuance of an audit report dated March 17, 2004, which was included in Daxor's 10-K.

8. Although Respondents were aware of the registration requirement, at no point was the Firm registered with the Public Company Accounting Oversight Board ("PCAOB").

9. The Firm received $11,000 for conducting an audit of Daxor's financial statements for its fiscal year 2003, and for issuing an audit report on those financial statements.

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

C. VIOLATIONS

1. Section 4C(a) of the Exchange Act provides, in relevant part, that the Commission "may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission … (1) not to possess the requisite qualifications to represent others … or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder."

2. Rule 102(e)(1) of the Commission's Rules of Practice provides that the Commission "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission ... (i) not to possess the requisite qualifications to represent others … or (iii) to have willfully violated … any provision of the Federal securities laws or the rules and regulations thereunder."

3. Section 102(a) of the Act provides that "it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer."[2]

4. The provisions of Section 102(a) of the Act became effective on October 22, 2003.[3]

5. Based on the conduct described above, the Firm willfully[4] violated Section 102(a) of the Act.

D. FINDINGS

1. Based on the foregoing, the Commission finds that the Firm and Kaden did not possess the requisite qualifications to represent others.

2. Based on the foregoing, the Commission finds that the Firm willfully violated Section 102(a) of the Sarbanes-Oxley Act of 2002.

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[2] A violation of the Act or any rule that the PCAOB issues under the Act is treated for all purposes in the same manner as a violation of the Exchange Act, including with respect to penalties. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7202(b)(1) (West 2002).

[3] Section 102(a) became effective "[b]eginning 180 days after the date of the determination of the Commission under Section 101(d)" of the Act that the PCAOB was prepared to undertake its statutory responsibilities. The Commission made the required determination on April 25, 2003. See Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8223, Exchange Act Release No. 47746, 2003 WL 1956164 (Apr. 25, 2003).

[4] "Willfully" as used in this Order means intentionally committing the act that constitutes the violation. There is no requirement that the actor also be aware that he is violating a rule or statute. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

1. Frederick A. Kaden & Co

A. The Firm is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After one year from the date of this Order, the Firm may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Firm's work in the Firm's practice before the Commission will be reviewed either by the independent audit committee of the public company for which the Firm works or in some other acceptable manner, as long as the Firm practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) the Firm is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective. However, if registration with the PCAOB is dependent upon reinstatement by the Commission, the Commission will consider an application on its other merits;

(b) the Firm has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(c) the Firm acknowledges responsibility, as long as the Firm appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by the Firm to resume appearing or practicing before the Commission provided that the Firm's state CPA license is current and the Firm has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Firm's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

2. Frederick A. Kaden, CPA

A. Kaden is censured.

B. Kaden may practice before the Commission as an independent accountant provided that:

1. The public accounting firm with which he is associated is registered with the PCAOB in accordance with the Act, and such registration continues to be effective; and

2. He has submitted to the Commission staff (attention: Office of the Chief Accountant) the PCAOB's letter notifying the public accounting firm with which he is associated that its registration application has been approved.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8883 / January 25, 2008

SECURITIES EXCHANGE ACT OF 1934
Release No. 57202 / January 25, 2008

INVESTMENT ADVISERS ACT OF 1940
Release No. 2696 / January 25, 2008

INVESTMENT COMPANY ACT OF 1940
Release No. 28135 / January 25, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12934

In the Matter of **Chronos Asset Management, Inc. and Mitchell L. Dong,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e) and 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Chronos Asset Management, Inc. ("Chronos") and Mitchell L. Dong ("Dong") (collectively "Respondents").

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II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(f) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Respondents

1. Chronos Asset Management, Inc. is a Delaware corporation based in Cambridge, Massachusetts that has been owned and controlled by Dong since it was incorporated in 1995. At all relevant times, Chronos provided investment advisory services to two hedge funds: Chronos Fund I, LP ("Chronos Onshore Fund") and Chronos Offshore Fund, Inc. ("Chronos Offshore Fund") (collectively, the "Chronos Funds"). Chronos has never been registered with the Commission.

2. Mitchell L. Dong, age 54, is a resident of Boston, Massachusetts. Dong is Chronos's founder and at all relevant times owned Chronos and served as its president and chief executive officer. Dong also served as director of the Chronos Offshore Fund. As principal owner of Chronos, Dong had the ultimate decision-making authority for Chronos's investments.

Summary

3. This case involves a fraudulent market timing and late trading scheme by hedge fund adviser Chronos and its principal, Dong. From January 2001 to September 2003 (the "Relevant Period"), Chronos and Dong used deceptive means to continue market timing in mutual funds that had previously attempted to detect and restrict, or that otherwise would not have permitted, Chronos's trading. In addition, from May 2003 to September 2003, Chronos traded mutual fund shares after 4:00 p.m. Eastern Time ("ET") while receiving the same day's price. By virtue of their conduct, Respondents willfully

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[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

violated, and aided and abetted and caused violations of, the antifraud and mutual fund pricing provisions of the federal securities laws.

Facts

4. Dong owned and controlled Chronos, which controlled the Chronos Funds. He also oversaw Chronos's overall operations and investment strategies. During the Relevant Period, Chronos managed approximately $270 million for the Chronos Funds. Chronos used market timing as a primary investment strategy. It executed the strategy through the use of a proprietary statistical model that analyzed historical trading data and market trends and generated "signals" that determined whether and when Chronos should buy and sell mutual fund shares. Market timing includes: (i) frequent buying and selling of shares of the same mutual fund or (ii) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares, if the market timer is exploiting pricing inefficiencies, or disrupt the management of the mutual fund's investment portfolio and can cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer. From May to September 2003, Chronos also engaged in "late trading," whereby Chronos placed mutual funds trade orders after mutual fund companies calculated their daily net asset value ("NAV"), while obtaining the same day's NAV pricing.

Market Timing

5. During the Relevant Period, Respondents engaged in deceptive tactics by placing mutual fund trade orders with registered broker-dealer Prudential Securities, Inc. ("Prudential") that contained false and misleading information to hide Chronos's identity from mutual funds and otherwise facilitate Chronos' market timing strategies. Chronos disguised its identity and volume and frequency of its trading by using multiple customer account names (some of which were in the names of other corporate entities) and numbers.

6. Chronos's traders typically placed multiple mutual fund transactions per day with Prudential during the Relevant Period. Chronos opened its first account with registered representatives based in Prudential's Boston, Massachusetts branch office in January 2000. During the Relevant Period, Respondents were aware that mutual fund companies typically placed limits on the number of mutual fund trades that could be placed in a particular mutual fund and tracked mutual fund trades by customer name and customer account number. As a result, Respondents were aware that if they repeatedly placed short-term mutual fund trades using a single account name and number through one broker, the mutual fund companies would likely determine that Chronos's market timing was excessive and would block any further trades. Throughout the Relevant Period, through Prudential, Chronos was notified of "block notices" from mutual fund

companies prohibiting Chronos from further trading in those fund families because of Chronos's previous market timing activity.[2]

7. Respondents opened a total of 21 additional accounts at Prudential (between 2000 and February 2003) after Chronos was prohibited from trading in certain mutual fund families. Respondents maintained, and market timed through, these accounts until Chronos ceased its market timing activities in September 2003. Many of Chronos's accounts at Prudential bore names that appeared unrelated to Chronos, such as the names of a Chronos trader's wife, hometown and dog. The primary purpose in opening these accounts was to conceal the accounts' connection to Chronos and thereby allow Chronos to continue to trade in mutual funds that had previously attempted to prohibit it from trading due to market timing.

8. Chronos used separate Prudential accounts as part of a "rotation strategy" to disguise its market timing activities from mutual fund companies. As part of its rotation strategy, Chronos made multiple purchases into a fund family using multiple accounts and traded in one fund until an account was blocked. Then Chronos rotated the blocked account out of the fund into another fund, and continued to use the remaining accounts to trade in the original fund, with the intent of deceiving mutual funds as to their identity. Using its various accounts, Chronos also divided large trades into smaller-sized trades in an effort to "fly under the radar" of mutual funds that detected market timers by monitoring trades with high dollar values.

Late Trading

9. Rule 22c-1(a) under the Investment Company Act requires registered open-end investment companies ("mutual funds"), persons designated in such funds' prospectuses as authorized to consummate transactions in any such security, their principal underwriters, and dealers in the funds' securities to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. Late trading refers to the act of executing trades in a mutual fund's shares after the time as of which the mutual fund has calculated its NAV in a manner that allows the trade to receive that day's net asset value per share, rather than the next day's net asset value per share. Most mutual funds, including the funds Chronos traded, calculate their daily net asset value as of the close of major United States securities exchanges and markets (normally 4:00 p.m. ET). Although Respondents were not themselves subject to Rule 22c-1, persons subject to that Rule must sell mutual fund shares at the NAV next computed after receipt of the trade order.

10. From May 2003 to September 2003, Chronos late traded through two broker-dealers (Broker-Dealer A and Broker-Dealer B) (which were unrelated to Prudential). Broker-Dealer A and Broker-Dealer B submitted Chronos' mutual fund trades through clearing brokers (Clearing Broker-Dealer A and Clearing Broker-Dealer

[2] Block notices restricted market timing trading by, among other things, prohibiting future trades in specific accounts, by particular registered representatives or by broker-dealer, and typically included a statement concerning the mutual fund's aversion to market timing.

B, respectively), each of which had dealer agreements with the relevant mutual funds. Broker-Dealer A and Broker-Dealer B routinely allowed Chronos to communicate orders to purchase and sell mutual fund shares after 4:00 p.m. ET at that day's NAV. During this period, between approximately 4:00 and 4:15 p.m. ET each day, Chronos traders analyzed both aftermarket news reports and the movement in the futures market (which continues to trade until 4:15 p.m. ET) to determine whether to buy or sell large cap mutual funds. Chronos' late trading arrangements thus allowed the traders to purchase or sell mutual fund shares at prices set as of the market close with the benefit of the aftermarket information. Chronos thereby obtained a competitive advantage by being able to capitalize on the aftermarket news and futures market trading, while obtaining the previously calculated NAV.

11. Respondents realized significant profits as a result of the conduct set forth in paragraphs 4-10, above.

Violations of the Federal Securities Laws

12. As a result of the conduct described in paragraphs 5-8 and 11 above, Respondents willfully violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

13. As a result of the conduct described in paragraphs 5-8 and 11 above, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

14. As a result of the conduct described in paragraphs 9-11 above, Respondents willfully aided and abetted and caused Clearing Broker-Dealer A's and Clearing Broker-Dealer B's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

15. As a result of the conduct described in paragraphs 9-11 above, Respondents willfully aided and abetted and caused violations of Rule 22c-1(a) of the Investment Company Act by Clearing Broker-Dealer A and Clearing Broker-Dealer B.

Undertakings

Respondent Dong undertakes to provide to the Commission, within 10 days after the end of the 12-month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the

Exchange Act, Sections 203(e) and 203(f) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Chronos is hereby censured;

B. Respondents Chronos and Dong shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Rule 22c-1 under the Investment Company Act;

C. Respondent Dong be, and hereby is, suspended from association with any investment adviser and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of 12 months, effective on the second Monday following entry of this Order; and

D. IT IS FURTHER ORDERED THAT Respondents shall together, on a joint and several basis, pay disgorgement in the amount of $303,000 plus prejudgment interest in the amount of $73,915.80, and pay a civil money penalty in the amount of $1,800,000. Respondents shall satisfy this obligation by making payment to the United States Treasury within 30 days of the entry of this Order. Such payment shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies Chronos and Dong as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John T. Dugan, Associate Regional Director, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, Massachusetts 02110. Such disgorgement, prejudgment interest and civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund distribution"). Regardless of whether such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by offset or reduction of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding.

For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 25, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12935

In the Matter of **Joseph A. Ferona, Jr.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act" and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Joseph A. Ferona, Jr. ("Respondent" or "Ferona"). [1]

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From October 2003 through March 2005 Respondent operated two d/b/a's, Castle Rock Trading Company ("Castle Rock Trading") and the Global Prosperity Fund ("Global Prosperity Fund"), which were, respectively, an unregistered investment adviser and an unregistered investment company. Acting as an unregistered broker or dealer,

[1] By order dated February 22, 2006, an administrative law judge dismissed without prejudice a prior administrative proceeding against Ferona, which was based upon the entry of the injunction against him, due to the Division of Enforcement's failure to serve Ferona with the Order Instituting Proceedings. See Investment Advisers Act Release No. 2447 (November 25, 2005). The Commission thereafter ratified the actions taken resulting in the dismissal and authorized the institution of this proceeding.

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Respondent offered for sale and sold securities of the Global Prosperity Fund. From monies held by the Global Prosperity Fund, Respondent compensated himself for his rendering of investment advice through Castle Rock Trading and his sales of securities. Respondent, age 44, lived in Castle Rock, Colorado, when he operated Castle Rock Trading and the Global Prosperity Fund and acted as an unregistered broker or dealer.

B. ENTRY OF AN INJUNCTION AND CONVICTION AGAINST RESPONDENT

2. On October 13, 2005, a final judgment was entered by default against Respondent, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, Sections 203(a), 204, 206(1) and 206(2) of the Advisers Act and Rule 204-2 thereunder, and Sections 7(a) and 31(b) of the Investment Company Act of 1940 ("Investment Company Act") in the civil action entitled Securities and Exchange Commission v. Joseph A. Ferona, Jr. et al., Civil Action No. 05-CV-00621-WDM-BNB, in the United States District Court for the District of Colorado.

3. The Commission's first amended complaint alleged that, from at least October 2003 through March 2005 Ferona sold interests in the Global Prosperity Fund, an unregistered investment company managed by Castle Rock Trading, an unregistered investment adviser, to at least 35 investors from whom he raised at least $2.8 million. The complaint further alleged that Ferona misappropriated investor funds, falsely stated to investors that their funds were invested, sent out false account statements representing that investors were earning positive returns, and otherwise engaged in a variety of conduct that operated as a fraud and deceit on investors. The complaint also alleged that Ferona offered to sell securities in unregistered transactions, failed to register Castle Rock Trading and the Global Prosperity Fund as an investment adviser and investment company, respectively, and failed to make the records of Castle Rock Trading and the Global Prosperity Fund available for inspection by Commission examiners.

4. On June 11, 2007, Respondent pled guilty to one count of mail fraud in violation of Title 18 United States Code, Sections 1341 and 1342 before the United States District Court for the District of Colorado in United States v. Jospeh A. Ferona, Jr., Case No. 06-cr-00455-EWN. On August 24, 2007, a judgment in the criminal case was entered against Respondent. He was sentenced to a prison term of 70 months followed by three years of supervised release and ordered to make restitution in the amount of $2,172,783.13.

5. The count of the indictment to which Respondent pled guilty alleged, inter alia, that Respondent defrauded investors and obtained money and property by means of materially false and misleading statements, and that he used the United States mails to send false account statements.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Atkins
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8884 / January 25, 2008

SECURITIES EXCHANGE ACT OF 1934
Release No. 57206 / January 25, 2008

INVESTMENT ADVISERS ACT OF 1940
Release No. 2698 / January 25, 2008

INVESTMENT COMPANY ACT OF 1940
Release No. 28136 / January 25, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12936

In the Matter of **Heartland Advisors, Inc., William J. Nasgovitz, Paul T. Beste, Thomas J. Conlin, Greg D. Winston, Kevin D. Clark, Kenneth J. Della, and Hugh F. Denison,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND CEASE-AND-DESIST ORDERS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b)(4), 15(b)(6) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(4), 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Heartland Advisors, Inc. ("Heartland Advisors"), William J. Nasgovitz ("Nasgovitz"), Paul T. Beste ("Beste"), Thomas J. Conlin ("Conlin"), Greg D. Winston ("Winston"), Kevin D. Clark ("Clark"), Kenneth J. Della ("Della"), and Hugh F. Denison ("Denison") (also referred to collectively as "Respondents").

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II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Section 8A of the Securities Act, Sections 15(b)(4), 15(b)(6) and 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

A. Respondents

1. **Heartland Advisors** was founded in 1982 and maintains its principal place of business in Milwaukee, Wisconsin. During the events relevant to this proceeding, Heartland Advisors was registered with the Commission as an investment adviser and broker-dealer. Heartland Advisors managed the mutual fund portfolio series of Heartland Group, Inc. ("Heartland Group"), a registered investment company, subject to the authority of, and supervision by, Heartland Group's Board of Directors, and served as the principal underwriter of Heartland Group's securities. Heartland Advisors managed Heartland Group's High-Yield Municipal Bond Fund and Heartland Group's Short Duration High-Yield Municipal Fund (collectively, the "Funds") until the Commission obtained an order placing the Funds into receivership in March 2001.[2]

2. **Nasgovitz**, of Milwaukee, Wisconsin, is the President, Chief Executive Officer and Chief Investment Officer of Heartland Advisors, and the President and a Director of Heartland Group. Nasgovitz is the majority owner of the holding company that owns Heartland Advisors.

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[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] On March 21, 2001, Heartland Group consented, without admitting or denying the allegations in the Complaint, to the entry of an order of permanent injunction and other equitable relief for violations of Sections 30(b)(2), 30(e) and 30(g) of the Investment Company Act and Rules 30b2-1, 30d-1(a) and 30d-1(c) promulgated thereunder, which froze the assets of the Funds. In addition, a receiver was appointed over the Funds. See SEC v. Heartland Group, Inc., Case No. 01 C 1984 (N.D. Ill.), Litigation Release No. 16938 (March 22, 2001). The receiver subsequently liquidated the Funds.

3. **Beste**, of Brookfield, Wisconsin, is the Chief Operating Officer of Heartland Advisors and a Vice President of Heartland Group. He also is a member of Heartland Advisors' Pricing Committee.

4. **Conlin**, of Wauwatosa, Wisconsin, was a co-portfolio manager of the Funds until September 2000. He was also, until September 2000, a Vice President of Heartland Advisors and a non-voting member of Heartland Advisors' Pricing Committee. Conlin is no longer employed by Heartland Advisors.

5. **Winston**, of Sussex, Wisconsin, was, during the events relevant to this proceeding, a co-portfolio manager of the Funds. He was a Vice President of Heartland Advisors and an alternate member of its Pricing Committee. Winston is no longer employed by Heartland Advisors.

6. **Clark**, of Menomonee Falls, Wisconsin, is the Senior Vice President of Trading at Heartland Advisors. He also is a member of Heartland Advisors' Pricing Committee.

7. **Della**, of Waukesha, Wisconsin, was, during the events relevant to this proceeding, a Senior Vice President and Treasurer of Heartland Advisors. He also was a member of Heartland Advisors' Pricing Committee. Della is no longer employed by Heartland Advisors.

8. **Denison**, of Whitefish Bay, Wisconsin, was a non-independent Director of Heartland Group, from 1988 to 2003.

B. Other Relevant Entities

1. **Heartland Group** is a Maryland corporation formed in 1986 that maintains its principal place of business in Milwaukee, Wisconsin. Heartland Group has been registered with the Commission as an open-end, management investment company since January 1987. During the period relevant to these proceedings, Heartland Group offered seven different series of mutual funds, including three equity and four fixed-income funds.

2. **Heartland Group's Short Duration High-Yield Municipal Fund** ("Short Duration Fund") began operating on January 2, 1997. Its stated investment objective was a high level of federally tax-exempt current income with a low degree of share price fluctuation.

3. **Heartland Group's High-Yield Municipal Bond Fund** ("High Yield Fund") also began operating on January 2, 1997. Its stated investment objective was to maximize after-tax total return by investing for a high level of federally tax-exempt current income.[3]

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[3] Heartland Group's former Independent Directors previously settled a Commission administrative proceeding arising from the events relevant to this proceeding. See In the Matter of Jon D. Hammes, Albert Gary Shilling, Allan H. Stefl, and Linda F. Stephenson, Administrative Proceeding File No. 3-11351 (December 11, 2003).

C. Overview

1. This matter stems from Heartland Advisors' mispricing of certain bonds owned by the Funds and its failure to effectively communicate to the Heartland Group's Board of Directors ("Directors"), and to investors, important facts concerning Heartland Advisors' efforts to evaluate bond issuers.

2. From March 1, 2000 into October 2000, the Funds' portfolios included several municipal bonds that were valued by the Funds at prices above their fair values. As a result, on numerous days throughout that time period, the Funds' Net Asset Values ("NAVs") were incorrect, the Funds' shares were incorrectly priced, and investors purchased and redeemed Fund shares at prices that benefited redeeming investors at the expense of remaining and new investors.

3. During the relevant period, information was presented to the Directors which should have alerted the Directors, including Denison, that the bonds were becoming increasingly illiquid and may have been mispriced. As a result, the Directors, including Denison, should have known that the prices at which the Funds carried their bonds did not reflect the bonds' "fair value" as required by Heartland Group's pricing procedures.

4. Heartland Advisors was forced on October 13, 2000 to devalue the bonds, thereby resulting in approximately $60 million in monetary losses to shareholders.

D. Background

1. The Funds invested primarily in non-rated, medium and lower quality municipal bonds. The majority of the municipal bonds owned by the Funds were below investment grade and illiquid. Market quotations were not readily available for most of the bonds owned by the Funds.

2. Open-end investment companies, such as the Funds, offer their own securities to investors on a redeemable basis. (Section 5(a) of the Investment Company Act [15 U.S.C. § 80a-5(a)].) Each of the Funds was required to calculate its net asset value ("NAV") daily. (Investment Company Act Rule 22c-1(b) [17 C.F.R. § 270.22c-1(b)].) The price at which an investor can buy or redeem shares of a mutual fund is based on that fund's NAV. (Investment Company Act Rule 22c-1(a) [17 C.F.R. § 270.22c-1(a)].)

3. During 2000, persons residing throughout the United States purchased and redeemed shares of each of the Funds. During 2000, Heartland Advisors publicly disseminated the NAV of each of the Funds in interstate commerce every business day. Persons who purchased and redeemed shares of the Funds effected such transactions at prices based on the NAVs publicly disseminated by Heartland Advisors.

4. A mutual fund generally must value any security for which market quotations are not readily available at "fair value as determined in good faith by the board of directors[.]" (Investment Company Act, Section 2(a)(41)(b) [15 U.S.C. § 80a-2(a)(41)]; Investment Company Act Rule 22c-1(a) [17 C.F.R. § 270.22c-1(a)].) The fair value of a portfolio security generally is the price that a fund might reasonably expect to receive for the security upon its current sale.

(Accounting Series Release No. 118, December 23, 1970 ("ASR 118").) The Directors considered fair value as the price that could be obtained from an arm's length buyer in a current sale.

5. The Directors delegated the day-to-day responsibility for operating the Funds to Heartland Advisors. Heartland Advisors made many decisions affecting the Funds' conduct through three committees, including the Pricing Committee.

6. Heartland Advisors' Pricing Committee was charged with the responsibility for the day-to-day valuation of the Funds' portfolio securities pursuant to Heartland Group's procedures for valuing those securities, and the implementation and administration of the Directors' procedures for valuing such securities.

7. The pricing procedures established by the Directors directed the Pricing Committee to use valuations provided by FT Interactive Data Corporation, f/k/a Interactive Data Corporation and Muller Data Corporation ("FT"), a pricing service, to fair value such securities in order to determine the Funds' daily NAVs. Heartland Group's pricing procedures required the Pricing Committee to review the evaluations provided by FT to ensure that those evaluations were "sufficiently timely and accurate."[4]

8. During 2000, Heartland Advisors created and preserved accounting records reflecting its calculations of the daily NAVs of the Funds.

9. During late 1999 and early 2000, the Funds' portfolio managers learned that projects underlying several bonds held by the Funds had gone into default and other projects were failing. FT did not reduce its valuations of the affected bonds based upon that information, while Heartland Advisors did not consider fully the implications of these events for the valuations of the affected bonds, but continued to use the FT valuations.

10. Between March 2000 and May 2000, FT gradually lowered the valuations of certain bonds held by the Funds. For example, between March 7, 2000 and May 8, 2000, the valuations of certain bonds owned by the Funds uniformly decreased on a daily basis. The valuations of these bonds in March ranged from approximately 87 percent of par value to 98 percent of par value. From March into May, the valuations of those bonds were reduced daily in increments of 0.5 percentage points until the valuations reached 80 percent of par value. These incremental price reductions were not based on any contemporaneous market or credit-related events, or other external factors affecting the individual securities. Between March 2000 and May 2000 Heartland Advisors continued to use FT's valuations.

11. The effect of these incremental price reductions was to spread out and thereby minimize the impact of the total valuation declines on the Funds' NAVs and on the performance reported by the Funds.

[4] FT previously settled a Commission administrative proceeding arising from the events relevant to this proceeding. See In the Matter of FT Interactive Data, Administrative Proceeding File No. 3-11352 (December 11, 2003).

12. The Funds' May 1, 2000, Statement of Additional Information ("SAI"), which was incorporated by reference in the Funds' May 1, 2000 prospectus, as supplemented as of June 9, 2000, represented that both Heartland Advisors and the Directors would, among other things, monitor the issuers of the high yield bonds held in the Funds' portfolios to assess and determine whether the issuers had sufficient cash flow to meet required principal and interest payments and to assure the continued liquidity of such bonds. Heartland Advisors and the Directors did not, however, adequately monitor the financial status of the bonds' issuers or the bonds' liquidity. Heartland Advisors publicly disseminated the May 1, 2000, SAI, the May 1, 2000, prospectus, and the June 9, 2000, supplement to that prospectus. The June 30, 2000, NAVs of the Funds were publicly disseminated by means of a semi-annual report dated July 1, 2000.

13. The Fund's June 9, 2000, prospectus represented that Heartland Advisors managed the risks associated with the Funds through "intensive credit research," pursuant to Heartland Advisors' proprietary method. In fact, by the late summer 2000, Heartland Advisors' Fixed Income Department was understaffed and performing what a senior manager described as "catch up research" on the Funds' portfolios.

14. Beginning in the Spring of 2000, the Funds were experiencing net redemptions, and the Funds had not been able to purchase any new bonds during the prior six months due to a lack of cash. Respondents failed to sell sufficient bonds held by the Funds to meet redemption requests in part because the Funds' portfolio managers made the determination not to sell bonds at prices below the Funds' valuations. As a result, the Funds borrowed heavily against a line of credit and used the borrowed money to meet redemption requests.

15. By the Spring of 2000, the Funds were also experiencing liquidity problems. For example, on April 27, 2000, almost 18% of the bonds held by the High Yield Fund were illiquid, and 6% of the bonds in the Short Duration Fund were illiquid. The fact that so many bonds held by the Funds were individually illiquid had the compounding effect of causing the portfolios of the Funds to be collectively illiquid, potentially exacerbating the Funds' liquidity problems.

16. At an August 10, 2000, meeting of the Directors, Conlin, one of the Funds' co-portfolio managers, stated that if forced to sell bonds owned by the Funds that day, a discount from current valuation would be required but that Heartland Advisors should be able to sell the bonds owned by the Funds in one week in the ordinary course. The Directors directed Heartland Advisors to sell bonds owned by the Funds to reduce the Funds' borrowings. Heartland Advisors failed to do so.

17. Shortly after the August 10, 2000, Directors meeting, Conlin tendered his resignation.

18. The Funds' liquidity problems continued into September 2000. Through September, Heartland Advisors experienced difficulty in selling bonds at or near the Funds' valuations. During September, several of the Respondents contacted potential purchasers, discussed the Funds' holdings and received expressions of interest at prices significantly below the prices at which the Funds were valuing the bonds. Heartland Advisors believed these potential purchasers were "vulture funds" and other investors who were attempting to purchase the Funds' holdings at prices that Heartland Advisors believed to be unreasonably low.

Although these expressions of interest did not establish valuation, Heartland Advisors should have given greater weight to such expressions in deciding whether to continue to utilize FT's valuations.

19. In late September 2000, Heartland Advisors sold some of the Funds' most illiquid bonds to the State of Wisconsin Investment Board ("SWIB"). The transaction was only completed because Nasgovitz and a company he controlled agreed to guaranty to SWIB that it would recover its investment plus a 20% return. While Heartland Advisors disclosed the details of the SWIB transaction to the Directors, no public disclosure was made.

20. On September 28, 2000, Heartland Advisors reduced the NAV of the High-Yield Fund by 8.2% and the NAV of the Short Duration Fund by 2.1%. As a result, the NAVs of the High Yield Fund and the Short Duration Fund dropped from $8.75 to $8.03 and $9.10 to $8.91, respectively, in one day.

21. Heartland Advisors issued a press release on September 28, 2000, announcing that two individuals would join Winston as co-portfolio managers of the Funds. The press release also announced Conlin's resignation. The press release said nothing regarding the reduced valuations of the Funds or the liquidity problems of the Funds.

22. On the evening of September 28, 2000, Winston decided to redeem some of his shares in the Funds. He then made a phone call to relatives. On September 29, 2000, Winston and his relatives redeemed a total of 9,530.75 shares of the Funds.

23. On October 10, Della called in a trade to redeem 147.62 shares in the Short Duration Fund and 194.37 shares in the High Yield Fund. Della also called in a trade for an account over which he had discretionary authority and redeemed 1,946.71 shares in another Heartland Group Fund which also owned several of the bonds owned by the Funds.

24. On October 12, the Chairperson of the Pricing Committee directed Heartland Advisors' Fixed Income Department to determine fair value prices of bonds held in the Funds' portfolios. The Fixed Income Department provided alternative valuations, but the Pricing Committee determined that it did not have any basis for concluding that these valuations were more reliable than FT's valuations. Thus the Pricing Committee continued to use FT's evaluations to value the Funds' bonds that day.

25. Later on October 12, one of the Funds' new co-portfolio managers sent an email to the Chairperson of the Pricing Committee stating his belief that the prices used to value the Funds that day did not reflect the value of the bonds held in the Funds.

26. On October 13, 2000, the Pricing Committee proceeded to assign new values to the bonds held by the Funds. Before doing so, the Pricing Committee asked the Fixed Income Department to provide fair values for the portfolio securities and were told that the Fixed Income Department could not provide such valuations. The Fixed Income Department provided alternative valuations which the Pricing Committee chose not to accept. Instead, the Pricing Committee further reduced the individual portfolio security evaluations recommended by the

Fixed Income Department by an additional 33% for the Short Duration Fund and 50% for the High Yield Fund.

27. As a result, on October 13, 2000, the NAV of the High Yield Fund decreased by 69.4%, from $8.01 to $2.45, and the NAV of the Short Duration Fund decreased by 44.0%, from $8.70 to $4.87 from the previous day.

28. The Directors' review, including Denison's, of Heartland Advisors' devaluation of the Funds' bonds on October 13, 2000 was inadequate because they failed to identify the deficiencies in Heartland Advisors' pricing of the bonds on that day.

29. As a result of the negligent conduct described above, Heartland Advisors did not properly fair value the bonds held by the Funds.

30. As a result of the negligent conduct described above, the NAV of each of the Funds was materially overstated from March 1, 2000 to October 13, 2000. Heartland Advisors publicly disseminated the Funds' materially misstated NAVs.

31. As a result of the negligent conduct described above, Heartland Advisors, the Funds' principal underwriter, effected purchases and redemptions of shares of the Funds at materially incorrect prices.

E. **<u>Findings</u>**.

1. As a result of the negligent conduct described above, the Commission finds that Respondents (other than Denison) willfully[5] violated the federal securities laws, as follows:

a. Heartland Advisors, Nasgovitz, Beste, Conlin, Winston, Clark and Della violated Sections 17(a)(2) and 17(a)(3) of the Securities Act;

b. Heartland Advisors, Nasgovitz, Beste, Conlin, Winston and Clark violated Section 34(b) of the Investment Company Act;

c. Heartland Advisors violated Rule 22c-1(a), promulgated pursuant to Section 22(c) of the Investment Company Act; and

[5] A willful violation of the securities laws means merely "'that the person charged with the violation knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

d. Heartland Advisors violated Section 206(2) of the Advisers Act, and Nasgovitz, Beste, Conlin, Winston, Clark and Della were a cause of Heartland Advisors' violation of Section 206(2) of the Advisers Act.[6]

2. As a result of the negligent conduct described above, the Commission finds that Denison violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and was a cause of Heartland Advisors' violation of Rule 22c-1(a), promulgated pursuant to Section 22(c) of the Investment Company Act.

IV.

In view of the foregoing, the Commission deems it appropriate to accept the Offers submitted by the Respondents and impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b)(4), 15(b)(6) and 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

1. Respondents cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and 17(a)(3) of the Securities Act.

2. Heartland Advisors, Nasgovitz, Beste, Conlin, Winston, and Clark cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act.

3. Heartland Advisors cease and desist from committing or causing any violations and any future violations of Rule 22(c)-1(a) promulgated under the Investment Company Act.

4. Heartland Advisors cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

5. Nasgovitz, Beste, Conlin, Winston, Clark and Della cease and desist from causing any violations and any future violations of Section 206(2) of the Advisers Act.

6. Denison cease and desist from causing any violations and any future violations of Rule 22c-1(a) promulgated pursuant to Section 22(c) of the Investment Company Act.

7. Heartland Advisors, Nasgovitz, Beste, Conlin, Winston, Clark, and Della are censured.

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[6] A violation of Section 206(2) may be established by a showing of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992). Moreover, "cause," as used herein, is based upon negligence, which is "sufficient to establish liability for causing a primary violation that does not require scienter." *Matter of Warwick Cap. Mgmt., Inc., et al.*, Admin. Proc. File No. 3-12357, 2007 WL 505772, at *10 (Feb. 15, 2007) (quoting *KPMG Marwick LLP*, 54 S.E.C. 1135, 1175 (2001), recon. denied, 55 S.E.C. 1 (2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002)).

8. Winston and Della are suspended from association with any broker, dealer, or investment adviser for a period of 12 months, effective on the second Monday following the entry of this Order.

9. Winston and Della are prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of 12 months, effective on the second Monday following the entry of this Order.

IT IS FURTHER ORDERED that:

A. Heartland Advisors shall, within 30 days of the entry of this Order, and jointly and severally with Nasgovitz, pay disgorgement of $1 and a civil money penalty in the amount of $3.5 million;

B. Beste shall, within 30 days of the entry of this Order, pay disgorgement of $1 and a civil money penalty in the amount of $95,000;

C. Conlin shall, within 30 days of the entry of this Order, pay disgorgement of $1 and a civil money penalty in the amount of $95,000;

D. Winston shall, within 30 days of the entry of this Order, pay disgorgement of $46,274, prejudgment interest of $21,687, and a civil money penalty in the amount of $95,000;

E. Clark shall, within 30 days of the entry of this Order, pay disgorgement of $1 and a civil money penalty in the amount of $25,000; and

F. Della shall, within 30 days of the entry of this Order, pay disgorgement of $2,833, prejudgment interest of $1,297, and a civil money penalty in the amount of $25,000.

G. Such payments of disgorgement, interest and penalties referenced in paragraphs A through F above shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the payor as a Respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John E. Birkenheier, Supervisory Trial Counsel, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

H. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraphs A through G above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that Respondents shall not, after offset or reduction in any Related Investor

Action based on Respondents' payment of disgorgement in this action, argue that Respondents are entitled to, nor shall Respondents further benefit by offset or reduction of any part of Respondents' payments of civil penalties in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that Respondents shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57209 / January 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2774 / January 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12937

In the Matter of

MICHAEL ODOM, CPA,

Respondent.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Michael Odom, CPA ("Odom" or "Respondent"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Odom has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Odom consents to the entry of this Order Instituting Public Administrative Proceedings

[1] Rule 102(e)(1)(ii) provides that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

Document 28 of 38

Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

Enron Corp.'s ("Enron") senior executives engaged a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission.[3] The fraudulent scheme was carried out through a variety of complex structured transactions, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles ("GAAP").

Arthur Andersen LLP ("Andersen") served as Enron's auditor, and for each year during the relevant time period, issued an auditor's report falsely stating that Enron's financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards ("GAAS"). Odom served as Practice Director in connection with the Enron engagement. As specified in this Order, Odom engaged in improper professional conduct by concurring with the audit engagement team's faulty conclusions regarding Enron's accounting for certain transactions and authorizing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

B. RESPONDENT

Michael C. Odom, 65, served as Practice Director at Andersen for the Gulf Coast Region during the relevant time period. According to Andersen's Audit Objectives and Procedures Manual, Practice Directors had authority to oversee the resolution of client issues and the extent of their involvement was driven by the engagement team's risk assessments. Consultation was normally required whenever significant, unusual, or judgment issues were encountered during any audit. Odom is currently and was a CPA licensed in the state of Louisiana at all relevant times.

C. OTHER PARTIES

Enron Corp. was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the

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2 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

3 In connection with this fraudulent scheme, several former Enron executives either pleaded guilty or were convicted of felonies, including Enron's former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than $100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than $80 per share to less than $1.

Arthur Andersen LLP once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.[4]

D. FACTS

1. Andersen Identified Enron as a Maximum Risk Client

Odom was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit*), and Odom should have known that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the audit engagement team documented that Enron placed an "undue emphasis on meeting earnings targets;" used "highly aggressive accounting;" utilized "unusual" year-end transactions that posed difficult "substance over form" questions; possessed a "philosophy of significantly managing (maximizing or minimizing) earnings;" and had a "high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes." In addition, an internal Andersen document prepared each year by the engagement team consistently classified the Enron engagement as involving "maximum risk" and noted that Enron's use of complex "form over substance" and "related party" transactions created an "extreme" or "very significant" financial reporting risk. This document, called a "SMART," was prepared each year to assist with the annual decision whether to retain Enron as an audit client. Odom reviewed the SMART documents and also attended an annual client retention meeting for the 2000 audit during which the risks identified above were discussed.

2. Enron's Prepay Transactions

Enron improperly reported structured financing proceeds as operating cash flows by means of "prepay" transactions with various financial institutions. Enron used prepay transactions to improperly report the cash it received from prepay transactions as cash flow from operating activities, rather than cash flow from financing activities. This allowed Enron to hide the true

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4 David B. Duncan served as the global engagement partner for Andersen's audits of Enron from 1997 until December 2001. Contemporaneously with the filing of this Order, the Commission filed a settled civil injunctive action in the U.S. District Court for the Southern District of Texas, Houston Division, against Duncan, in which Duncan consented to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon entry of the injunction by the Court, Duncan has also offered to settle an administrative proceeding by the Commission in which he agrees to be permanently barred from appearing or practicing before the Commission as an accountant.

extent of its borrowing from investors and the national credit rating agencies because sums borrowed in prepay transactions appeared as "price risk management liabilities" rather than additional debt on Enron's balance sheet.

Enron's prepay transactions were in substance financings because Enron used a three party structure involving a bank and a bank sponsored SPE that were not independent of each other to remove all commodity price risk from the transaction. The circular nature of delivery and payments with respect to the commodities and the lack of independence between the bank counterparties had the effect of eliminating any material risk or any potential gain with respect to changes in the price of the underlying commodity. In effect, Enron's prepay transactions involved an investment bank making a large payment to Enron in exchange for Enron's promise to pay the bank sponsored entity an amount in excess of what Enron received in the initial prepayment.

Amounts borrowed by Enron using the prepay structure were finely tuned each quarter for maximum reporting benefit. Enron simply determined the amount of operating cash flows it wanted to report, projected any "shortfall" as the end of a reporting period approached, and then used prepay transactions to fill the gap. From 1997 through September 30, 2001, Enron, using prepay transactions, received over $5 billion in funds in this manner.

Enron never separately disclosed in its public filings that it was entering into prepay transactions. Such disclosure was necessary because of the large dollar amounts and volume of prepay transactions entered into by Enron and the significant future obligated cash commitments associated with the transactions. Rather, the prepay transactions were aggregated into Enron's "price risk management liabilities." Enron provided a generic and inadequate description of its price risk management activities in the notes to the financial statements and in the management's discussion and analysis section of its annual reports on Form 10-K and its quarterly reports on Form 10-Q.

GAAS provides that "the presentation of financial statements in conformity with [GAAP] includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes . . ." (AU §431, *Adequacy of Disclosure in Financial Statements*). GAAS also states that "[GAAP] recognize[s] the importance of reporting transactions and events in accordance with their substance" and that the "auditor should consider whether the substance of the transactions or events differs materially from their form." (AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*). Enron's financial statement presentation and disclosure of the prepay transactions was not in conformity with GAAP because it mischaracterized the nature of the cash flows associated with the transactions, obscured the true economic substance of these financing transactions, and did not address the material impact they had on Enron's financial statements.

Enron's disclosures regarding prepay transactions were materially inadequate. In conjunction with both the 1999 and 2000 audits, the engagement team had advised Enron of the need for more robust disclosure of the prepay transactions. David Duncan, the engagement partner for the audits, even proposed to Enron's senior management specific language used by another

Andersen audit client that would have disclosed the fact that Enron used "prepaid commodity contracts" and also the dollar amount of liabilities associated with the prepay transactions. Andersen's recommendations to enhance the disclosure for prepay transactions were rejected by Enron's management. Odom consulted with Duncan and others regarding Enron's prepay transaction disclosures and they determined, improperly, that Enron's disclosures complied with GAAP without the proposed enhancements.

3. Enron's Raptor Transactions

Beginning in the spring of 2000, Enron and LJM2, a partnership formed and managed by Enron's then-Chief Financial Officer Andrew Fastow, engaged in a series of complex financial transactions with four SPE structures called Raptor I, Raptor II, Raptor III and Raptor IV (collectively "Raptors"). Enron's senior management used the Raptors, in part, to manipulate Enron's financial statements.

By 1999, a large percentage of Enron's quarterly earnings were attributed to unrealized gains in its merchant energy portfolio and in various technology investments. Many of these assets were extremely volatile. The Raptors were used by Enron to "hedge" the value of those investments with a purported independent third party SPE, so that Enron could offset declines in the value of these assets with the Raptor hedges. Enron capitalized Raptors I, II and IV with Enron stock. Raptor III was capitalized with warrants of an Enron spin-off company. Enron received an economic interest in the Raptors and $1.2 billion in notes receivable from the Raptors in return for the Enron shares and warrants. Because of the related party nature and complexity of the transaction, the engagement team reviewed the features of the Raptors structures with Odom and the concurring review partner before Enron entered into the transactions and consulted with them both on various Raptors related issues throughout 2000 and 2001.

LJM2 contributed $30 million of equity to each Raptor. However, through undisclosed side agreements between Fastow and others, the structures were designed so that amounts equal to LJM2's equity was returned to LJM2 for each Raptor prior to any hedges being put in place. As a result of the side agreements and related effective return of capital, LJM2 had no equity at risk and Enron should have consolidated the Raptors into its financial statements. LJM2's equity was effectively returned to it through three separate $41 million put options in Enron stock in Raptors I, II and IV, and through a distribution in Raptor III. These put options provided a return equal to LJM2's initial $30 million capital contribution in each Raptor, along with an agreed upon rate of return on such capital, before the Raptor SPEs entered into the hedging transactions. Effectively, Enron was entering into hedging contracts with entities backed solely with its own stock.

Since the Enron engagement was classified as maximum risk, and related party transactions created an "extreme" or "very significant" financial reporting risk, the existence of the put options in the Raptor structures should have triggered increased professional skepticism. The puts were priced at a premium that matched exactly LJM2's targeted return, and were included as part of aggressive and complex related party transactions that had a material effect on Enron's reported earnings. Additionally, LJM2 received its $41 million payout in each Raptor shortly after signing the contracts - resulting in a short-term return on investment in excess of 130% in each case.

Moreover, the payout occurred in each Raptor after Enron settled the put option early and before any hedges were put in place. The timing of settlement by Enron of these out-of-the-money put options should have been an additional red flag that prompted Odom and others to increase their professional skepticism and question why Enron would repeatedly make such economically irrational payments. These payments actually eliminated the supposed protection from a drop in its stock price that the company purportedly had purchased at a premium. Despite the need for greater scrutiny, Odom did not exercise due professional care or professional skepticism with regard to this aspect of the Raptor transactions (AU §230, *Due Professional Care in the Performance of Work*). In addition, Odom and members of the engagement team allowed Enron to avoid recording significant Raptor-related impairment charges at year-end 2000 and for the first quarter of 2001 by improperly allowing Enron to offset losses in Raptors I and III against the excess credit capacity in Raptors II and IV.

4. Violations

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Odom repeatedly acted unreasonably by concurring with the Enron audit engagement team's faulty conclusions regarding Enron's accounting for certain transactions and allowing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

5. Findings

Based on the foregoing, the Commission finds that Odom engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Odom is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two years from the date of this order, Odom may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The

Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57211 / January 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2776 / January 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12939

In the Matter of THOMAS H. BAUER, CPA, Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Thomas H. Bauer, CPA ("Bauer" or "Respondent"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Bauer has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Bauer consents to the entry of this Order Instituting Public Administrative Proceedings

1 Rule 102(e)(1)(ii) provides that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

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Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

Enron Corp.'s ("Enron") senior executives engaged in a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission.[3] The fraudulent scheme was carried out through a variety of complex structured transactions, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles ("GAAP").

Arthur Andersen LLP ("Andersen") served as Enron's auditor, and for each year during the relevant time period, issued an auditor's report falsely stating that Enron's financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards ("GAAS"). Bauer served as one of the partners on the Enron engagement team and was responsible for the auditing of Enron's largest division. As specified in this Order, Bauer engaged in improper professional conduct by failing to design and implement auditing procedures adequate to address the known risk of fraud inherent in the Enron engagement in violation of GAAS.

B. RESPONDENT

Thomas H. Bauer, 54, served as one of the partners on the Enron engagement and was a CPA licensed in the state of Texas at all relevant times.

C. OTHER PARTIES

Enron Corp. was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than $100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than $80 per share to less than $1.

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2 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

3 In connection with this fraudulent scheme, several former Enron executives either pleaded guilty or were convicted of felonies, including Enron's former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

Arthur Andersen LLP once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.[4]

D. FACTS

1. Andersen Identified Enron as a Maximum Risk Client

Bauer was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit*), and Bauer should have known that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the audit engagement team documented that Enron placed an "undue emphasis on meeting earnings targets;" used "highly aggressive accounting;" utilized "unusual" year-end transactions that posed difficult "substance over form" questions; possessed a "philosophy of significantly managing (maximizing or minimizing) earnings;" and had a "high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes." In addition, an internal Andersen document prepared each year by the engagement team consistently classified the Enron engagement as involving "maximum risk" and noted that Enron's use of complex "form over substance" and "related party" transactions created an "extreme" or "very significant" financial reporting risk. This document, called a "SMART," was prepared each year to assist with the annual decision whether to retain Enron as an audit client. Bauer reviewed the SMART documents and also attended annual client retention meetings during which the risks identified above were discussed.

2. JEDI/Chewco Transaction

In May 1993, Enron teamed with the California Public Employees' Retirement System ("CalPERS") to form the Joint Energy Development Investments Limited Partnership ("JEDI") to invest in natural gas assets. CalPERS contributed $250 million and Enron funded its share of the joint venture with $250 million of its own stock. Enron did not consolidate JEDI into its financial statements. Rather, it accounted for JEDI using the equity method and recorded its share of gains and losses from JEDI in its financial statements.

In 1997, Enron proposed to CalPERS that a new, larger partnership be formed – JEDI II. CalPERS representatives were hesitant to enter into JEDI II because they felt that CalPERS' board of directors would not approve the increased exposure to Enron. Thus, Enron offered to buy out

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4 David B. Duncan served as the global engagement partner for Andersen's audits of Enron from 1997 until December 2001. Contemporaneously with the filing of this Order, the Commission filed a settled civil injunctive action in the U.S. District Court for the Southern District of Texas, Houston Division, against Duncan, in which Duncan consented to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon entry of the injunction by the Court, Duncan has also offered to settle an administrative proceeding by the Commission in which he agrees to be permanently barred from appearing or practicing before the Commission as an accountant.

CalPERS' interest in JEDI. CalPERS agreed and a $383 million purchase price was negotiated. Because Enron did not want to bring JEDI's debt onto its balance sheet, Enron formed a special purpose entity ("SPE") named Chewco Investments L.P. ("Chewco") to step into the shoes of CalPERS. An Enron employee, Michael Kopper ("Kopper"), managed Chewco's business affairs and also invested personally in Chewco.

To properly treat Chewco as an off-balance sheet SPE, GAAP required the partnership to have independent outside investors who had at least a three percent equity investment in Chewco. These investors also needed to control the SPE and have the substantive risks and rewards of ownership associated with the SPE. The transaction, however, did not satisfy these requirements. Because Barclays Bank ("Barclays"), which contributed $11.4 million of purported equity, was not comfortable providing the funds backed solely by the assets held by JEDI, it wanted additional credit support. To satisfy Barclays, reserve accounts controlled by Barclays were set up and funded in the amount of $6.5 million upon the closing of the transaction. The funding of the reserve accounts was accomplished by a special distribution from JEDI to Chewco that was agreed to in an undisclosed side letter signed by Kopper on behalf of Chewco, and an Enron employee on behalf of JEDI. The funding of the reserve accounts meant that the requisite three percent equity was not actually at risk. Thus, the structure did not comply with applicable accounting rules.

Andersen spent considerable time working with Enron on the Chewco transaction. Bauer advised Enron about the three percent equity capital requirement and also on governance issues. Bauer also performed audit procedures to determine whether Chewco and JEDI were required to be consolidated into Enron's financial statements.

However, despite numerous red flags associated with this transaction, Bauer failed to exercise due professional care, did not exhibit professional skepticism, and failed to obtain sufficient competent evidential matter to support his analysis of either the control issue or the three percent independent equity requirement (AU §230, *Due Professional Care in the Performance of Work* and AU §326, *Evidential Matter*). Instead, Bauer placed an undue reliance on oral representations from Enron's management (AU §333, *Management Representations*). Bauer asked for, but was denied access to, documents related to the funding of Chewco. Bauer should have insisted on seeing the relevant documents rather than relying solely on management representations. Bauer also violated professional standards by failing to sufficiently document in the audit workpapers his planning and supervision of audit procedures and the nature and extent of the audit evidence obtained in reaching his conclusions (AU §339, *Working Papers*).

3. Violations

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Bauer repeatedly acted unreasonably in failing to conduct or supervise the audit of Enron's JEDI/Chewco transaction in accordance with GAAS.

4. Findings

Based on the foregoing, the Commission finds that Bauer engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.[5]

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Bauer is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After three years from the date of this order, Bauer may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms

[5] In determining to accept Bauer's Offer, the Commission considered Bauer's cooperation with the Department of Justice and his testimony at the criminal trial of Enron's former top two executives.

of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Nancy M. Morris
Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57210 / January 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2775 / January 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12938

In the Matter of **MICHAEL LOWTHER, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Michael Lowther, CPA ("Lowther" or "Respondent"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Lowther has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are

[1] Rule 102(e)(1)(ii) provides that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

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admitted, Lowther consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

Enron Corp.'s ("Enron") senior executives engaged a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission.[3] The fraudulent scheme was carried out through a variety of complex structured transactions, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles ("GAAP").

Arthur Andersen LLP ("Andersen") served as Enron's auditor, and for each year during the relevant time period, issued an auditor's report falsely stating that Enron's financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards ("GAAS"). Lowther served as the concurring review partner for the Enron audits. As specified in this Order, Lowther engaged in improper professional conduct by concurring with the audit engagement team's faulty conclusions regarding Enron's accounting for certain transactions and authorizing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

B. RESPONDENT

Michael Lowther, 51, served as the partner in charge of Andersen's energy audit division in Houston, Texas, and also served as the concurring review partner for the Enron audits during the relevant time period. As a concurring review partner, Lowther was required to provide additional assurance that Enron's financial statements were in conformity with GAAP and that Andersen's report thereon was in accordance with GAAS. Lowther is currently and was a CPA licensed in the state of Texas at all relevant times.

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2 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

3 In connection with this fraudulent scheme, several former Enron executives either pleaded guilty or were convicted of felonies, including Enron's former Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

C. OTHER PARTIES

Enron Corp. was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than $100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than $80 per share to less than $1.

Arthur Andersen LLP once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.[4]

D. FACTS

1. Andersen Identified Enron as a Maximum Risk Client

Lowther was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit*), and Lowther should have known that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the audit engagement team documented that Enron placed an "undue emphasis on meeting earnings targets;" used "highly aggressive accounting;" utilized "unusual" year-end transactions that posed difficult "substance over form" questions; possessed a "philosophy of significantly managing (maximizing or minimizing) earnings;" and had a "high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes." In addition, an internal Andersen document prepared each year by the engagement team consistently classified the Enron engagement as involving "maximum risk" and noted that Enron's use of complex "form over substance" and "related party" transactions created an "extreme" or "very significant" financial reporting risk. This document, called a "SMART," was prepared each year to assist with the annual decision whether to retain Enron as an audit client. Lowther reviewed the SMART documents and also attended annual client retention meetings during which the risks identified above were discussed.

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[4] David B. Duncan served as the global engagement partner for Andersen's audits of Enron from 1997 until December 2001. Contemporaneously with the filing of this Order, the Commission filed a settled civil injunctive action in the U.S. District Court for the Southern District of Texas, Houston Division, against Duncan, in which Duncan consented to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon entry of the injunction by the Court, Duncan has also offered to settle an administrative proceeding by the Commission in which he agrees to be permanently barred from appearing or practicing before the Commission as an accountant.

2. Enron's Prepay Transactions

Enron improperly reported structured financing proceeds as operating cash flows by means of "prepay" transactions with various financial institutions. Enron used prepay transactions to improperly report the cash it received from prepay transactions as cash flow from operating activities, rather than cash flow from financing activities. This allowed Enron to hide the true extent of its borrowing from investors and the national credit rating agencies because sums borrowed in prepay transactions appeared as "price risk management liabilities" rather than additional debt on Enron's balance sheet.

Enron's prepay transactions were in substance financings because Enron used a three party structure involving a bank and a bank sponsored SPE that were not independent of each other to remove all commodity price risk from the transaction. The circular nature of delivery and payments with respect to the commodities and the lack of independence between the bank counterparties had the effect of eliminating any material risk or any potential gain with respect to changes in the price of the underlying commodity. In effect, Enron's prepay transactions involved an investment bank making a large payment to Enron in exchange for Enron's promise to pay the bank sponsored entity an amount in excess of what Enron received in the initial prepayment.

Amounts borrowed by Enron using the prepay structure were finely tuned each quarter for maximum reporting benefit. Enron simply determined the amount of operating cash flows it wanted to report, projected any "shortfall" as the end of a reporting period approached, and then used prepay transactions to fill the gap. From 1997 through September 30, 2001, Enron, using prepay transactions, received over $5 billion in funds in this manner.

Enron never separately disclosed in its public filings that it was entering into prepay transactions. Such disclosure was necessary because of the large dollar amounts and volume of prepay transactions entered into by Enron and the significant future obligated cash commitments associated with the transactions. Rather, the prepay transactions were aggregated into Enron's "price risk management liabilities." Enron provided a generic and inadequate description of its price risk management activities in the notes to the financial statements and in the management's discussion and analysis section of its annual reports on Form 10-K and its quarterly reports on Form 10-Q.

GAAS provides that "the presentation of financial statements in conformity with [GAAP] includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes . . ." (AU §431, *Adequacy of Disclosure in Financial Statements*). GAAS also states that "[GAAP] recognize[s] the importance of reporting transactions and events in accordance with their substance" and that the "auditor should consider whether the substance of the transactions or events differs materially from their form." (AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*). Enron's financial statement presentation and disclosure of the prepay transactions was not in conformity with GAAP because it mischaracterized the nature of the cash flows associated with the transactions, obscured the true economic substance of these financing transactions, and did not address the material impact they had on Enron's financial statements.

Enron's disclosures regarding prepay transactions were materially inadequate. In conjunction with both the 1999 and 2000 audits, the engagement team advised Enron of the need for more robust disclosure of the prepay transactions. David Duncan, the engagement partner for the audits, even proposed to Enron's senior management specific language used by another Andersen audit client that would have disclosed the fact that Enron used "prepaid commodity contracts" and also the dollar amount of liabilities associated with the prepay transactions. Andersen's recommendations to enhance the disclosure for prepay transactions were rejected by Enron's management. Lowther consulted with Duncan and others regarding Enron's prepay transaction disclosures and they determined, improperly, that Enron's disclosures complied with GAAP without the proposed enhancements.

3. Enron's Project Nahanni

After completing an $800 million prepay transaction in November 1999, Enron still was approximately $500 million short of the funds flow target Enron had told the credit rating agencies it intended to achieve for the year. To make up for this shortfall, Enron entered into a transaction code-named Project Nahanni that, in its entirety, had no material economic benefit to Enron. This transaction was in substance a year-end, one month, $500 million financing that Enron used to manipulate its financial statements by: (i) inflating reported cash flow from operating activities; (ii) under-reporting cash flow from financing activities; and (iii) under-reporting debt -- in each instance by $500 million.

Project Nahanni was structured as a minority interest transaction in which Citigroup, through an SPE called Nahanni, provided capital in return for a minority interest in a consolidated subsidiary of Enron called Marengo. Marengo was a partnership between Enron and Nahanni created specifically to effectuate the subject transaction. As a result, cash flow associated with the activities of Marengo appeared as cash flow from operating activities on Enron's financial statements, and Nahanni's financial contribution to Marengo appeared as a minority interest on Enron's balance sheet, rather than debt.

On or about December 17, 1999, Citigroup funded Nahanni with $485 million in debt and $15 million in outside equity. Nahanni immediately purchased $500 million of short-term U.S. Treasury bills ("T-bills") and then contributed the T-bills to acquire a minority interest in Marengo. On or about December 29, 1999, two days before Enron's annual reporting period ended, Enron directed Marengo to sell the $500 million in T-bills. The sale of the T-bills appeared as cash flow from operating activities on Enron's consolidated statement of cash flow. Enron then borrowed from Marengo the cash proceeds from the sale of the T-bills to pay down its reported debt by $500 million just before year-end 1999. Since Enron treated the transaction with Marengo as an inter-company loan, it did not increase Enron's reported debt. By replacing $500 million of debt with a minority interest in a consolidated subsidiary, Enron improved its reported debt-to-equity ratio by 16 percent at year-end, December 31, 1999. In addition, the $500 million in operating cash flow from Project Nahanni accounted for 41 percent of Enron's total cash flow reported for the year.

On or about January 14, 2000, Enron repaid the $500 million loan from Marengo with interest. Marengo then paid Nahanni approximately $487.1 million, representing $485 million in principal, plus $2.1 million in interest. While the initiation of the transaction was reported as an increase in cash flow from operating activities, its wind-down just weeks later was reported differently by Enron, as a reduction in cash flow from investing activities.

In order for the Nahanni transaction to achieve Enron's goal of increasing its cash flow from operating activities, it was necessary for Enron to take the position that holding Treasury securities was part of its "merchant activities," so that it could then claim that the sale of those securities generated cash flow from operating activities. Accordingly, Enron changed the merchant activities footnote in its financial statements to include government securities in the definition of merchant investments. Such a change was materially misleading because T-bill investing was not a part of Enron's merchant business, and because, contrary to the definition of merchant investment, Enron never had any intent to hold the securities for the purpose of making a profit.

Enron's overall disclosure of the Nahanni transaction in its Form 10-K for year 2000 was materially misleading because Enron did not disclose: (i) that the partnership was created in December to fund a transaction that lasted just long enough to achieve a year-end financial reporting objective; and (ii) that the Nahanni transaction was a one-time boost to cash flow, not a continuous, sustainable cash flow from operations. Thus, Enron's disclosure created the false impression that the transaction related to Enron's regular-course-of-business investments in energy and technology companies.

Lowther, in his concurring partner role, reviewed documentation for the Nahanni transaction and missed various red flags indicating that Project Nahanni was purely a "window dressing" transaction that had no material economic benefit to Enron. Consequently, in his review of the Nahanni transaction, Lowther failed to exercise due professional care and skepticism (AU §230, *Due Professional Care in the Performance of Work*) and failed to ensure Enron's balance sheet and cash flow presentation were not materially misleading (AU §431, *Adequacy of Disclosure in Financial Statements* and AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*).

4. Enron's Raptor Transactions

Beginning in the spring of 2000, Enron and LJM2, a partnership formed and managed by Enron's then-Chief Financial Officer Andrew Fastow, engaged in a series of complex financial transactions with four SPE structures called Raptor I, Raptor II, Raptor III and Raptor IV (collectively "Raptors"). Enron's senior management used the Raptors, in part, to manipulate Enron's financial statements.

By 1999, a large percentage of Enron's quarterly earnings were attributed to unrealized gains in its merchant energy portfolio and in various technology investments. Many of these assets were extremely volatile. The Raptors were used by Enron to "hedge" the value of those investments with a purported independent third party SPE, so that Enron could offset declines in the value of these assets with the Raptor hedges. Enron capitalized Raptors I, II and IV with Enron stock. Raptor III was capitalized with warrants of an Enron spin-off company. Enron received an economic interest in the Raptors and $1.2 billion in notes receivable from the Raptors in return for the Enron shares and warrants. Because of the related party nature and complexity of the transaction, the engagement team reviewed the features of the Raptors structures with Lowther and Andersen's regional practice director before Enron entered into the transactions and consulted with them both on various Raptors related issues throughout 2000 and 2001.

LJM2 contributed $30 million of equity to each Raptor. However, through undisclosed side agreements between Fastow and others, the structures were designed so that amounts equal to LJM2's equity was returned to LJM2 for each Raptor prior to any hedges being put in place. As a result of the side agreements and related effective return of capital, LJM2 had no equity at risk and Enron should have consolidated the Raptors into its financial statements. LJM2's equity was effectively returned to it through three separate $41 million put options in Enron stock in Raptors I, II and IV, and through a distribution in Raptor III. These put options provided a return equal to LJM2's initial $30 million capital contribution in each Raptor, along with an agreed upon rate of return on such capital, before the Raptor SPEs entered into the hedging transactions. Effectively, Enron was entering into hedging contracts with entities backed solely with its own stock.

Since the Enron engagement was classified as maximum risk, and related party transactions created an "extreme" or "very significant" financial reporting risk, the existence of the put options in the Raptor structures should have triggered increased professional skepticism. The puts were priced at a premium that matched exactly LJM2's targeted return, and were included as part of aggressive and complex related party transactions that had a material effect on Enron's reported earnings. Additionally, LJM2 received its $41 million payout in each Raptor shortly after signing the contracts - resulting in a short-term return on investment in excess of 130% in each case. Moreover, the payout occurred in each Raptor after Enron settled the put option early and before any hedges were put in place. The timing of settlement by Enron of these out-of-the-money put options should have been an additional red flag that prompted Lowther and others to increase their professional skepticism and question why Enron would repeatedly make such economically irrational payments. These payments actually eliminated the supposed protection from a drop in its stock price that the company purportedly had purchased at a premium. Despite the need for greater scrutiny, Lowther did not exercise due professional care or professional skepticism with regard to this aspect of the Raptor transactions (AU §230, *Due Professional Care in the Performance of Work*). In addition, Lowther and members of the engagement team allowed Enron to avoid recording significant Raptor-related impairment charges at year-end 2000 and for the first quarter of 2001 by improperly allowing Enron to offset losses in Raptors I and III against the excess credit capacity in Raptors II and IV.

Enron's footnote disclosure in its Form 10-K for year 2000 contains a paragraph describing some aspects of the Raptor transactions. However, the disclosure was not in accordance with GAAP (FAS 57, *Related Party Disclosures*) since it did not include an adequate description of the Raptor transactions and information necessary to understand the effects these transactions had on Enron's financial statements. Furthermore, in the footnote, Enron asserted, without any reasonable basis or substantiation, that "the terms of the transactions with the Related Party were reasonable compared to those which could have been negotiated with unrelated third parties." FAS 57 states that financial statement representations "shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated." Lowther reviewed Enron's related party disclosure and should have known that the disclosure did not comply with GAAP, that the terms of the Raptor transactions were not equivalent to an arm's-length transaction, and that the disclosure was materially misleading.

5. Violations

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Lowther repeatedly acted unreasonably by concurring with the Enron audit engagement team's faulty conclusions regarding Enron's accounting for certain transactions and allowing the issuance by Andersen of unqualified audit reports that were materially false and misleading.

6. Findings

Based on the foregoing, the Commission finds that Lowther engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Lowther is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two years from the date of this order, Lowther may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 202, 230, 240, 260, and 270

[Release Nos. 33-8885, 34-57218, 39-2452, IC-28137]

Amendment of Procedures for Payment of Fees

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is amending its procedures for payment of fees imposed under the federal securities laws to update the procedures and reflect the designation of U.S. Bank, N.A. ("U.S. Bank") as the Commission's U.S. Treasury Department ("Treasury") designated lockbox depository.

EFFECTIVE DATE: [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Kenneth Johnson, (202) 551-4306, Chief Management Analyst, Office of the Executive Director; Stephen Jung, (202) 551-5162, Assistant General Counsel, Office of the General Counsel; Michael Bloise, (202) 551-5116, Senior Counsel, Office of the General Counsel, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION

The Commission is amending rule 3a [17 CFR 202.3a] of its Informal and Other Procedures, rule 111 [17 CFR 230.111] under the Securities Act of 1933 ("Securities Act"),[1] rule 0-9 [17 CFR 240.0-9] under the Securities Exchange Act of 1934 ("Exchange Act"),[2] rule 7a-10 [17 CFR 260.7a-10] under the Trust Indenture Act of 1939 ("Trust

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1 15 U.S.C. 77a.

2 15 U.S.C. 78a.

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Indenture Act"),[3] and rule 0-8 [17 CFR 270.0-8] under the Investment Company Act of 1940 ("Investment Company Act").[4]

I. Discussion

The federal securities laws impose a number of fees.[5] Many of these fees currently are transmitted to a Treasury designated lockbox depository. Mellon Bank, N.A. ("Mellon") currently serves as this lockbox depository. As of February 4, 2008, the responsibility for providing lockbox depository services to Treasury will switch from Mellon to U.S. Bank. Mellon is referenced in payment instructions appearing in rule 3a [17 CFR 202.3a] of the Commission's Informal and Other Procedures and rule 111 [17 CFR 230.111] under the Securities Act. The Commission is amending these rules to reflect the change in depository institutions.

The Commission also is amending rule 111 [17 CFR 230.111] under the Securities Act, rule 0-9 [17 CFR 240.0-9] under the Exchange Act, and rule 0-8 [17 CFR 270.0-8] under the Investment Company Act to clarify that payment of fees pursuant to these rules may be made by wire transfer, as well as by certified check, bank cashiers check, United States postal money order, or bank money order, and to eliminate the option of making payment by cash or personal check.

In addition, the Commission is amending rule 3a [17 CFR 202.3a] of its Informal and Other Procedures, which governs the payment of filing fees under the Securities Act, Exchange Act, and Investment Company Act. The revised rule updates the instructions for payment of filing fees to the Treasury designated lockbox depository, as discussed

3 15 U.S.C. 77aaa.

4 15 U.S.C. 80a.

5 See ,e.g., section 6(b) of the Securities Act, sections 13(e), 14(g), and 31 of the Securities Exchange Act and section 24(f) of the Investment Company Act.

above. It also eliminates outdated procedures for the payment of filing fees, such as payment by hand delivery, payment by mail directly to the Commission's headquarters in Washington, DC, the use of Form ID to update a filer's address, and the distinction between "restricted" and "unrestricted" fees. In addition, the revised rule incorporates the special instructions for payment of filing fees for rule 462(b) and rule 110(d) filings previously included in rule 111 [17 CFR 230.111] under the Securities Act.

An explanatory note also is added to rule 3a [17 CFR 202.3a] with respect to filing fee accounts. A filing fee account is maintained for each filer who submits a filing requiring a fee on the Commission's EDGAR system or who submits funds to the Treasury designated lockbox depository in anticipation of paying a filing fee. The note explains that, under current law, the deposit of money into a filing fee account does not constitute payment of a filing fee. Payment of the filing fee occurs at the time the filing is made, commensurate with the drawing down of the balance of the filing fee account.

Finally, the Commission is removing references in its regulations to the payment of fees under the Trust Indenture Act, since fees that were imposed under that Act were repealed by the Investor and Capital Markets Fee Relief Act.[6]

II. Administrative Procedure Act and Other Administrative Laws

The Commission has determined that these amendments to its rules relate solely to the agency's organization, procedure, or practice. Therefore, the provisions of the Administrative Procedure Act ("APA") regarding notice of proposed rulemaking and opportunity for public participation are not applicable.[7] The APA also requires publication of a rule at least 30 days before its effective date unless the agency finds

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6 Pub. L. No. 107-123; 115 Stat. 2930 (2002).

7 5 U.S.C. 553(b).

otherwise for good cause.[8] Since the Commission's Treasury designated lockbox depository will change on February 4, 2008, we find that immediate effectiveness of these amendments will clarify the obligations of payors and prevent the confusion that might otherwise occur if the Commission's rules are not amended contemporaneously. Consequently, we find there is good cause for the amendments to take effect immediately upon publication in the Federal Register. For the same reasons, and because these amendments do not substantially affect the rights or obligations of non-agency parties, the provisions of the Small Business Regulatory Enforcement Fairness Act are not applicable.[9] In addition, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or other law, are not applicable.[10] Finally, these amendments do not contain any collection of information requirements as defined by the Paperwork Reduction Act of 1995, as amended.[11]

III. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The rule amendments the Commission is adopting today amend the Commission's rules to reflect a change of the Commission's Treasury designated lockbox depository and to update the procedures for payment of fees required under the securities laws. The Commission does not believe that the rule amendments will impose any costs on non-agency parties, or that if there are any such costs, they are negligible.

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[8] 5 U.S.C. 553(d)(3).

[9] 5 U.S.C. 804.

[10] 5 U.S.C. 601-12.

[11] 44 U.S.C. 3501-20.

IV. Consideration of Burden on Competition

Section 23(a)(2) of the Exchange Act requires the Commission, in making rules pursuant to any provision of the Exchange Act, to consider among other matters the impact any such rule would have on competition. Section 2(c) of the Investment Company Act requires the Commission to give the same consideration in making rules under the Investment Company Act. The Commission does not believe that the amendments that the Commission is adopting today will have any impact on competition.

V. Statutory Basis

The Commission is adopting amendments pursuant to sections 6(b) and 19 of the Securities Act, sections 13(e), 14(g), 23, and 31 of the Exchange Act, section 319 of the Trust Indenture Act, and sections 24(f) and 38 of the Investment Company Act.

VI. Text of Final Amendments

List of Subjects

17 CFR Part 202

Administrative practice and procedure, Securities.

17 CFR Part 230

Reporting and recordkeeping requirements, Securities.

17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

17 CFR Part 260

Reporting and recordkeeping requirements, Securities, Trusts and Trustees.

17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, 17 CFR, Chapter II of the Code of Federal Regulations is amended as follows:

PART 202- INFORMAL AND OTHER PROCEDURES

1. The authority citation for Part 202 continues to read in part as follows:

Authority: 15 U.S.C. 77s, 77t, 78d–1, 78u, 78w, 78ll(d), 79r, 79t, 77sss, 77uuu, 80a–37, 80a–41, 80b–9, 80b–11, 7202 and 7211 et seq., unless otherwise noted.

* * * * *

2. Section 202.3a is revised to read as follows:

§ 202.3a Instructions for filing fees.

(a) General instructions for remittance of filing fees. Payment of filing fees specified by the following sections shall be made according to the directions listed in this section: § 230.111 of this chapter, § 240.0-9 of this chapter, and § 270.0-8 of this chapter. All such fees are to be paid through the U.S. Treasury designated lockbox depository and may be paid by wire transfer, certified check, bank cashier's check, United States postal money order, or bank money order pursuant to the specific instructions set forth in paragraph (b) of this section. Personal checks will not be accepted for payment of fees. To ensure proper posting, all filers must include their Commission-assigned Central Index Key (CIK) number (also known as the Commission-assigned registrant or payor account number) on fee payments. If a third party submits a fee payment, the fee payment must specify the account number to which the fee is to be applied.

(b) Instructions for payment of filing fees. Except as provided in paragraph (c) of this section, these instructions provide direction for remitting fees specified in paragraph

(a) of this section. You may contact the Fee Account Services Branch in the Office of Financial Management at (202) 551-8989 for additional information if you have questions.

(1) Instructions for payment of fees by wire transfer (FEDWIRE). U.S. Bank, N.A. in St. Louis, Missouri is the U.S. Treasury designated lockbox depository and financial agent for Commission filing fee payments. The hours of operation at U.S. Bank are 8:30 a.m. to 6:00 p.m. Eastern time for wire transfers. Any bank or wire transfer service may initiate wire transfers of filing fee payments through the FEDWIRE system to U.S. Bank. A filing entity does not need to establish an account at U.S. Bank in order to remit filing fee payments.

(i) To ensure proper credit and prompt filing acceptance, in all wire transfers of filing fees to the Commission, you must include:

(A) The Commission's account number at U.S. Bank (152307768324); and

(B) The payor's CIK number.

(ii) You may refer to the examples found on the Commission's Web site at www.sec.gov for the proper format.

(2) Instructions for payment of fees by check or money order. To remit a filing fee payment by check (certified or bank cashier's check) or money order (United States postal or bank money order), you must make it payable to the Securities and Exchange Commission, omitting the name or title of any official of the Commission. On the front of the check or money order, you must include the Commission's account number (152307768324) and CIK number of the account to which the fee is to be applied.

U.S. Bank does not accept walk-in deliveries by individuals. You must mail checks or money orders to the following U.S. Bank addresses:

(i) Remittances through the U.S. Postal Service must be sent to the following address:

Securities and Exchange Commission

P.O. Box 979081

St. Louis, MO 63197-9000

(ii) The following address can be used for remittances through other common carriers:

U.S. Bank

Government Lockbox 979081

1005 Convention Plaza

SL-MO-C2-GL

St. Louis, MO 63101

Note to paragraph (b). Wire transfers are not instantaneous. The time required to process a wire transfer through the FEDWIRE system, from origination to receipt by U.S. Bank, varies substantially. Specified filings, such as registration statements pursuant to section 6(b) of the Securities Act of 1933 that provide for the registration of securities and mandate the receipt of the appropriate fee payment upon filing, and transactional filings pursuant to the Securities Exchange Act of 1934, such as many proxy statements involving extraordinary business transactions, will not be accepted if sufficient funds have not been received by the Commission at the time of filing. You should obtain from your bank or wire transfer service the reference number of the wire transfer. Having this number can greatly facilitate tracing the funds if any problems occur. If a wire transfer of filing fees does not contain the required information in the proper format, the Commission may not be able to identify the payor and the acceptance of filings may be delayed. To ensure proper credit, you must provide all required information to the sending bank or wire transfer service. Commission data must be inserted in the proper fields. The most critical data are the Commission's account number at U.S. Bank and the Commission-assigned account number identified as the CIK number.

(c) <u>Special instructions for §§ 230.462(b) and 230.110(d) of this chapter</u>.

Notwithstanding paragraphs (a) and (b) of this section, for registration statements filed pursuant to §§ 230.462(b) and § 230.110(d) of this chapter, payment of filing fees for the purposes of this section may be made by:

(1) The registrant or its agent instructing its bank or a wire transfer service to transmit to the Commission the applicable filing fee by a wire transfer of such amount from the issuer's account or its agent's account to the U.S. Treasury designated lockbox depository as soon as practicable, but no later than the close of the next business day following the filing of the registration statement; and

(2) The registrant submitting with the registration statement at the time of filing a certification that:

(i) The registrant or its agent has so instructed its bank or a wire transfer service;

(ii) The registrant or its agent will not revoke such instructions; and

(iii) The registrant or its agent has sufficient funds in such account to cover the amount of such filing fee.

Note to paragraph (c). Such instructions may be sent on the date of filing the registration statement after the close of business of such bank or wire transfer service, provided that the registrant undertakes in the certification sent to the Commission with the registration statement that it will confirm receipt of such instructions by the bank or wire transfer service during regular business hours on the following business day.

(d) Filing fee accounts. A filing fee account is maintained for each filer who submits a filing requiring a fee on the Commission's EDGAR system or who submits funds to the U.S. Treasury designated depository in anticipation of paying a filing fee. Account statements are regularly prepared and provided to account holders. Account holders must maintain a current account address with the Commission to ensure timely access to these statements.

Note to paragraph (d). The deposit of money into a filing fee account does not constitute payment of a filing fee. Payment of the filing fee occurs at the time the filing is made, commensurate with the drawing down of the balance of the fee account.

(e) Return of funds from inactive accounts. Funds held in any filing fee account in which there has not been a deposit, withdrawal or other adjustment for more than 180 calendar days will be returned to the account holder, and account statements will not be sent again until a deposit, withdrawal or other adjustment is made with respect to the account. Filers must maintain a current account address to assure the timely return of funds. It may not be possible to return funds from inactive accounts if the Commission is unable to identify a current account address of an account holder after making reasonable efforts to do so.

Note to paragraph (e). A company must update its account and other addresses using the EDGAR Web site. This method ensures data integrity and the timeliest update. Simply changing an address in the text of the cover page of a filing made on the EDGAR system will not be sufficient to update the Commission's account address records.

PART 230- GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

3. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

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4. Section 230.111 is revised to read as follows:

§ 230.111 Payment of fees.

All payments of fees for registration statements under the Act shall be made by wire transfer, or by certified check, bank cashier's check, United States postal money order, or bank money order payable to the Securities and Exchange Commission, omitting the name or title of any official of the Commission. There will be no refunds. Payment of fees required by this section shall be made in accordance with the directions set forth in § 202.3a of this chapter.

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

5. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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6. Section. 240.0-9 is revised to read as follows:

§ 240.0-9 Payment of fees.

All payment of fees shall be made by wire transfer, or by certified check, bank cashier's check, United States postal money order, or bank money order payable to the Securities and Exchange Commission, omitting the name or title of any official of the Commission. Payment of filing fees required by this section shall be made in accordance with the directions set forth in § 202.3a of this chapter.

PART 260 - GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939

7. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b–3, 80b–4, and 80b–11.

8. Section 260.7a-10 is removed.

PART 270 - RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

9. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a–1 et seq., 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

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10. Section 270.0-8 is revised to read as follows:

§ 270.0-8 Payment of fees.

All payment of fees shall be made by wire transfer, or by certified check, bank cashier's check, United States postal money order, or bank money order payable to the Securities and Exchange Commission, omitting the name or title of any official of the Commission. Payment of fees required by this section shall be made in accordance with the directions set forth in § 202.3a of this chapter.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Date: January 29, 2008

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12943

In the Matter of **Thomas J. Dudchik and** **Rodney R. Schoemann,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Thomas J. Dudchik and Rodney R. Schoemann (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Thomas J. Dudchik ("Dudchik"), 47, resides in East Haddam, Connecticut.

2. Rodney R. Schoemann ("Schoemann"), 41, resides in Metairie, Louisiana.

B. OTHER RELEVANT ENTITY AND PEOPLE[1]

1. Stinger Systems, Inc. ("Stinger") is a Nevada corporation that was created as a shell company in 1996 under another name (the "Predecessor Corporation"). The Predecessor Corporation had no operations until it was acquired by Robert Gruder and his partner in September 2004. Stinger's shares began trading publicly in November 2004, and were quoted on the Pink Sheets. The company is now a reporting company and its stock has been quoted on the OTC Bulletin Board since February 2006. Currently, Stinger purportedly manufactures stun guns and other non-lethal electronic products for law enforcement agencies.

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1 The Commission has filed separate civil actions in federal district court against Stinger Systems, Inc., Robert F. Gruder and F. Douglas Murrell. See SEC v. Robert F. Gruder, et al, Civil Action File No. 1:08-CV-0294 (N.D. Ga.). The action against Murrell was filed as a settled matter.

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2. Robert F. Gruder ("Gruder"), 48, is Stinger's Chairman, CEO, and second largest shareholder. Gruder was also the Chairman, CEO, and controlling shareholder of another company from as early as March 1997 until August 2002, when that company was delisted from the Nasdaq for failing to satisfy Nasdaq's capitalization requirements. Gruder is a friend and business associate of Dudchik and Schoemann. Gruder and Dudchik are former college roommates, have spoken nearly every day for the past twenty years and previously worked together.

3. F. Douglas Murrell ("Murrell"), 61, resides in Austin, Texas and is the owner and operator of a consulting firm. For the past twenty years, Murrell has assisted companies seeking to become publicly traded by identifying and brokering the sale of shell companies for that purpose.

C. THE UNREGISTERED DISTRIBUTION OF STINGER SHARES

1. The Predecessor Corporation was formed as a shell company in 1996. In 1999, Murrell agreed to acquire the Predecessor Corporation and, in April 2000, the Predecessor Corporation's board of directors approved the issuance of 750,000 shares to Murrell pursuant to this agreement for $8,250, giving Murrell 75% ownership of the Predecessor Corporation. At this time, no share certificates were issued to Murrell and Murrell's shares were not designated as freely tradable. The prior controlling shareholder of the Predecessor Corporation, who remained an officer of that company until May 1, 2000, retained Murrell to search for potential buyers for the Predecessor Corporation. The Predecessor Corporation never had any actual operations under the ownership of either Murrell or the prior controlling shareholder.

2. In May 2000, for no consideration, the Predecessor Corporation issued 10,000,000 shares to Murrell's son. No certificates were issued for these shares and they were not designated as freely tradable. Around the same time, Murrell's son was named the President, Secretary, Treasurer and sole director of the Predecessor Corporation. Despite Murrell's son holding these various positions and shares, Murrell remained in control of the Predecessor Corporation.

3. In or around the Spring of 2004, Gruder began searching for a shell company that he and his partner could acquire and merge with an operating company that Gruder and his partner were in the process of buying. In that regard, Gruder began discussing with Murrell the possible acquisition of the Predecessor Corporation in or around May 2004. In September 2004, Gruder and his partner finalized the acquisition of the operating company, a non-public company that produced various non-stun gun security related products ("the Operating Company").

4. On September 23, 2004, through a series of transactions with companies that Gruder and his partner controlled, Gruder and his partner acquired the Predecessor Corporation, merged the Operating Company into the Predecessor Corporation, and changed the Predecessor Corporation's name to Stinger. As part of this transaction, (1) Gruder and his partner collectively received 9,250,000 shares of Stinger, which were designated as not freely

tradable, (2) Stinger cancelled the 10 million shares that the Predecessor Corporation had previously issued to Murrell' son for no consideration, and (3) Murrell's son resigned as an officer and director of the company. The 750,000 shares belonging to Murrell were not cancelled.

5. As part of the negotiations to acquire the Predecessor Corporation, Gruder insisted that Murrell transfer some of Murrell's 750,000 shares in the Predecessor Corporation to Dudchik, an "extremely good friend" and former college roommate of Gruder. Accordingly, in July 2004, Murrell and Dudchik executed an agreement whereby Murrell agreed to transfer approximately 350,000 shares in the Predecessor Corporation to Dudchik. These shares supposedly compensated Dudchik for consulting services Dudchik would perform for the Predecessor Corporation or Stinger.

6. On or before September 23, 2004, Schoemann asked Gruder if there was anyone that had any "freely tradable shares" in Stinger or the Predecessor Corporation that they may be willing to sell. Gruder referred Schoemann to Murrell. When Schoemann contacted Murrell, Schoemann advised that he was looking to buy freely tradable shares in Stinger or the Predecessor Corporation.

7. On September 23, 2004, the same day Gruder acquired the Predecessor Corporation, Murrell sold 100,000 shares in the Predecessor Corporation to Schoemann for $75,000. The purchase agreement that Schoemann and Murrell executed in connection with this sale was dated September 23, 2004 and specified that Schoemann would purchase "freely tradable shares."

8. On September 23, 2004, Murrell authored a letter acknowledging that he had previously "transferred" shares to several parties, including Dudchik and Schoemann, and directing Stinger's transfer agent to issue certificates to Dudchik and Schoemann for 345,000 shares and 100,000 shares, respectively.

9. On or about September 23, 2004, Murrell asked Stinger's counsel to provide a legal opinion, to be relied on by Stinger's transfer agent, that the certificates for the shares Murrell transferred to Dudchik and Schoemann should be issued without any restrictive legend. In connection with seeking this legal opinion, Murrell misled Stinger's counsel that Murrell's son controlled the Predecessor Corporation since April or May 2000.

10. On October 1, 2004, Stinger's counsel authored an opinion letter to Stinger's transfer agent. That letter opined, incorrectly, that Murrell was never affiliated with the Predecessor Corporation and that the transfer agent could issue the certificates for the shares Murrell transferred to Dudchik and Shoemann without any restrictive legend.

11. On October 1, 2004, Stinger's transfer agent, at the request of Stinger's counsel, issued certificates to (1) Murrell for 275,000 shares, (2) Dudchik for 345,000 shares, and (3) Schoemann for 100,000 shares. These certificates were the first ever issued for the stock

of either the Predecessor Corporation or Stinger. None of these certificates had a restrictive legend.

12. On November 11, 2004, a broker dealer entered the first quote on the Pink Sheets and executed the first public trade for Stinger's stock.

13. During the first two weeks of public trading of Stinger's stock, i.e., between November 11, 2004, and November 24, 2004, Dudchik sold approximately 81,000 of the Stinger shares obtained from Murrell though the over-the-counter market in nine transactions and Schoemann sold approximately 100,000 of the Stinger shares he obtained from Murrell through the over-the-counter market in approximately seventy-six transactions. These transactions generated net sales proceeds of approximately $866,000 for Dudchik and $1.044 million for Schoemann.

14. Combined, Dudchik and Schoemann sold approximately 181,000 Stinger shares through the Pink Sheets during the first two weeks of public trading, representing approximately 18% of Stinger's public float.

15. At no time during any of these sales by Dudchik or Schoemann was a registration statement for Stinger shares in effect or filed with the Commission. Respondents cannot establish an applicable exemption from the securities registration requirements of Section 5 of the Securities Act.

D. VIOLATIONS

As a result of the conduct described above, Respondents Dudchik and Schoemann violated Sections 5(a) and (c) of the Securities Act, which prohibit the offer and sale of securities through the mails or in interstate commerce, unless a registration statement has been filed with the Commission or is in effect as to such securities.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it appropriate that cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. Whether, pursuant to Section 8A of the Securities Act, Respondents should be ordered to cease and desist from committing violations of and any future violations of Section 5 of the Securities Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If a Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12944

In the Matter of **STEVEN ALTMAN, ESQ.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE.**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Steven Altman, Esq. ("Respondent") pursuant to Section 4C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

After an investigation, the Office of the General Counsel alleges that:

A. RESPONDENT

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[1] Rule 102(e)(1)(ii), 17 C.F.R. 201.102(e)(1)(ii), provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in unethical or improper professional conduct . . . .

Section 4C(a), 15 U.S.C. 78d-3(a), provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission . . . to have engaged in unethical or improper professional conduct . . . .

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1. Respondent is an attorney and a member of the New York Bar. Respondent, 46 years old, is a resident of New York City, New York.

B. IMPROPER PROFESSIONAL CONDUCT

1. In late 2003 and early 2004 (the "relevant period"), Respondent represented an individual, who was a witness in a Commission administrative proceeding entitled *In the Matter of Harrison Securities Inc., et al.*, AP File No. 3-11084 (*Harrison Securities* proceeding). In January 2004, the Commission's Division of Enforcement ("Division") learned that Respondent's client might be able to provide testimony that could establish that one of the factual defenses asserted by the respondents in the *Harrison Securities* proceeding lacked merit.

2. When Division staff contacted Respondent's client, she referred them to Respondent. During the next few weeks, Respondent represented his client in her dealings with the Division staff.

3. During the relevant period, Respondent contacted, by telephone, the attorney who was representing Harrison Securities and its president, Fred Blumer ("Blumer"), in the *Harrison Securities* proceeding. Respondent and Blumer's attorney had at least six telephone conversations during this time. Unbeknownst to Respondent, Blumer's attorney tape recorded five of these conversations.

4. During the taped conversations, Respondent requested that Blumer arrange for a "severance package" (i.e., removing his client as the co-signer on two car leases with Blumer and paying her salary) for his client. In return for this severance package, Respondent indicated that his client might not cooperate with the Commission and/or that her recollection of the relevant events might "fade." In the last of these conversations, Blumer's attorney asked Respondent "what package" his client wanted to "not cooperate." Respondent stated, "Get her off those leases and, you know, your salary, and you can even pay it out over a year." Blumer's attorney then asked, "what will we get if they do that, she won't cooperate or she won't remember?" Respondent stated "probably both."

5. Respondent's knowing conduct violates DR 1-102(A)(4) barring "conduct involving dishonesty, fraud, deceit, or misrepresentation," DR 1-102(A)(5) barring "conduct that is prejudicial to the administration of justice" and/or DR 1-102(A)(7) barring "any other conduct that adversely reflects on the lawyer's fitness as a lawyer" of the New York State Bar Association's Code of Professional Responsibility's Disciplinary Rules, to which he was subject during the relevant period.

C. VIOLATIONS

As a result of the conduct described above, Respondent engaged in improper professional conduct and is subject to discipline pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

III.

In view of the allegations made by the Office of the General Counsel, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice including, but not limited to, denying, temporarily or permanently, the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 57234 / January 30, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2778 / January 30, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12942

In the Matter of **DAVID B. DUNCAN, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against David B. Duncan ("Respondent" or "Duncan") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e)

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Duncan, age 48, resides in Houston, Texas. Duncan served as the global engagement partner for Arthur Andersen LLP's ("Andersen) audits of Enron Corp. ("Enron") from 1997 until January 2002. During the relevant time period, Duncan was a certified public accountant licensed in the State of Texas. As the global engagement partner, Duncan was ultimately responsible for determining whether an unqualified opinion should be issued within the auditor's report.

2. Enron was an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer, with reported annual revenue of more than $100 billion. In 2000, Enron rose to number seven on the *Fortune* 500 list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped in less than one year from more than $80 per share to less than $1.

3. Andersen once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston and London.

4. On January 28, 2008, the Commission filed a complaint against Duncan in Securities and Exchange Commission v. David B. Duncan, Civil Action No. 4:08-CV-00314 (S.D. Tex.). On January 29, 2008, the court entered its Final Judgment against Duncan, which, among other things, permanently enjoined Duncan, by consent, from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

5. The Commission's complaint alleged that Enron's senior executives engaged in and presided over a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission. The fraudulent scheme was carried out through a variety of complex structured transactions, off-balance sheet financings, related party transactions, misleading disclosures, and a widespread abuse of GAAP. As the global engagement partner responsible for the Enron audits, Duncan was ultimately responsible for determining whether an unqualified opinion should be issued within the auditor's report. The complaint also alleged that for years 1998 through 2000, Duncan was reckless in not knowing, that the unqualified audit reports he signed on behalf of Andersen were materially false and misleading. These auditor's reports were part of Enron's annual reports on Forms 10-K filed with the Commission in 1998, 1999 and 2000.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Duncan's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that Duncan is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
January 31, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-12945

In the Matter of	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**
Aimsi Technologies, Inc., formerly known as Advanced Integrated Management Services, Inc.,	
Respondent.	

I.

The Securities and Exchange Commission "Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Aimsi Technologies, Inc., formerly known as Advanced Integrated Management Services, Inc. ("Aimsi " or "Respondent").

II.

As a result of its investigation, the Division of Enforcement alleges that:

A. Aimsi (CIK No. 1115054) is a Utah corporation which formerly maintained offices in Tennessee. At all times relevant to this proceeding, the common stock of Aimsi was registered with the Commission under Exchange Act Section 12(g). As of May 14, 2007, the common stock of Aimsi ("AIMT") was traded on the over-the-counter markets.

B. Aimsi has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to September 30, 2004.

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IIII.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that proceedings be instituted pursuant to Section 12(j) of the Exchange Act to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding 12 months or revoke the registration of each class of securities of Aimsi registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served upon Respondent in accordance with Rule 141 of the Commission's Rules of Practice [17 C.F.R. § 201.141].

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision on this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Cox
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Rel. No. 8887 / January 31, 2008

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57243 / January 31, 2008

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2699 / January 31, 2008

INVESTMENT COMPANY ACT OF 1940
Rel. No. 28138 / January 31, 2008

Admin. Proc. File No. 3-12559

In the Matter of

TRAUTMAN WASSERMAN & COMPANY, INC.,
GREGORY O. TRAUTMAN,
SAMUEL M. WASSERMAN,
MARK BARBERA,
JAMES A. WILSON, JR.,
JEROME SNYDER, and
FORDE H. PRIGOT

ORDER DENYING MOTION FOR EXTENSION

On December 7, 2007, the Chief Administrative Law Judge, who is presiding over this proceeding, moved, pursuant to Commission Rule of Practice 360(a)(3), */ for an extension of time within which to file her initial decision in this proceeding with the Office of the Secretary. Pending our consideration of this motion, the law judge filed her initial decision within the prescribed time frame, rendering her request moot.

Accordingly, IT IS ORDERED that the motion for an extension of time to file the initial decision in this matter be, and it hereby is, denied.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

*/ 17 C.F.R. § 201.360(a)(3).

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Rel. No. 8888 / January 31, 2008

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57246 / January 31, 2008

Admin. Proc. File No. 3-11626

In the Matter of

JOHN A. CARLEY,
EUGENE C. GEIGER,
THOMAS A. KAUFMANN,
EDWARD H. PRICE, and
CHRISTOPHER H. ZACHARIAS

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Unregistered Offer and Sale of Securities

Fraud

Failure to Report Securities Transactions

Failure to Supervise

Officers of issuer unlawfully made unregistered offers and sales of securities. Officers committed fraud by omitting to disclose material facts concerning the sale of unregistered securities. One of the officers also failed to report a securities transaction. Held, it is in the public interest to order officers to disgorge ill-gotten profits and to cease and desist from committing or causing any violations or future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5, 12b-20, 13a-1, and 13a-11.

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Associated persons of broker-dealer made unregistered offers and sales of securities. Held, it is in the public interest to order associated persons to disgorge ill-gotten profits; to pay civil money penalties, to cease and desist from committing or causing any violations or future violations of Securities Act Sections 5(a) and 5(c); to bar one associated person from association with a broker or dealer and to bar the other associated person from association with a broker or dealer with a right to reapply after five years.

President, chief executive officer, and chief compliance officer of registered broker-dealer failed to exercise reasonable supervision over associated persons with a view to preventing their violations of the securities laws. Held, it is in the public interest to bar president, chief executive officer, and chief compliance officer from association with any broker or dealer in a supervisory capacity and to order him to pay a civil money penalty.

APPEARANCES:

Thomas D. Birge and Carla B. Minckley, of Birge & Minckley, P.C., for John A. Carley.

Bradford J. Lam, of the Law Offices of Bradford J. Lam, PLLC, for Eugene C. Geiger.

Jeffrey J. Scott, of Scott & Associates, P.C., for Thomas A. Kaufmann.

Gordon Dihle, for Edward H. Price.

David A. Zisser, of Isaacson Rosenbaum, P.C., for Christopher H. Zacharias.

Julie K. Lutz and Thomas J. Krysa, for the Division of Enforcement.

Appeal filed: August 5, 2005
Last brief received: December 28, 2005
Oral argument: February 7, 2007

I.

Respondents John A. Carley, Eugene C. Geiger, Thomas A. Kaufmann, Edward H. Price, and Christopher H. Zacharias each appeal from the decision of an administrative law judge. Carley and Zacharias were officers and directors of Starnet Communications International, Inc. ("Starnet"), a Delaware corporation with its principal places of business in St. Johns, Antigua and Vancouver, British Columbia, Canada. 1/ Geiger and Kaufmann were associated persons of Spencer Edwards, Inc. ("Spencer Edwards"), a registered broker-dealer. Price was president, chief executive officer, and chief compliance officer of Spencer Edwards; he supervised Geiger and Kaufmann. The law judge found that Carley and Zacharias violated, and Geiger and Kaufmann willfully violated, Sections 5(a) and 5(c) of the Securities Act of 1933 2/ by offering to sell, selling, and delivering to members of the public shares of Starnet common stock when no registration statement was filed or in effect with respect to those securities and no exemption from registration was available. The law judge found that Price failed reasonably to supervise Geiger and Kaufmann. 3/ The law judge also found that Carley and Zacharias violated the antifraud provisions of the federal securities laws by filing current and annual reports with the Commission that were false and misleading. 4/ The law judge further concluded that Zacharias violated Section 16(a) of the Securities Exchange Act of 1934 and Exchange Act Rule 16a-3 5/ by failing to file a required Form 4.

The law judge imposed cease-and-desist orders on Carley, Zacharias, Geiger, and Kaufmann, barred Geiger and Kaufmann from associating with any broker or dealer, and barred Price from associating with any broker or dealer in a supervisory capacity. The law judge ordered Carley and Zacharias each to disgorge an amount representing payments made to them in connection with their unregistered sale of shares of Starnet common stock. The law judge ordered Geiger and Kaufmann each to disgorge fifty percent of the net commissions that they earned on all Starnet trades attributable to their joint account number at Spencer Edwards from January 1999 through February 2001. The law judge imposed third-tier penalties of $400,000

1/ On May 25, 2001, Starnet became a wholly-owned subsidiary of World Gaming PLC, a company organized in England and Wales.

2/ 15 U.S.C. §§ 77e(a), 77e(c).

3/ The law judge also found that Spencer Edwards failed reasonably to supervise Geiger and Kaufmann. Spencer Edwards did not appeal, and we declared the law judge's decision final. Roy E. Gould, Securities Act Rel. No. 8603 (Aug. 18, 2005), 86 SEC Docket 94, 95.

4/ 15 U.S.C. §§ 77q(a), 78j(b); 17 C.F.R. § 240.10b-5.

5/ 15 U.S.C. § 78p(a); 17 C.F.R. § 240.16a-3.

against Geiger and $300,000 against Kaufmann. He imposed a second-tier penalty of $150,000 against Price.

We base our findings on an independent review of the record except with respect to those findings not challenged on appeal.

II.

This case arises from a complex series of transactions involving the unregistered offer and sale of Starnet stock to the public. Officers of Starnet together with associated persons of a broker-dealer engaged in a distribution of Starnet shares to the public without registration or exemption from registration in violation of the federal securities laws. The violative distribution was designed to enable Starnet's officers, directors, and employees to sell and receive the proceeds from sales of stock received upon exercise of employee stock options. Seven foreign entities, which were controlled by a single adviser and which held Starnet common stock and warrants, previously acquired in unregistered transactions, participated in the illegal distribution.

The Starnet officers compounded the foregoing violations by omitting to disclose material facts concerning the nature of the related party transactions involving the exercise of employee stock options by Carley and Zacharias. One of the officers also violated the reporting provisions by failing to report his acquisition of Starnet shares. Finally, the broker-dealer's president failed to exercise reasonable supervision over the associated persons.

In Part III, we discuss the "swap" transactions that resulted in the unregistered distribution of Starnet stock to the public in connection with the exercise of employee stock options. Part IV considers whether the offers and sales of Starnet stock violated the registration requirements of the securities laws and discusses the Respondents' arguments with respect to the availability of the safe harbors provided by Regulation S and Securities Act Rule 144, as well as the exemptions from registration provided in Securities Act Section 4. In Part V, we describe the steps taken by the president of the broker-dealer to supervise the two associated persons and address the adequacy of that supervision. In Part VI, we consider the omissions in Starnet's public filings that form the basis for the fraud allegations against the two Starnet officers. Part VII addresses the alleged Exchange Act Section 16 reporting violation. In Part VIII, we address the Respondents' procedural arguments concerning severance and the statute of limitations. Part IX concludes with an analysis of what sanctions are appropriate in the public interest.

III.

In Section A below, we discuss the "swap" transactions that resulted in the unregistered distribution of Starnet stock to the public. In Section B, we discuss the role played by each Respondent in those transactions.

A. From September 1997 until May 2001, Starnet common stock traded on the OTC Bulletin Board and was registered with the Commission pursuant to Section 12(g) of the Exchange Act. 6/ In the late 1990s, Starnet created two employee stock option plans as incentive compensation for its officers, directors, and employees ("Option Holders"). Starnet filed its first Form S-8 with the Commission on March 12, 1998 to register the offer and sale of 3 million shares of common stock upon exercise of employee stock options issued under Starnet's 1997 Stock Option Plan. Starnet filed its second Form S-8 with the Commission on March 10, 1999 to register the offer and sale of 4 million shares of common stock upon exercise of employee stock options issued under Starnet's 1999 Stock Option Plan. 7/ The Stock Option Plans, which were attached as exhibits to the Forms S-8, stated that the exercise of the options would be deemed effective upon payment to Starnet of the option price. The Forms S-8 did not register the resale of the Plan Shares, and Starnet never filed any post-effective amendments to its Forms S-8. 8/

Shortly after filing its first Form S-8, Starnet learned, in April 1998, from its Canadian counsel that the British Columbia securities laws would impose an indefinite holding period on any Plan Shares issued to Starnet's Canadian Option Holders. Counsel further opined that British Columbia securities laws could also limit the resale of Plan Shares in the United States resulting from the exercise of such options. 9/

In or around December 1998, Zacharias discussed with Roy E. Gould, a resident of Vancouver, British Columbia, Canada, and a partial owner of United Capital Securities, Inc. ("United Capital"), a Canadian broker-dealer, the limitations under the British Columbia securities laws on the resale of Starnet shares issued upon exercise of stock options. 10/ Gould

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6/ 15 U.S.C. § $78l$(g).

7/ The shares of common stock issued upon the exercise of options issued under the 1997 and 1999 Stock Option Plans hereinafter are referred to as "Plan Shares."

8/ Form S-8 provides, in certain situations, for the resale of shares pursuant to a reoffer prospectus or a post-effective amendment to the Form. See General Instruction C to Form S-8, Fed. Sec. L. Rep. (CCH) ¶ 8141.

9/ Canadian counsel suggested that the options be issued to a trust account directed by a non-Canadian trustee. Starnet, however, decided not to create such a trust. See infra note 56.

10/ In late 1998 and 1999, Starnet's stock price began to rise as it shifted its business operations from adult entertainment to Internet gambling. Between June and December 1998, Starnet stock traded at prices between \$0.37 and \$1.50 per share. By early July 1999, Starnet's stock traded at prices above \$26 per share, and its daily trading volume

(continued...)

contacted Kaufmann at Spencer Edwards, and Starnet's chief executive officer, Mark N. Dohlen, contacted Geiger at Spencer Edwards. Geiger's long-time client, Alfred Peeper, controlled seven foreign entities (the "Peeper Entities") that had acquired common stock (the "1997 Shares"), warrants, and piggyback warrants from Starnet in an unregistered offering pursuant to Regulation S in December 1997. 11/ Gould and Dohlen asked whether the Peeper Entities would "swap" their Starnet common stock for Plan Shares issued to Starnet's Option Holders. Peeper agreed. Zacharias, Geiger, Kaufmann, Gould, and Peeper subsequently developed a procedure involving sales to the public of the Peeper Entities' Starnet common stock, followed by offsetting transfers of Starnet Plan Shares to the Peeper Entities. 12/ In this manner, Starnet's Option Holders would receive the financial benefit equivalent to both the "cashless" exercise of their options and the subsequent sale of the shares obtained upon exercise into the open market. 13/

10/ (...continued)
exceeded 1.5 million shares. As a result, Starnet's Canadian Option Holders wanted to exercise their options and sell the resulting Plan Shares.

11/ On December 2, 1997, Starnet issued 2.45 million shares of common stock, with warrants, to the Peeper Entities, in consideration for $2.45 million. As reported in its Form 8-K filed on December 11, 1997, Starnet issued these shares in unregistered transactions pursuant to Rule 903 of Regulation S. Each of the seven Peeper Entities received 350,000 shares of common stock; warrants attached to the shares could be exercised at $2.00 per share and expired in one year. Each warrant exercised at $2.00 per share entitled the purchaser to one share of common stock and a second warrant, the "piggyback" warrant, which could be exercised at $4.00 per share within one year of the "piggyback" warrant being issued. In total, these warrants gave the Peeper Entities the right to purchase an additional 4.35 million shares of Starnet common stock. In addition, Starnet issued an additional two blocks of 350,000 shares to the Peeper Entities.

12/ The law judge found that Gould willfully violated Securities Act Sections 5(a) and 5(c) by offering and selling unregistered Starnet securities and that he willfully violated Exchange Act Section 15(a), 15 U.S.C. § 78o(a), by engaging in business in the United States as an unregistered broker. Gould did not appeal the initial decision of the law judge. We declared that decision final. Roy E. Gould, 86 SEC Docket at 95.

Dohlen, Peeper, and Paul A. Giles, a president and director of Starnet, were each named in the OIP but were severed from this proceeding because they had not been served with the OIP. John A. Carley, Securities Exchange Act Rel. No. 50954 (Jan. 3, 2005), 84 SEC Docket 2317. Our findings with respect to Dohlen, Peeper, and Giles are solely for the purpose of this opinion.

13/ The only document to describe this arrangement in its totality is a memorandum by Dennis Brovarone, Peeper's attorney, dated September 29, 1999 and addressed to
(continued...)

To implement this procedure, Starnet required its Option Holders to open brokerage accounts with Gould at United Capital. When these Option Holders wished to exercise their stock options, they executed an irrevocable authorization permitting Gould to exercise their options and transfer the resulting Plan Shares to one or more of the Peeper Entities' accounts. 14/ The Peeper Entities that did not previously have accounts at Spencer Edwards opened new accounts in 1999 to participate in this procedure. Geiger and Kaufmann served as account executives to all of the Peeper Entities. Gould notified Kaufmann or Geiger at Spencer Edwards of the aggregate number of shares that the Option Holder wished to sell, and then Kaufmann or Geiger would execute the sale of the equivalent number of Starnet shares to the public from the Spencer Edwards accounts of one or more of the Peeper Entities.

After payment of commissions, Spencer Edwards transmitted the net proceeds from the Peeper Entities' sales to Dennis Brovarone, Peeper's attorney. Brovarone deposited the funds in client trust accounts and then wired from the trust account a portion of the proceeds equal to the exercise price for the applicable options to Starnet. Starnet in turn issued Plan Shares in the name of the Option Holder. Consistent with the terms of the irrevocable authorization, however, the Plan Shares were delivered to Gould at United Capital. Gould sent the Plan Shares to the appropriate Peeper Entity's Spencer Edwards account as reimbursement for the shares of Starnet common stock that the Peeper Entity had sold. Upon delivery of the Plan Shares to the Peeper Entity, Brovarone wired the balance of the proceeds to the Option Holder's United Capital account. The Peeper Entities then resold the Plan Shares into the public market at a time of their choosing for their own financial benefit.

By the end of 1998 the Peeper Entities did not hold enough 1997 Shares to offset the anticipated quantities of Plan Shares to be sold by the Option Holders. By December 1998, Starnet's Option Holders held options for 3 million shares (and would soon hold options for another 4 million shares to be issued under the 1999 Stock Option Plan). In contrast, the Peeper Entities had already sold some of the 2.45 million 1997 Shares. Moreover, the warrants attached

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13/ (...continued)
Zacharias, Kaufmann, Gould, and Peeper. In addition to outlining the arrangement as described above, the memorandum stated that "[t]he Peeper accounts received ?????? for their services." This memorandum was written at Peeper's request. At the hearing, Zacharias and Gould agreed that the memorandum accurately described the manner in which the sale of the Plan Shares was implemented. None of the Respondents disputes the accuracy of the memorandum.

14/ The irrevocable authorization stated that Starnet was "facilitating this trade," that shares were being sold "on my [the Option Holder's] behalf" prior to the receipt of the Plan Shares, and that Gould would transfer the shares received in the Option Holder's name "into an appropriate account in order to reimburse for the shares sold on my behalf." The Option Holder also authorized Gould "to pay directly to Starnet the strike price per share upon the sale of the shares."

to the 1997 Shares expired on December 2, 1998, and the Peeper Entities had no incentive to exercise them at $2.00 per share when Starnet common stock was trading at about $1.00 per share at or around this time. Consequently, on December 2, 1998, Starnet extended for one year the period in which the Peeper Entities could exercise their warrants. 15/

During 1999, Starnet's stock price rose; by early July 1999, it was trading at above $26 per share, with daily trading volume in excess of 1.5 million shares. From January to October 1999, the seven Peeper Entities acquired 4.9 million shares from Starnet by exercising their warrants and piggyback warrants and deposited the shares into their Spencer Edwards accounts, where they were commingled with other shares held by the Peeper Entities, including the 1997 Shares and Plan Shares. As Starnet's Option Holders exercised their stock options during this period, the seven Peeper Entities sold shares of Starnet common stock to the public to finance these option exercises. After the Peeper Entities received the Plan Shares from the Option Holders as reimbursement, they sold those shares into the market for their own financial benefit. In total, the Peeper Entities sold more than 5.2 million shares of Starnet common stock in this distribution from January 1999 through February 2001.

B. Carley was Starnet's chairman of the board and its chief financial officer. 16/ Carley opened a brokerage account at United Capital in December 1998 to participate in the procedure to "swap" his Plan Shares with the Peeper Entities' shares. He received $2.48 million through this account in connection with his exercise of stock options and subsequent sale of the Plan Shares to the Peeper Entities between February and August 1999. Zacharias opened a brokerage account at United Capital before December 1998. He received $1.45 million through this account in connection with his exercise of stock options and subsequent sale of the Plan Shares to the Peeper Entities between February and August 1999. In connection with their participation in the procedure, both executed irrevocable authorizations permitting Gould to exercise their stock options and to transfer the Starnet shares obtained upon exercise to the Peeper Entities.

Brokerage accounts at Spencer Edwards also were opened in the names of Starnet officers, including Carley and Zacharias, as part of the plan to "swap" shares held by the Peeper Entities with Plan Shares. Carley testified that he was told this was a "control account," although he did not explain what that meant. Carley signed certain documents and a margin agreement in connection with the account. Carley received brokerage statements for the account in his name, but testified that he did not control the transactions in that account, and he did not consider himself the owner of stock in the account or entitled to any proceeds from the account. Zacharias

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15/ See Starnet's Form 8-K, filed December 17, 1998, as amended by Form 8-K/A, filed March 18, 1999. The law judge found that Starnet's decision to extend the warrant exercise period "brought the scheme to life."

16/ Carley resigned from his positions at Starnet on December 23, 1999. He remained president of EFS Caribbean, Inc., Starnet's electronic credit card subsidiary, until April 3, 2000.

testified that he also received statements for the account in his name, but claimed that he did not read any statements after the first one and did not know what stock was traded through that account. He stated that "someone" at Spencer Edwards told him that this account was "unimportant" and that it was "necessary as part of the process of exercising options" and "nothing that [he] needed to worry about." He testified further that, from his point of view, transactions conducted in that account involved someone else's money. Approximately 345,000 shares of Starnet stock were sold through accounts at Spencer Edwards in the names of Carley and Zacharias. The law judge found that neither Carley nor Zacharias received any proceeds from the trading accounts in their names at Spencer Edwards. 17/

As Starnet's secretary, treasurer, and corporate counsel, Zacharias participated in establishing Starnet's stock option plans and served as a liaison with Starnet's outside counsel. 18/ Zacharias reviewed the 1998 Form S-8 and drafted the 1999 Form S-8.

Kaufmann and Geiger were the account executives for the Peeper Entities, for the Starnet officers, including Carley and Zacharias, and for an entity called Celestine Asset Management that was controlled by Gould, and executed transactions in Starnet stock in these accounts. Kaufmann has been associated with Spencer Edwards since November 1993. At the time of the hearing before the law judge, Kaufmann was the vice president of sales, a position he had held for eight years. Geiger was associated with Spencer Edwards from November 1993 through January 31, 2001. Kaufmann and Geiger worked together at Spencer Edwards under a joint account executive number, shared a private office, and split commissions on all transactions conducted in accounts managed under their joint account executive number.

Geiger had advised Peeper to participate in Starnet's 1997 Regulation S offering and, in connection with the offering, had traveled to Vancouver twice to examine Starnet's operations on Peeper's behalf. Geiger was aware that Starnet stock obtained from the exercise of warrants and piggyback warrants was being placed in the Peeper Entities' accounts and shortly thereafter resold to the public. Geiger processed orders in Starnet stock from Peeper and then from Gould after Peeper gave Geiger written notice in December 1998 that he had authorized Gould to conduct transactions in the Peeper Entities' accounts at Spencer Edwards. 19/

17/ The record is not clear as to the precise number of Plan Shares that were transferred directly to the Peeper Entities -- versus those that were placed into Starnet officers' Spencer Edwards accounts -- to complete the "swap" for the shares held by those entities.

18/ Zacharias resigned as secretary, treasurer, and director on August 12, 1999, and resigned as corporate counsel on February 14, 2000.

19/ Geiger also was receiving valuable consideration from the Peeper Entities in the form of legal fees, housing and house-related expenses, capital gains from the sale of one of the

(continued...)

Kaufmann also accepted orders from Gould directing the sale to the public of Starnet stock from the Peeper Entities' accounts. The record reflects that Gould sent Kaufmann hundreds of facsimile messages containing such orders. Kaufmann also testified that Gould would "call . . . in the morning to let us know how much stock for the employees would need to be sold." Kaufmann and Gould exchanged numerous e-mails through Kaufmann's private e-mail accounts. Along with Gould, Kaufmann kept a running total of the stock being sold by the Peeper Entities' accounts. The trading instructions that Kaufmann received from Gould with respect to the Peeper Entities' accounts usually did not refer to a specific account, indicating that the accounts were being used as a fungible pool of stock to facilitate the exercise of stock options by Starnet's officers and employees. 20/ Kaufmann also executed orders for the sale of Plan Shares from the Starnet officers' Spencer Edwards accounts. 21/

IV.

Violations of the Registration Requirements

Securities Act Section 5(a) prohibits any person, directly or indirectly, from selling a security in interstate commerce unless a registration statement is in effect as to the offer and sale of that security or there is an applicable exemption from the registration requirements. Securities Act Section 5(c) prohibits the offer or sale of a security unless a registration statement as to such security has been filed with the Commission, or an exemption is available. 22/ The purpose of

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19/ (...continued)
houses that he lived in without paying rent or a mortgage, and a country club membership.

20/ In a facsimile dated April 6, 1999, that Gould sent Brovarone, Gould stated that "it doesn't really matter which account [the shares] come[] from as long as the amounts are correct." In a facsimile dated April 15, 1999, from Gould to Brovarone, Gould instructed that "if insufficient funds are in the accounts request them from Tom [Kaufmann] or take them from another account as it should all balance out in the end."

21/ Kaufmann completed Forms 144 for the Starnet stock sales associated with the accounts of Carley and Zacharias. Certain forms misstated the number of outstanding shares of Starnet, and none of the Forms 144 for the transactions was filed with the Commission.

22/ 15 U.S.C. § 77e(a) and (c); see also Jacob Wonsover, 54 S.E.C. 1, 8 (1999), petition denied, 205 F.3d 408 (D.C. Cir. 2000); Michael A. Niebuhr, 52 S.E.C. 546, 549 (1995).

the registration requirements is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions." 23/

The elements of a prima facie violation of Section 5 are that (1) no registration statement was filed or in effect as to the security; (2) the respondents, directly or indirectly, sold or offered to sell the security; and (3) interstate transportation or communication or the mails were used in connection with the offer or sale. 24/ A showing of scienter is not required to establish a violation of Section 5. 25/

It is undisputed that the stock sales at issue here were not registered under the Securities Act. The Respondents argue that these sales need not have been registered because at least one of several possible exemptions from registration applies to each sale at issue. Exemptions from registration are affirmative defenses that must be established by the person claiming the exemption. 26/ Further, "exemptions from the general policy of the Securities Act requiring registration are strictly construed against the claimant." 27/ Evidence in support of an exemption must be explicit, exact, and not built on mere conclusory statements. 28/

In support of their exemption claims, Respondents attempt to isolate certain components of the distribution and argue that various exemptions to registration apply to those component transactions. However, the registration requirements of the Securities Act apply to the "entire process in a public offering through which a block of securities is dispersed and ultimately comes

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23/ SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953); SEC v. Murphy, 626 F.2d 633, 642-43 (9th Cir. 1980).

24/ SEC v. Cont'l Tobacco Co., 463 F.2d 137, 155 (5th Cir. 1972).

25/ Swenson v. Engelstad, 626 F.2d 421, 424 (5th Cir. 1980) ("The Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities . . . regardless of . . . any degree of fault, negligent or intentional, on the seller's part.") (internal citation omitted); SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1046-47 (2d Cir. 1976).

26/ Engelstad, 626 F.2d at 425; Lively v. Hirschfeld, 440 F.2d 631, 632 (10th Cir. 1971).

27/ Gearhart & Otis, Inc., 42 S.E.C. 1, 4-5 n.3 (1964) (citing Ralston Purina, 346 U.S. 119 (1953)), aff'd, 348 F.2d 798 (D.C. Cir. 1965); see also Murphy, 626 F.2d at 641; Quinn & Co. v. SEC, 452 F.2d 943, 945-46 (10th Cir. 1971).

28/ Robert G. Weeks, Exchange Act Rel. No. 48684 (Oct. 23, 2003), 81 SEC Docket 1319, 1337 n.35; V.F. Minton Sec., Inc., 51 S.E.C. 346, 352 (1993) (and authority cited therein), aff'd, 18 F.3d 937 (5th Cir. 1994) (Table).

to rest in the hands of the public." 29/ Here, the record shows that, beginning in January 1999, the sales of Starnet stock at issue were effectuated as part of a single, ongoing distribution of unregistered Starnet stock from Starnet to the public. We address Respondents' arguments with respect to each exemption below.

1. Possible Exemptions From Registration

a. Securities Act Section 4(1)

Securities Act Section 4(1) exempts from the registration requirement "transactions by any person other than an issuer, underwriter, or dealer." The term "underwriter" is defined to mean "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security . . . ." 30/

Section 4(1) is intended to exempt routine trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions. 31/ Individual investors who are not securities professionals may be deemed "underwriters" within the statutory meaning of that term if they act as links in a chain of securities transactions from issuers or control persons to the public. 32/ A sale by the intermediary in such a distribution is a transaction by an underwriter and thus not exempt from registration under Section 4(1).

(i) Sales by the Peeper Entities. Zacharias and Geiger each argue that the exemption provided by Section 4(1) applies to the resale of the 2.45 million 1997 Starnet Shares originally issued to the Peeper Entities pursuant to Regulation S. 33/ Kaufmann and Geiger maintain that,

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29/ Wonsover, 54 S.E.C. at 13 n.25.

30/ Securities Act Section 2(11), 15 U.S.C. § 77b(a)(11).

31/ See Preliminary Note to Rule 144, 17 C.F.R. § 230.144; Owen V. Kane, 48 S.E.C. 617, 619 (1986), aff'd, 842 F.2d 194 (8th Cir. 1988).

32/ See Preliminary Note to Rule 144, 17 C.F.R. § 230.144; Quinn & Co., Inc., 44 S.E.C. 461, 464 (1971), aff'd, 452 F.2d 943 (10th Cir. 1971); see also SEC v. Holschuh, 694 F.2d 130, 138 (7th Cir. 1982) (stating that "even assuming that a particular defendant is not an issuer, underwriter, or dealer, he is not protected by Section 4(1) if the offer or sale of unregistered securities in question was part of a transaction by someone who was an issuer, underwriter, or dealer").

33/ Geiger also suggests that the resales of the Regulation S stock were exempt under Rule 904 of Regulation S. 17 C.F.R. § 230.904. However, two general conditions apply to all
(continued...)

because the Peeper Entities purchased these shares in December 1997, the stock had come to rest under Regulation S and could be sold by the Peeper Entities in 1999 without restriction pursuant to Section 4(1).

Beginning in January 1999, the Peeper Entities purchased shares from Starnet through the exercise of warrants and piggyback warrants with a view to reselling those shares to the public, commingled those shares with the 1997 Shares, and then resold the shares of Starnet common stock (including the 1997 Shares) to the public in order to fund the option exercises of Starnet Option Holders. Starnet extended the term of the warrants for one year to enable the Peeper Entities to function as a conduit for the sale of Plan Shares and other shares of Starnet common stock to the public without registration. Once a Starnet Option Holder determined to exercise his or her stock options, the Peeper Entities would sell shares of Starnet common stock to the public equal to the number of shares to be issued upon exercise of the relevant stock options. Plan Shares then were transferred to the Peeper Entities to complete the "swap" transaction and were resold by the Peeper Entities to the public. 34/ In total, from January to October 1999, the Peeper Entities purchased 4.9 million shares of Starnet common stock through the exercise of the warrants and piggyback warrants in addition to the 2.45 million 1997 Shares. From January 1999 through February 2001, the Peeper Entities sold more than 5.2 million shares of Starnet common stock (comprising the 1997 Shares, the Plan Shares, and shares received upon exercise of the warrants and piggyback warrants) to the public. The more than 5.2 million shares sold by the Peeper Entities to the public represented a significant percentage of Starnet's outstanding stock during this period. 35/

33/ (...continued)
resales made in reliance on the safe harbor provided by Rule 904: first, such offer or sale must be made in an "offshore transaction" by any person other than an issuer, a distributor, an affiliate of either (other than specified officers and directors) and any person acting on behalf of any of the foregoing, and second, no "directed selling efforts" may by made in the United States in connection with an offer or sale of securities in reliance on the safe harbor. Here, the resales were made by Peeper Entities in their role as the conduit of Starnet common stock from Starnet to the public, and the resales were directed by Peeper, Geiger, Kaufmann, and Gould to the public within the United States.

34/ Geiger incorrectly asserts that the law judge improperly integrated Starnet's offering of the 1997 Shares with the sale of the Plan Shares. The law judge found, as described above, that the resale -- not the original offering -- of the 1997 Shares was part of the effort to distribute unregistered securities.

35/ As of October 31, 1998, prior to the commencement of the distribution, Starnet reported 22,450,000 shares of common stock outstanding. See Form 10-QSB for the quarter ended October 31, 1998. As of January 31, 2000, Starnet reported 31,531,488 shares outstanding. See Form 10-QSB for the quarter ended January 31, 2000.

We find that the Peeper Entities were underwriters. The Peeper Entities purchased Starnet common stock on the exercise of the warrants and piggyback warrants with a view to the distribution of such shares. They resold those shares, along with the 1997 Shares and the Plan Shares, in connection with a distribution in order to fund the option exercises of Starnet Option Holders. Accordingly, because the Peeper Entities acted as a conduit beginning in January 1999 for the distribution to the public of the 1997 Shares, the Plan Shares, and shares received upon exercising the warrants and piggyback warrants that had been commingled together, they functioned as statutory underwriters for such distribution, and any sales in connection therewith were not exempt from registration under Section 4(1) of the Securities Act. 36/

b. "Section 4(1 ½)"

Carley and Zacharias each contend that their sales of the Plan Shares were exempt from registration pursuant to the so-called Section 4(1 ½) exemption because the sales were made in private transactions to the Peeper Entities and not to the public. Geiger similarly contends that the sales of the Plan Shares were exempt as private transactions because the shares were sold to the Peeper Entities in private transactions and not to the public. The Section 4(1 ½) exemption is a "hybrid exemption" not specifically provided for in the Securities Act that basically allows "affiliates to make private sales of securities held by them so long as some of the established criteria for sales under both Section 4(1) and Section 4(2) of the Act are satisfied." 37/ As with the other exemptions from the registration requirements, persons claiming such an exemption have the burden of establishing that such sales do not constitute a public distribution. 38/ Respondents have not met this burden.

36/ We further reject the argument that the exemption provided by Section 4(1) applies to the resale of the 1997 Shares issued to the Peeper Entities pursuant to Regulation S. We have made clear that a person who acts as an underwriter may not resell Regulation S stock absent registration. Problematic Practices Under Regulation S, Securities Act Rel. No. 7190 (June 27, 1995), 59 SEC Docket 1998.

37/ Employee Benefit Plans, Securities Act Rel. No. 6188 (Feb. 1, 1980), 19 SEC Docket 465, 496 n.178; see also, e.g., United States v. Lindo, 18 F.3d 353, 358 (6th Cir. 1994); SEC v. Cavanagh, 1 F. Supp. 2d 337, 368 (S.D.N.Y. 1998); Louis Loss and Joel Seligman, Fundamentals of Securities Regulation 338 (3d ed. 1995); Hicks, Exempted Transactions Under The Securities Act of 1933 § 9.05 (1992); The Section "4(1) ½" Phenomenon: Private Resales of "Restricted" Securities, 34 Bus. Law. 1961 (1979). This implied exemption, which allows affiliates to sell substantial amounts of their shares to private investors, has been referred to as the 4(1½) exemption because it falls between the 4(1) and 4(2) exemptions, which allow, respectively, for sales among persons who are not issuers, underwriters, or dealers, and for private sales by an issuer. Cavanagh, 1 F. Supp. 2d at 368.

38/ See Cavanagh, 1 F. Supp. 2d at 368-69.

Carley, Zacharias, and the other Starnet Option Holders sold their Plan Shares to the Peeper Entities to replace the Starnet shares that the Peeper Entities had owned and previously sold to the public on behalf of Starnet Option Holders. The Plan Shares sold to the Peeper Entities were, in short order, resold to the public. Thus, the sales to the Peeper Entities were a necessary and critical step in the overall distribution of shares to the public. Carley and Zacharias knew, or should have known, of the Peeper Entities' role as the conduit of shares of Starnet common stock to the public. Accordingly, because these sales were not made in private transactions but were instead a necessary step in the distribution of securities to the public, they do not qualify for exemption under the registration requirements. 39/

c. Securities Act Section 4(4)

With respect to their own participation in the distribution of securities, Geiger and Kaufmann assert that the broker's exemption contained in Section 4(4) of the Securities Act, which exempts "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders" from the registration requirements of Securities Act Section 5, is available. However, this exemption – which is designed to exempt ordinary brokerage transactions – is not available to a registered representative if he knows or has reasonable grounds to believe that the selling customer's part of the transaction is not exempt from Section 5 of the Securities Act. In that event, the registered representative likewise violates Section 5 of the Securities Act by virtue of participating in a non-exempt transaction. 40/ The amount of inquiry required of the broker necessarily varies with the circumstances of each case; however, "when a dealer is offered a substantial block of a little-known security . . . where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for." 41/

39/ Cf. Earl J. Knudson & Co., 40 S.E.C. 599, 604 (1961) ("Under all the circumstances, we find that an illegal public distribution of International stock by controlling interests was effected and that Knudson participated in significant steps essential thereto and aided and abetted in such distribution. It is apparent that in light of the extensive distribution, no private offering exemption under Section 4(1) as claimed by Knudson was available.").

40/ See United States v. Wolfson, 405 F.2d 779, 782-83 (2d Cir. 1968), cert. denied, 394 U.S. 946 (1969); Loss & Seligman, supra note 37, at 1463; Wonsover, 54 S.E.C. at 13 n.27 (citing Quinn & Co., 44 S.E.C. at 468); Robert G. Leigh, 50 S.E.C. 189, 193 (1990) (noting that "the duty of inquiry extends to salesmen").

41/ Distribution By Broker-Dealers of Unregistered Securities, Securities Act Rel. No. 4445 (Feb. 2, 1962) (footnote omitted) (quoting SEC v. Culpepper, 270 F.2d 241, 251 (2d Cir. 1959)); see also Kane v. SEC, 842 F.2d 194, 199 (8th Cir. 1988); Wonsover, 54 S.E.C. at 14; Leigh, 50 S.E.C. at 193 (stating that "the duty of inquiry extends to salesmen").

Kaufmann and Geiger were responsible for executing a large number of transactions in a little-known security over a short period of time. Through this procedure, the Peeper Entities sold more than 5.2 million shares of Starnet common stock to the public. Kaufmann and Geiger knew or should have known that the Peeper Entities' sales of shares of Starnet common stock were part of an unlawful distribution. Kaufmann and Geiger helped to structure the steps in the distribution and had knowledge that the Peeper Entities agreed to sell shares of Starnet common stock to the public in order to fund the option exercises of Starnet's Option Holders, including Starnet directors and executive officers. Geiger knew that Starnet stock was being placed into the Peeper Entities' and Starnet officers' accounts at Spencer Edwards and sold to the public shortly thereafter. Kaufmann testified that he knew the Peeper Entities' accounts were selling Starnet stock on a "fairly continuous" basis. The trading instructions that Kaufmann received from Gould with respect to the Peeper Entities' accounts usually did not refer to a specific account, indicating that the accounts were being used as a fungible pool of stock that was sold to the public in order to facilitate the exercise of stock options by Starnet's officers and employees. Along with Gould, Kaufmann kept a running total of the stock being sold by the Peeper Entities' accounts. Kaufmann and Geiger also processed orders to wire the proceeds from the sale of Starnet stock by the Peeper Entities to the Brovarone trust accounts. Despite these facts, which strongly indicated that an unregistered distribution of Starnet stock was being accomplished through the Peeper Entities, Kaufmann and Geiger failed to make the searching inquiry required of them under these circumstances. Accordingly, Kaufmann and Geiger either knew or should have known that their clients' sales of Starnet common stock violated the provisions of Section 5 of the Securities Act; hence, Section 4(4) is not available to exempt their transactions. 42/

d. "Free Trading" Stock

Kaufmann argues that a July 1996 offering of 10 million shares by Starnet's predecessor pursuant to Rule 504 of Regulation D created a freely-trading public float. 43/ In his brief, Kaufmann maintains that these 10 million shares were commingled with the 1997 Shares and the

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42/ For the same reason, Geiger's argument that the Starnet officers' sales complied with Rule 144 fails. Rule 144 requires that sales pursuant to Rule 144 comply with Securities Act Section 4(4). Rule 144(g), 17 C.F.R. § 230.144(g). As discussed above, these sales did not. Nor had the officers satisfied the holding period for the sale of the Plan Shares. A new holding period begins upon exercise of the option. See Resales of Restricted and Other Securities, Securities Act Rel. No. 6099 (Aug. 2, 1979), 17 SEC Docket 1422, 1432 (stating that Rule 144 "permits tacking only if the consideration surrendered upon exercise of the warrants consists solely of other securities of the same issuer" and that where the consideration includes cash "the exercise of the warrants is deemed to involve the acquisition of new restricted securities for which tacking is not permitted").

43/ Rule 504 of Regulation D, 17 C.F.R. § 230.504, as in effect in 1996, permitted a non-reporting issuer to offer and sell securities without filing a registration statement, so long as the offer and sale was limited to $1 million in any twelve-month period.

Plan Shares in the Spencer Edwards accounts of the Peeper Entities and Starnet's officers and, therefore, there is no evidence in the record that any single share sold from these accounts "was other than a free trading share."

The record is clear that the Peeper Entities purchased their shares of Starnet common stock directly from Starnet, either in the Regulation S offering, which closed in December 1997, or through the exercise of warrants and piggyback warrants in 1999, and that it was these shares, along with shares of Starnet stock issued upon exercise of stock options and transferred to the Peeper Entities and commingled with the other shares, that were resold to the public as part of the distribution. Moreover, assuming that the July 1996 offering complied with the provisions of Rule 504, any resale of the shares had to be registered or qualify for an exemption. 44/ The Division established that there was never a registered public offering of Starnet stock, and Kaufmann has failed to establish that, with one possible exception cited by the law judge involving 100,000 shares, any subsequent transactions in the 10 million shares were exempt from registration. 45/

2. Participant Liability for Section 5 Violations

To show that a person bears participant liability for a Section 5 violation, the Division must prove that the person was a "necessary participant" or "substantial factor" in the violation. 46/ Even where the person or entity does not have individual contact with the purchasers of the securities, that person or entity has indirectly offered or sold the security to the

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44/ See Preliminary Note 4 to Regulation D, 17 C.F.R. §§ 230.501-.508 ("These rules are available only to the issuer of the securities and not to any affiliate of that issuer or to any other person for resales of the issuer's securities. The rules provide an exemption only for the transactions in which the securities are offered or sold by the issuer, not for the securities themselves.").

45/ Kaufmann and Price also objected to four of the Division's exhibits summarizing the sale of Starnet stock on the basis that the transactions reflected therein could include the alleged 10 million shares that were free trading public float. Respondents have failed to establish that the resales of this stock previously issued under Rule 504 were either registered or entitled to an exemption and, therefore, there is no basis for excluding the challenged Division exhibits.

46/ SEC v. Calvo, 378 F.3d 1211, 1215 (11th Cir. 2004); see also Holschuh, 694 F.2d at 139-40; Murphy, 626 F.2d at 649-52.

public "if he or it has employed or directed others to sell or offer them, or has conceived of and planned the scheme by which the unregistered securities were offered or sold." 47/

Carley and Zacharias each contend that the record does not support a finding that they participated in sales of securities in violation of the registration requirements of Section 5. 48/ The record establishes that Carley and Zacharias each participated in the unregistered distribution of securities and received proceeds from the Peeper Entities in connection with their exercise of stock options. Both Carley and Zacharias executed Gould's irrevocable authorization acknowledging that "certain shares will be sold" on their behalf prior to the receipt of the Plan Shares and that Gould would transfer the shares received in their name "into an appropriate account in order to reimburse for the shares sold on my behalf." What Carley characterizes as "control accounts" at Spencer Edwards were opened for both Carley and Zacharias through which Starnet stock was sold, and each received monthly statements for these accounts. Thus, Carley and Zacharias were necessary participants in the unregistered transactions through which they exercised and sold their stock options. 49/

47/ SEC v. Friendly Power, 49 F. Supp. 2d 1363, 1371 (S.D. Fla. 1999); see also Holschuh, 694 F.2d at 140 ("To hold that proof of direct contact [with investors] is necessary would be to ignore and render meaningless the language of Section 5, which prohibits any person from 'directly or indirectly' engaging in the offer or sale of unregistered securities.").

48/ Zacharias contends that the law judge found that Zacharias violated Section 5 only in connection with sales of his own stock and rejected the contention that he violated Section 5 in any other way. The law judge, however, concluded that Zacharias was directly involved in the sale of his own shares and indirectly involved in the sale of Plan Shares by Starnet's Option Holders.

49/ Carley argues that he did not become an officer of Starnet until October 1997 and that he worked for Starnet on a part-time basis until March or April 1998, at which time he assumed full-time status. He contends that these facts establish that he was not a participant in the unregistered sale of Starnet stock and that the law judge violated his due process rights by finding that Carley had been a Starnet director since January 1997.

It is unclear how Carley's claim that he did not become a full-time officer until April 1998 supports his contention that he did not violate the registration requirements. Carley does not dispute that he was a full-time Starnet officer in January 1999, when Starnet began its unregistered distribution through the Peeper Entities' purchase and sale of Starnet stock obtained upon the exercise of the warrants and piggyback warrants and when he began to exercise his stock options. Thus, he was a substantial participant in the sale of unregistered Starnet stock regardless of when he became an officer of the company.

(continued...)

Moreover, Zacharias was involved in structuring the various steps of the distribution. He first discussed with Gould the inability of Starnet Option Holders to resell their Plan Shares in Canada. He was responsible for directing the transfer agent to issue Starnet stock upon the Peeper Entities' exercise of the warrants and piggyback warrants, making that stock available to be sold as part of an unregistered distribution. As an addressee on Brovarone's memorandum, he clearly knew the process by which the plan to distribute Starnet stock was being effectuated. 50/

Kaufmann and Geiger were also necessary participants and substantial factors in the sale of unregistered Starnet stock. Kaufmann and Geiger were account executives on the Spencer Edwards accounts of the Peeper Entities, of Carley, Zacharias, other Starnet officers, and of Celestine. Under their joint account number, they executed the trades in Starnet stock for these accounts. 51/

Geiger claims that he cannot be liable as a participant because he acted as "one who simply brokers a transaction . . . and receives usual and customary compensation." Geiger understates his involvement. In 1997, Geiger took two trips to Vancouver to meet with Starnet officers, and he recommended that Peeper participate in the 1997 Regulation S offering. 52/ Later, he met with Gould regarding the plan to "swap" the Peeper Entities' shares for the Plan Shares, and he informed Peeper that stock held by Starnet's employees and officers might become available. Geiger knew that the Peeper Entities were purchasing large quantities of Starnet stock from the exercise of the warrants and piggyback warrants (as well as receiving Plan Shares) and shortly thereafter selling them to the public. 53/ Indeed, Geiger executed most of these trades.

49/ (...continued)
In any event, Carley admitted in his answer to the OIP that he was Starnet's chief financial officer from at least March 10, 1997, although he now claims that this admission was incorrect. Amendment No. 1 to Form 10-SB, filed August 14, 1997, and Form 10-KSB, filed July 30, 1999, also state that Carley became a Starnet director on January 27, 1997.

50/ See supra note 13.

51/ Although Geiger executed most of the sales from the Peeper Entities' accounts, Kaufmann testified that he executed at least some of the sales from the Peeper Entities' accounts.

52/ Geiger also received valuable consideration from the Peeper Entities. See supra note 19.

53/ Geiger v. SEC, 363 F.3d 481, 487 (D.C. Cir. 2004) (holding that a person responsible for "finding the buyer, negotiating the terms, [and] facilitating the resale" is a participant in the sale of unregistered securities).

Kaufmann asserts that he was a fringe participant in these transactions. Kaufmann communicated frequently with Gould. He accepted orders from Gould and ensured that Brovarone had funds to wire as directed by Gould. Kaufmann tracked the transactions in Starnet stock from the Peeper Entities' accounts and knew that it did not matter which Peeper Entities' accounts sold stock to facilitate the exercise of the Starnet Plan options and that the shares of Starnet stock held in the Peeper Entities' accounts were treated as being fungible. He completed Forms 144 in connection with the sales of Plan Shares from Starnet officers' Spencer Edwards accounts.

Kaufmann argues that he took steps to assure that Starnet securities could lawfully be sold. For example, Kaufmann created a form for Spencer Edwards's use in investigating the history of stock certificates. During an examination of Spencer Edwards by Commission staff in August 1999, Kaufmann asked a Commission examiner whether Kaufmann had correctly completed two sets of Forms 144 for Starnet officers and directors with respect to their sale of Starnet stock. Kaufmann stated that, while the examiner "didn't do detailed research into it," he thought that the two Forms 144 "appeared, at least in form, to be filled out properly." When he encountered a stock certificate in the name of a predecessor company of Starnet with which he was unfamiliar, he discussed his concerns with Brovarone and the transfer agent. Nevertheless, Kaufmann's actions fell short of the searching inquiry required given the numerous indications that the millions of shares of Starnet stock that were being sold through accounts at Spencer Edwards were part of an unregistered distribution. Indeed, when he asked Brovarone about the predecessor corporation stock certificate, Brovarone warned him that all affiliates' stock was restricted and unregistered stock could not be sold. As demonstrated above, Kaufmann disregarded this advice.

Accordingly, we conclude that Carley, Zacharias, Kaufmann, and Geiger are each liable as participants in the offer or sale of unregistered securities.

3. Advice of Counsel

Geiger and Kaufmann each argue that they properly relied on the advice of counsel. Reliance on the advice of counsel requires that a respondent "made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith." 54/ Geiger and Kaufmann produced no evidence that they disclosed the mechanics of the swap transactions to an attorney and received advice that those transactions complied with the securities laws.

Although the record contains several opinion letters discussing isolated components of the swap transactions, no letter addresses the legality of the plan to swap Starnet common stock held by the Peeper entities for Plan Shares issued to Starnet's Option Holders. Kaufmann

54/ Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir. 1994) (citing SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981)).

contends that counsel "issued opinions regarding the propriety and legality of removing the restrictive legends from the shares utilized in the employee stock option process," 55/ but these letters do not analyze the propriety or legality of swapping the shares acquired by the Peeper entities pursuant to the Regulation S offering for the shares issued to Starnet's Option Holders under the stock option plans. 56/ In 1997, Brovarone wrote Starnet's transfer agent opining that the sale of the 1997 Shares was "exempt" from registration pursuant to Regulation S and that the stock certificates could be issued without restrictive legends. In December 1998, attorney Scott Reed gave Zacharias an opinion that Starnet could also issue the shares obtained by the Peeper Entities upon exercise of the warrants without restrictive legends. Geiger and Kaufmann could not rely on either opinion because both discussed only the legality of issuing the shares without a restrictive legend and did not address the legality of swapping those shares for Plan Shares.

Brovarone's opinion letters discussing Rule 144 transactions by Starnet officers also involved only one component of the swap transactions. These opinion letters expressed only the opinion that Starnet was current in its filings, that Starnet and its management did not know of any reason why the proposed sale could not be made within ninety days under Rule 144, that the number of shares sold or planned to be sold by the shareholder was less than the greater of one percent of the outstanding shares of common stock or the average weekly volume for the past four weeks, and that the shareholder was exempt from registration pursuant to the Securities Act of British Columbia. Brovarone also rendered his opinion after his "review of the attached documentation, and in reliance upon certain representations made by the Shareholder," which included the representation that the seller was "not individually, or together with others, engaged in making a distribution of a substantial amount of such securities, and has no intention of making or participating in such distribution." Geiger and Kaufmann knew that the transaction described in the opinion letter was only one step in the process of swapping Starnet common stock held by the Peeper entities for Plan Shares issued to Starnet's Option Holders. The Rule 144 opinion letters did not opine on the legality of this process.

55/ A restrictive legend is "a statement place on restricted stock notifying the holder that the stock may not be resold without registration." Charles F. Kirby, Securities Act Rel. No. 8174 (Jan. 9, 2003), 79 SEC Docket 1081, 1084, petition denied sub nom. Geiger v. SEC, 363 F.3d 481 (D.C. Cir. 2004). The absence of a restrictive legend on stock certificates, however, does not "warrant the conclusion that they must be freely tradable." Gilbert F. Tuffli, Jr., 46 S.E.C. 401, 409 (1976).

56/ Geiger and Kaufmann also may not rely on Canadian counsel's opinion letter that proposed transferring the Plan Shares out of British Columbia and then reselling them because Starnet never implemented this hypothetical structure. See supra note 9. Geiger suggests that Gould fulfilled a role akin to the non-Canadian trustee suggested by counsel. There is no suggestion in the record, however, that Gould, a Vancouver resident, acted other than as an associated person of United Capital, a broker-dealer.

The only document which discusses the entirety of the swap transaction process is Brovarone's September 1999 memorandum. We reject Kaufmann's assertion that this document "was, in and of itself, a legal opinion validating the stock option process which is the subject of this administrative proceeding." This memorandum simply recited the steps involved in the swap transactions and did not opine on their legality. We therefore reject the argument that Geiger and Kaufmann properly relied on the advice of counsel because they produced no evidence that an attorney provided advice that the swap transactions complied with the securities laws. 57/

Geiger and Kaufmann also claim reliance on the removal of restrictive legends from Starnet officers' stock certificates by Starnet's transfer agent. We have held that "a securities professional cannot rely on the determination of a transfer agent that stock is free trading." 58/

57/ Cf. SEC v. McNamee, 481 F.3d 451, 456 (7th Cir. 2007) (rejecting advice of counsel defense because defendant "did not produce any letter from a securities lawyer giving advice that reflected knowledge of all material facts"); see also Wonsover, 205 F.3d at 415 (finding that "[p]recedent will not suffer [respondent's] argument that he justifiably relied on the clearance of sales by [the restricted stock department], the transfer agent and counsel" because an "investment executive . . . has the primary responsibility to prevent illegal sales of restricted or control stock").

58/ Kirby, 79 SEC Docket at 1092 n.34 (citing Wonsover, 54 S.E.C. at 15 (finding that registered representative was not relieved of his obligation to explore whether shares are freely tradeable "simply because the transfer agent and Restricted Stock Department eventually cleared the stock"); Leigh, 50 S.E.C. at 194 (finding that, "as the courts and this Commission have held, the transfer agent's willingness to reissue the certificates without restrictive legends did not relieve [the registered representative] of his obligation to investigate")).

Kaufmann and Geiger each claim that their violations of Securities Act Section 5 were not "willful" within the meaning of Exchange Act Section 15(b)(4), 15 U.S.C. § 78o(b)(4). Exchange Act 15(b) authorizes the Commission to impose certain sanctions based on willful violations of the securities laws. A "willful violation of the securities law . . . means merely the intentional commission of an act which constitutes the violation and does not require that the actor 'also be aware that he is violating one of the Rules or Acts.'" Wonsover, 205 F.3d at 414 (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)); see also V.F. Minton, 51 S.E.C. 346, 352 (1993), aff'd, 18 F.3d 937 (5th Cir. 1994) (Table). At best, Kaufmann and Geiger closed their eyes to suspicious facts suggesting that the Starnet stock being sold through Spencer Edwards constituted an unregistered distribution, and they ignored the obvious need for further inquiry in violation of their duties as registered representatives of a broker-dealer. In so doing, they willfully violated Securities Act Sections 5(a) and 5(c).

* * *

We conclude that the offers and sales of Starnet stock at issue here were not registered under the Securities Act, that Carley, Zacharias, Geiger, and Kaufmann participated in the sale of unregistered Starnet stock, and that the sales at issue here did not fall within any applicable exemption to the registration requirements. As a result, in accordance with Securities Act Section 8A and Exchange Act Section 21C, we find that Carley and Zacharias violated Securities Act Sections 5(a) and 5(c), and, in accordance with Exchange Act Section 15(b), we find that Geiger and Kaufmann willfully violated Securities Act Sections 5(a) and 5(c). 59/

V.

Supervision of Geiger and Kaufmann

A. Edward Price has been president, CEO, branch manager, and compliance officer for Spencer Edwards since March 1994. Price was responsible for supervising Kaufmann and Geiger during the events at issue in this proceeding, as well as for overseeing the daily operations of Spencer Edwards. As part of his responsibilities, Price organized and ran annual compliance meetings and ultimately was responsible for compliance matters at Spencer Edwards. Price testified that his compliance responsibilities comprised "anything of a legal nature that was part of our procedures."

Geiger and Price were respondents in a previous Commission administrative proceeding involving stock sales as part of an unregistered distribution in violation of Securities Act Section 5 by one of the Peeper Entities involved in this proceeding (the "Kirby proceeding"). 60/ Price

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59/ The law judge also found that sales of Starnet stock by Madison Park Trust, a trust for which Carley and his wife were the sole beneficiaries, violated Securities Act Sections 5(a) and 5(c). We have determined, given the lack of evidence in the record before us in this proceeding, to dismiss the allegation that these sales were part of an unregistered distribution in violation of Securities Act Sections 5(a) and 5(c).

60/ Geiger was charged with willfully violating Securities Act Section 5. Price was charged with failing to supervise Geiger. We found that Geiger willfully violated Section 5 in the offer and sale of two blocks of Golden Eagle International, Inc. stock, totaling roughly 2.8 million shares, by LaSalle Investments, Ltd., one of the Peeper Entities involved in this proceeding. We barred Geiger from association with any broker or dealer with a right to reapply after five years and from participation in any penny stock offering, ordered him to cease and desist from violations or future violations of Securities Act Section 5, and ordered him to pay $14,109.21 in disgorgement and a civil penalty of $300,000. Charles F. Kirby, Securities Act Rel. No. 8174 (Jan. 9, 2003), 79 SEC Docket 1081, petition denied sub nom. Geiger v. SEC, 363 F.3d 481 (D.C. Cir. 2004). The law judge found (continued...)

responded to the investigation in the Kirby proceeding by placing Geiger and Kaufmann on "special supervision." Price placed Geiger on special supervision after Spencer Edwards determined that, in connection with the Kirby proceeding, Geiger failed to engage in a searching inquiry into the origin of securities to ensure that he was not facilitating an unregistered sale. Price removed Geiger from special supervision after Spencer Edwards determined that Geiger was "now capable of identifying the circumstances which give rise to a higher than usual level of scrutiny before engaging in a particular transaction." Geiger's special supervision lasted from September 1996 to September 1997. Kaufmann was not a respondent in the Kirby proceeding, but Price learned during the investigation in that proceeding that Kaufmann had signed a broker-dealer representation letter required under Rule 144 without authority to do so. Price placed Kaufmann on special supervision from September 1996 to March 1997. 61/

Price maintained that, although he did not return Geiger and Kaufmann to "special" supervision following the hearing in the Kirby proceeding, he exercised what he characterized as "heightened supervision" over all the transactions conducted by Geiger and Kaufmann. 62/ However, Price allowed Geiger and Kaufmann to share a separate private office. That office included a separate facsimile machine. Price testified that he "assumed if there was anything of

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60/ (...continued)
that Price had not failed reasonably to supervise Geiger and dismissed the proceeding against him. We declared that determination final. Kirby, 79 SEC Docket at 1082 n.3.

61/ Price also called a special compliance meeting in September 1996 after giving investigative testimony in the Kirby proceeding. All registered representatives, including Kaufmann and Geiger, were required to attend. Until that time, Spencer Edwards's salespersons had verified the origin of a stock certificate by checking with the transfer agent and speaking with the issuer and the customer. Price told the registered representatives that a more searching inquiry was required before processing transactions. Spencer Edwards also sent a memorandum to all its brokers listing several red flags, such as certificates delivered into foreign accounts and certificates for large blocks of stock relative to the stock's average trading volume, that indicated the need for a more searching inquiry into a stock certificate.

62/ Price stated in his investigative testimony in the instant proceeding that the trial in the Kirby proceeding was an "eye-opening" experience regarding Geiger. According to Price, Geiger "lied about the whole thing." Price testified further at the hearing in this proceeding that "[m]any of the things that we had thought in the compliance department to be true . . . turned out to be incorrect."

importance they would bring me the fax like everybody in the firm did." 63/ Price acknowledged that he never saw any of the numerous facsimiles exchanged between Kaufmann and Gould. 64/

Price testified that he reviewed the account activity in the Peeper Entities' accounts as part of his heightened supervision. Price knew that both Geiger and Kaufmann were the account executives for the Peeper Entities' accounts and that the Peeper Entities' accounts were "very active." He saw that the Peeper accounts were selling large amounts of Starnet stock into the market starting in January 1999. Price asked Geiger and Kaufmann about these transactions. He testified that they told him "that the employees of Starnet were exercising their stock options and that Mr. Peeper was buying them in a private transaction and selling them back into the market, and that they were registered under S-8." Price learned, as the Starnet shares continued to come through the accounts, that some of the stock being sold by the Peeper Entities' accounts was acquired through the exercise by the Peeper Entities of warrants and piggyback warrants issued as part of an earlier Regulation S offering.

Price testified that he did not request to see any opinion letters associated with the Starnet stock being sold in the Peeper accounts even though his understanding was that Regulation S shares could not be "sold back into the United States except in certain circumstances." He simply asked Geiger and Kaufmann if opinion letters "existed" and if Geiger and Kaufmann "felt comfortable with the transactions." Price also testified that he "questioned" Geiger and Kaufmann about the transactions involving Starnet. He asked Geiger and Kaufmann whether they had met all of the firm's requirements with respect to these transactions and whether they had gone further than they usually would on a regular transaction. Price testified that Geiger and Kaufmann answered these questions affirmatively. Price admitted that he did not himself do anything to investigate the source of the stock.

Price also testified that he reviewed the Starnet officers' Rule 144 transactions. He stated that he knew Carley and Zacharias opened accounts at Spencer Edwards, that he associated these accounts with the sale of control stock, and that Kaufmann prepared most of the Rule 144 paperwork with respect to the sale of control stock through the Starnet officers' accounts. Price admitted that the Forms 144 associated with these sales were never filed with the Commission. Price further acknowledged certain inaccuracies, such as the number of outstanding shares of Starnet, on the Forms 144. Price testified that he was not responsible for the accuracy of the information on the forms and that the obligation to ensure that the forms contained correct information rested with the account executive.

63/ Spencer Edwards's compliance manual provided, among other requirements, that all incoming correspondence "be reviewed by the Operations Manager or the Compliance Department prior to distribution" and that all "correspondence or other written communication with a customer or prospective customer which relates to [Spencer Edwards] and its business shall be reviewed prior to mailing or delivery."

64/ Price also did not see the few facsimile messages addressed to Geiger.

B. Exchange Act Sections 15(b)(6) and 15(b)(4)(E) provide that we may sanction a person associated with a broker-dealer if we find that such person failed reasonably to supervise, with a view to preventing violations of the federal securities laws and rules and regulations thereunder, another person who commits such violations if such person is subject to the individual's supervision. 65/ No person shall be deemed to have failed reasonably to supervise any other person if (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with. 66/

We find that Price failed reasonably to supervise Kaufmann and Geiger. Supervision of an associated person must be "reasonable . . . under the attendant circumstances." 67/ Here, Price knew that Geiger had previously been charged with offering and selling unregistered securities from an account in the name of one of the Peeper Entities involved in this proceeding. He also believed that Geiger had lied to him about transactions involving unregistered stock in the Kirby proceeding. Price knew further, as a result of the investigation in the Kirby matter, that Kaufmann had signed a Rule 144 broker-dealer representation letter without authority to do so. These facts highlighted the need for Price's heightened supervision over Geiger and Kaufmann, especially regarding unregistered sales of securities and alleged Rule 144 transactions. 68/ Under these circumstances, Price had a particular responsibility to ensure not only that rules and procedures were in place to supervise Geiger and Kaufmann properly, but also that those rules and procedures were enforced. 69/

65/ 15 U.S.C. §§ 78*o*(b)(6), (b)(4)(E).

66/ Id.

67/ Clarence Z. Wurtz, 54 S.E.C. 1121, 1130 (2001) (quoting Arthur James Huff, 50 S.E.C. 524, 528-29 (1991)); see also Louis R. Trujillo, 49 S.E.C. 1106, 1110 (1989) (stating that supervision must be reasonable "under all the circumstances").

68/ See John A. Chepak, 54 S.E.C. 502, 514 (2000) (stating that "prior misconduct indicated the need for heightened supervision, particularly in areas that had resulted in previous violations"); see also Consol. Invs. Servs., Inc., 52 S.E.C. 582, 588-89 (1996) (stating that an employee who has previously evidenced misconduct can only be retained if he subsequently is subjected to a commensurately higher level of supervision).

69/ See Wurtz, 54 S.E.C. at 1130 (stating that supervisors who know of an employee's past disciplinary history must ensure not only that rules and procedures are in place to supervise the employee properly, but also that those rules and procedures are enforced).

The procedures Price instituted in response to the misconduct in the Kirby proceeding were inadequate. "We have repeatedly stressed that supervisors cannot rely on the unverified representations of their subordinates." 70/ Here, however, Price relied primarily on Geiger's and Kaufmann's statements in reviewing their account activity. 71/ Price conducted his review of the Starnet sales by asking Geiger and Kaufmann whether they were "comfortable with the transactions," whether they had "met all of [the firm's] requirements with these transactions," and whether they had "gone further than [they] usually would on a regular transaction." Price testified further that he did not request to see any opinion letters associated with the Starnet stock being sold out of the Peeper accounts and simply asked Geiger and Kaufmann "if they existed" and if Geiger and Kaufmann "felt comfortable with the transactions." We find this method for assessing the activity in the Peeper accounts "woefully inadequate." 72/

We have held previously that "any indication of irregularity brought to a supervisor's attention must be treated with the utmost vigilance." 73/ Price knew that the Peeper accounts were selling large amounts of Starnet stock. Geiger and Kaufmann told him that Peeper was buying Plan Shares and selling them back into the market. Price learned that Peeper bought the Plan Shares by selling Starnet shares previously obtained through the exercise of warrants and piggyback warrants tied to an earlier Regulation S offering. He testified that he knew Regulation S shares "could not be sold back into the United States except under certain circumstances." Price knew further that the misconduct in the Kirby case involved unregistered sales allegedly pursuant to Regulation S of securities in accounts controlled by Peeper. He acknowledged that he considered the Kirby proceeding an "eye-opening" experience. However, although Price maintained that he exercised "heightened supervision" over Geiger and Kaufmann following the Kirby proceeding, Price allowed Geiger and Kaufmann to retain a private office with a separate facsimile machine. Price also "questioned" Geiger and Kaufman with respect to the sales of Starnet stock in the Peeper Entities' accounts, but when asked whether he himself did "anything to investigate the source of the stock," he answered no. Price's failure to monitor more closely Geiger and Kaufmann's transactions and conduct his own investigation into these transactions was unreasonable, particularly in light of the previous Regulation S-related misconduct and the

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70/ Quest Capital Strategies, 55 S.E.C. 362, 372 (2001) (citing John H. Gutfreund, 51 S.E.C. 93, 108 (1992) and Michael H. Hume, 52 S.E.C. 243, 248 (1995)).

71/ As noted, Price had previously instructed Spencer Edwards's registered representatives to conduct a searching inquiry regarding unregistered stock and to do more than rely on the word of the transfer agent, issuer, or customer.

72/ Cf. Quest Capital Strategies, 55 S.E.C. at 374 (finding that, although respondents had a comprehensive set of rules, respondents' system for applying the rules to the misconduct at issue was "woefully inadequate" because "[r]elying on a subordinate's assurances is hardly an effective method of preventing or detecting violations").

73/ See Consol. Invs. Servs., 52 S.E.C. at 588.

evidence of numerous ongoing Regulation S-related sales and sales of the Plan Shares as part of the distribution. 74/

Price's review of the Rule 144 paperwork prepared by Kaufmann was deficient, particularly in light of Kaufmann's past failure to follow firm procedures regarding such transactions. Price testified that he reviewed the Forms 144 prepared by Kaufmann, but he acknowledged the misstatement of the number of outstanding Starnet shares in certain of these forms. 75/ Price admitted further that the Forms 144 associated with these sales were never filed with the Commission. Price's supervisory review of the Rule 144 paperwork was cursory at best and constituted a failure of supervision. 76/

We reject Price's contention that the law judge improperly failed to consider the dismissal in the Kirby proceeding of the allegations that Price failed to supervise reasonably. The adequacy of supervisory procedures and their implementation necessarily depends on the facts and circumstances of each case. 77/ The circumstances which led the law judge in Kirby to conclude that Price's supervision was "reasonable" in that case are not present here. For example, in Kirby, the law judge concluded that Price "had no reason to think that Mr. Kirby would hide his activities from his review" and that Price "had no reason to think Mr. Geiger would lie about his dealings with the issuer and the issuer's attorney." 78/ At the time he was supervising the transactions at issue in this proceeding, however, Price knew, as he testified, that, with respect to the Kirby matter, Geiger had "lied about the whole thing."

74/ Cf. James J. Pasztor, 54 S.E.C. 398, 412-13 (1999) (finding failure to supervise where, in light of "many red flags" that employee was effecting wash trades and matched orders, supervisor "[a]t a minimum" "should have conducted an independent investigation"); Michael E. Tennenbaum, 47 S.E.C. 703, 711 (1982) (finding failure to supervise where, despite specific warnings that employee might be engaging in excessive trading, supervisor "failed to take or recommend any action to investigate [his] activities").

75/ Price testified that this error was not something he would have noticed at the time.

76/ See Blinder, Robinson & Co., 47 S.E.C. 812, 814 (1982) (finding respondents' "cursory examination" "clearly inadequate" because a failure of supervision "connotes 'a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them.'") (quoting Jerome F. Tegeler, 45 S.E.C. 512, 515 n.8 (1974) and Anthony J. Amato, 45 S.E.C. 282, 286 (1973)).

77/ La Jolla Capital Corp., 54 S.E.C. 275, 281 (1999).

78/ Charles F. Kirby, Initial Decision Rel. No. 177 (Dec. 7, 2000), 73 SEC Docket 3550, 3577, 3580.

We also reject Price's contention that finding violations of the registration provisions of the federal securities laws by the other Respondents "is inconsistent" with finding that Price failed to supervise because the covert nature of the violations "circumvented his ability to uncover and stop" the misconduct. The duty of supervision includes the responsibility to investigate red flags that suggest that misconduct may be occurring and to act upon the results of such investigation. 79/ Price's knowledge of the misconduct in the Kirby proceeding, which involved the unregistered sale of securities allegedly pursuant to Regulation S from accounts controlled by Peeper, as well as the numerous sales of Starnet stock in 1999 many of which were acquired in a Regulation S offering, demanded further investigation, which could have allowed Price to detect the violations of the securities laws. 80/ In addition to the red flags, Price might have discovered the misconduct had he monitored the facsimiles between Kaufmann and Gould. However, although Spencer Edwards required that a compliance officer review all client correspondence, Price allowed Geiger and Kaufmann to retain a separate facsimile machine in their private office even after the misconduct in the Kirby proceeding because he still "assumed if there was anything of importance they would bring me the fax like everybody in the firm did."

Price contends further that he did not fail to supervise reasonably because he relied on "green flags" provided by attorneys. He invokes the court's finding in Howard v. SEC 81/ that a broker did not recklessly aid and abet securities law violations because "rather than red flags, [he] encountered green ones, as outside and inside counsel approved [the transactions.]" According to Price, "Zoe Cole, a full-time compliance attorney who was Price's direct assistant, reviewed and supervised the transactions." Although Price testified that Cole reviewed unspecified opinion letters associated with Starnet's Regulation S offering and reviewed purported Rule 144 transactions by Starnet officers, no evidence suggests that she approved the resale of shares obtained pursuant to the Regulation S offering or the swap of those shares for Plan Shares. Price acknowledged that he did not discuss with Cole the issue of resales in the United States of stock issued pursuant to the Regulation S offering and that his understanding was that "Reg S shares could not be sold back into the United States except under certain circumstances." 82/

79/ Michael T. Studer, Exchange Act Rel. No. 50543A (Nov. 30, 2004), 84 SEC Docket 911, 922

80/ See Christopher J. Benz, 52 S.E.C. 1280, 1282 (1997) (rejecting contention that supervisor "could not have discovered" employee's violations because there were "numerous red flags" that supervisor "should not have ignored" such as employee's history of compliance problems and suspicious activities in employee's accounts).

81/ 376 F.3d 1136, 1147 (D.C. Cir. 2004).

82/ We also reject Price's contention that "[u]nder the ruling of Arthur James Huff, [50 S.E.C. 524 (1991)], Price cannot be disciplined in this matter. If there was deficient

(continued...)

Unlike in Howard, moreover, where the court found no "unusual circumstances" suggesting that the respondent acted recklessly, 83/ numerous red flags, as described above, existed here that suggested Geiger and Kaufmann were violating the securities laws. "When a broker ignores the obvious need for further inquiry, even in reliance on assurances from other brokers or attorneys, he violates the act." 84/ A broker has the primary responsibility to prevent illegal sales of restricted or control stock. 85/ Brokers are expected to have sufficient knowledge of the securities laws to investigate affirmatively when it appears that an offering may require registration. 86/ A supervisor may no more ignore the obvious need for further inquiry, even in reliance on assurances from an attorney, than may a salesperson.

Price also contends that he relied on attorney opinion letters authored by Reed and Brovarone regarding the legality of removing restrictive legends from the Starnet shares and selling Starnet shares pursuant to Rule 144. Price could not rely on the letters opining on the removal of restrictive legends because they did not deal with resales of the shares by the Peeper entities. 87/ The letters opining on the validity of individual Rule 144 transactions by Starnet officers did not relieve Price from conducting further searching inquiry. Even if the Rule 144 opinion letters authorized individual transactions by Starnet officers, Price knew of numerous additional sales of Starnet stock that should have put him on inquiry notice that the Rule 144

82/ (...continued)
supervision in this matter, Cole, not Price was the deficient supervisor and, therefore, Price cannot be disciplined." According to Price, the Commission held in Huff that "an individual cannot be disciplined for failing to supervise another individual who was in turn, a deficient supervisor." Price contends that "Cole was in fact, a supervisor who was in turn, supervised by Price." Price, however, was not charged with failing to supervise Cole, but with failing to supervise Geiger and Kaufmann. The record establishes that Price supervised Geiger and Kaufmann, and thus may be sanctioned for failing to supervise reasonably with a view to prevent their violations of the securities laws.

83/ 376 F.3d at 1149.

84/ Sorrell v. SEC, 679 F.2d 1323, 1327 (9th Cir. 1982).

85/ See Wonsover, 205 F.3d at 415 (rejecting broker's argument that he justifiably relied on the clearance of sales by the restricted stock department, the transfer agent, and counsel).

86/ Sorrell, 679 F.2d at 1327 (citing Quinn & Co., 452 F.2d at 946-47).

87/ See Robert G. Leigh, 50 S.E.C. 189, 194 (1990) (stating that a broker could not rely on a letter from issuer's counsel because the letter in question dealt only with the legality of reissuing the shares to certain persons and not with the legality of sales by those persons). We note further that a transfer agent's willingness to reissue certificates without restrictive legends does not relieve a broker of his obligation to investigate. Id.

transactions were part of an unregistered distribution. Accordingly, those letters would not diminish Price's responsibility to probe the transactions conducted by Geiger and Kaufmann.

VI.

Violations of the Antifraud Provisions

A. On July 30, 1999, Starnet filed with the Commission its annual report on Form 10-KSB for the fiscal year ending April 30, 1999. On August 12, 1999, Starnet filed an amended annual report for fiscal year 1999 on Form 10-KSB/A. In Item 12 of each form, which was required to contain disclosure regarding "Certain Relationships and Related Transactions," Starnet stated that there was "nothing reportable." 88/ Zacharias prepared and signed the Form 10-KSB, and both Zacharias and Carley signed the Form 10-KSB/A.

B. Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 proscribe fraudulent conduct. Material misstatements, or omissions necessary to make other statements not misleading, in connection with the offer, sale, or purchase of securities constitute violations of these provisions. 89/ The Division contends that Carley and Zacharias violated these provisions by failing to disclose in Starnet's 1999 annual report the nature and extent of the related-party transactions with respect to its Plans. Regulation S-B requires that small business issuers disclose any transactions with related parties that occurred during the

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88/ Item 404 of Regulation S-B, Certain Relationships and Related Transactions, 17 C.F.R. § 228.404. In general, at the time of the conduct described herein, the Item required that, subject to certain exclusions not relevant here, small business issuers disclose any transactions during the previous two years in which the small business issuer was a party and in which individuals or entities specified in Item 404(a), including directors and executive officers, had a direct or indirect material interest. No information needed to be included for any transaction in which the amount involved did not exceed $60,000.

89/ A fact is material if there is a substantial likelihood that a reasonable investor would have considered the omitted or misstated fact important to his or her investment decision, and disclosure of the omitted or misstated fact would have significantly altered the total mix of information available to the investor. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

To violate Sections 17(a), 10(b) and Rule 10b-5, respondents must act with scienter, the "mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). There is no scienter requirement for violations of Sections 17(a)(2) or 17(a)(3) of the Securities Act; negligence is sufficient. Aaron v. SEC, 446 U.S. 680, 685, 701-02 (1980).

previous two years. 90/ Generally, issuers are required (subject to certain exclusions not relevant here) to disclose transactions in which the issuer was a party, the amount exceeded $60,000, and an executive officer or director (among others) had a direct or indirect material interest in the transaction. 91/

Starnet needed to disclose the transactions which resulted in its directors and executive officers, among others, obtaining cash in the amount that they would have obtained had they been able to exercise their stock options. Item 404 of Regulation S-B required disclosure of the transactions through which Starnet enabled its Option Holders to obtain the financial benefit equivalent to the exercise of those options. The transactions were not simple option exercises and were materially different from the transactions contemplated by Starnet's option plans. Starnet, through Zacharias, devised a procedure to facilitate the exercise of the options. This procedure involved a series of transactions that exceeded $60,000 and that resulted in the Option Holders receiving cash in the amount that they would have obtained had they been able to exercise the options. The Peeper Entities sold shares with the proceeds going to the Option Holders, and the Peeper Entities received the Option Holders' shares as replacements. The fact that Starnet arranged the series of transactions in excess of $60,000 and that the officers and directors had a direct material interest in those transactions required their disclosure under Item 404.

Zacharias argues that the employee stock option transactions in question did not need to be disclosed because the price of the Regulation S stock and prices at which the options and Regulation S warrants were issued had been negotiated at arms-length and determined prior to the time that the option exercise plan was devised. Whether the price of the stock, warrants, and options had been disclosed is not dispositive because Zacharias and Carley failed to disclose the related-party "swap" transactions from which they benefitted. These "swap" transactions were not typical option exercise transactions -- the transactions were not contemplated in, and could not be expected from, the disclosures contained in Starnet's Forms S-8. In reports filed under Section 16 of the Exchange Act, Carley and Zacharias reported sales of Starnet shares obtained upon exercise of options. The funds that Carley and Zacharias received, however, came from the sales of Starnet shares by the Peeper Entities as part of the "swap" transactions outlined above, and not from their own sales of Starnet shares. The reports filed by Carley and Zacharias did not disclose that Carley and Zacharias received funds from the swap transactions involving the Peeper Entities rather than from a standard option exercise. The omitted disclosures were material because they had the effect of hiding the distribution through the Peeper Entities' sales of unregistered Starnet securities to facilitate the exercise of options by Starnet officers in

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90/ Item 404 of Regulation S-B, Certain Relationships and Related Transactions, 17 C.F.R. § 228.404.

91/ Id.

violation of Securities Act Section 5. Thus, the undisclosed sales could expose the company to claims of rescission under Securities Act Section 12. 92/

The record establishes that Carley and Zacharias acted with scienter in failing to disclose as a related-party transaction in Starnet's 1999 annual report the procedure for Starnet officers and employees to exercise their Plan options. Carley and Zacharias each knew that a procedure had been put in place at Starnet to permit them to obtain the cash that they would have received had they been able to exercise their stock options. Zacharias negotiated the structure of the option exercise program with Gould and processed the warrant exercises by Peeper which allowed the program to work. Zacharias testified that he did not take any steps to amend any of the company's public filings to disclose the method by which Starnet officers would resell their Plan Shares. The irrevocable authorizations that Carley and Zacharias signed as part of their exercise of Plan options and resulting sales of Plan Shares informed them that Starnet was "facilitating this trade." It further informed them that shares were being sold "on my behalf" prior to their receipt of the Plan Shares and that they were authorizing Gould to transfer their Plan Shares "into an appropriate account in order to reimburse for the shares sold on my behalf." At a minimum, Carley and Zacharias were reckless in ignoring these numerous indications that, when Starnet arranged for the Peeper Entities to sell Starnet shares and transfer the proceeds from those sales to the Option Holders in the amounts they would have received had they been able to exercise their options, Starnet was participating in a related-party transaction that should have been disclosed. We conclude that Carley and Zacharias violated the antifraud provisions of the federal securities laws when they omitted to disclose as a related-party transaction in Starnet's 1999 annual report the nature and extent of the plan to provide Starnet officers and employees with a way in which to exercise their Plan options. 93/

C. Carley and Zacharias also violated the Commission's reporting requirements by omitting material information from the applicable Starnet reports as described above. Exchange Act Section 13(a) and Rules 13a-1 and 13a-11 thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file annual and current reports with the Commission. Exchange Act Rule 12b-20 further requires that such reports include any additional material information that is necessary to make the required statements, in light of the circumstances under which they are made, not misleading. Implicit in Section 13(a) and the rules thereunder is the

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92/ 15 U.S.C. § 77l.

93/ The Division also alleged that Zacharias violated Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, and that Carley violated Securities Act Sections 17(a)(2) and (3), with respect to a Form 8-K and Form 8-K/A filed with the Commission in December 1998 and March 1999, respectively, that identified the Regulation S purchasers as "seven separate sophisticated foreign investment groups" when, in fact, those groups were all controlled by one individual, Peeper. In light of the record in this case, we do not reach this allegation.

requirement that the reports be accurate. 94/ When Carley and Zacharias omitted the material information described above from the applicable reports filed with the Commission, they violated Exchange Act Section 13(a) and Exchange Act Rules 12b-20, 13a-1, and 13a-11.

VII.

Violation of the Reporting Requirements

A. Zacharias was an officer and director of Starnet until at least August 12, 1999. Zacharias acquired 10,000 shares of Starnet on July 21, 1999. Although the record contains several Forms 3 and 4 filed by Zacharias, it does not contain a Form 4 disclosing the acquisition of these 10,000 shares.

B. Exchange Act Section 16(a) provides, among other requirements, that any person who is an officer or director of an issuer of equity securities registered pursuant to Section 12 of the Exchange Act shall file with the Commission initial statements disclosing the amount of all equity securities of the issuer of which such person is the beneficial owner as well as statements disclosing any changes in such ownership. 95/ Exchange Act Rule 16a-3 provides that statements of changes in beneficial ownership required by Exchange Act Section 16(a) shall be filed on Form 4. 96/ Zacharias failed to make a filing for the July 21, 1999 acquisition. Accordingly, we find that Zacharias violated Exchange Act Section 16(a) and Rule 16a-3 by failing to file a Form 4 disclosing this transaction. 97/

94/ SEC v. Kalvex, Inc., 425 F. Supp. 310, 316 (S.D.N.Y. 1975). Proof of scienter is not required to establish violations of the Commission's reporting provisions. See Savoy Indus., 587 F.2d at 1167; SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

95/ 15 U.S.C. § 78p(a). The purpose of Exchange Act Section 16 is to require disclosure of the corporate holdings of, among others, officers and directors of the corporation, as well as prompt disclosure of any changes that occur in their corporate holdings. SEC v. World-Wide Coin Invs., Ltd., 567 F. Supp. 724, 758 (N.D. Ga. 1983). No showing of scienter is required to establish a violation of this provision. Savoy, 587 F.2d at 1167. In 1999, Section 16(a) provided that a statement disclosing a change in the ownership of the issuer's securities be filed within ten days of the close of the calendar month in which the change occurred. 15 U.S.C. § 78p(a) (1994) (amended 2002).

96/ 17 C.F.R. § 240.16a-3.

97/ Although Zacharias contends in his petition for review that "[t]he finding that Mr. Zacharias violated Section 16(a) of the Exchange Act by failing to file a required Form 4 is not supported by substantial evidence in the record taken as a whole," his briefs do not address the law judge's finding that he committed a violation of Section 16(a).

VIII.

A. Severance

Kaufmann argues that his due process rights were violated by our denial of his motion to sever the charges against him from this proceeding. 98/ We denied Kaufmann's motion on the ground that "joinder before the Commission requires only that there be a common issue of law or fact" and the OIP alleged that all the Respondents were involved in a single plan to distribute unregistered securities. 99/ Kaufmann demonstrates no prejudice from this denial. The plan involved facts common to each of the Respondents. The evidence established that Kaufmann was a necessary participant and substantial factor in the execution of the plan. We have evaluated the record with respect to Kaufmann's individual conduct and have assessed his liability and imposed sanctions accordingly.

Price argues that the severance of certain Respondents from this proceeding prejudiced his case. 100/ Mark Dohlen, Starnet's chief executive officer, Paul A. Giles, president and a director of Starnet, and Peeper were each named as Respondents, but were severed from this proceeding because they had not been served with the OIP. The OIP alleged that Price failed reasonably to supervise Spencer Edwards employees Geiger and Kaufmann. Both Geiger and Kaufmann testified at the hearing. Dohlen, Giles, and Peeper were not employed by or associated with Spencer Edwards. While Dohlen, Giles, and Peeper participated in the effort to distribute Starnet shares, there was ample evidence about that plan. Price does not explain how evidence that could be offered by Dohlen, Giles, and Peeper would be relevant to his supervision of Geiger and Kaufmann. 101/

B. Statute of Limitations

Kaufmann claims that the statute of limitations in 28 U.S.C. § 2462, in conjunction with the decision of the United States Court of Appeals for the District of Columbia Circuit in

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98/ See Order Denying Motion of Thomas A. Kaufmann to Sever Proceedings, Exchange Act Rel. No. 50695 (Nov. 18, 2004), 84 SEC Docket 434.

99/ Id. at 434-35 (citing Commission Rule of Practice 201(a), 17 C.F.R. § 201.201(a)).

100/ John A. Carley, Exchange Act Rel. No. 50954 (Jan. 3, 2005), 84 SEC Docket 2317-18.

101/ We find the cases cited by Price in support of his argument inapposite here for the same reasons we found them inapposite in Price's motion opposing the severance. See Carley, 84 SEC Docket at 2318 n.6. We also reject Price's contention that denying his alternative motion to sever him from the proceeding prejudiced his case for the same reasons we find proper the denial of Kaufmann's motion to sever.

Johnson v. SEC, 102/ bars this proceeding. Geiger argues that Section 2462 bars the imposition of a cease-and-desist order, a civil penalty, or a bar from association. Section 2462 provides, in pertinent part, that any "proceeding for the enforcement of any civil fine, penalty, or forfeiture" must be commenced "within five years from the date when the claim first accrued." 103/

The violations in this case occurred between December 1998 and February 2001. We initiated these proceedings on September 1, 2004. A substantial portion of the misconduct thus falls within the limitations period because it occurred after September 1, 1999. Accordingly, Kaufmann and Geiger committed willful violations within the limitations period and the proceeding is not time-barred. 104/ We have not considered misconduct occurring before September 1, 1999, in determining to impose bars or civil penalties, but rather have based these sanctions exclusively on Respondents' conduct during the five-year period preceding issuance of the OIP. 105/ However, we may consider acts outside the limitations period as evidence of a respondent's motive, intent, or knowledge in committing violations within the limitations period. 106/ We have also held that remedial relief such as the imposition of a cease-and-desist order is not barred by the statute of limitations in Section 2462. 107/

Carley, Zacharias, and Geiger all argue that Section 2462 bars us from ordering disgorgement with respect to violations that occurred before September 1, 1999. Section 2462 applies, as noted above, to "any civil fine, penalty, or forfeiture," or, as characterized by the court in Johnson, to "punishment[s] imposed by the government for unlawful or proscribed

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102/ In Johnson, the District of Columbia Circuit Court of Appeals held that Section 2462 applied to Commission administrative proceedings. 87 F.3d 484, 486 (D.C. Cir. 1996).

103/ 28 U.S.C. § 2462.

104/ See Robert W. Armstrong, III, Exchange Act Rel. No. 51920 (June 24, 2005), 85 SEC Docket 3011, 3035-36 (finding that 28 U.S.C. § 2462 did not bar a cease-and-desist and Rule 102(e) proceeding where the violations in the case were ongoing and a substantial portion of the misconduct occurred within the limitations period).

105/ See Edgar B. Alacan, Exchange Act Rel. No. 49970 (July 6, 2004), 83 SEC Docket 842, 868-69 (imposing a bar and civil penalty where certain conduct occurred outside the limitations period because the Commission did not consider conduct occurring more than five years before the issuance date of the OIP in determining to impose those sanctions but rather based those sanctions exclusively on the respondent's conduct during the five-year period preceding the issuance date of the OIP).

106/ See Joseph J. Barbato, 53 S.E.C. 1259, 1278 (1999); Sharon M. Graham, 53 S.E.C. 1072, 1089 n.47 (1998), aff'd, 222 F.3d 994 (D.C. Cir. 2000).

107/ See Herbert Moskowitz, 55 S.E.C. 658, 683 (2002).

conduct." 108/ A disgorgement order, however, is not a punitive measure; it is intended primarily to prevent unjust enrichment. 109/ In Johnson, the court held that Section 2462 would not apply to proceedings for the disgorgement of ill-gotten gains. 110/ The disgorgement orders here are limited to such "wrongfully obtained proceeds." 111/ Accordingly, we reject Respondents' contention that Section 2462 precludes us from ordering disgorgement with respect to violations occurring before September 1, 1999. 112/

108/ Johnson, 87 F.3d at 488 (stating that "a 'penalty,' as the term is used in § 2462, is a form of punishment imposed by the government for unlawful or proscribed conduct").

109/ SEC v. Banner Fund Int'l, 211 F.3d 602, 617 (D.C. Cir. 2000).

110/ 87 F.3d at 491 (stating that "where the effect of the SEC's action is to restore the status quo ante, such as through a proceeding for restitution or disgorgement of ill-gotten profits, § 2462 will not apply"); see also SEC v. Dibella, 409 F. Supp. 2d 122, 127 (D. Conn. 2006) ("Section 2462 does not preclude disgorgement action . . . where the claim seeks to 'deprive []one of wrongfully obtained proceeds.'") (quoting SEC v. Lorin, 869 F. Supp. 1117, 1122 (S.D.N.Y. 1994)).

111/ See infra Section IX.C.

112/ We also reject Carley's and Kaufmann's suggestion that Section 2462 bars the assessment of prejudgment interest at the rates imposed by the law judge because such rates are "punitive." The law judge ordered prejudgment interest calculated at the underpayment rate established under Section 6621(a)(2) of the Internal Revenue Code. See Commission Rule of Practice 600(b), 17 C.F.R. § 201.600(b). The IRS underpayment rate is a non-punitive rate. See SEC v. Falbo, 14 F. Supp. 2d 508, 528 (S.D.N.Y. 1998) (ordering application of the "standard non-punitive rate of interest used in enforcement actions (including those for underpayment of taxes)" in fixing an amount to be disgorged); see also SEC v. Berger, 244 F. Supp. 2d 180, 193 (S.D.N.Y. 2001) (ordering prejudgment interest at the IRS underpayment rate because "the remedial purpose of the statute takes on special importance" in an SEC enforcement action and the underpayment rate "'reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud'") (citing SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1476 (2d Cir. 1996)); Rules of Practice, Exchange Act Rel. No. 35833 (June 9, 1995), 59 SEC Docket 1546, 1596 (stating that prejudgment interest is necessary "to effectuate fully the remedial purposes of disgorgement" and that "the IRS underpayment rate is a reasonable and appropriate rate to use in assessing prejudgment interest on disgorgement ordered as the result of remedial administrative proceedings").

IX.

A. Bar Orders

Exchange Act Section 15(b)(6) authorizes the Commission to censure, place limitations on, suspend, or bar a person associated with a broker, dealer, or municipal securities dealer if the Commission finds such sanctions in the public interest and the person has, among other violations, willfully violated the federal securities laws, or failed reasonably to supervise another person who commits such a violation if such other person is subject to his supervision. 113/ When Congress grants an agency the responsibility to impose sanctions to achieve the purposes of a statute, "the relation of remedy to policy is peculiarly a matter for administrative competence." 114/ We have stated that, in determining an appropriate sanction in the public interest, we consider the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations. 115/

Section 5, "the keystone of the Securities Act," "serves to protect the public in the offer and sale of new securities issues" and "set[s] forth basic requirements for the protection of investors." 116/ After September 1, 1999, Geiger and Kaufmann continued their repeated unregistered sales of Starnet stock, worth millions of dollars in the aggregate, in violation of Section 5. 117/ Their central role in the plan to evade the registration requirements of the

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113/ 15 U.S.C. § 78*o*(b)(6), (b)(4)(D)-(E); see also Leslie A. Arouh, Exchange Act Rel. No. 50889 (Dec. 20, 2004), 84 SEC Docket 1880, 1894.

114/ Butz v. Glover Livestock Comm'n Co., Inc., 411 U.S. 182, 185 (1973) (quoting Am. Power Co. v. SEC, 329 U.S. 90, 112 (1946)).

115/ Arouh, 84 SEC Docket at 1894-95; see also Sharon M. Graham, 53 S.E.C. 1072, 1090 n.48 (1998) (quoting Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981)), aff'd, 222 F.3d 994 (D.C. Cir. 2000).

116/ Alvin W. Gebhart, Jr. and Donna T. Gebhart, Exchange Act Rel. No. 53136 (Jan. 18, 2006), 87 SEC Docket 437, 468 (citing First Heritage Inv. Co., 51 S.E.C. 953, 959 (1994) and Indep. Sec. Corp., 47 S.E.C. 780, 784 (1982)), appeal filed, No. 06-71201 (9th Cir.).

117/ We noted earlier that, in accordance with 28 U.S.C. § 2462 and Johnson v. SEC, we have not considered misconduct occurring before September 1, 1999, in determining to impose bars or civil penalties, but rather have based these sanctions exclusively on Respondents'
(continued...)

securities laws with respect to these sales renders their violations egregious. 118/ Geiger and Kaufmann ignored numerous red flags suggesting they were facilitating an unlawful distribution by a statutory underwriter. Their failure to conduct a searching inquiry into the origin of the Starnet stock, despite numerous indications that it was part of an unregistered distribution, evinces a disregard for regulatory requirements that calls into serious question their ability to function as securities professionals. Geiger has previously been disciplined for similar violations. 119/ We believe that, after considering the totality of these factors, the public interest requires imposing a bar from association with a broker or dealer on Geiger and Kaufmann. 120/

We have recognized repeatedly the relevance of prior disciplinary history in imposing sanctions. 121/ Geiger's recent disciplinary history supports a bar with no right to reapply. Geiger's continued willful violations of Securities Act Section 5, after being sanctioned for similar conduct with a Peeper-related entity, justify a bar from association with any broker or

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117/ (...continued)
conduct during the five-year period preceding issuance of the OIP. See supra text accompanying note 108.

118/ See Kirby, 79 SEC Docket at 1105 (finding broker's conduct egregious where broker "facilitated a series of transactions that resulted in the distribution of well over a million dollars worth of unregistered securities into the market").

119/ We reject Geiger's contention that his resignation from Spencer Edwards and the age of the misconduct render remedial relief inappropriate because we find these factors outweighed by other considerations. See Robert Bruce Lohmann, Exchange Act Rel. No. 48092 (June 26, 2003), 80 SEC Docket 1790, 1798 (finding that the public interest warranted a bar and a cease-and-desist order because no assurances existed that respondent, who was not currently employed in the securities industry, would not try to reenter the industry and thereafter have the opportunity to commit future violations); Armstrong, 85 SEC Docket at 3040 (finding age of misconduct outweighed by other factors).

120/ See Arouh, 84 SEC Docket at 1895 (imposing bar where respondent committed egregious misconduct, failed to acknowledge the wrongful nature of his conduct, attempted to shift blame to others, and had opportunities to violate the securities laws in the future through his employment in the securities industry).

121/ See, e.g., Consol. Inv. Servs., 52 S.E.C. at 591 (noting that prior disciplinary history evinces whether an applicant's misconduct is isolated, the sincerity of the applicant's assurance that he will not commit future violations, and the egregiousness of the applicant's misconduct).

dealer. 122/ Kaufmann does not share Geiger's disciplinary history. 123/ The record indicates that Kaufmann has not been subject to disciplinary action since 1983. 124/ Kaufmann's lack of a recent disciplinary history leads us to conclude that a bar with a right to reapply in five years is appropriate. 125/

In his discussion of the sanctions imposed by the law judge, Price does not challenge the imposition of a supervisory bar, and we find that this sanction is in the public interest. Price knew that the Peeper Entities' and the Starnet officers' accounts were selling large amounts of Starnet stock into the market. Price also knew that Geiger committed previous securities law violations involving the unregistered sale of securities in an account controlled by Peeper. However, Price conducted no investigation into the source of the stock. He relied on Geiger's and Kaufmann's representations even though he knew Geiger had lied about his previous misconduct. Price's supervisory failures allowed Geiger and Kaufmann to commit repeated securities law violations between September 1999 and February 2001. Accordingly, we find that the public interest warrants barring Price from associating with any broker or dealer in a supervisory capacity.

B. Cease-and-Desist Orders

Securities Act Section 8A(a) and Exchange Act Section 21C authorize the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of either of these acts or any rule or regulation thereunder, or against any person who "is, was, or would be a cause of [a] violation" due to an act or omission the person

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122/ See Frank J. Custable, Jr., 51 S.E.C. 855, 863 (1993) (upholding bar in all capacities because "the fact that [respondent] previously engaged in similar misconduct underscores the appropriateness of the sanctions in this case").

123/ The law judge also noted as mitigating evidence that Kaufmann investigated the history of a stock certificate of Starnet's predecessor company, developed a form for Spencer Edwards to use in investigating the history of shares of stock, and questioned a Commission inspector during a routine audit about the Rule 144 transactions.

124/ In 1983, the Securities Division of the Commonwealth of Massachusetts charged Kaufmann with transacting a securities business in Massachusetts without registering as an agent of a broker or dealer. Kaufmann defaulted and was prohibited from transacting a securities business in Massachusetts until properly registered. Kaufmann has been properly registered and in good standing in Massachusetts since 1985.

125/ We hope to impress upon Kaufmann, by virtue of this sanction, the importance of the regulatory requirements he violated and, thereby, help ensure his compliance in the event he is subsequently permitted to return to the industry. Cf. Kirby, 79 SEC Docket at 1106.

"knew or should have known would contribute to such a violation." 126/ In determining whether a cease-and-desist order is an appropriate sanction, we look to whether there is some risk of future violations. 127/ The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. 128/ Our finding that a violation is egregious "raises an inference that it will be repeated." 129/ We also consider whether other factors demonstrate a risk of future violations, but not all factors need to be considered, and no factor is dispositive. Beyond the seriousness of the violation, these factors include the isolated or recurrent nature of the violation, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, recognition of the wrongful nature of the conduct, opportunity to commit future violations, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions sought in the proceeding. 130/

We find that the public interest warrants imposing cease-and-desist orders against Carley and Zacharias. Their failures to disclose material facts in violation of the antifraud provisions and their sales of unregistered securities in violation of the registration requirements constitute serious misconduct. 131/ "[C]onduct that violate[s] the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions under the securities laws." 132/ As noted above, the registration requirements of the federal securities laws are "at the heart of the securities regulatory system" and disregarding those requirements justifies strong remedial measures. 133/ These violations occurred repeatedly over an extended period of

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126/ 15 U.S.C. §§ 77A(a), 78u-3.

127/ KPMG Peat Marwick, LLP, 54 S.E.C. 1135, 1185 (2001), motion for reconsideration denied, 55 S.E.C. 1 (2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002).

128/ KPMG Peat Marwick, 54 S.E.C. at 1191.

129/ See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004).

130/ KPMG Peat Marwick, 54 S.E.C. at 1192.

131/ We specifically reject Carley's characterization of his violations as "at the less-serious end of the spectrum" and "an isolated event."

132/ Gebhart, 87 SEC Docket at 469 (citing Marshall E. Melton, Investment Advisers Act Rel. No. 2151 (July 25, 2003), 80 SEC Docket 2812, 2825).

133/ Kirby, 79 SEC Docket at 1105.

time. 134/ Zacharias will have opportunities to commit future violations in his role as a consultant assisting firms in rasing capital by issuing securities, and Carley, although not currently employed by an issuer, may again become active in the financial markets at any time. In his brief, Carley argues that imposition of sanctions "would impair [his] ability to serve as an officer or director of a public company," suggesting that he will seek such opportunities in the future. 135/ A cease-and-desist order will serve the remedial purpose of encouraging both Respondents to take their responsibilities more seriously in the future. We find that the serious and prolonged nature of the violations establishes a sufficient risk of future violations warranting cease-and-desist orders against Carley and Zacharias. 136/

We reject Zacharias's contention that cease-and-desist relief against him is inappropriate because he "had a reasonable belief in the propriety of his actions." 137/ Zacharias failed to take basic precautions to ensure that Starnet did not violate the federal securities laws. Zacharias did not obtain a legal opinion regarding the propriety of the plan that enabled Starnet's officers and employees to exercise their stock options and sell their stock. He also took no steps to amend

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134/ We consider the entire record here because the statute of limitations in 28 U.S.C. § 2462 does not apply to cease-and-desist proceedings. See supra text accompanying note 107.

135/ Carley cites SEC v. First City Fin. Corp., 890 F.2d 1215, 1229 (D.C. Cir. 1989), for the proposition that the law judge improperly "held it against" Carley that Carley "offered no assurances against future violations or recognized the wrongful nature of his conduct." However, in Geiger v. SEC, the court specifically rejected the argument Carley advances here. Geiger, 363 F.3d at 489.

136/ Carley contends that the age of the misconduct militates against imposing a cease-and-desist order, but the other relevant factors more than justify cease-and-desist relief. Cf. Armstrong, 85 SEC Docket at 3040 (finding age of misconduct outweighed by other factors).

137/ To the extent Zacharias relies on any assurances from Brovarone, we find such reliance unavailing. Brovarone testified that he represented Peeper and the entities purchasing the Regulation S stock. One cannot rely on the advice of another's counsel because that counsel cannot be relied upon to give disinterested advice. Sorrell v. SEC, 679 F.2d 1323, 1327 (9th Cir. 1982) ("A broker may not rely on counsel's advice when the attorney is an interested party."); C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1436 (10th Cir. 1988) ("We agree with SEC that counsel also must be independent."); David M. Haber, 52 S.E.C. 201, 206 (1995) ("However, Haber could not rely on counsel for Brown, who could not be counted on to give disinterested advice.").

any of the company's public filings to disclose this plan. In our view, Zacharias's insistence that he behaved reasonably in light of this evidence suggests the need for cease-and-desist relief. 138/

We also find that the public interest warrants imposing cease-and-desist orders against Geiger and Kaufmann. In addition to the factors discussed above with respect to imposing a bar, Geiger and Kaufmann pose a risk of future violations. Geiger's serious and repeated misconduct over an extended period, along with his disciplinary history, raises at least "some risk" of future violations. 139/ Whether or not Kaufmann seeks association in the securities industry after five years, a cease-and-desist order will serve the remedial purpose of encouraging him to take his responsibilities and the securities registration requirements more seriously. Given the seriousness of their violations and their apparent failure to appreciate their duties as securities professionals, we find that the record presents sufficient risk that Kaufmann and Geiger will commit future violations to warrant imposition of cease-and-desist orders.

C. Disgorgement

Exchange Act Section 21B authorizes orders of disgorgement in, among others, cases involving willful violations of the Securities Act or the Exchange Act. 140/ Disgorgement is an equitable remedy designed to deprive wrongdoers of unjust enrichment and to deter others from violating the securities laws. 141/ Disgorgement need only be a reasonable approximation of profits causally connected to the violation. 142/ Once the Division establishes that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden of going forward shifts to the Respondents who are "then obliged clearly to demonstrate that the

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138/ We have determined in our discretion not to impose a cease-and-desist order on Zacharias with respect to Exchange Act Section 16(a) and Exchange Act Rule 16a-3.

139/ See Mark David Anderson, Exchange Act Rel. No. 48352 (Aug. 15, 2003), 80 SEC Docket 3250, 3271 (imposing cease-and-desist order where respondent's "serious and repeated misconduct over an extended period, along with his disciplinary history, raise[d] at least 'some risk' of future violations"); Kenneth R. Ward, Exchange Act Rel No. 47535 (Mar. 19, 2003), 79 SEC Docket 3035, 3062 (finding that respondent's "serious misconduct and disciplinary history raise[d] at least 'some risk' of future violations"), aff'd, 75 Fed. Appx. 320 (5th Cir. 2003).

140/ 15 U.S.C. § 78u-2(e).

141/ First City Fin. Corp., 890 F.2d at 1230; SEC v. Johnston, 143 F.3d 260, 263 (6th Cir. 1998); John J. Kenny, Exchange Act Rel. No. 47847 (May 14, 2003), 80 SEC Docket 564, 595, aff'd, 87 Fed. Appx. 608 (8th Cir. 2004).

142/ First City Fin. Corp., 890 F.2d at 1231; see also SEC v. Bilzerian, 29 F.3d 689, 697 (D.C. Cir. 1994).

disgorgement figure was not a reasonable approximation." 143/ Where disgorgement cannot be exact, "any risk of uncertainty . . . should fall on the wrongdoer whose illegal conduct created that uncertainty." 144/

The Division has established that, in connection with the sale of unregistered Starnet stock, Carley received $2,489,740 through his United Capital account. Carley argues that ordering him to disgorge this amount would be punitive because he would owe nothing if "the securities professionals relied upon by Mr. Carley had done their jobs right" and because he "was not the cause of the damage the [Commission] seeks to remedy through disgorgement." Carley, however, was a necessary participant in the unregistered sale of Starnet stock in violation of the federal securities laws, and he profited from these transactions. The amounts Carley received through these sales are therefore ill-gotten gains that should be disgorged. 145/

The Division has established that Zacharias received $1,451,128.55 through his United Capital account in connection with the sale of unregistered Starnet stock. Zacharias argues that disgorgement of this amount would be punitive because such disgorgement would not "return Mr. Zacharias to the status quo ante" as "[r]eturning Mr. Zacharias to the status quo ante would require restoration" of his Starnet stock. Zacharias sold that stock, however, in violation of Section 5 of the Securities Act. Disgorgement prevents Zacharias from retaining the proceeds of these illegal sales and as such serves a remedial rather than punitive purpose. 146/ Zacharias also

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143/ First City Fin. Corp., 890 F.2d at 1232.

144/ SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995).

145/ See SEC v. Gemstar-TV Guide Inter., Inc., 401 F.3d 1031, 1047 (9th Cir. 2005) ("The deterrent effect of a Commission enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."), cert. denied, 126 S. Ct. 416 (2005).

The Division also seeks an order requiring Carley to disgorge the $1,687,578.38 that Madison Park Trust received from the sale of Starnet stock. We have determined not to impose such an order in light of our conclusion dismissing the allegations with respect to sales by Madison Park Trust.

146/ See Gartner v. SEC, 913 F. Supp. 1372, 1377 n.6 (C.D. Cal. 1995) (stating that an "SEC disgorgement proceeding serves a remedial purpose by divesting a violator of the securities laws of ill-gotten gains"); see also SEC v. ETS Payphones, Inc., 408 F.3d 727, 735 (11th Cir. 2005) (stating that the purpose of disgorgement is to deprive the wrongdoer of his ill-gotten gain); SEC v. Randy, 38 F. Supp. 2d 657, 673-74 (N.D. Ill. 1999) (stating that the Seventh Circuit "has explained that disgorgement is a remedial

(continued...)

argues that disgorgement is not appropriate because it will not serve to reimburse persons who suffered losses by his conduct. The remedy of disgorgement, however, is designed primarily to deprive wrongdoers of their ill-gotten gains, not to compensate for damages, if any, suffered by the victims of the wrongful conduct. 147/

The Division has presented a summary of evidence from Spencer Edwards's clearing firm detailing the commissions generated by transactions in Starnet stock in the customer accounts of Kaufmann and Geiger from January 1999 through February 2001. In determining the amount of disgorgement sought from Kaufmann and Geiger, the Division excluded commissions generated on sale transactions by persons "unrelated" to Respondents. 148/ The Division assumed, based on Kaufmann's investigative testimony, that Spencer Edwards retained thirty percent of the gross commission generated by Kaufmann's and Geiger's client accounts. With respect to the remaining seventy percent, the law judge concluded that Kaufmann and Geiger split the commissions generated from trades made under their joint account number on an equal basis and ordered Kaufmann and Geiger each to disgorge $885,738.62.

Kaufmann asserts a variety of sometimes conflicting reasons that he argues support his claim that he should not have to disgorge half of the gross profits generated by trades under his and Geiger's joint account number. Kaufmann argues that he executed trades only for Starnet officers, while Geiger executed trades for the Peeper Entities. Kaufmann claims that commissions for transactions with respect to their joint account number were allocated based on who generated the business, but also claims that an unsigned handwritten document reflects his agreement with Geiger to divide commissions on a sliding scale based on the amount of commissions earned. In his brief, Kaufmann claims that Geiger's share of commission on the Peeper accounts was seventy-six percent, but Kaufmann and Geiger asserted at the hearing that they split commissions on a sliding scale that varied from month to month.

We are not persuaded by Kaufmann's attempts to reduce the disgorgement amount attributable to him. The law judge found that Kaufmann's and Geiger's testimony regarding the

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146/ (...continued)
measure to deter future violations of the securities laws and to deprive wrongdoers of their ill-gotten gains and is not a punitive measure").

147/ First City Fin. Corp., 890 F.2d at 1230; Hately v. SEC, 8 F.3d 653, 655 (9th Cir. 1993).

148/ The Division included in its request for disgorgement commissions on all buy transactions because it was reasonable to infer that purchases of Starnet stock by customers of Kaufmann and Geiger were filled with the substantial inventory of unregistered stock being sold through Spencer Edwards as part of the unregistered distribution. The Division included sale transactions only for Respondents and persons "related" to Respondents.

sliding scale of commissions lacked credibility. 149/ His finding is supported by the numerous and conflicting explanations offered by Kaufmann, which indicate post hoc attempts to limit the disgorgement amount rather than a contemporaneous agreement on splitting commissions. The unsigned, handwritten document contains a chart but no explanation of how it applies or to what accounts it applies. The document is dated July 7, 1999, approximately seven months after the unregistered distribution of Starnet shares began, indicating at a minimum that it did not apply to a significant portion of the trading period at issue here. Given these facts, we find that Kaufmann has failed clearly to demonstrate that the disgorgement sought here was not a reasonable approximation of his ill-gotten gains.

We find Respondents' arguments challenging the disgorgement sought here to be without merit. Ordering disgorgement will prevent the Respondents from reaping substantial financial gain from their violations. Disgorgement will also impress upon them and other officers of public companies and associated persons of broker-dealers the need to comply with the registration requirements of the federal securities laws and deter them from evading such requirements in the future in the hopes of reaping a substantial financial windfall. In light of our determination to dismiss the allegations with respect to sales by Madison Park Trust, we will not order disgorgement with respect to commissions obtained from those sales and, therefore, we will reduce the disgorgement amount ordered against both Kaufmann and Geiger by $12,591.78. Accordingly, we order Carley to disgorge $2,489,740, Zacharias to disgorge $1,451,128.55, and Kaufmann and Geiger each to disgorge $873,146.84. 150/

D. Civil Money Penalties

Exchange Act Section 21B authorizes the Commission to impose a civil penalty in any proceeding instituted pursuant to, among other provisions, Exchange Act Sections 15(b)(4) and 15(b)(6) where the Commission finds that such penalty is in the public interest and that a respondent has, among other misconduct, willfully violated any provision of the federal securities

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149/ Tricarico, 51 S.E.C. at 460 (stating that credibility findings are entitled to "considerable weight" and "can be overcome only where the record contains 'substantial evidence' for doing so").

150/ Securities Act Section 8A(e) and Exchange Act Sections 21B(e) and 21C(e) authorize the Commission to assess "reasonable interest" in connection with an order for disgorgement in any cease-and-desist proceeding or any proceeding in which a civil money penalty could be imposed. Commission Rule of Practice 600(b) provides that interest shall be computed at the underpayment rate established by Section 6621(a)(2) of the Internal Revenue Code and shall be compounded quarterly. We have held previously that the IRS underpayment rate applies to disgorgement amounts for the entire period from the date of assessment until paid. Alacan, 83 SEC Docket at 872 n.79 (citing Laurie Jones Canady, 54 S.E.C. 65, 85 (1999)). The Division contends that the starting date for the assessment of prejudgment interest should be March 1, 2001.

laws or failed reasonably to supervise another person who has committed such violations. 151/ Section 21B establishes three tiers of penalties, each with a larger maximum penalty amount, applicable to increasingly serious misconduct. 152/ The factors we consider in assessing the penalty required in the public interest are whether there was fraudulent misconduct, harm to others, or unjust enrichment, whether the respondents had prior violations, and the need for deterrence, as well as such other matters as justice may require. 153/ The law judge imposed third-tier penalties of $400,000 on Geiger and $300,000 on Kaufmann. The law judge imposed a second-tier penalty of $150,000 on Price.

We find third-tier penalties appropriate in response to Geiger's and Kaufmann's misconduct. The Exchange Act provides that we may impose third-tier penalties where 1) the misconduct "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; and 2) such misconduct "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed" the misconduct. 154/ Geiger's and Kaufmann's misconduct involved both a reckless disregard of the registration requirements of the federal securities laws and substantial pecuniary gain to themselves.

The maximum third-tier penalty for misconduct by a natural person committed during the time period at issue in this proceeding was $110,000 for each violation. 155/ We have determined to impose civil penalties based on the totality of Geiger's and Kaufmann's misconduct. Both Geiger and Kaufmann participated in an unlawful distribution. They executed the trades that effectuated the unregistered sales of Starnet stock into the market. They followed Gould's instructions regarding the sales of Starnet stock and the distribution of the proceeds. Geiger handled the trades in the Peeper entities' accounts and Kaufmann handled the trades in the Starnet officers' Spencer Edwards accounts. Geiger and Kaufmann enriched themselves through this substantial participation in the offer and sale of unregistered securities. Significant penalties are necessary to deter other violators. 156/ Some of the conduct in question occurred

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151/ 15 U.S.C. § 78u-2.

152/ Id. § 78u-2(b).

153/ See, e.g., William C. Piontek, Exchange Act Rel. No. 48903 (Dec. 11, 2003), 81 SEC Docket 3044, 3060.

154/ 15 U.S.C. § 78u-2(b)(3).

155/ 17 C.F.R. § 201.1001.

156/ We reject Kaufmann's argument that a civil penalty is inappropriate because there is no reasonable basis that the penalty will remedy the harm caused by Kaufmann's

(continued...)

outside of the limitations period, and we consider this fact in reducing the penalty imposed by the law judge. Nevertheless, Kaufmann's and Geiger's large number of sales of unregistered Starnet stock after September 1, 1999, violated Section 5, and they each received substantial gains from these violative sales. Accordingly, we impose one third-tier penalty of $110,000 each on Geiger and Kaufmann. 157/

We find a second-tier penalty appropriate in response to Price's failure to supervise. The Exchange Act provides that we may impose second-tier penalties where the misconduct "involved fraud, deceit, manipulation, or deliberate or reckless disregard of regulatory requirement." 158/ Price's failure to supervise involved a reckless disregard for his supervisory responsibilities in light of the numerous red flags suggesting that Geiger and Kaufmann were violating the securities laws.

The maximum second-tier penalty for misconduct by a natural person committed during the time period at issue in this proceeding was $55,000 for each violation. 159/ Price's supervisory failures allowed Geiger and Kaufmann unjustly to enrich themselves. Price has no disciplinary history, but he failed to supervise Geiger reasonably despite his knowledge that Geiger committed previous misconduct involving violations of the same provisions Geiger violated here. As demonstrated above, Price's supervision of Geiger and Kaufmann approached

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156/ (...continued)
misconduct. A civil money penalty is designed to serve as a deterrent against securities law violations. SEC v. Lybrand, 281 F. Supp. 2d 726, 729 (S.D.N.Y. 2003).

157/ We have previously considered each violative action as deserving of a separate penalty. See Anderson, 80 SEC Docket at 3270. To help place these sanctions in context, we note that each of the numerous unregistered sales of Starnet stock that took place after September 1, 1999, could be considered a separate violation of Securities Act Section 5. We believe, based on the facts and circumstances of this case, that imposing one third-tier penalty is appropriate.

158/ 15 U.S.C. § 78u-2(b)(2).

159/ 17 C.F.R. § 201.1001.

willful blindness. Accordingly, we find a civil money penalty of $55,000 – one maximum second-tier penalty – appropriate in the public interest. 160/

An appropriate order will issue. 161/

By the Commission (Chairman COX and Commissioners ATKINS, NAZARETH, and CASEY).

Nancy M. Morris
Secretary

Nancy M. Morris
Secretary

160/ Price asserts an inability to pay civil penalties. The law judge determined that Price had the ability to pay a civil penalty of $150,000, representing 16% of his reported net worth. Price contends that the law judge improperly included his pension assets and the value of his home in making this determination. Although Price submitted a sworn financial statement to the law judge, he did not comply with Commission Rule of Practice 410(c), 17 C.F.R. § 201.410(c), requiring any person seeking review of an initial decision who asserts inability to pay to file with the opening brief a sworn financial statement. We have reduced the penalty imposed by the law judge from $150,000 to $55,000. Under these circumstances, no further reduction is warranted based on an inability to pay. Cf. SEC v. Pardue, 367 F. Supp. 2d 773, 778 (E.D. Pa. 2005) (imposing penalty of $25,000 on defendant with negative net worth of between $50,000 and $100,000); see also SEC v. Svoboda, 409 F. Supp. 2d 331, 348-49 (S.D.N.Y. 2006) (imposing penalty of $150,000 on defendant who represented that his sole remaining asset was an IRA worth $690,000 and penalty of $250,000 on defendant who represented his net worth was $45,450).

161/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 8888 / January 31, 2008

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57246 January 31, 2008

Admin. Proc. File No. 3-11626

In the Matter of

JOHN A. CARLEY,
EUGENE C. GEIGER,
THOMAS A. KAUFMANN,
EDWARD H. PRICE, and
CHRISTOPHER H. ZACHARIAS

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day it is

ORDERED that John A. Carley cease and desist from committing or being a cause of any violations or future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) and 13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5, 12b-20, 13a-1, and 13a-11; and it is further

ORDERED that Christopher H. Zacharias cease and desist from committing or being a cause of any violations or future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) and 13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5, 12b-20, 13a-1, and 13a-11; and it is further

ORDERED that Eugene C. Geiger and Thomas E. Kaufmann cease and desist from committing or being a cause of any violations or future violations of Sections 5(a) and 5(c) of the Securities Act of 1933; and it is further

ORDERED that Eugene C. Geiger be, and he hereby is, barred from association with any broker or dealer; and it is further

ORDERED that Thomas E. Kaufmann be, and he hereby is, barred from association with any broker or dealer, provided that he may apply to become so associated after five years; and it is further

ORDERED that Edward H. Price be, and he hereby is, barred from association with any broker or dealer in a supervisory capacity; and it is further

ORDERED that John A. Carley disgorge $2,489,740.00, plus prejudgment interest of $1,296,061.63, Christopher H. Zacharias disgorge $1,451,128.55, plus prejudgment interest of $755,401.00, Eugene C. Geiger disgorge $873,146.84, plus prejudgment interest of $454,526.24, and Thomas A. Kaufmann disgorge $873,146.84, plus prejudgment interest of $454,526.24, such prejudgment interest calculated beginning on March 1, 2001, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Eugene C. Geiger pay a civil money penalty of $110,000, Thomas A. Kaufmann pay a civil money penalty of $110,000, and Edward H. Price pay a civil money penalty of $55,000;

Payment of the amount to be disgorged and the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Virginia 22312; and (iv) submitted under cover letter that identifies the Respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to Julie K. Lutz, counsel for the Division of Enforcement, Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver, Colorado 80202.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 57244 / January 31, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2779 / January 31, 2008

Admin. Proc. File No. 3-12064

In the Matter of

GREGORY M. DEARLOVE, CPA

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Causing Violations of Reporting Provisions

RULE 102(e) PROCEEDING

Grounds for Remedial Action

Improper Professional Conduct

Certified public accountant acting as engagement partner engaged in improper professional conduct in the audit of the financial statements of a public company and caused company's violations of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 12b-20. Held, it is in the public interest to order that accountant cease and desist from causing any violations or future violations of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 12b-20, and to deny the accountant the privilege of appearing or practicing before the Commission with a right to reapply after four years.

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APPEARANCES:

Joseph V. Sedita, Benjamin M. Zuffranieri, Michelle Merola Kane, and Robert J. Fluskey, Jr., of Hodgson Russ LLP, for Gregory M. Dearlove.

Nancy A. Brown, Alistaire Bambach, Jack Kaufman, and Panayiota K. Bougiamas, for the Division of Enforcement.

Appeal filed: August 30, 2006
Last brief received: December 4, 2006
Oral argument: July 24, 2007

TABLE OF CONTENTS

I. Introduction

Gregory M. Dearlove, a certified public accountant and formerly a partner with the accounting firm Deloitte & Touche LLP ("Deloitte"), appeals from the decision of an administrative law judge. The law judge found that Dearlove, who served as the engagement partner on Deloitte's audit of the financial statements of Adelphia Communications Corporation ("Adelphia"), a public company, for the fiscal year ended December 31, 2000, engaged in improper professional conduct within the meaning of Rule of Practice 102(e). 1/ The law judge found that Adelphia's financial statements were not in accordance with generally accepted accounting principles ("GAAP"), and that Dearlove violated generally accepted auditing standards ("GAAS"). 2/ The law judge also found that Dearlove was a cause of Adelphia's

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1/ 17 C.F.R. § 201.102(e). Rule 102(e) permits the Commission to censure or deny, permanently or temporarily, the privilege of appearing or practicing before it to persons found to have engaged in improper professional conduct. As applied to accountants, "improper professional conduct" includes the following:

> (A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or
>
> (B) either of the following two types of negligent conduct:
>
> (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
>
> (2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

Rule 102(e)(1)(iv), 17 C.F.R. § 201.102(e)(1)(iv). With the passage in 2002 of Section 602 of the Sarbanes Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 794, this language was codified in Exchange Act Section 4C, 15 U.S.C. § 78d-3.

2/ The law judge concluded that Dearlove engaged in repeated instances of unreasonable conduct as well as a single instance of highly unreasonable conduct under Rule 102(e)(iv)(B)(1). However, it is unclear which conduct constituted the single instance of highly unreasonable conduct. We therefore decline to consider whether any of Dearlove's conduct was "highly unreasonable." We limit ourselves to the question of whether Dearlove engaged in "repeated instances of unreasonable conduct, each resulting in a violation of applicable standards, that indicate a lack of competence to practice before the Commission." Rule of Practice 102(e)(iv)(B)(2).

violations of the reporting and recordkeeping provisions of the Exchange Act. 3/ The law judge permanently denied Dearlove the privilege of appearing or practicing in any capacity before the Commission. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II. Background

Adelphia, a cable television company incorporated in Delaware and headquartered in Coudersport, Pennsylvania, was founded in 1952 by John Rigas and went public in 1986. Adelphia had several large subsidiaries, some of which were public companies, and Adelphia consolidated its financial statements with those of its subsidiaries. The Rigas family retained control over Adelphia through their exclusive ownership of Adelphia's Class B shares. 4/ Whenever Adelphia raised capital by issuing Class A shares, the Rigas family would arrange for Adelphia to make a direct placement of Class B shares so that the Rigases' ownership and majority voting interests would not be diluted. The Rigases' Class B stock was convertible into shares of Class A stock. In addition to their controlling ownership of Adelphia, the Rigas family held five of nine seats on Adelphia's board of directors.

Members of the family also owned several dozen private companies ("Rigas Entities"). The largest of these Rigas Entities also were engaged in the cable television business, and Adelphia used its own personnel, inventory, trucks, and equipment to provide services to the customers of these companies. Adelphia, its subsidiaries, and the Rigas Entities shared a centralized treasury system organized using cost centers, in which the cash balances of each company were separately maintained. Adelphia charged a fee for providing the Rigas Entities management, accounting, and other services.

By 2000, Adelphia was among the largest cable television and telecommunications providers in the United States. Adelphia had grown substantially at the end of 1999 by acquiring several other cable companies (more than doubling Adelphia's cable subscribers), and Adelphia continued to grow in 2000. Concomitant with this growth in assets, Adelphia's debt increased significantly. Between 1996 and 2000, Adelphia, its subsidiaries, and some Rigas Entities entered as co-borrowers into a series of credit agreements. By 1999, Adelphia and the Rigas Entities had obtained $1.05 billion in credit; in 2000, they tripled their available credit and drew down essentially all of the funds then available under the agreements.

Deloitte served as the independent auditor for Adelphia, one of its largest audit clients, from 1980 through 2002. The audits were complex. Several of Adelphia's subsidiaries filed their own Forms 10-K, and Adelphia frequently acquired other companies. For several years, Deloitte had concluded that the Adelphia engagement posed a "much greater than normal" risk of

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3/ 15 U.S.C. §§ 78m(a), 78m(b)(2)(A).

4/ Class A shares each received one vote; Class B shares each received ten.

fraud, misstatement, or error; this was the highest risk category that Deloitte recognized. Risk factors that Deloitte specifically identified in reaching this assessment for the 2000 audit included the following:

- Adelphia operated in a volatile industry, expanded rapidly, and had a large number of decentralized operating entities with a complex reporting structure;
- Adelphia carried substantial debt and was near the limit of its financial resources, making it critical that the company comply with debt covenants;
- Management of Adelphia was concentrated in a small group without compensating controls;
- Adelphia management lacked technical accounting expertise but nevertheless appeared willing to accept unusually high levels of risk, tended to interpret accounting standards aggressively, and was reluctant to record adjustments proposed by auditors; and
- Adelphia engaged in significant related party transactions with affiliated entities that Deloitte would not be auditing.

To help manage the audit risk, Deloitte planned, among other things, to increase Deloitte's management involvement at all stages of the audit "to ensure that the appropriate work is planned and its performance is properly supervised." It also proposed to heighten professional skepticism "to ensure that accounting estimates, related party transactions and transactions in the normal course of business appear reasonable and are appropriately identified and disclosed."

In 1999 and 2000, the American Institute of Certified Public Accountants ("AICPA") required that member firms rotate an engagement partner off the audit of a public company after seven years to bring a fresh perspective and maintain auditor independence. 5/ To replace Don Cottrill, the engagement partner who had conducted Adelphia's audits from 1993 to 1999, Deloitte asked Dearlove to assume responsibility as engagement partner for the audit of Adelphia's 2000 financial statements.

Dearlove, a Deloitte partner since 1986, had been an accountant working for the firm since he graduated from college in 1976. In 1997, Dearlove had become the managing partner for Deloitte's Buffalo and Rochester offices. Dearlove had served as the engagement partner on ten public company audits and the concurring review partner on several others. Nevertheless, Dearlove had no prior experience auditing companies in the cable television industry, and did not

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5/ See AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS ("AICPA"), SEC PRACTICE SECTION REFERENCE MANUAL § 1000.08(e).

immediately accept the assignment because Dearlove had not dealt before with audits of Adelphia's "complexity or sensitivity." Dearlove testified that, prior to the Adelphia audit, he "had never been in a greater than normal risk environment." After meeting with Cottrill and others on Adelphia's audit team, reviewing Adelphia's most recent financial statements and quarterly reports, and reading trade publications about the cable industry, Dearlove accepted the assignment in October 1999.

Dearlove began by shadowing Cottrill as he worked on Adelphia's 1999 financial statements. When the 1999 audit was completed, Deloitte's senior manager on the Adelphia audit team reviewed Adelphia's 1999 financial statements with Dearlove and explained the theory and history behind the accounting presentations therein. Dearlove also participated in the audit of the 1999 financial statements of one of Adelphia's subsidiaries that was considered to present the least sensitivity and risk. Dearlove assumed full responsibility for Adelphia's audit beginning with the quarterly review for the first quarter of 2000. Dearlove and other Deloitte partners agreed that the "much higher than normal risk" assessment continued to apply to the 2000 audit.

The staffing of Deloitte's audit team for the 2000 audit remained largely unchanged from prior years. The team consisted of about twenty staff accountants and tax professionals, divided into subgroups that were supervised by ten Deloitte managers and headed by senior manager William Caswell, who reported directly to Dearlove. Several of the Deloitte managers had significant prior experience auditing and reviewing Adelphia's annual and quarterly reports: Caswell had spent six years working on Adelphia engagements; Ivan Hofmann and Robert Fitzgerald, both audit managers, had each spent five years. In addition, Michael Lindsey served as the concurring partner as he had on Adelphia audits since 1996, and Stephen Biegel was assigned as risk review partner after serving in that capacity for the 1999 Adelphia audit. Dearlove had once met Caswell at a firm meeting but did not otherwise know any members of the Adelphia audit team when he assumed his role as engagement partner.

Deloitte devoted an estimated 21,000 hours to the audit of Adelphia's 2000 financial statements and related accounting advisory activities; Dearlove himself spent over 700 hours. Dearlove spent a total of ten to fifteen days on-site in Coudersport with the audit team. Dearlove participated in discussions with the team, reviewed workpapers and underlying Adelphia documents when the team brought them to his attention, and "worked through the issues" with his staff in what Dearlove characterized as a "consultative process." At the end of the audit, Dearlove looked at certain workpapers and drew conclusions as to whether the team completed its review. Dearlove testified that he also consulted Deloitte's national office on a number of accounting issues during the course of the audit, mostly involving revenue recognition.

On March 29, 2001, Deloitte issued its independent auditor's report, signed by Dearlove, which stated that it had conducted its audit in accordance with GAAS and that such audit provided a reasonable basis for its opinion that Adelphia's 2000 financial statements fairly presented Adelphia's financial position in conformity with GAAP. 6/

In January 2002, following the collapse of Enron Corporation, the Commission released guidance clarifying the disclosures that issuers should consider making with respect to, among other things, related party transactions. 7/ In reaction, Adelphia disclosed for the first time in a press release the extent of the Rigas Entities' co-borrowed debt. The disclosure alarmed investors and analysts, leading to a formal investigation by a special committee of Adelphia's board of directors into related party transactions between Adelphia and the Rigases that resulted in the public disclosure of the Rigas family's related party transactions as well as various accounting irregularities. Adelphia's stock price declined from about $30 per share in January 2002 to $0.30 per share in June 2002, and the stock was delisted from the Nasdaq market. After defaulting on various credit agreements, Adelphia filed for bankruptcy under Chapter 11 in June 2002.

In the wake of Adelphia's decline, the Department of Justice brought criminal fraud charges against several members of the Rigas family and other Adelphia officials. 8/ The Department of Justice declined to file criminal charges against Adelphia as part of a settlement in which Adelphia agreed to pay $715 million in stock and cash to a victims' restitution fund once the company emerged from bankruptcy. 9/

The Commission also brought several actions related to the decline of Adelphia. On April 25, 2005, Adelphia, John Rigas, and Rigas's three sons settled a civil injunctive action in which the respondents, without admitting or denying the allegations against them, were enjoined from committing or causing further violations of the antifraud, reporting, recordkeeping, and

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6/ Dearlove resigned his position with Deloitte in September 2001 and accepted an offer of employment to serve as a senior vice president and chief financial officer of a public company. There is no evidence in the record to suggest that the Adelphia audit was a cause of Dearlove's departure from Deloitte.

7/ Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, 67 Fed. Reg. 3,746 (Jan. 25, 2002).

8/ James Brown, Adelphia's vice president of finance, and Tim Werth, Adelphia's director of accounting, both pled guilty. John and Timothy Rigas were convicted and sentenced to lengthy prison terms by the United States District Court for the Southern District of New York. The Court of Appeals for the Second Circuit affirmed the convictions on all but one of twenty-three counts and remanded the case for sentencing. See United States v. Timothy J. Rigas and John J. Rigas, 490 F.3d 208 (2d. Cir. 2007).

9/ See United States v. Rigas, 371 F. Supp. 2d 474 (S.D.N.Y.), aff'd, 409 F.3d 555 (2d Cir. 2005); In re Adelphia Commc'ns Corp., 327 B.R. 143 (Bankr. S.D.N.Y. 2005).

internal controls provisions of the federal securities laws. 10/ The next day, the Commission instituted and settled administrative proceedings against Deloitte under Rule 102(e). 11/ Without admitting or denying the Commission's allegations, Deloitte consented to the entry of findings that it engaged in repeated instances of unreasonable conduct with respect to the audit of Adelphia's 2000 financial statements. Deloitte also consented to a finding that it caused Adelphia's violations of those provisions of the Exchange Act that require issuers to file annual reports, make and keep accurate books and records, and devise and maintain a system of sufficient internal controls. Deloitte agreed to pay a $25 million penalty and to implement various prophylactic policies and procedures. The Commission also settled a civil action based on the same conduct in which Deloitte agreed to pay another $25 million penalty. 12/ Senior manager Caswell consented to Commission findings that he committed repeated instances of unreasonable conduct and agreed to a bar from appearing or practicing as an accountant before the Commission with a right to apply for reinstatement after two years. 13/

III. Applicable Professional Standards: The Requirements of GAAS

In determining whether to discipline an accountant under Rule 102(e)(1)(iv), the Commission has consistently measured auditors' conduct by their adherence to or deviation from GAAS. 14/ There are ten fundamental generally accepted auditing standards, consisting of three

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10/ See In re Adelphia Commc'ns Corp., 327 B.R. at 156-58; SEC and U.S. Attorney Settle Massive Financial Fraud Case Against Adelphia and Rigas Family for $715 Million, Press Rel. No. 2005-63 (Apr. 25, 2005), available at http://www.sec.gov/news/press/2005-63.htm.

11/ See Deloitte & Touche LLP, Securities Exchange Act Rel. No. 51606 (Apr. 26, 2005), 85 SEC Docket 1111.

12/ See SEC v. Deloitte & Touche LLP, No. 05-Civ.-4119 (PKC) (Apr. 26, 2005 S.D.N.Y.); SEC Charges Deloitte & Touche for Adelphia Audit, Press Rel. No. 2005-65 (Apr. 26, 2005), available at http://www.sec.gov/news/press/2005-65.htm.

13/ See William E. Caswell, CPA, Exchange Act Rel. No. 52538 (Sept. 30, 2005), 86 SEC Docket 1257.

14/ See, e.g., James Thomas McCurdy, CPA, 57 S.E.C. 277, 295 (2004) (basing Rule 102(e) finding on auditor's deviation from "fundamental principles of auditing," which included, among other things, failure to obtain sufficient competent evidential matter, render an accurate audit report, maintain an attitude of professional skepticism, and exercise due care), aff'd, 396 F.3d 1258 (D.C. Cir. 2005); Barry C. Scutillo, 56 S.E.C. 714, 746 (2003) (basing Rule 102(e) finding on auditor's "[r]eckless failures to comply with auditing standards," including, among other things, failure to maintain professional skepticism and

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General Standards, three Standards of Field Work, and four Standards of Reporting. 15/ As explained by the Division of Enforcement's ("Division's") expert,

> [t]he General Standards require the auditor to have adequate technical training and audit proficiency, maintain independence and exercise due professional care. The Standards of Fieldwork set forth the requirements for adequate planning and supervision of assistants, gaining an understanding of the company's internal controls, and gathering sufficient competent evidential matter. The Standards of Reporting provide that the auditor's report state the financial statements are presented in accordance with GAAP and if not, it must identify circumstances where GAAP is not observed.

These ten fundamental standards are amplified by Statements on Auditing Standards issued and codified by AICPA's Auditing Standards Board.

GAAS require auditors to plan the audit adequately and to properly supervise any assistants. 16/ Auditors must exercise due professional care in performing an audit and preparing a report. 17/ They must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence." 18/ They must obtain sufficient

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14/ (...continued)
to exercise due care); Michael J. Marrie, CPA, 56 S.E.C. 760, 791-93 (2003) (basing Rule 102(e) finding on auditors' reckless failure to conduct the audit in accordance with GAAS, including their failure to exercise professional skepticism and to obtain sufficient competent evidential matter), rev'd on other grounds, 374 F.3d 1196 (D.C. Cir. 2004) (reversing based on retroactive application of amended rule but noting that the requirements of GAAS to exercise due care and professional skepticism and to obtain sufficient evidential matter are "'standards to which all accountants must adhere'") (citing Potts v. SEC, 151 F.3d 810, 813 (8th Cir. 1998)).

As discussed in Section IX, the question of whether Dearlove caused Adelphia's violations of the reporting provisions of the securities laws is also informed by the degree to which he departed from the applicable standard of care, i.e., whether he acted negligently.

15/ AICPA, CODIFICATION OF STATEMENTS OF AUDITING STANDARDS § 150.02 (2000) (hereinafter, "AU § ___").

16/ AU §§ 311.01, 311.11.

17/ AU § 230.01.

18/ AU §§ 230.07-08.

competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under review. 19/

Certain audit conditions require auditors to increase their professional care and skepticism, as when the audit presents a risk of material misstatement or fraud. 20/ When an audit includes review of related party transactions, auditors must tailor their examinations to obtain satisfaction concerning the purpose, nature, and extent of those transactions on the financial statements. 21/ Unless and until an auditor obtains an understanding of the business purpose of material related party transactions, the audit is not complete. 22/ As we have previously observed, these standards can overlap somewhat, and one GAAS failure may contribute to another. 23/

Dearlove urges us to compare the reasonableness of his conduct to a somewhat different standard. Dearlove argues, citing pattern jury instructions used by New York state courts in professional negligence cases, that the standard for determining negligence by an accountant should be based on whether the respondent "use[d] the same degree of skill and care that other [accountants] in the community would reasonably use in the same situation." Dearlove asks us to evaluate his actions in the context of the large, complex Adelphia audit and to determine whether Dearlove exercised the degree of skill and care that a reasonable engagement partner would have used in similar circumstances. Dearlove contends that this analysis "necessarily includes . . . conclusions previously reached by other professionals," a reference to the Adelphia audits Deloitte conducted from 1994 through 1999. Dearlove asserts that he could place some reliance on audit precedent. Moreover, in his view, the fact that prior auditors reached the same conclusions is "compelling evidence" that Dearlove acted reasonably.

The complexity of the Adelphia audit, the number of accountants assigned to it, the risk that Deloitte attributed to it, and the conclusions of prior auditors certainly provide context to our review. However, we reject any suggestion that the conduct of prior auditors should be a

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19/ AU § 326.22.

20/ AU §§ 312.17, 316.27.

21/ AU § 334.09.

22/ AU § 334.09(a) & n.6.

23/ McCurdy, 57 S.E.C. at 286 ("For example, a failure to maintain professional skepticism about information obtained from management can result in a failure independently to verify that information and gather sufficient competent evidential matter. Similarly, if an auditor fails to exercise due professional care, he may not obtain sufficient competent evidential matter to support an audit conclusion that the financial statements were prepared in compliance with GAAP.").

substitute for the standards established by GAAS. GAAS are the fundamental standards of auditing promulgated by auditors themselves. AICPA membership approved and adopted the ten fundamental auditing standards, i.e., the General, Field Work, and Reporting Standards. 24/ AICPA's Auditing Standards Board has developed and issued subsequent auditing standards "through a due process that includes deliberation in meetings open to the public, public exposure of proposed [standards], and a formal vote." 25/ These standards apply to audits of all sizes and all levels of complexity and describe the conduct that the accounting profession itself has established as reasonable, "provid[ing] a measure of audit quality and the objectives to be achieved in an audit." 26/ We therefore decline to create a separate standard of professional conduct for auditors that depends in each case on the behavior of a particular auditor's predecessors. The accounting profession itself has already prescribed the applicable standards.

Moreover, as required at the time by AICPA, Dearlove was assigned to the Adelphia audit to replace the incumbent engagement partner for the specific purpose of bringing a fresh perspective to the audit. The rotation of audit partners assigned to the audits of public companies has long been required of most independent auditors by AICPA and, more recently, by federal law. 27/ Deloitte itself recognized that audit partner rotation is "vital" to an auditor's objectivity and that "[t]he impartiality of the external audit is a critical component of the function auditors perform for issuers, their investors, and their potential investors, and measures that militate against complacency and reinforce the external auditor's professional skepticism can protect that impartiality." 28/ Reliance on prior audit conclusions, especially in areas of high risk, without

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24/ AU § 150.02.

25/ AU § 150.03.

26/ AU § 150.01. See also SEC v. Dain Rauscher, Inc., 254 F.3d 852, 857 (9th Cir. 2001) (noting that GAAS are a "time-honored standard set by an authoritative source recognized and followed throughout the profession" against which auditors' conduct can be judged); Potts v. SEC, 151 F.3d at 812 (stating that GAAS are "well-established norms of the accounting profession").

27/ See AICPA, SEC PRACTICE SECTION REFERENCE MANUAL § 1000.08(e) (promulgated in 1977 and requiring members, excepting small firms with few public-company clients, to rotate engagement partner from audit of public company every seven years); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 203, 116 Stat. 745, 773 (codified at 15 U.S.C. § 78j-1(j)) (making it unlawful for registered accounting firms to audit public companies if the lead audit partner or reviewing partner performed audit services for the company for the five preceding years).

28/ Deloitte & Touche LLP, Comment Letter of Deloitte & Touche LLP on the Commission's Proposed Rule Implementing Sections 201, 202, 203, 204, and 206 of the Sarbanes-Oxley

(continued...)

questioning whether that reliance was appropriate under the circumstances, defeats the purpose of auditor rotation – i.e., to preserve auditor independence and encourage critical thinking. 29/

On the record before us, we find that prior Deloitte audit conclusions offered little support for the conclusions reached in the 2000 audit. The record does not describe how the audits of prior financial statements were performed or what evidential matter supported those audit conclusions. Moreover, Dearlove's expert, while arguing that partner rotation does not require the new auditor to perform a "de novo audit of the client," nevertheless explained that an engagement partner "would perform . . . new audit procedures or GAAP research and consultation . . . to address changed conditions or professional standards." In 2000, Dearlove was presented with markedly different circumstances from those presented to prior teams: since 1999, Adelphia had tripled its co-borrowed debt, doubled its revenues and operating expenses, and acquired more cable subscribers. The changes implicated areas of the Adelphia audit that Deloitte had specifically identified as posing high risk, namely, its rapid expansion, substantial debt load, and significant related party transactions. Therefore, we reject Dearlove's argument that the similarity of prior audit conclusions lends reasonableness to his own audit, and we find no reason to reject GAAS as the standard by which we judge all audits.

IV. Netting of Related Party Payables and Receivables

A. Facts

Since the company went public in 1986, Adelphia netted, or offset against each other, accounts payable to and receivable from various Rigas Entities on its consolidated financial statements. Adelphia calculated its net receivable balance by subtracting the balances of all accounts payable that Adelphia and its subsidiaries owed to Rigas Entities from the balances of all the accounts receivable that the Rigas Entities owed to Adelphia and its subsidiaries. Dearlove testified that when he was transitioning onto the Adelphia audit engagement in the spring of 2000, he discussed Adelphia's practice of netting with the Deloitte senior manager who had worked on Adelphia's 1999 financial statement audit. Dearlove "learned about the history of it," and testified that netting wasn't "something that I dealt with often in my history." Dearlove "hadn't had a client that did that" before, at least not one that "had these types of related parties that netted." Dearlove testified that, in approving Adelphia's use of netting in the 2000 financial statements, he relied on the fact that prior Deloitte auditors, whom Dearlove considered "highly technically competent," had permitted it in the past. He also took "some comfort from the fact that the concurring partner and the risk partner in '99 were going to be the concurring partner and

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28/ (...continued)
Act of 2002 (Jan. 10, 2003), available at http://www.sec.gov/rules/proposed/s74902/deloitte1.htm#P400_127619.

29/ Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6,006, 6,017 (Feb. 5, 2003).

risk partner in 2000," because Dearlove "was the only one . . . coming up to speed. They had already gotten there. The issues were similar, the client was similar. The industry was the same."

Dearlove had been told by Adelphia management that they were concerned about the growing net receivable balance in the second quarter review, and that they would seek to reduce it through additional related party borrowing. Indeed, the audit team reviewed the net receivables Adelphia presented during each quarterly review and knew that Adelphia's net related party receivables were reported as $178 million at the end of 1999, $254 million at the end of the first quarter in 2000, $263 million at the end of the second quarter, and $19 million at the end of the third quarter. Ultimately, a line item titled "Related Party Receivables - Net" on Adelphia's balance sheet and Form 10-K for 2000 reported $3,071,000.

Adelphia's 2000 year-end gross related party accounts payable and receivable, however, totaled more than $1 billion each. Dearlove was aware of the dramatic reduction of the net balance and testified that the balance had dropped "as we expected it." However, Dearlove could not recall whether or how the audit team tested Adelphia's affiliate receivables, could not explain how his team tested management's explanations for the fluctuations in Adelphia's reported net balance, and could not recall having any discussions with his team about the propriety of Adelphia's netting.

B. Analysis

Accounting Principles Board Opinion No. 10 states that "[i]t is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists." 30/ Rule 5-02 of the Commission's Regulation S-X requires that issuers "state separately" amounts payable and receivable. 31/ FASB Interpretation 39, Offsetting of Amounts Related to Certain Contracts ("FIN 39"), defines a right of setoff as "a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to

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30/ Accounting Principles Board Opinion No. 10, ¶ 7.1.

31/ 17 C.F.R. §§ 210.5-02.3, 210.5-02.19. For Commission registrants, the rules promulgated under Regulation S-X have an authority similar to the highest-level GAAP pronouncements. See AU § 411.10 n.3.

another party by applying against the debt an amount that the other party owes to the debtor." 32/ It also provides that a right of setoff exists only when all of four conditions are met:

a. each of two parties owes the other determinable amounts;

b. the reporting party has the right to set off the amount owed with the amount owed by the other party;

c. the reporting party intends to set off; and

d. the right of setoff is enforceable at law. 33/

We conclude that Adelphia's presentation of a net figure for its related party payables and receivables violated GAAP. Because Adelphia netted the accounts payable and receivable of its various subsidiaries against the accounts payable and receivable of various Rigas Entities on a global basis, it did not comport with FIN 39's basic requirement that netting is appropriate only when two parties are involved.

Dearlove argues that FIN 39 prohibits only unilateral offsetting; that is, FIN 39 requires that at least two entities seek to offset, but it does not prohibit more than two entities from offsetting. We disagree. The "two-party" limitation on circumstances in which netting is permitted by FIN 39 is unambiguous. Moreover, FIN 39 is an exception to the general accounting rule that financial statements should present related party payables and receivables as gross figures; it is an exception that should be construed narrowly. 34/ FIN 39 itself specifically rejects the notion that offsetting is permissible among more than two parties except in very limited circumstances, none of which is applicable here. 35/

32/ An Interpretation issued by the Financial Accounting Standards Board ("FIN") is considered authoritative GAAP. See AU § 411.10(a).

33/ FIN 39 ¶ 5 (emphasis in original).

34/ FIN 39 ¶ 43 ("Some respondents indicated that the number of entities involved in the transaction is not relevant to the decision to offset. The general principle of a right of offset involves only two parties, and exceptions to that general principle should be limited to practices specifically permitted by the pronouncements indicated in paragraph 7 of this Interpretation.").

35/ FIN 39 ¶ 7 cites to certain provisions that permit offsetting regarding leases, insurance enterprises, pensions, income taxes, and other specialized situations. Dearlove has not argued that any of these provisions applies to Adelphia's netting, and we find that none applies.

Dearlove also suggests that Adelphia and its subsidiaries should be deemed to constitute one entity, while the Rigas Entities as a group constitute the other, thereby satisfying FIN 39's two-party requirement. However, FIN 39 allows offsetting only by two parties, and not by groups of entities claiming to be functionally equivalent to one party. Moreover, even if FIN 39 could be construed to permit a group of similarly-situated entities to be considered one "party" for purposes of FIN 39, such a construction is not acceptable here. Although Dearlove argues that "[t]he private entities were all owned by the Rigas family," the scant evidence in the record about the ownership of the Entities demonstrates that not every Rigas Entity whose accounts were netted with Adelphia's was owned in equal proportions by the same members of the Rigas family. For example, a Rigas Entity called Eleni Interiors was owned by John Rigas's wife, Doris Rigas, but she is not named as a member of the Rigas family partnership that owned several other Rigas Entities whose accounts Adelphia netted. There is no evidence in the record that Dearlove took any steps to determine the ownership structures of the Rigas Entities.

FIN 39 requires compliance with all four of its conditions; therefore, because Adelphia could not satisfy the first condition, FIN 39 was not available to Adelphia. 36/ Accordingly, we find that, based on Adelphia's failure to satisfy FIN 39's fundamental requirement that only two parties may offset, Adelphia's failure to report its related party payables and receivables as gross figures was a GAAP violation.

We also find that Dearlove's conduct in his audit of Adelphia's net presentation of affiliate accounts payable and receivable was at least unreasonable, resulting in several GAAS violations. As we have previously noted, Deloitte considered the Adelphia audit to present much greater than normal risk; under such circumstances, GAAS require "more extensive supervision by the auditor with final responsibility for the engagement during both the planning and conduct of the engagement" and should cause the auditor to "expand the extent of procedures applied, apply procedures closer to or as of year end, particularly in critical audit areas, or modify the nature of procedures to obtain more persuasive evidence." 37/ Where, as with Adelphia's practice of netting, a specific audit area involves related party transactions, GAAS require auditors to obtain an understanding of the business purpose of those transactions; if the auditor "lacks sufficient specialized knowledge to understand a particular transaction, he should consult

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36/ We note, however, that the record does not appear to support the conclusion that Adelphia could satisfy the remaining requirements. FIN 39 requires that the right of offset must be enforceable at law, and, although written agreements are not necessary to demonstrate enforceability, see FIN 39 ¶ 47, there is a dearth of evidence showing that such agreements existed. Moreover, the parties have not addressed how "legal constraints" such as state law and the federal bankruptcy code might have affected the legal enforceability of a right of offset. See FIN 39 ¶ 6 ("Legal constraints should be considered to determine whether the right of setoff is enforceable.").

37/ AU § 312.17.

with persons who do have the requisite knowledge." 38/ Dearlove, who admittedly had little experience with netting, knew that Adelphia management tended to embrace aggressive accounting interpretations and that they succeeded in dramatically reducing Adelphia's reported net affiliate receivables to deflect investor criticism.

Despite the need for increased attention to this audit area, there is no evidence, in the audit workpapers or elsewhere in the record, that Dearlove gave any consideration to the propriety of Adelphia's netting during the 2000 audit or that the audit team conducted any analysis of FIN 39's requirements. 39/ There is no evidence, in fact, that Dearlove made any attempt to determine the gross amounts of Adelphia's related party accounts payable and receivable, which each totaled more than $1 billion.

Instead, Dearlove accepted Adelphia's accounting treatment primarily, if not solely, because prior auditors had done so. This reliance on prior auditing conclusions was unreasonable because this audit generally called for heightened skepticism and because this account, in particular, involved related party transactions and a precipitous drop in the amount of net receivables that Adelphia reported compared to prior years. Moreover, Dearlove's unquestioning reliance on prior audit conclusions is precisely the result that audit partner rotation was designed to remedy. 40/ We also find that Dearlove's inattention to Adelphia's net presentation of related party receivables resulted in violations of applicable professional standards: Dearlove did not obtain sufficient competent evidential material to support his conclusion that Adelphia's netting was properly done, he did not exercise appropriate skepticism despite circumstances requiring heightened scrutiny, and he did not properly supervise the audit team to ensure that significant related party transactions like these were afforded appropriate review. 41/

Dearlove argues that the law judge's decision essentially attributed an alleged overall audit failure to Dearlove without identifying the conduct on which that responsibility is based. He contends that the law judge cannot hold Dearlove accountable for every audit failure simply

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38/ AU § 334.09(a) & n.6.

39/ An auditor does not violate GAAS simply by failing to document the basis for his audit conclusions in audit workpapers, and the Order Instituting Proceedings in this case did not charge Dearlove with having violated GAAS by failing to adequately document his work. Nevertheless, workpapers are ordinarily the foundation on which support for audit conclusions is demonstrated. See AU § 339 ("Audit documentation is the principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement."). We consider the absence of work papers to be evidence that the audit team did not devote substantial, if any, effort to review the areas in question.

40/ See supra note 27 and accompanying text.

41/ AU §§ 230.07-08, 311.01, 311.11, 312.17, 316.27, 326.22, 334.09.

by saying that Dearlove was the individual in charge and is therefore liable. Even if we agreed that the law judge so erred, our de novo review cures any error that the law judge may have made. 42/ Our own review leads us to conclude that Dearlove's conduct was deficient because, despite the need for heightened scrutiny and despite his admitted lack of experience with the practice of netting in general, he did not pursue, or direct his team to pursue, the reason behind the dramatic reduction in Adelphia's net receivable balance; he did not consult with members of the audit team or anyone in Deloitte's national office about the issue; and he could not confirm that he ever considered FIN 39 during the audit. Taking note of the fact that Adelphia's practice of netting effectively defeated investor scrutiny of over $2 billion of related party accounts, we find that Dearlove's lack of attention to the issue was inconsistent with the requirements of GAAS.

V. Co-Borrowed Debt

A. Facts

As noted above, between 1996 and 2000, several Adelphia subsidiaries and some of the Rigas Entities had entered as co-borrowers into a series of three credit agreements with a consortium of banks. Although the agreements differed in the amount of credit available, their terms were substantially the same: each borrower provided collateral for the loan; each could draw funds under the loan agreement; and each was jointly and severally liable for the entire amount of funds drawn down under the agreement regardless of which entity drew down the amount.

Combining the features of term loans and revolving credit lines, the agreements permitted co-borrowers to draw funds and repay the loans at will and required almost no principal payments until the loans began to mature in 2004. The amount of debt outstanding under the agreements therefore could fluctuate as co-borrowers drew down and made payments on the loans. Cross-default provisions in the agreements provided that it was considered an event of default if the borrowers failed to timely pay any other substantial debts – co-borrowed or otherwise – they had assumed, which would permit the banks to demand immediate payment of

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42/ See Robert M. Fuller, 56 S.E.C. 976, 989 n.30 (2003), petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004). The law judge's opinion ceased to have any force or effect once Dearlove filed his petition for review. See Fundamental Portfolio Advisers, Inc., 56 S.E.C. 651, 679 n.44 (2003); 17 C.F.R. §§ 201.360(d), (e). For the same reason, we reject as moot Dearlove's complaint that certain of the law judge's findings of GAAS violations were ill-founded because the law judge, in finding that Dearlove failed to supervise the audit team, cited two auditing standards that were not specifically cited in the OIP. Similarly, we reject his complaint that the law judge appeared to base a GAAS failure on the fact that the audit team created no workpaper on the netting issue, which violation was not pled in the OIP.

all outstanding amounts. 43/ The agreements also provided that an event of default occurred if the Rigas family lost its majority control of the co-borrowing companies.

By year-end 2000, the total amount of co-borrowed funds drawn under the credit agreements was $3.751 billion, more than triple the $1.025 billion borrowed at year-end 1999. Of this amount, Adelphia subsidiaries had drawn approximately $2.1 billion, and Rigas Entities had drawn $1.6 billion.

Generally, an issuer must accrue on its balance sheet a debt for which it is the primary obligor. However, when an issuer deems itself to be merely contingently liable for a debt, Statement of Accounting Standards No. 5 ("FAS 5") provides the appropriate accounting and reporting treatment for that liability. 44/ FAS 5 establishes a three-tiered system for determining the appropriate accounting treatment of a contingent liability, based on the likelihood that the issuer will suffer a loss – that is, be required to pay the debt for which it is contingently liable. If a loss is "probable" (i.e., "likely") and its amount can be reasonably estimated, the liability should be accrued on the issuer's financial statements as if the issuer were the primary obligor for the debt. 45/ If the likelihood of loss is only "reasonably possible" (defined as "more than remote but less than likely"), or if the loss is probable but not estimable, the issuer need not accrue the loss but should disclose the nature of the contingency and give an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Even if the likelihood of loss is only "remote" (or "slight"), the issuer must still disclose the "nature and amount" of the liability. From 1997 through 1999, Adelphia had included in the liabilities recorded on its balance sheet the amount its own subsidiaries had borrowed, but it did not consider itself the primary obligor for the amount that the Rigas Entities had borrowed and therefore did not include that amount on its balance sheet. Instead, Adelphia accounted for the amounts borrowed by the Rigas Entities by making the following disclosure in the footnotes to its financial statements:

43/ The 2000 agreement provided that it was an event of default if "(a) Any Company fails to pay when due (after lapse of any applicable grace periods) any Debt of such Company (other than the Obligation) in excess (individually or collectively) of $25,000,000; or (b) the acceleration of any Debt of any Company, the principal amount of which Debt exceeds (individually or collectively) $25,000,000." "Debt" was defined as "all liabilities, obligations, and indebtedness . . . which in accordance with GAAP should be classified upon [the] balance sheet as liabilities. . . ." The 1999 and 1996 agreements contained similar provisions but applied to debts in the amount of $10 million or more and $7.5 million or more, respectively.

44/ A Statement of the Financial Accounting Standards Board ("FAS") is considered authoritative GAAP. See AU § 411.10(a).

45/ FAS 5 ¶ 8.

> Certain subsidiaries of Adelphia are co-borrowers with Managed Partnerships [i.e., Rigas Entities] under credit facilities for borrowings of up to [the total amount of all co-borrowed debt available to Adelphia and the Rigas Entities that year]. Each of the co-borrowers is liable for all borrowings under this credit agreement, although the lenders have no recourse against Adelphia other than against Adelphia's interest in such subsidiaries.

Deloitte had approved this treatment in the audits it conducted from 1997 to 1999.

In its 2000 financial statements, Adelphia planned to account for its co-borrowed debt in the same way it had in prior years. Adelphia concluded that it was the primary obligor for only the amount of co-borrowed debt that its own subsidiaries had drawn. Therefore, Adelphia included $2.1 billion as a liability on its balance sheet. 46/ Adelphia considered itself only contingently liable as a guarantor for the $1.6 billion that the Rigas Entities had drawn, and again concluded that disclosure of the co-borrowed debt in the notes to its financial statements would be adequate.

Dearlove knew that Adelphia considered the Rigas Entity debt to be a contingent liability for which its chances of suffering a loss were merely "remote," making accrual on the balance sheet unnecessary pursuant to FAS 5. Deloitte created no workpapers documenting its examination of Adelphia's decision. However, from the record, it appears that Deloitte considered the matter and focused its review on the likelihood, as defined by FAS 5, that Adelphia would have to pay the Rigas Entities' share of co-borrowed debt.

Dearlove estimated the value of the Rigas Entities' cable systems and assets by multiplying the number of Rigas Entity basic cable subscribers by the market value per subscriber as established by industry transactions in 1999 and 2000 and concluded that the Entities' subscriber assets were worth approximately $1 billion. Dearlove did not consider whether the Rigas Entities' cash flow was sufficient to service the debt, did not perform a cash flow analysis for the Rigas Entity co-borrowers, and did not know if the Rigas Entities serviced any portion of their co-borrowed debt with funds provided by Adelphia.

Dearlove also believed that, although the Rigas family was not legally obligated to contribute funds in the event of a default by the co-borrowers, the family would be economically compelled to protect their Adelphia holdings by stepping in to prevent a default by the Entities. Dearlove did not, however, conduct any inquiry into whether the family would, in fact, use their personal assets to prevent a default by Adelphia. Dearlove estimated the value of the Rigas family's holdings of Adelphia stock by multiplying the number of shares the Rigases owned by the price per Class A share, resulting in a figure of approximately $2.3 billion, which he

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46/ The $2.1 billion in co-borrowed debt was included as part of the $9.1 billion figure reported on Adelphia's 10-K as "subsidiary debt."

concluded was by itself ample to cover the debt and conclude his FAS 5 analysis. However, Dearlove did not determine if these Rigas family assets were already encumbered by other debt; he saw no financial statements or other proof of the family's financial condition other than local media reports that the Rigases "were billionaires." Dearlove testified that he "never asked them: Are you worth 2 billion, 3 billion or 10 billion?" Dearlove also did not consider whether disposing of some or all of the family's stock might result in a downward spiral in the stock's value or in a change in their control of Adelphia, an event of default under the co-borrowing agreements.

Dearlove testified that, at the end of the 2000 audit, he spoke to senior manager Caswell for about fifteen minutes regarding the requirements of FAS 5. During this meeting, they concluded that "the assets of the cable systems and the Adelphia common stock that the Rigases owned exceeded the amount of debt that was on the co-borrowed entities, and the overhang . . . exceeded the co-borrowing by hundreds of millions if not billions of dollars." Dearlove testified that, although other assets could have been included in a FAS 5 analysis, these two assets alone were sufficient to allow the auditors to conclude that Adelphia's contingent liability was remote. Deloitte therefore approved Adelphia's decision to exclude the Rigas Entities' $1.6 billion in co-borrowed debt from its balance sheet and to instead disclose the debt in a footnote to the financial statements.

When it reviewed the adequacy of the note disclosure that Adelphia planned to use (which was identical to the language it had used in previous years), the audit team initially believed the disclosure should be revised. During the 2000 quarterly reviews, audit manager Hofmann and others had repeatedly encouraged Adelphia management to disclose the specific dollar amount of Rigas Entity co-borrowings, but Adelphia continually ignored Deloitte's suggestions. Although Deloitte was unaware of it at the time, Adelphia management was purposefully working to obfuscate the disclosure of Rigas Entity co-borrowed debt.

In November 2000, at a third-quarter wrap-up meeting attended by Dearlove, Caswell, and Hofmann, Adelphia management (including Adelphia's vice president of finance, James Brown), agreed to make disclosures regarding the amounts borrowed by the Rigas Entities under the co-borrowing agreements. Caswell and Hofmann subsequently suggested improvements to the note disclosure in written comments on at least six drafts of the 10-K; they proposed adding language that would distinguish the amount of borrowings by Adelphia subsidiaries and Rigas Entities, such as the following: "A total of $__ related to such credit agreements is included in the Company's consolidated balance sheet at December 31, 2000. The [Rigas] Entities have outstanding borrowings of $__ as of December 31, 2000 under such facilities."

At the end of March 2001, as Deloitte was concluding its audit of the 2000 financials, Brown – despite his agreement in November 2000 to disclose the amount of Rigas Entity borrowing – informed the audit team that he did not think the additional disclosure was necessary. Instead, Brown proposed adding a phrase explaining that each of the co-borrowers "may borrow up to the entire amount available under the credit facility." Brown argued that his proposed language was more accurate than Deloitte's proposal, because the lines of credit could fluctuate and, as a result, it would be better to disclose Adelphia's maximum possible exposure. Caswell agreed to take Brown's language back to the engagement team, but he told Brown that he did not agree with Brown and did not think Deloitte would accept his proposed language. 47/

Notwithstanding Caswell's reaction, Brown soon afterwards presented his proposed language to the audit team, including Dearlove, Caswell, and Hofmann, during the audit exit meeting on March 30, 2001. Brown claimed that his proposed disclosure language had been discussed with, and approved by, Adelphia's outside counsel. Although Dearlove characterized the disclosure issue as "really one of the more minor points that [the audit team was] trying to reconcile at that point," the law judge did not credit this testimony. Dearlove testified that he was "concerned" about "making it clear to the reader how much Adelphia could be guaranteeing," and that Brown's language was "more conservative" but "wasn't necessarily what we were attempting to help clarify." Dearlove also testified that he told Brown, "I don't understand how that [proposed change] enhances the note" but that, after "an exchange back and forth relative to that," Dearlove "couldn't persuade him as to what he wanted." Nevertheless, Dearlove told Brown that he agreed with the proposal and approved the change. Caswell and Hofmann also indicated their agreement.

Dearlove did not understand, and did not ask, why Brown opposed full disclosure of the Rigas Entity debt. Dearlove did not seek Adelphia's permission to speak directly with Adelphia's outside counsel about Brown's proposed language. Nor did Dearlove attempt to verify that Brown actually presented the issue to Buchanan Ingersoll. 48/ Although Dearlove testified that he "believe[d] that we had communicated to both [risk reviewer] Steve Biegel through Bill Caswell and to [concurring partner] Mike Lindsey through Ivan Hofmann that we had proposed changes to various things in the document," he did not contact Lindsey or Biegel directly to ensure that they understood the changes to the disclosure language. 49/ Nevertheless, Dearlove

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47/ Caswell testified that he later discussed Brown's proposal with Dearlove and Hofmann, but Caswell does not recall the substance of the conversation, and no other testimony in the record illuminates the specifics of the engagement team's discussion.

48/ In fact, Brown had not consulted outside counsel about this issue.

49/ Moreover, neither Hofmann nor Caswell, during testimony, confirmed that they consulted, or were asked to consult, Biegel or Lindsey on this issue. Although Lindsey remembered reading a draft of the 10-K that included the team's recommended disclosure of the co-borrowed and guaranteed amounts, Lindsey did not recall seeing any draft of the 10-K that included Brown's language. Biegel testified that although he believed he had discussions with the audit team about co-borrowed debt, he did not recall any specific discussions; he also testified that he was not aware of any disagreement between Deloitte and Adelphia over the note disclosure.

testified that he believed the disclosure was GAAP compliant, and therefore Deloitte "didn't have a basis to force a change."

Adelphia's note disclosure of the co-borrowed debt, as it appeared in its 2000 Form 10-K with Brown's added language, read as follows:

> Certain subsidiaries of Adelphia are co-borrowers with Managed Entities under credit facilities for borrowings of up to $3,751,250[,000]. Each of the co-borrowers is liable for all borrowings under the credit agreements, and may borrow up to the entire amount of the available credit under the facility. The lenders have no recourse against Adelphia other than against Adelphia's interest in such subsidiaries.

B. Dearlove's Audit of Adelphia's FAS 5 Determination

The law judge found that the Division failed to prove that Adelphia violated GAAP by treating the Rigas Entities' co-borrowed debt as a contingent rather than a primary liability in its financial statements, or that Adelphia wrongly determined that its chances of having to repay that debt was only remote under FAS 5. The Division did not appeal the law judge's decision, and therefore we do not consider whether Adelphia violated GAAP by mis-applying FAS 5. 50/ Nevertheless, our inquiry does not end here: even assuming that Adelphia's accounting treatment

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50/ On July 23, 2007, Dearlove filed a motion to adduce additional evidence, seeking to add to the record on appeal excerpts of testimony given by James Brown in another proceeding that came to the attention of Dearlove's counsel when it was attached as an exhibit to a motion made by the Rigases in their criminal trial pending before the District Court for the Southern District of New York. Dearlove believes the testimony establishes two things.

As relevant here, Dearlove argues that one excerpt of the testimony establishes that the Rigas Entities had the financial wherewithal to pay their share of co-borrowed debt. Although Dearlove characterizes this as a "central issue in this proceeding," as we have just explained, whether Adelphia violated GAAP by incorrectly estimating its chances of having to pay the Rigas Entity debt is not before the Commission. Therefore, Dearlove does not meet the requirement of Commission Rule of Practice 452, 17 C.F.R. § 201.452, that the evidence he seeks to adduce be "material," and we decline to consider the proffered testimony in this context.

Dearlove next argues that a second excerpt establishes that a certain reclassification of debt was not a "sham" transaction. We deal with this portion of Dearlove's motion in our discussion of Adelphia's debt reclassifications, infra at note 72.

of the Rigas Entities' co-borrowed debt was GAAP-compliant, we may still find, as we do here, that an auditor's review of that accounting treatment violated GAAS. 51/

Deloitte, with Dearlove's participation and agreement, had concluded that the Adelphia audit generally presented a "much greater than normal risk" based on several factors, including its multiple related party transactions, recent significant growth in the company, and substantial debt load. Adelphia's accounting for co-borrowed debt, specifically, implicated all of these risk factors. GAAS require that when an audit presents an increased risk, the auditor must increase the professional care and skepticism he applies to his review, which may include, for example, "increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions." 52/ Despite the clear need for increased care and skepticism, Dearlove conducted only a cursory review of Adelphia's accounting for the Rigas Entities' share of co-borrowed debt. There is no evidence in the workpapers that Dearlove or the audit team conducted an analysis of Adelphia's potential for liability under the credit agreements; nor is there any evidence in the workpapers that he directed his team to conduct such an analysis. 53/ Instead, Dearlove's conclusion was based on a series of assumptions about the Rigas Entities' and the Rigas family's willingness and ability to pay the co-borrowing Rigas Entities' debt – assumptions that were either untested or inadequately tested.

First, Dearlove and the audit team assumed that all Rigas Entities were willing to liquidate their assets to cover other Entities' debts. There is no evidence that the team made any effort to confirm this assumption, or at least to confirm that the Rigas Entities whose assets were being pooled had identical ownership structures. Having made this untested assumption, the audit team did not analyze whether each Rigas Entity could service its own share of the debt, but instead examined only whether all the Rigas Entities taken together – including non-co-borrowers – owned sufficient assets to cover the debt. Although Dearlove concluded that the collective value of Rigas Entity cable subscribers and accounts receivable was sufficient to cover the debt, he did so without examining the consequences of liquidating those assets. Moreover, there is no evidence in the record that Dearlove considered that, in order to prevent default by

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51/ See Michael J. Marrie, CPA, 56 S.E.C. at 776 ("An auditor who fails to audit properly under GAAS should not be shielded because the audited financial statements fortuitously are not materially misleading. An auditor who skips procedures designed to test a company's reports or looks the other way despite suspicions is a threat to the Commission's processes. Even if an auditor's improper professional conduct does not result in false financial statements, it damages the integrity of the Commission's processes because filings with the Commission are unreliable if auditors certify that their audits were conducted in accordance with GAAS when in fact they were not."). Dearlove does not argue that he cannot be sanctioned under Rule 102(e) if no GAAP violation is found.

52/ AU § 316.27; see also AU § 312.17.

53/ See supra note 39.

virtue of the cross-default provisions in the co-borrowing agreements, the Rigas Entities' available assets would have to prove sufficient to service all significant debts of the co-borrowers. 54/

Dearlove also assumed that, if the Rigas Entities could not pay their share of co-borrowed debt, the apparently wealthy Rigas family would step in to cover any impending default on the debt. Dearlove did nothing to confirm the Rigases' willingness to pay the Entities' debt, instead relying on a general presumption that all persons can be assumed to act in an economically rational manner. Dearlove further concluded that the Rigases were, in fact, financially able to cover the debt, but based this conclusion on incomplete information: Dearlove's understanding of the Rigas family's wealth was based only upon their holdings of Adelphia stock and the media's portrayal of the family as "billionaires." Dearlove did not evaluate the liquidity of the Rigases' shares and did not address whether their liquidation might be so large as to cost them majority ownership of Adelphia, thereby triggering a default under the debt agreements. Further, he failed to consider or make any inquiry into the possibility that the Rigas family's assets – however substantial – were already encumbered by other obligations and therefore unavailable for use against the Entities' co-borrowed debt. Finally, Dearlove did not discuss his FAS 5 conclusion with anyone at Adelphia or consult with Deloitte's risk review or concurring partner.

Dearlove's failures in examining the critical assumptions underlying his FAS 5 determination were at least unreasonable in light of the circumstances of this audit area that clearly called for increased care and scrutiny. Adelphia's co-borrowed debt was a multi-billion-dollar related-party transaction used, in part, to finance recent significant growth in the company, and it represented a substantial portion of the company's total debt load of approximately $12 billion. Adelphia's accounting treatment of the debt warranted more than a brief discussion about assets potentially available for liquidation: it called, at least, for testing and analysis of the actual availability, liquidity, and encumbrances of those assets.

Each of Dearlove's failures to meaningfully review Adelphia's chances of suffering a loss, moreover, resulted in a violation of professional standards. Dearlove's cursory treatment of co-borrowed debt did not comport with the generally-applicable requirements of GAAS to exercise due professional care and professional skepticism, adequately plan the audit, and obtain sufficient competent evidential matter to afford a reasonable basis for his opinion that Adelphia's chances of incurring a loss were remote. 55/ Nor did Dearlove's review satisfy the GAAS requirement to apply increased professional care and skepticism to audit areas presenting

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54/ See supra note 43. If Dearlove or the audit team attempted to identify for FAS 5 purposes the amounts of all significant debt (as defined by the co-borrowing agreements) carried by the Rigas Entities and Adelphia subsidiaries, there is no evidence of this in the record.

55/ AU §§ 311.01, 311.11, 230.01, 230.07 - 08, 326.22.

increased risk. 56/ To the contrary, Dearlove failed to apply even basic – let alone heightened – scrutiny to Adelphia's accounting for co-borrowed debt.

Dearlove argues that it was reasonable for the audit team to base a FAS 5 analysis on a comparison of the debt of the borrower to the value of the borrower's assets, and that his consideration of FAS 5 was adequate given that Dearlove knew that the co-borrowers held substantial assets and that the Rigases were economically compelled to respond with their own substantial, personal assets to prevent default. Dearlove's argument fails to address the fact that the team's reliance on the value of these assets is unfounded because Dearlove did not confirm, nor ask his team to confirm, that the assets were actually available for application against the co-borrowed debt as well as unencumbered.

Dearlove also argued in his brief and at oral argument that his consideration of Adelphia's chances of incurring a loss, though consuming only fifteen minutes at year-end, was supported by "extensive liquidity testing and debt-covenant testing of the co-borrowing groups" that had occurred during Deloitte's quarterly reviews. Dearlove cites to his own testimony to prove that he "considered the contingency and potential for loss on a quarterly basis when reviewing the financial statements." However, there is no evidence in the workpapers that the team specifically considered Adelphia's contingent liability under FAS 5 during the quarterly reviews. 57/ Moreover, the quarterly debt testing evidenced in the workpapers focused on confirming principal due under various loan agreements and other debt, calculation of interest, and proper entry of the debt on the books of Adelphia and its subsidiaries. Dearlove testified that these quarterly reviews helped him become "knowledgeable about" the value of Adelphia stock owned by the Rigases, subscriber assets owned by various Rigas Entities, and receivables owed to Rigas Entities. As we have explained, any knowledge that Dearlove gained about the value of various Rigas Entity and Rigas family assets through quarterly reviews still required testing as to whether those assets were in fact unencumbered and available for use against the Rigas Entities' share of co-borrowed debt.

C. Adequacy of the Note Disclosure of Adelphia's Contingent Liability

We next consider whether Adelphia's footnote disclosure of Rigas Entity co-borrowings was appropriate under GAAP. As explained above, FAS 5 states that, when the likelihood of loss arising from a contingent liabilty is only remote, a company need not accrue the amount of debt on its balance sheet. However, FAS 5 requires that a company must still disclose the "nature and amount" of the liability when it is a guarantee of another's indebtedness. 58/

56/ AU § 316.27; see also AU § 312.17.

57/ See supra note 39.

58/ The law judge declined to consider whether Adelphia's footnote properly disclosed the "nature" of the guarantee, because he believed the Division had presented its argument (continued...)

Adelphia disclosed the total amount of credit available to the co-borrowers ("up to" $3.75 billion) without indicating whether any portion of that available credit had actually been drawn down, much less that all of it had. This disclosure was inadequate to inform the investing public that Adelphia was already primarily liable for $2.1 billion and a guarantor for the remaining $1.6 billion that had been borrowed by Rigas Entities. Therefore, it did not comply with the requirement in FAS 5 to disclose the amount of the contingent liability.

We believe that Dearlove acted at least unreasonably in his audit of Adelphia's note disclosure, resulting in several violations of GAAS. In high-risk audit environments such as that presented by the Adelphia engagement, GAAS specifically recommend "increased recognition of the need to corroborate management explanations or representations concerning material matters – such as further analytical procedures, examination of documentation, or discussion with others within or outside the entity" when audit risk increases. 59/ The accounting for Adelphia's co-borrowed debt implicated the extensive related party transactions and high debt load that were part of the basis for Deloitte's high-risk assessment for the Adelphia audit. Management's insistence on its own accounting interpretation was precisely the behavior identified by the audit plan as presenting a much higher than normal risk of misstatement in the audit.

Moreover, Dearlove knew that the audit team believed that the previous years' footnote disclosure was inadequate and had urged additional disclosure that would have made clear the extent of Rigas Entity actual borrowings and Adelphia's potential liability therefor. Dearlove did not think Brown's language helped achieve Deloitte's goal of clarifying the extent of Rigas Entity debt and Adelphia's obligation as guarantor. Yet Dearlove accepted Brown's language without probing his reasons for the change, without understanding Adelphia's reasons for rejecting Deloitte's language, and without discussing the issue with the concurring or risk review partners assigned to the audit. This unquestioning acceptance of Brown's proposed disclosure language was a clear – and at least unreasonable – departure from the requirements of GAAS to apply greater than normal skepticism and additional audit procedures in order to corroborate management representations in a high-risk environment. Dearlove's conduct resulted in violations of applicable professional standards: Dearlove failed to exercise the level of professional care called for by the high-risk account and failed to employ professional skepticism in analyzing the note disclosure, 60/ and he failed to apply audit procedures necessary to afford a reasonable basis for an opinion regarding the financial statements. 61/

58/ (...continued)
too late when it raised the issue in its post-hearing reply brief. That decision has not been appealed and, as a result, is not before us.

59/ AU § 316.27.

60/ AU §§ 230.01, 230.07-08, 312.17, 316.27, 334.09; McCurdy, 396 F.3d at 1261-62.

61/ AU § 333.02.

Dearlove asserts that disclosure of the amount that the Rigas Entities could theoretically borrow (up to $3.75 billion) was more conservative than disclosure of the $1.6 billion that they had actually borrowed. We think the footnote disclosure was materially misleading to investors. "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information." 62/ If "there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision," the information is material. 63/ A reasonable investor would think it significant that the footnote disclosure spoke only in terms of potential debt when, in fact, the entire line of credit had been borrowed and $1.6 billion of it was excluded from Adelphia's balance sheet but potentially payable by Adelphia. It was especially important for this information to appear in Adelphia's financial statements because investors had no access to the financial statements of the privately-held Rigas Entities. We therefore reject Dearlove's argument that Adelphia's note complied with FAS 5's requirement to disclose the amount of debt that Adelphia guaranteed.

Dearlove also contends that Financial Accounting Standards Board Interpretation ("FIN") 45, issued in November 2002, contains accounting guidance that supports his view that the disclosure was adequate under GAAP. In the alternative, Dearlove argues, FIN 45 evidences enough uncertainty about the appropriate GAAP treatment that we cannot second-guess the reasonableness of his conclusions. FIN 45, which interprets the requirements of FAS 5, specifies that the disclosure of a guarantee should state (a) the nature of the guarantee, (b) the maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee, (c) the current carrying amount of the liability, and (d) the nature of certain third-party assets against which the guarantor could use to cover a loss. 64/ Dearlove argues that disclosure of "up to $3.75 billion" represented the "maximum potential amount of future payments" that FIN 45 presents as the disclosure "most relevant to a reader."

FIN 45 does not alter our conclusion that Adelphia's disclosure was not GAAP-compliant. As an initial matter, FIN 45 was enacted after the 2000 Adelphia audit, and therefore is of only uncertain applicability here. To the extent FIN 45 has any relevance to Adelphia's disclosure, FIN 45 explains that, in disclosing the nature of a guarantee, an issuer should present "the approximate term of the guarantee, how the guarantee arose, and the events or circumstances

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62/ Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); see also SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (stating that a fundamental purpose of the federal securities laws is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor").

63/ SEC v. Rogers, 790 F.2d 1450, 1458 (9th Cir. 1986).

64/ FIN 45 ¶ 13.

that would require the] guarantor to perform under the guarantee." 65/ Whether Adelphia properly disclosed the nature of its guarantee of the Rigas Entities' co-borrowed debt is not before us; 66/ however, FIN 45's description of the factors relevant to the nature of the guarantee also informs the disclosure of the amount of the guarantee. Here, Adelphia's liability arose from a co-borrowing agreement under which Adelphia itself actually borrowed and recorded $2.1 billion and actually guaranteed $1.6 billion borrowed by Rigas Entities; Adelphia knew that it might have to pay this $1.6 billion if the Rigas Entities could not. In these circumstances, FIN 45 indicates that Adelphia should have disclosed that the amount of the guarantee was $1.6 billion, the maximum potential future payments for which Adelphia was then obligated as guarantor, rather than a hypothetical amount based on payoffs and borrowings that might never occur. In FIN 45, the FASB "observed that there are differing interpretations about the disclosures required of guarantors under [FAS 5]." 67/ However, under these circumstances, FAS 5's requirement to disclose the amount of the guarantee, a known sum, could not have been subject to differing interpretations by reasonable auditors. Accordingly, nothing in FIN 45 leads us to conclude that Dearlove reasonably exercised his professional judgment in deciding that the disclosure was adequate.

VI. Debt Reclassification

A. Facts

After the end of the second, third, and fourth quarters of 2000, Adelphia's accounting department transferred the reporting of approximately $296 million of debt from the books of Adelphia's subsidiaries to the books of various Rigas Entities. In exchange, Adelphia eliminated from its books receivables owed to it by the respective Rigas Entities in the amount of debt transferred. The three transfers were in the amounts of $36 million, approximately $222 million, and more than $38 million, respectively. 68/ In each instance, the transaction took place after the

65/ FIN 45 ¶ 13(a).

66/ See supra note 58.

67/ FIN 45 ¶ 1.

68/ Although these amounts were clearly recorded as debts on the books of the subsidiaries, the record does not make clear from whom the money was borrowed. See Gregory M. Dearlove, Initial Dec. Rel. No. 623 (July 27, 2006), 88 SEC Docket 1808, 1841 n.33 (finding that although the OIP implied, and the parties assumed, that all of the reclassified debt was co-borrowed debt, the Division did not establish that to be true).

end of the quarter, and each transfer involved a post-closing journal entry that was retroactive to the last day of the quarter. 69/

A checklist prepared by Deloitte in anticipation of the 2000 audit showed that Deloitte was aware of a significant number of related party transactions that had arisen outside the normal course of business and that past audits had indicated a significant number of misstatements or correcting entries made by Adelphia, particularly at or near year-end. An audit overview memorandum recognized as a risk area that "Adelphia records numerous post-closing adjusting journal entries" and provided as an audit response, "[Deloitte] engagement team to review post-closing journal entries recorded and review with appropriate personnel. Conclude as to reasonableness of entries posted." An audit planning memorandum provided that "[p]rofessional skepticism will be heightened to ensure that . . . related party transactions . . . are appropriately identified and disclosed" and that auditors should "increase professional skepticism in [areas] where significant related party transactions could occur."

Dearlove testified that Deloitte had identified the Rigases' control of both Adelphia and the Rigas Entities as posing a special risk. 70/ Dearlove also testified that he believed it was important to know whose debt was whose, as between Adelphia and the Rigas Entities. He testified that he was "generally aware the debt was audited," but that he did not review the debt workpapers directly. He also testified: "I don't recall [debt] being [a] particularly sensitive area, . . . I don't recall issues raised to me of difficulties we had. I don't recall any particular conversation [I] had with the team" concerning the audit of the debt. The record does not show that Dearlove knew of the three journal entries involving debt reclassification at the time of the audit.

B. Analysis

Paragraph 16 of Statement of Accounting Standards No. 125 ("FAS 125"), Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, permits a

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69/ For example, after the end of the second quarter of 2000, Adelphia transferred the reporting of $36 million of debt from the books of UCA Corporation, an Adelphia subsidiary, to the books of Hilton Head Communications, a Rigas Entity. The entry was booked on July 14, 2000, and it involves a post-closing journal entry that was made retroactive to June 30, 2000.

70/ In planning the audit, Deloitte had identified Adelphia's complex organizational structure and the concentration of its management in a small group as factors contributing to the "much greater than normal" risk of fraud, misstatement, or error posed by the Adelphia engagement. See supra Section II (discussing general risk factors identified in audit planning).

debtor to derecognize a liability "if and only if it has been extinguished." 71/ FAS 125 ¶ 16 provides that a liability is extinguished if either (a) the debtor pays the creditor and is relieved of its obligation for the liability, or (b) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

When the Adelphia subsidiaries posted the debt in question to their books, they acknowledged their primary liability for the amounts posted. They could not properly remove the debt from their books without first satisfying the requirements of FAS 125 ¶ 16 that either (1) the Adelphia subsidiaries repaid the debt to the creditor during the relevant reporting periods, or (2) a creditor had released the subsidiaries from their liability for repayment. The evidence does not show, and Dearlove does not contend, that either of these events occurred. Adelphia's attempt to extinguish the debt unilaterally merely by shifting the reporting to the Rigas Entities violated GAAP and rendered its financial statements materially misleading by making Adelphia's debt appear less than it was. 72/

Dearlove points out that Elliot Lesser, the Division's expert, offered no opinion as to the alleged debt reclassifications, and made no assertion of any GAAP violation with respect to FAS 125. 73/ Without the support of expert testimony, Dearlove argues, the law judge, and by implication the Commission, may not find a violation of FAS 125. 74/ Dearlove's argument is incorrect. The Commission may consider expert testimony, but it is not bound by such testimony

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71/ FAS 125 was superceded by FAS 140, effective for extinguishments of liabilities occurring after March 21, 2001. The provisions discussed here were carried over unchanged into FAS 140.

72/ The law judge found that the $38 million debt reclassification after the end of the fourth quarter of 2000 was a sham transaction that had no rational purpose other than to reduce the level of debt that Adelphia reported in its public filings. We reach no conclusion as to whether that transaction was a sham because the resolution of that question does not alter our FAS 125 analysis. The Brown testimony that Dearlove seeks to introduce through his Rule 452 motion, see supra note 50, is irrelevant because we do not need to make a finding as to whether the transaction was a sham.

73/ Dearlove characterizes Lesser's testimony as an "obvious refusal" to adopt the Division's theory of a FAS 125 violation. The testimony to which Dearlove refers, however, was not related to the alleged FAS 125 violations. Rather, Lesser was responding to a request that he identify factors supporting his conclusion that the Rigas Entities' co-borrowed debt should have been booked as Adelphia's primary obligation under FAS 5.

74/ Dearlove makes a similar argument regarding the law judge's (and the Commission's) purported inability to find a GAAP violation with respect to Adelphia's accounting treatment of direct placements without expert testimony. See infra note 88.

even where it is available, and the absence of expert testimony does not preclude the Commission from making necessary findings with respect to principles of accounting. 75/

Dearlove does not dispute that "certain debt which had been posted to Adelphia was later posted to a Rigas entity." However, focusing on the statement in the Initial Decision that "[o]nce Adelphia's subsidiaries had posted this debt to their books they became primary obligors for the amounts posted," Dearlove argues that FAS 125 does not define the circumstances under which an entity recognizes debt that may be derecognized only under the FAS 125 criteria. He claims that the Initial Decision improperly "assumed without analysis" that the posting of debt in a ledger is such a circumstance. Dearlove argues that the application of FAS 125 is complex where entities are jointly and severally liable for an obligation. He argues that FAS 125 does not apply where an entity is secondarily or contingently rather than primarily liable. He asserts that Adelphia was arguably not required to recognize debt in cases where co-borrowed funds were intended to be used by other co-borrowers. 76/ He stops short, however, of saying that the funds at issue were so intended, and our review of the record yields nothing to support such a contention.

75/ Cf., e.g., Pagel, Inc., 48 S.E.C. 223, 230 (1985) (stating that law judge "highly sophisticated in securities matters with many years of experience in determining issues under the securities laws" could determine that manipulation occurred without expert testimony), aff'd, 803 F.2d 942, 947 (8th Cir. 1986) ("There is no reason to believe that the [proffered] expert's testimony would have added anything to this administrative adjudication directed and decided by a person already knowledgeable in securities regulation matters."). See also Haskins & Sells, Accounting Series Release No. 73 (Oct. 30, 1952), 1952 SEC LEXIS 1062, at *28 ("[W]hile the opinions of qualified expert accountants may be helpful, this Commission must in the last analysis weigh the value of expert testimony against its own judgment of what is sound accounting practice."). This conclusion also applies to the similar argument Dearlove asserts in connection with Adelphia's accounting for certain direct placements. See infra note 88.

Despite Dearlove's argument that FAS 125 is a "highly technical standard," we find its application to the facts at issue straightforward, and well within our expertise. We do not read For Liability Extinguishment, a December 2003 document by the Financial Accounting Standards Advisory Committee cited in Dearlove's reply brief and by his counsel at oral argument, as endorsing Adelphia's accounting treatment of the reclassified debt. Although that document indicates that there is some ambiguity as to the application of FAS 140 (the successor to FAS 125) where there is joint and several liability for a debt, nothing in that document supports the accounting treatment by Adelphia of its reclassified debt in this case.

76/ Dearlove adduces no support for his contention that the debts were not recognized when Adelphia booked them.

The record does not establish that all of the reclassified debt was co-borrowed debt, and the law judge correctly concluded that the impropriety of Adelphia's debt reclassification was unaffected by the question whether the debt was co-borrowed. In addition, Dearlove cites no authority to support his contention that FAS 125 is applicable only where primary obligors were required to recognize a liability, and we are aware of none.

In any event, the original recording of the debt on the subsidiaries' books is, at a minimum, circumstantial evidence of their receipt of money, whether co-borrowed or otherwise borrowed. Moreover, Adelphia gave up something of value when it transferred the reporting of the debt: it removed from its books corresponding amounts of receivables owed to it by Rigas Entities. The removal of the receivables is most reasonably viewed as a quid pro quo for the transfer of debt that was properly Adelphia's. Adelphia's subsequent transfer of that debt to the Rigas Entities was tied to the removal from Adelphia's books of receivables owed to it by the Rigas Entities and supports the conclusion that the subsidiaries received the money at issue from the lender.

The crucial question for the FAS 125 analysis is whether the debt was extinguished in one of the enumerated ways. If the debt was not extinguished as provided in FAS 125, the debtor may not derecognize it. We find that the debts were recognized when booked and that, because there was no evidence that the debts were extinguished under FAS 125 ¶ 16, the accounting treatment violated GAAP.

We also find that Dearlove's conduct in his audit of Adelphia's accounting for debt was at least unreasonable, resulting in several GAAS violations. As explained above, Dearlove knew that Adelphia had a large number of decentralized operating entities with a complex reporting structure, carried substantial debt, and engaged in significant related party transactions with affiliated entities that Deloitte would not be auditing. He also knew that Adelphia management tended to interpret accounting standards aggressively. Moreover, the audit plan specifically required that post-closing journal entries be examined in particular detail and that the audit team conclude as to their reasonableness. Dearlove knew that these factors, together with others, led Deloitte to identify the Adelphia audit as posing a "much greater than normal" risk of fraud, misstatement, or error. Additionally, Dearlove knew that Adelphia management netted its affiliate accounts payable and receivable and sought to reduce the amount of related party receivables it reported.

In this context, GAAS required Dearlove to consider the "much greater than normal" risk of the audit in determining the extent of procedures, assigning staff, and requiring appropriate levels of supervision. 77/ Additionally, he was required to "direct the efforts of assistants who [were] involved in accomplishing the objectives of the audit and [to] determin[e] whether those

77/ AU § 312.17.

objectives were accomplished." 78/ He was required to exercise "an attitude that includes a questioning mind and a critical assessment of audit evidence," 79/ "to obtain sufficient competent evidential matter to provide . . . a reasonable basis for forming a conclusion," 80/ and, after identifying related party transactions, to "apply the procedures he consider[ed] necessary to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements." 81/

A reasonable engagement partner, under the circumstances present here, would have developed a much more thorough understanding of Adelphia's accounting for debt than Dearlove did and would have paid more attention to ensuring that the engagement team was asking the sorts of questions that would have brought matters like the accounting for reclassified debt to light (for example, questions about how Adelphia recorded debt or decided where debt belonged, how related party receivables were audited, and how Adelphia managed to reduce the receivable line item on its balance sheet by 98% over the prior year). A reasonable engagement partner would have specifically ensured that the requirement in the audit plan concerning post-closing journal entries was followed. Instead, Dearlove paid only cursory attention to the audit of Adelphia's debt and thus remained unaware of the existence – and thus the accounting treatment – of the debt reclassifications.

The reclassified debt involved post-closing journal entries of a magnitude significant enough to require the auditors to confront management and request an explanation, as required by Deloitte's audit planning documents. After discussing the entries with appropriate Adelphia personnel, Deloitte should have documented management's explanation, and Deloitte's conclusions as to whether the accounting treatment was reasonable, in the audit workpapers. The record does not show that any of these steps was taken. The failure to take them was, at the very least, unreasonable. 82/

Dearlove reiterates his general argument that his active involvement in the audit represented the reasonable conduct of an engagement partner in an audit of this complexity. He argues that he never learned of the three accounting events characterized as debt reclassification until after the conclusion of the audit and that, "although [he] was active in the audit, he did not have the clairvoyance to ask every question that is now at issue in this proceeding, or the ability, [six] years hence, to remember every question he did ask."

78/ AU § 311.11.

79/ AU § 230.07.

80/ AU § 326.22.

81/ AU § 334.09.

82/ Dearlove's view that FAS 125 is a "highly technical standard," see supra note 75, should have given him even more reason to devote particular attention to its application.

As the engagement partner, however, Dearlove was responsible for assigning tasks to and supervising assistants. 83/ He was required to review the work performed by each assistant to determine whether it was adequately performed and to evaluate whether the results were consistent with the conclusions to be presented in the auditor's report. 84/ Dearlove could not satisfy his duty to supervise by waiting passively for his subordinates to bring these matters to his attention. The audit plan itself directed the audit team to examine related party transactions and post-closing journal entries, and Dearlove himself admitted that he believed it was important to know whose debt was whose. In light of these facts, we find that Dearlove's failure to apprise himself of the circumstances of the debt reclassification was a clear violation of his GAAS obligations to exercise due professional care, supervise assistants, and gather sufficient competent evidential matter to support his audit conclusions. Dearlove's failure to be more proactive was at least unreasonable.

Accordingly, we find that Dearlove acted at least unreasonably in signing an unqualified audit opinion stating that Deloitte had conducted its audit in accordance with GAAS and that such audit provided a reasonable basis for its opinion that Adelphia's 2000 financial statements fairly presented Adelphia's financial position in conformity with GAAP.

VII. Direct Placements of Stock

A. Facts

During 2000, the Rigases acquired Adelphia Class B common stock through two direct placements. 85/ The first of these occurred in January 2000, when Adelphia issued $368 million of such stock to Highland 2000 L.P., a Rigas Entity partnership that was not a co-borrower ("Highland 2000-Rigas"). 86/ The second occurred in July 2000, when the Rigases acquired additional Adelphia Class B common stock through the issuance of approximately $145 million of such stock also to Highland 2000-Rigas. The Rigases financed both transactions with co-borrowed funds for which Adelphia was jointly and severally liable.

83/ AU § 311.01, 311.11.

84/ AU § 311.11.

85/ See supra Section II (describing the Rigas family's maintenance of control over Adelphia through direct placements of Class B shares).

86/ To help the reader more easily understand the series of transactions involved in the direct placements of stock, we have appended "-Rigas" or "-Adelphia," as appropriate, to names of entities.

1. The July 2000 Direct Placement

In July 2000, Highland Prestige Georgia, a Rigas Entity co-borrower ("Highland Prestige-Rigas"), drew down $145 million under the 2000 credit agreement. Highland Prestige-Rigas transferred the money to Highland Holdings, a Rigas Entity that was not a co-borrower ("Highland Holdings-Rigas"). Highland Holdings-Rigas then transferred $144,537,533 to Adelphia in exchange for shares of Adelphia stock. Adelphia recorded an increase in equity. Highland Holdings-Rigas assigned the Adelphia shares to its subsidiary, Highland 2000-Rigas.

2. The January 2000 Direct Placement

a. The Loan Transaction

The January 2000 direct placement used a similar model to the one in July, but was more complicated. In January, the co-borrowers collectively drew down $368 million under the 1999 credit agreement. At the request of the co-borrowers, the lenders wired the funds to the account of UCA, an Adelphia subsidiary ("UCA-Adelphia"). UCA-Adelphia recorded on its books the receipt of the $368 million in cash and a corresponding note payable in the same amount, evidencing debt owed by UCA-Adelphia to the lenders.

Adelphia later claimed that the co-borrowers mistakenly entered an incorrect account number in their wiring instructions and that the co-borrowers had intended that the $368 million drawn down under the credit agreement go to Hilton Head Communications, a Rigas Entity co-borrower ("Hilton Head-Rigas"), not to UCA-Adelphia. There is no indication that the co-borrowers notified the lenders of this alleged mistake in the wiring instructions. Adelphia did not return the $368 million to the lenders, nor did it transfer the cash to Hilton Head-Rigas, allegedly the intended recipient. Instead, Adelphia retained the money and used it to pay down preexisting debt of UCA-Adelphia and another Adelphia subsidiary.

In an attempt to make its books show that Hilton Head-Rigas, not UCA-Adelphia, was primarily responsible for the borrowed $368 million, Adelphia made journal entries on the books of both of these entities. Adephia transferred the $368 million "draw" (the recordation of debt from the lenders) from UCA-Adelphia to Hilton Head-Rigas, resulting in the removal of that debt from UCA-Adelphia's books and the recordation of that debt on Hilton Head-Rigas's books. There is no indication either that Adelphia tried to notify the lenders of this attempt to reallocate responsibility for the borrowed $368 million or that the lenders knew about (much less approved) the reallocation. To reflect UCA-Adelphia's retention of the $368 million it received from the lenders, Adelphia also recorded on UCA-Adelphia's books a note payable to Hilton Head-Rigas in the amount of $368 million, representing the $368 million that UCA-Adelphia "owed" Hilton Head-Rigas for the "miswired" cash it had retained. The borrowed $368 million had not been repaid to the lenders or given to Hilton Head-Rigas, but, at least as far as the journal entries were concerned, that debt was now the responsibility of Hilton Head-Rigas, not UCA-Adelphia.

b. The Stock Transaction

Also in January 2000, Adelphia issued $368 million worth of shares of Class B common stock to Highland Holdings-Rigas. Highland Holdings-Rigas did not pay Adelphia cash for the shares; instead, it gave Adelphia a note in the amount of $368 million, payable to Adelphia. Highland Holdings-Rigas then assigned the Class B shares to its subsidiary Highland 2000-Rigas. Adelphia increased its equity by $368 million and recorded the $368 million note receivable from Highland Holdings-Rigas as an asset in exchange for the stock, thus treating the transaction as a sale of stock.

c. Netting

As explained above, Adelphia's accounting for the January loan transaction resulted in the creation of a note payable by Adelphia to Hilton Head-Rigas in the amount of $368 million, and its accounting for the January stock transaction resulted in the creation of a $368 million note receivable from Highland Holdings-Rigas to Adelphia. Consistent with its practice of netting affiliate payables and receivables discussed above, Adelphia netted the $368 million note payable by Adelphia to Hilton Head-Rigas against the $368 million note receivable from Highland Holdings-Rigas to Adelphia, and both the payable and the receivable disappeared from Adelphia's books.

B. Analysis

As discussed above, 87/ FAS 125 ¶ 16 permits a debtor to derecognize a liability "if and only if it has been extinguished," and provides that a liability is extinguished only if either (a) the debtor pays the creditor and is relieved of its obligation for the liability, or (b) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. When UCA-Adelphia received the borrowed $368 million and booked the loan, it became the primary obligor for that amount. At that point, FAS 125 applied, and Adelphia therefore could not properly remove the debt from UCA-Adelphia's books without first satisfying the requirements of FAS 125 ¶ 16. In other words, UCA-Adelphia could not extinguish the debt without showing either (1) that it repaid the debt to the lenders, or (2) that the lenders had released UCA-Adelphia from its liability for repayment. The evidence does not show, and Dearlove does not contend, that either of these events occurred. Neither Adelphia nor UCA-Adelphia repaid the debt to the lenders, and although Adelphia revised the books of both UCA-Adelphia and Hilton Head-Rigas to show a transfer of the liability, there is no indication that Adelphia notified the lenders that it no longer viewed UCA-Adelphia as liable, much less that the lenders agreed to the purported transfer or released UCA-Adelphia from liability. Thus, the liability was not extinguished as required by FAS 125, and Adelphia should have shown the liability on its balance sheet. Adelphia's attempt to extinguish the debt unilaterally merely by transferring the "draw" from UCA-Adelphia to Hilton Head-Rigas, rather than obtaining a release

87/ See supra Section VI.B.

from the lender or otherwise satisfying the requirements of FAS 125, violated GAAP and rendered Adelphia's financial statements materially misleading. 88/

Emerging Issues Task Force Consensus No. 85-1, Classifying Notes Received for Capital Stock (1985) ("EITF 85-1") provides that, when an enterprise receives a note, rather than cash, for the sale of capital stock, the enterprise should generally report the note receivable as a reduction of shareholders' equity and not as an asset. 89/ EITF 85-1 further provides that notes received for the sale of stock "may be recorded as an asset if collected in cash prior to issuance of the financial statements." Rule 5-02.30 of Regulation S-X requires public companies to show on the face of their balance sheets the dollar amount of any common stock shares subscribed but unissued, and to show subscriptions receivable as a deduction from shareholders' equity; these two entries offset each other, resulting in no net change to the total amount of equity shown on the balance sheet. 90/

Applying EITF 85-1 and Rule 5-02.30, we find that the January direct placement should have been treated as a stock subscription, with resulting reduction to shareholder equity, rather than as a stock sale. 91/ Adelphia received only a note, not cash, in payment for the shares it issued. The note therefore should have been recorded as a receivable, with a corresponding, offsetting reduction to equity.

We further find that netting the $368 million receivable against the $368 million payable that resulted from the loan transaction did not cause the receivable to be "collected in cash" for

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88/ The analytic basis for this finding is the same as that for the three instances of debt reclassification discussed supra in Section VI.B.

We have already rejected Dearlove's argument that we cannot find a violation of FAS 125 without expert testimony. See supra notes 74 and 75 and accompanying text.

89/ Consensus positions of the FASB Emerging Issues Task Force have a recognized position within the GAAP hierarchy. AU § 411.10. They represent the consensus position of the best thinking of the accounting profession on areas for which there are no specific standards. AU § 411.10 ¶ 3.

90/ 17 C.F.R. § 210.5-02.30. For Commission registrants, Commission rules have an authority similar to the most authoritative pronouncements within the GAAP hierarchy. AU § 411.10 n.3.

91/ The Division argued before the law judge that, under EITF 85-1, the July direct placement also should have been treated as a stock subscription rather than a stock purchase. The law judge found no GAAP violations with respect to Adelphia's accounting treatment of the July direct placement. Because the Division did not appeal, this issue is not before us.

purposes of EITF 85-1 analysis and thus did not permit Adelphia to report the receivable as an asset. Adelphia's netting of its payable to Hilton Head-Rigas against its receivable from Highland Holdings-Rigas was inappropriate, at the very least, because more than two parties were involved: Highland Holdings-Rigas, to whom Adelphia issued the Class B shares, was not the same entity as Hilton Head-Rigas, to whom Adelphia attempted to transfer the co-borrowed debt. 92/ Thus, even if the transfer of the borrowed funds from UCA-Adelphia to Hilton Head-Rigas and the resulting creation of a payable owed by Adelphia to Hilton Head-Rigas had been allowed under FAS 125, the netting was improper, the receivable was not satisfied in cash, and Adelphia therefore should have treated the stock transaction as a stock subscription. 93/

The effect of treating the transaction as a stock sale was that Adelphia showed an increase to equity of $368 million, with no offsetting reduction. In reality, Adelphia's financial position was not improved by either the January loan transaction or the January stock transaction. As discussed above, the $368 million that Adelphia received in January was borrowed from the lenders, and because the debt was not properly extinguished, Adelphia still owed the lenders that money. Moreover, until the receivable was collected, the increase to equity that Adelphia showed had to be offset by a reduction in equity because payment was in the form of a receivable, not cash.

92/ See supra Section IV.B (discussing two-party requirement for netting under FIN 39 and also stating that the record does not demonstrate that the Rigas Entities were owned in equal proportions by the same members of the Rigas family).

93/ Moreover, even if appropriate, Adelphia's netting of the payable to Hilton Head-Rigas against the receivable from Highland Holdings-Rigas in this case merely canceled out both amounts; it did not create cash.

Dearlove asserts that the Division raises the argument for the first time on appeal "that the stock purchase should have been recorded as a stock subscription because the receivable from [Highland Holdings-Rigas] to Adelphia could not be netted against the [note] payable from [UCA-Adelphia] to [Hilton Head-Rigas] under FIN 39." Contrary to Dearlove's assertion, neither the propriety of the netting nor the propriety of recording the transaction as a stock subscription was raised for the first time on appeal. The OIP charged that "Highland paid nothing [for the $368 million in Class B shares] and Adelphia booked an affiliate receivable from Highland [Holdings] for the purchase price of the shares . . . . [T]his receivable was never satisfied for cash, but, along with other affiliate receivables, was netted against, and reduced by, the fake affiliate payables created by Adelphia's reclassifications of co-borrowed debt." (Moreover, Dearlove testified at the hearing, "The Rigases collectively had $368 million worth of debt. They also owned $368 million worth of stock. The affiliated payable and the affiliated receivable netted to zero.") In the same paragraph, the OIP charged that Adelphia's receipt of a receivable that was not satisfied for cash in connection with the January direct placement "created a stock subscription."

Dearlove contends that the record shows that the $368 million borrowed in January should have gone to Hilton Head-Rigas originally, and that "the July direct placement looks exactly the way the January direct placement would have in the absence of a misposting," i.e., with the money drawn going to a Rigas Entity co-borrower rather than an Adelphia subsidiary. He argues that, if we accept his argument that the $368 million loan was originally intended for Hilton Head-Rigas, we cannot find a GAAP violation with respect to the January 2000 direct placement. On appeal, Dearlove moved to admit into evidence the supposedly exculpatory testimony of Adelphia treasury supervisor James Helms, which Dearlove claims to have discovered after the hearing. According to Dearlove, the testimony "conclusively establishes" that Hilton Head-Rigas rather than UCA-Adelphia was the intended recipient of the $368 million draw. 94/

The question whether the loan was intended for Hilton Head-Rigas rather than UCA-Adelphia does not affect our analysis under FAS 125. Whether or not the co-borrowers wanted the money to go to UCA-Adelphia, that is what happened: UCA-Adelphia received the money and booked the loan. UCA-Adelphia also kept the money and used the money. Having thus become the primary obligor, Adelphia was required to comply with FAS 125 ¶16 in order to extinguish its liability. As discussed above, it failed to do so. Because the co-borrowers' intent as to where the money should have been wired is irrelevant, Dearlove's newly introduced evidence, the Helms testimony, is also irrelevant. 95/

Dearlove's argument that "the July direct placement looks exactly the way the January direct placement would have in the absence of a misposting" is conjectural. We do not know what might have happened if the borrowed funds had gone directly to Hilton Head-Rigas or how the Class B shares might have been paid for under those circumstances. We base our conclusions on what did happen: Adelphia got a receivable in exchange for the shares and booked the

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94/ See Commission Rule of Practice 452, 17 C.F.R. § 201.452 (stating that a motion to introduce new evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). The Office of the General Counsel, acting pursuant to delegated authority, granted Dearlove's motion on September 13, 2006. Dearlove's allegedly belated discovery of this testimony is the lynchpin of his argument that he was denied due process by the failure to continue the hearing date. See infra Section X.

95/ Dearlove argues that the journal entries for the January direct placement had been "corrected" long before Deloitte began its audit of Adelphia's books, so there is no evidence that "any record of journal entries made many months earlier would have emerged at year end." This argument is unclear. To the extent Dearlove refers to the alleged misposting of $368 million to UCA-Adelphia and the subsequent journal entries Adelphia made allegedly to correct the mistake, for the reasons discussed in the text, this argument is irrelevant to our analysis.

transaction as a stock sale, although the receivable was not collected in cash. That violated GAAP.

Statement of Accounting Standards No. 57 ("FAS 57") requires disclosure of material related party transactions. 96/ Such disclosures must include the nature of the relationship involved, a description of the transactions (including the amounts thereof), and amounts due from or to related parties as of the date of the balance sheet.

The disclosure of the January direct placement in the notes to Adelphia's 2000 financial statements was incomplete because it did not disclose that a stock subscription was involved, or that co-borrowed funds drawn by an Adelphia subsidiary had been used to fund the direct placement. The disclosure, therefore, failed to comply with FAS 57.

As for the GAAS violations charged, Dearlove knew that both direct placements had occurred; the dates and amounts of both transactions had been disclosed in Adelphia's quarterly and annual reports. Dearlove testified, however, that the engagement team did not bring to his attention the mechanics of the two direct placements, and neither Caswell nor Hofmann recalled discussing the direct placements with Dearlove during the audit. 97/ With respect to the January direct placement, Dearlove understood that $368 million in cash went to Adelphia and that equity was issued to the Rigases, but he did not understand "the misposting and the directing issues and the netting," which were not brought to his attention. Similarly, with respect to the July direct placement, Dearlove understood that Highland Holdings-Rigas paid Adelphia $145 million for the Class B shares, but he was not aware "that the $145 million was borrowed by [Highland Prestige-Rigas] and lent to an entity that we didn't have visibility to so that they could make that payment."

As was true with respect to the issues discussed above, GAAS required Dearlove to consider the "much greater than normal" risk of the audit in determining the extent of procedures, assigning staff, and requiring appropriate levels of supervision. 98/ Additionally, he was required to direct the efforts of assistants working under his supervision and to evaluate their work as it pertained to accomplishing the objectives of the audit. 99/ He was required to exercise

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96/ FAS 57 ¶ 2.

97/ The record contains conflicting testimony as to whether Brown and Werth discussed with Caswell and Hofmann the question whether one or both of the direct placements discussed above should be recorded as stock subscriptions rather than stock sales. The law judge credited the testimony of Brown and Werth that such conversations took place.

98/ AU § 312.17.

99/ AU § 311.11.

professional skepticism, 100/ to obtain sufficient competent evidential matter to provide reasonable support for his conclusions, 101/ and, after identifying related party transactions, to apply necessary procedures to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements. 102/

The direct placements involved many of the factors that Deloitte recognized had contributed to the high risk level assigned to the audit: they were significant transactions involving related parties, including affiliates that Deloitte was not auditing. The transactions were unusual in that the co-borrowers that drew down the funds were not the entities that received the Class B shares. Moreover, they were large transactions, totaling more than half a billion dollars, and the sources of funds paid for the shares were unclear. Both auditing standards and Deloitte's own audit plan required the engagement team to understand the impact of such transactions on Adelphia's financial statements and to investigate the sources of financial resources supporting significant or unusual transactions. Yet Dearlove failed to question the facts that underlay the direct placements, accepting as adequate the superficial explanation that Adelphia got $368 million and issued $368 million in equity without seeking to understand the transactions involved. In doing so, he acted at least unreasonably.

With respect to the direct placements, as in other areas, Dearlove needed to do more than wait for other Deloitte personnel to inform him of potential issues. He had a duty to inquire in more detail about the direct placements, or to direct his staff to do so, rather than rely on his assistants to make the judgment on their own. While Dearlove could appropriately delegate much of the hands-on work of the Adelphia audit to his team, he was nonetheless bound by his duty to supervise that work, and he retained responsibility for doing so. Under the circumstances present here, we find that Dearlove violated his obligation under GAAS to supervise.

The record shows that the engagement team was aware that Adelphia had recorded the direct placements as stock purchases rather than stock subscriptions, but the team did not test this decision, nor did it take steps to ascertain the source of funds used for the stock purchases. The large amount of money involved and the fact that the transactions involved related parties (including ones that Deloitte would not be auditing) rendered Dearlove's acceptance of the transactions at face value unreasonable. In failing to probe further into the facts pertaining to the direct placements and their accounting treatment, Dearlove failed to employ the increased professional skepticism that the known risks of the audit required, and thus violated GAAS. 103/

100/ AU § 230.07.

101/ AU § 326.22.

102/ AU § 334.09.

103/ Although we have found that the accounting treatment of the January direct placement violated FAS 57, see text accompanying note 96, supra, we decline to find that Dearlove's (continued...)

VIII. Analysis of Liability and Appropriate Sanction Under Rule 102(e)

A. Liability

Rule of Practice 102(e)(1)(iv) provides that the Commission may discipline a person licensed to practice as an accountant if we find that the accountant has engaged in any of three types of improper professional conduct. 104/ However, as applied to this case, we need determine only whether Dearlove engaged in "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." 105/ We have already discussed our findings that Dearlove repeatedly engaged in at least unreasonable conduct during his audit of four critical areas of Adelphia's financial statements and that his conduct resulted in violations of GAAS. We must now determine whether Dearlove's conduct, though only negligent, nonetheless demonstrates a lack of competence to practice before the Commission.

This case presents to us the first litigated proceeding in which a respondent's conduct is being judged solely against Rule 102(e)'s third definition of improper professional conduct. We are guided in our analysis by the 1998 release accompanying the amendments to Rule 102(e), which explained that

> [t]he term "unreasonable," as distinguished from the term "highly unreasonable" used in subparagraph B(1), connotes an ordinary or simple negligence standard. The lower standard of culpability is justified in this instance because the repetition of the unreasonable conduct may show the

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103/ (...continued)
failure to include the appropriate disclosure regarding that direct placement in the notes to the financial statements was a separate violation of GAAS. Moreover, because we believe the OIP was somewhat ambiguous in identifying the other transactions that are alleged to have been inadequately disclosed under FAS 57, we decline to consider whether any of the other three accounting areas at issue in this case (i.e., netting, co-borrowed debt, and debt reclassifications) involve violations of FAS 57. Although we find that the OIP provided adequate notice to Dearlove that he was charged with failing to review Adelphia's disclosure under FAS 57 of the common treasury system it used to manage its own accounts and the accounts of its subsidiaries and the Rigas Entities, it is not clear to us that such disclosure was necessary under FAS 57. Given the several examples in this case of accounting presentations that depart from GAAP, as well as the several examples of conduct that already form a basis for finding that Dearlove departed from GAAS, we decline to decide whether disclosure of the common treasury system was necessary or whether Dearlove gave appropriate consideration to the issue.

104/ See supra note 1.

105/ Commission Rule of Practice 102(e)(1)(iv)(B)(2); see supra note 2.

> accountant's lack of competence to practice before the Commission. If an accountant fails to exercise reasonable care on more than one occasion, the Commission's processes may be threatened. More than one violation of applicable professional standards ordinarily will indicate a lack of competence. 106/

The Commission distinguished such conduct from, for example, "two isolated violations of applicable professional standards . . . that may not pose a threat to the Commission's processes." 107/ Upon review of the totality of the circumstances of this case, we conclude that the frequency and gravity of Dearlove's negligent failures on the Adelphia audit demonstrate that he engaged in improper professional conduct under this standard.

As discussed above, Dearlove approved Adelphia's net presentation of over $1 billion each in related party payables and receivables without devoting any attention to the matter, despite his admitted inexperience with the issue and despite knowing that management sought to reduce the net balance to improve its financial picture. He also summarily approved Adelphia's accounting for $1.6 billion in related party contingent debt while failing to test any of several assumptions underlying his conclusion that Adelphia was unlikely to have to repay that debt. Dearlove also approved the company's obfuscatory disclosure of that obligation; despite audit plan warnings about aggressive management accounting positions, he acquiesced in management's formulation of the disclosure without probing its reasons for rejecting Deloitte's proposed language, and he took no steps to confirm with Deloitte's risk or reviewing partners that the disclosure was GAAP compliant. Dearlove did not himself review, or ensure that his team reviewed, three significant reclassifications of related party debt that did not comply with GAAP and that should have been subject to careful attention as post-closing journal entries. He approved the accounting treatment for two sizeable direct placements of Adelphia stock with related parties involving unspecified sources of funds without inquiring about, or instructing his audit team to inquire about, the specifics of those transactions. Dearlove conducted his review of Adelphia's financial statements with these serious failings despite the need for heightened scrutiny called for generally by the high-risk engagement, and despite the special care with which GAAS required Dearlove to review these significant, related party transactions.

These repeated failures, taken together, evidence a troubling disregard of some of the most basic auditing principles. GAAS require auditors to adequately plan the audit and to

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106/ Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,166 (Oct. 26, 1998).

107/ Id.

properly supervise any assistants, 108/ to exercise due professional care, 109/ maintain an attitude of professional skepticism, 110/ and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under review. 111/ As audit risk increases, so does the need for care and skepticism. 112/ Although there may be room for debate among auditors regarding the best way to tailor an audit to satisfy these requirements, no reasonable auditor could conclude that Dearlove satisfied them here, where Dearlove, in a high-risk audit environment, neglected to ask what gross dollar amounts were behind the net related party receivables presented on Adelphia's balance sheet, relied on media reports as evidence of the Rigases' financial status, made no inquiry into post-closing journal entries that were specifically identified by Deloitte as requiring attention, and made no effort to ensure his team identified the source of funds used for multi-million-dollar stock placements to affiliated companies. Dearlove repeatedly ignored rudimentary audit principles not just with respect to one auditing area, but several: his failures were extensive. We conclude, therefore, that Dearlove engaged in repeated instances of conduct that were at least unreasonable, that departed from GAAS in fundamental respects, and that indicate a lack of competence to practice before the Commission.

Dearlove argues that the record contains evidence of Dearlove's "overall diligence and competence," including that Dearlove was involved in Deloitte's risk identification process, and that Dearlove was an active, engaged, and accessible supervisor who reviewed and signed off on numerous workpapers. Dearlove contends that it would be unreasonable to hold him to a standard that would require him "to have personally reviewed over 32,000 pages of the audit documentation and to have participated in all conversations that related to any audit conclusions." We believe that Dearlove's argument misapprehends the requirements of GAAS. We agree that GAAS do not require engagement partners to review every workpaper, analyze every transaction, or supervise every task, and our findings in this opinion are not intended to suggest otherwise. However, in deciding which audit areas deserve more of his or her attention, the auditor must be mindful of the GAAS requirement to exercise special care in high-risk audit environments 113/ and to ensure that the staff devotes appropriate attention to all audit

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108/ AU §§ 311.01, 311.11.

109/ AU § 230.01.

110/ AU §§ 230.07-08.

111/ AU § 326.22.

112/ AU §§ 312.17, 316.27.

113/ AU §§ 312.17, 316.27.

areas. 114/ In any audit, areas that present more risk will demand more attention. We find fault with Dearlove not because he failed to review every workpaper but because he failed to devote enough care and attention to certain significant audit issues that presented him with clear, previously-identified risks of fraud, misstatement, or error. Evidence that Dearlove spent substantial time and effort on some auditing areas does not insulate him from liability for his failure to spend enough time and effort on others that were so material to Adelphia's financial statements.

We find, therefore, that Dearlove engaged in repeated instances of at least unreasonable conduct during his audit of four critical areas of Adelphia's financial statements, that his conduct resulted in violations of GAAS, and that his conduct indicates a lack of competence to practice before the Commission.

B. Denial of the Privilege of Appearing or Practicing Before the Commission

In determining the appropriate sanction, we are mindful of the remedial nature of Rule 102(e) and our purpose in promulgating the rule to ensure that the Commission's "processes continue to be protected, and that the investing public continues to have confidence in the integrity of the financial reporting process." 115/ In the Commission's release adopting the 1998 amendments to Rule 102(e), we recognized that

> [i]nvestors have come to rely on the accuracy of the financial statements of public companies when making investment decisions. Because the Commission has limited resources, it cannot closely scrutinize every financial statement. Consequently, the Commission must rely on the competence and independence of the auditors who certify, and the accountants who prepare, financial statements. In short, both the Commission and the investing public rely heavily on accountants to assure corporate compliance with federal securities law and disclosure of accurate and reliable financial information. 116/

Further, we stated that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive." 117/ We thus recognized that, under some circumstances, unreasonable conduct is not necessarily a less egregious discplinary matter than either intentional or reckless conduct, or highly unreasonable conduct in circumstances warranting heightened scrutiny. The requirement that we make a finding that an auditor's

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114/ AU §§ 311.01, 311.11.

115/ Amendment to Rule 102(e), 63 Fed. Reg. at 57,164; see also Robert W. Armstrong, III, Exchange Act Rel. No. 51920 (June 24, 2005), 85 SEC Docket 3011, 3041.

116/ Id. at 57,165.

117/ Amendment to Rule 102(e), 63 Fed. Reg. at 57,167.

negligent conduct indicates a lack of competence to practice before us would justify, under appropriate circumstances, permanently barring the auditor from doing so.

Here, Dearlove violated fundamental principles of auditing. He failed to exercise due care and appropriate professional skepticism. He also failed to collect sufficient competent evidential matter to provide the basis for the expression of an audit opinion with respect to several significant related party transactions despite the clear need for heightened scrutiny presented by the Adelphia audit. The frequency of Dearlove's failures far exceed the minimum threshold established by Rule 102(e)(1)(iv)(B)(2): he engaged in many instances of unreasonable conduct resulting in several GAAS violations in each of four auditing areas. Unreasonable failures to comply with auditing standards that so pervasively compromise an audit, such as those of Dearlove, "jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors." 118/ Moreover, Dearlove's lengthy audit experience makes his failure to conduct the Adelphia audit in accordance with applicable professional standards all the more troubling. 119/ Dearlove's repeated, substantial departures from his professional duties establish that the Commission cannot, at present, rely upon him to perform diligently and with reasonable competence his audit responsibilities.

We have determined under these circumstances to deny Dearlove the privilege of appearing or practicing before the Commission coupled with a right to apply for reinstatement after four years. We conclude that this sanction is necessary to protect the integrity of the Commission's processes and encourage more rigorous compliance with auditing standards both by Dearlove and by other independent auditors, without being punitive. 120/

118/ Touche Ross & Co. v. SEC, 609 F.2d 570, 581 (2d Cir. 1979).

119/ See, e.g., McCurdy v. SEC, 396 F.3d at 1265 (upholding Commission's finding that respondent's "'signficant experience in audit work'" rendered his audit failures "'particularly troublesome,'" and affirming sanction based on its demonstrated remedial purpose to "protect the public from his demonstrated capacity for recklessness in the present, and presumably to encourage his more rigorous compliance with GAAS in the future"); Marrie, 56 S.E.C. at 799 (finding respondent's lengthy audit experience made his failure to conduct audit in accordance with generally accepted auditing standards particularly troublesome).

120/ Cf. McCurdy v. SEC, 396 F.3d at 1265 (recognizing that, where auditor departed from GAAS in the audit of one asset during the audit of one year's financial statements, order suspending auditor from practice before the Commission for one year served remedial purpose of encouraging more rigorous compliance with generally accepted auditing standards in future); Marrie, 56 S.E.C. at 798-99 (imposing permanent bar on auditors who failed to conduct an adequate review of three critical audit areas during the audit of one year's financial statements and noting that "substantial departures from their

(continued...)

IX. Causing Violations of the Reporting, Recordkeeping, and Internal Accounting Control Provisions of the Exchange Act

A. Liability

Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 require issuers of securities to file annual reports with the Commission. 121/ The reports must comply with Commission Regulation S-X, 122/ which in turn requires that financial statements be prepared in conformity with GAAP. 123/ The obligation to file these reports includes an obligation that the filings be accurate. 124/ Under Exchange Act Rule 12b-20, an issuer has a duty to provide any additional material information necessary to make the required statements, in the light of the

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120/ (...continued)
professional duties establish[ed] that the Commission [could] not rely upon Marrie and Berry to perform diligently and with reasonable competence their audit responsibilities in the future"), rev'd on other grounds, 374 F.3d 1196, see supra note 13; Russell Ponce, 54 S.E.C. 804, 825 (2000) (imposing on auditor bar with right to reapply after five years for failing, during audit of one year's financial statements, to adequately review two critical audit areas and maintain auditor independence), aff'd, 345 F.3d 722 (9th Cir. 2003).

121/ 15 U.S.C. § 78m(a) and 17 C.F.R. § 240.13a-1.

122/ 17 C.F.R. Part 210. Title 17 C.F.R. Section 249.310 requires generally that a Form 10-K be used for annual reports pursuant to Exchange Act Section 13. Form 10-K (Item 8) in turn requires issuers to furnish financial statements meeting the requirements of Regulation S-X, including the requirement in Rule 2-02 that an accountant's report (defined in 17 C.F.R. § 210.1-02(a) as a document in which an "independent" public or certified public accountant sets forth certain information) state whether the audit was made in accordance with GAAS. See also Rule 1-01(a)(2) of Regulation S-X, 17 C.F.R. 210.1-01(a)(2) (directing that Regulation S-X govern "the form and content of and requirements for financial statements required to be filed as part of" annual reports, among other filings).

123/ Rule 4-01(a)(1) of Regulation S-X, 17 C.F.R. § 201.4-01(a)(1) ("Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.").

124/ See, e.g., SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978) ("The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports") (citing SEC v. IMC Int'l, Inc., 384 F. Supp. 889, 893 (N.D. Tex.), aff'd mem., 505 F.2d 733 (5th Cir. 1974).

circumstances under which they are made, not misleading. 125/ No showing of scienter is necessary to establish a violation of Section 13(a) and Rules 13a-1 and 12b-20. 126/

Under Section 21C(a) of the Exchange Act, 127/ the Commission may impose a cease-and-desist order on a person who is a cause of another's violation. Being a cause of another's violation under Section 21C(a) requires findings that: (1) a primary violation occurred; (2) the respondent engaged in an act or omission that contributed to the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. 128/ Negligence is sufficient to establish "causing" under Section 21C(a) where the underlying primary violation does not require scienter. 129/ Negligence is the failure to exercise reasonable care. 130/ Here, as discussed above in Section III, GAAS establish the standard of care against which we measure Dearlove's conduct.

As discussed above, we find that the financial statements included in Adelphia's 2000 Form 10-K contained several violations of GAAP. The lack of conformity with GAAP rendered the annual report misleading. Adelphia's filing of the Form 10-K, together with the financial

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125/ 17 C.F.R. § 240.12b-20; see also Armstrong, 85 SEC Docket at 3029 & n.58; Ponce v. SEC, 345 F.3d 722, 735 (9th Cir. 2003).

126/ SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998); SEC v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 751 (N.D. Ga. 1983); SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

127/ 15 U.S.C. § 78u-3.

128/ See, e.g., Gateway Int'l Holdings, Inc., Exchange Act Rel. No. 53907 (May 31, 2006), 88 SEC Docket 430, 444; Armstrong, 85 SEC Docket at 3029; Robert M. Fuller, 56 S.E.C. 926, 984 (2003), petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004); Erik W. Chan, 55 S.E.C. 715, 725-33 (2002).

129/ See, e.g., Gateway Int'l Holdings, 88 SEC Docket at 444-45 & n.48; KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 & n.100 (2001), petition denied, 289 F.3d 109 (D.C. Cir. 2002); see also KPMG Peat Markwick, LLP v. SEC, 289 F.3d 109, 120 (D.C. Cir. 2002) ("[T]he Commission was virtually compelled by Congress' choice of language in enacting Section 21C to interpret the phrase 'an act or omission the person knew or should have known would contribute to such violation' as setting a negligence standard.") (emphasis in original).

130/ IFG Network Sec., Inc., Exchange Act Rel. No. 54127 (July 11, 2006), 88 SEC Docket 1374, 1389 (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997)).

statements and Deloitte's audit report, was a primary violation of Exchange Act Section 13(a) and Rules 13a-1 and 12b-20 thereunder. 131/

By signing the audit report, Dearlove engaged in an act that contributed to Adelphia's primary violation. 132/ Because of the requirement in Regulation S-X that financial statements filed with annual reports be prepared in conformance with GAAP, without an unqualified audit opinion, Adelphia could not have filed its Form 10-K. Thus, Dearlove should have known that his conduct of the audit (which, as noted above, failed to satisfy GAAS in a variety of ways) and his signature on the unqualified audit opinion contributed to the violation by allowing Adelphia to proceed to file the Form 10-K and the non-GAAP-compliant financial statements. In the high-risk auditing environment presented by the circumstances attending Deloitte's audit of Adelphia's 2000 financial statements, with the array of potential problem areas discussed above, it is likely that an audit conducted in accordance with GAAS would have brought to Dearlove's attention some, if not all, of the GAAP violations we have found. Dearlove, whose departures from GAAS were at least negligent, should have known that his deficient audit would contribute to Adelphia's primary violation. For these reasons, we find that Dearlove was a cause of Adelphia's violations of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 12b-20. 133/

B. Cease-and-Desist Order

Exchange Act Section 21C(a) authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or any rule or regulation thereunder, or against any person who "is, was, or would be a cause of [a] violation, due to an act or omission the person knew or should have known

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131/ Armstrong, 85 SEC Docket at 3029; KPMG, 54 S.E.C. at 1173-74 & n.97. For the reasons discussed above, we reject Dearlove's arguments that the financial statements complied with GAAP and that there was therefore no primary violation of Exchange Act Section 13(a) and Rules 13a-1 and 12b-20 thereunder by Adelphia.

132/ See KPMG, 54 S.E.C. at 1174-83 (holding that accounting firm's negligent conclusion that it was independent from audit client was a cause of audit client's violation of Exchange Act Section 13(a) and Rule 13a-1 thereunder based on filing of annual report that included financial statements that were not, as required, audited by independent accountants).

133/ Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A), requires issuers to make and keep books, records, and accounts that, in reasonable detail, accurately and fairly reflect their transactions and dispositions of assets. The OIP charged, and the law judge found, that Adelphia violated Exchange Act Section 13(b)(2)(A) and that Dearlove was a cause of Adelphia's violation. As a discretionary matter, we decline to reach the question whether Dearlove engaged in an act or omission that was a cause of an Exchange Act Section 13(b)(2)(A) violation within the meaning of Exchange Act Section 21C(a).

would contribute to such violation." 134/ To determine whether a cease-and-desist order is an appropriate sanction for Dearlove's role in Adelphia's violations of the reporting requirements contained in Exchange Act Section 13(a) and related rules, we must look to whether there is some risk of future violations. 135/ The existence of a violation raises an inference that the violation will be repeated, and where the misconduct that results in the violation is egregious, the inference is justified. 136/ We also consider whether other factors demonstrate a risk of future violations. Beyond the seriousness of the violation, these may include the isolated or recurrent nature of the violation, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, the opportunity to commit future violations, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions sought in the proceeding. 137/ Not all of these factors need to be considered, and none of them, by itself, is dispositive.

The law judge declined to impose a cease-and-desist order because, having imposed a permanent bar on Dearlove's ability to appear or practice before the Commission that would have effectively precluded Dearlove from serving in any position in which he might cause future violations of Exchange Act Section 13(a) and related rules, the law judge concluded that the Division did not meet the minimum threshold required to impose a cease-and-desist order, i.e., that there exists some risk of future violations. Because we are permitting Dearlove to apply for reinstatement after four years, that sanction does not obviate the need for a cease-and-desist order. Dearlove may resume appearing or practicing before the Commission should he apply for, and be granted, reinstatement. Dearlove may eventually, therefore, be once again in a position to violate or cause violations of the reporting requirements of the Exchange Act.

The violations Dearlove caused were serious and of substantial import to investors. His signature on Deloitte's unqualified audit opinion was a cause of Adelphia's filing of financial statements that were inaccurate in a number of ways and that masked the true financial condition of Adelphia as well as the company's interdependency with the Rigas Entities. Revelation of the accounting deficiencies in Adelphia's financial statements would eventually result in harm to

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134/ 15 U.S.C. § 78u-3(a).

135/ KPMG Peat Marwick LLP, 54 S.E.C. at 1185. The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction. Id. at 1191; see also KPMG, 289 F.3d at 124 (finding that the plain language of Exchange Act Section 21C and its legislative history support the Commission's issuance of a cease-and-desist order on the basis of a lower risk of future violation than that required for an injunction).

136/ See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004) and cases cited therein.

137/ KPMG, 54 S.E.C. at 1192.

investors estimated to be at least $715 million, the amount of cash and stock Adelphia agreed to pay into a victims' restitution fund to help recompense harmed investors. 138/ Dearlove signed his unqualified opinion despite having conducted an audit that was seriously deficient in the face of numerous and obvious risk factors that called for increased professional care. Although Dearlove's audit encompassed only one year's financial statements, the failures on this one audit were several and occurred in several auditing areas, the responsibility for which Dearlove consistently attempts to shift to others. Moreover, while several years have elapsed since Dearlove completed the audit of Adelphia, this case is not so aged as to give comfort that the conduct will not be repeated, and, in any event, the other factors weigh strongly in favor of imposing a cease-and-desist order. 139/ We believe that the issuance of a cease-and-desist order will serve the important remedial purpose of encouraging Dearlove to discharge his responsibilities with more care in the future, thereby contributing to the integrity of, and investor confidence in, the financial reporting process.

We find that the record as a whole, especially the evidence with regard to the gravity of the violations and the harm to the marketplace and the regulatory scheme, establishes a sufficient risk that Dearlove would commit future violations to warrant imposition of a cease-and-desist order. Based on all of these factors, we find a cease-and-desist order against Dearlove to be in the public interest. 140/

X. Dearlove's Due Process Argument

We conclude this opinion by addressing Dearlove's argument that the proceedings against him are defective because he was denied due process. As explained in detail below, we reject his argument and find no basis for relief.

138/ See supra note 9 and accompanying text.

139/ See Armstrong, 85 SEC Docket at 3040 (imposing cease-and-desist order based on conduct that occurred more than twelve years prior to the issuance of the Commission's opinion, noting that, although the age of the violations militated against imposition of the order, "this consideration [was] outweighed by the other factors" discussed in the opinion); Rita J. McConville, Exchange Act Rel. No. 51950 (June 30, 2005), 85 SEC Docket 3127, 3152 (imposing cease-and-desist order based on "relatively recent" conduct that occurred more than five years prior to issuance of the Commission's opinion), aff'd, 465 F.3d 780 (7th Cir. 2006).

140/ See McConville, 85 SEC Docket at 3151-52 (imposing cease-and-desist order on corporate officer for causing Section 13 violations based on, among other things, the significance of the violations, harm caused to investors, and denial of responsibility for violations charged), aff'd, 465 F.3d 780 (7th Cir. 2006).

A. Facts

We issued the Order Instituting Proceedings ("OIP") in this matter on September 30, 2005. The OIP directed, pursuant to Commission Rule of Practice 360(a)(2), 141/ that the law judge issue an initial decision in this proceeding within 300 days from the date of service of the OIP. The OIP was served on October 5, 2005, giving the law judge until August 5, 2006, to issue his initial decision.

On November 1, 2005, the law judge entered a scheduling order setting a January 23, 2006, hearing date. 142/ On December 8, 2005, Dearlove moved for a sixty-day postponement of the hearing date on the ground that he did not have adequate time to prepare for the hearing. Dearlove argued that if he had to go forward on January 23, 2006, he would be prejudiced in his ability to defend himself, in violation of his Fifth Amendment right to due process.

Under Commission Rule of Practice 161(a), 143/ a law judge may, for good cause shown, postpone a hearing, consistent with Commission Rule of Practice 161(b). Rule 161(b) states that a law judge must adhere to a policy of strongly disfavoring postponement motions, except in circumstances where the moving party makes a "strong showing" that denial of the motion would "substantially prejudice" its case. 144/ In determining whether to grant a motion for a postponement, the law judge should consider, in addition to any other relevant factors: (1) the length of the proceeding to date; (2) the number of postponements already granted; (3) the stage of the proceeding at the time of the request; (4) the impact of the request on the law judge's ability to complete the proceeding in the time specified by the Commission; and (5) such other matters as justice may require. 145/ The law judge weighed these factors and found that Dearlove failed to make the required "strong showing of substantial prejudice" to warrant a postponement.

141/ Under Rule 360(a)(2), we must specify in the OIP a deadline for completion of the hearing and issuance of the initial decision. 17 C.F.R. § 201.360(a)(2). This deadline will be either 120, 210, or 300 days, in our discretion, "after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors." Id.

142/ The order also recited that the parties had agreed to this schedule.

143/ 17 C.F.R. § 201.161(a).

144/ 17 C.F.R. § 201.161(b)(1).

145/ 17 C.F.R. § 201.161(b)(1)(i)-(v).

Dearlove petitioned for interlocutory review of the law judge's denial of a postponement. We denied the petition, finding no "extraordinary circumstances." 146/

The hearing commenced on January 23, 2006, as scheduled, and extended over nine days. Dearlove was represented by counsel of his choice and submitted evidence about the merits of the allegations against him. After the hearing, Dearlove renewed his argument that the denial of a sixty-day postponement deprived him of due process. He also argued that the Commission's Rules of Practice, and Rule 360(a)(2) in particular, violated his right to due process.

In the initial decision, the law judge ruled that the denial of a sixty-day postponement did not violate Dearlove's due process rights. The law judge declined to rule on Dearlove's claim that the Rules of Practice are unconstitutional. He asserted that "any claim that the Rules of Practice are unconstitutional must be addressed to the Commission."

B. Dearlove's Contentions on Appeal

1. Dearlove argues that the denial of a sixty-day postponement deprived him of due process because he did not have adequate time to prepare for the hearing. He cites the complexity of the case, as well as the large size of the investigative file, which "prevented effective preparation and caused exculpatory material to lie unreviewed." Dearlove argues that he was given "less than four months" to prepare for the hearing, whereas the Division had "over three and a half years" to investigate the case. He points to Helms's testimony, which was provided by the Division along with "millions of pages" of other documents in advance of the hearing, as "[t]he clearest example of undiscovered, and therefore unpresented, exculpatory evidence." 147/ Dearlove contends that, had he been afforded adequate time to prepare, he would have uncovered Helms's testimony among the mass of material provided to him, which would have refuted the law judge's finding, in connection with the January 2000 direct placement of stock, that "the $368 million loan [directed to Adelphia] was originally intended for UCA."

Dearlove additionally contends that the task of preparing for the hearing "was made more difficult by the Division's late production of adequate witness and exhibit lists, and its eleventh-hour inclusion of allegations not specified in the OIP." The failure of third parties, i.e., Adelphia, PricewaterhouseCoopers, and other Adelphia advisors, to produce documents in response to his subpoenas assertedly compounded the prejudice to his case.

146/ Gregory M. Dearlove, CPA, Order Denying Application for Interlocutory Review, Admin. Proc. File No. 3-12064 (Jan. 6, 2006) (citing 17 C.F.R. § 201.400(a) (providing that "[t]he Commission will not review a hearing officer's ruling prior to its consideration of the entire proceeding in the absence of extraordinary circumstances")).

147/ See discussion supra at note 94 and accompanying text.

Dearlove uses the United States Supreme Court's due process analysis in Mathews v. Eldridge 148/ to argue that the denial of a sixty-day postponement deprived him of due process. In Mathews, the Supreme Court spoke of a balancing of three factors to determine what process is due in a given case: (1) the nature of the private interest affected by the official action; (2) the risk of erroneous deprivation of such an interest through the procedures used and the probable value of additional or substitute procedural safeguards; and (3) the government's interest, including the "function involved and the fiscal and administrative burdens that the additional or substitute procedural safeguards would entail." 149/ Dearlove characterizes the private interest at stake as his protected property interest in appearing and practicing before the Commission. 150/ He asserts that, "[b]ecause of the private interest at stake, the risk of an erroneous deprivation of the interest, and the Government's interest in the accurate determination of this matter, Dearlove was entitled to sufficient time to prepare his defense, and therefore to a continuance."

2. Dearlove argues, without citation to any authority, that Rule of Practice 360(a)(2) violates due process. He characterizes the hearing schedules in Commission administrative proceedings as "rigid" and "inflexible." Dearlove argues that Rule 360(a)(2) takes "a one-size-fits-all approach [that] does not adequately safeguard an individual's due process rights." Dearlove finds support for his constitutional challenge to Rule 360(a)(2) in the law judge's finding that his argument "echoed" some of the public comments submitted during the rulemaking proceeding that led to Rule 360(a)(2)'s adoption. 151/

148/ 424 U.S. 319 (1976).

149/ Id. at 335.

150/ Dearlove cites various licensing cases, as well as the Ninth Circuit Court of Appeals' decision in Sartain v. SEC, 601 F.2d 1366 (9th Cir. 1979), to support his claim of a protected property interest. In Sartain, the court held that due process entitled a broker-dealer's registered representative to a fair hearing before the Commission and the right to be represented by independent counsel where the registered representative stood to lose the "valuable privilege" of being employed in the securities industry. Id. at 1375; see also Michael J. Crane, Note, Disciplinary Proceedings Against Accountants: The Need for a More Ascertainable Improper Professional Conduct Standard in the SEC's Rule 2(e), 53 Fordham L. Rev. 351 (1984) (stating that an accountant has a property interest in his right to practice before the Commission that may not be terminated without due process).

151/ See Letter from the District of Columbia Bar, Corporation, Finance and Securities Law Section to the Commission (Mar. 21, 2003); Letter from the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities to the Commission (May 13, 2003), available at http://www.sec.gov/rules/proposed/s70403.html.

C. Denial of Sixty-Day Extension

In Ungar v. Sarafite, 152/ the Supreme Court articulated the standard for analyzing a due process challenge to the denial of a continuance:

> The matter of a continuance is traditionally within the discretion of the trial judge, and it is not every denial of a request for more time that violates due process even if the party fails to offer evidence or is compelled to defend without counsel. Contrariwise, a myopic insistence upon expeditiousness in the face of a justifiable request for delay can render the right to defend with counsel an empty formality. There are no mechanical tests for deciding when a denial of a continuance is so arbitrary as to violate due process. The answer must be found in the circumstances present in every case, particularly in the reasons presented to the trial judge at the time the request is denied. 153/

We have consistently followed the principles articulated in Ungar. We have recognized that the trier of fact has discretion in deciding whether to grant a motion for a postponement or continuance. 154/ We have stated that our inquiry on review of a denial of a postponement or continuance is whether the denial constituted "an unreasoning and arbitrary insistence upon expeditiousness in the face of a justifiable request for delay." 155/

152/ 376 U.S. 575 (1964).

153/ Id. at 589-90; accord Morris v. Slappy, 461 U.S. 1, 11-12 (1983) ("[B]road discretion must be granted trial courts on matters of continuances; only an unreasoning and arbitrary 'insistence upon expeditiousness in the face of a justifiable request for delay' violates the right to assistance of counsel.") (citing Ungar).

154/ See, e.g., Underhill Sec. Corp., 42 S.E.C. 689, 699 (1965) (stating that "[t]he determination whether to grant a continuance was a matter resting in the sound discretion of the [hearing] examiner"; examiner's denial of one-month adjournment to give counsel more time to prepare his defense was a proper exercise of that discretion where any lack of preparation by respondents' counsel was a result of their own dilatory conduct, and where counsel conducted a vigorous defense in the course of the hearings which extended over many weeks and was afforded the opportunity to recall any witness and to request additional time).

155/ See, e.g., Richard W. Suter, 47 S.E.C. 951, 963 (1983) (holding that law judge's refusal to grant further postponements of hearing was not an abuse of discretion or "unreasoning and arbitrary insistence upon expeditiousness" where hearing already had been delayed for a long period of time); Gary L. Jackson, 48 S.E.C. 435, 441 (1986) (holding that law judge's refusal to permit respondent's various requests for postponement of the hearing was not an abuse of discretion or "unreasoning and arbitrary insistence upon

(continued...)

A review of our precedent applying this standard reveals that most cases have held that the trier of fact's denial of a postponement was not an abuse of discretion and did not violate due process. 156/ In the "rare" cases where the denial was deemed to be improper, we have found that there were "extraordinary circumstances" supporting a postponement, i.e., the respondent was left without assistance of counsel at or near the hearing date. 157/

155/ (...continued) expeditiousness"; "[w]hile a respondent has the right to be represented by counsel, the law does not require endless postponements of judicial proceedings while respondents attempt to secure legal representation").

156/ See, e.g., Falcon Trading Group, Ltd., 52 S.E.C. 554, 560-61 (1995) (finding no due process violation in NASD's denial of applicants' motions for continuance and adherence to the previously-scheduled hearing date where applicants were given six weeks' notice of the hearing date, and they had sufficient time to obtain new counsel after discovering that joint counsel had potential conflict of interest), aff'd, 102 F.3d 579 (D.C. Cir. 1996); Alexander V. Stein, 52 S.E.C. 296, 300-01 (1995) (finding no due process violation in law judge's denial of a postponement where respondent had well over a month to prepare any defense to the allegations in the OIP, he failed to claim that he could not defend himself without certain materials or witnesses, and he failed to specify those materials that he claimed to need); Michael Markowski, 51 S.E.C. 553, 558-59 (1993) (finding no due process violation in NASD's refusal to grant an additional continuance of the second hearing date where hearing panel had already granted counsel a continuance of the second hearing date, and attorneys gave no indication to panel prior to rescheduled hearing that they would not be ready to go forward at that time), aff'd, 34 F.3d 99 (2d Cir. 1994).

157/ See, e.g., Philip L. Pascale, CPA, Order Granting Postponement of Administrative Hearing, Admin. Proc. File No. 3-11194 (Nov. 24, 2003) (holding, on interlocutory review of a law judge's denial of a postponement request, that respondent demonstrated substantial prejudice warranting a short postponement of the hearing where the medical condition of respondent's counsel was incapacitating, and counsel learned about this condition so close to the hearing that substitute counsel could not be obtained; the Commission acknowledged that "[t]he substantial prejudice test is a difficult one to meet," but found, in this "rare" case, that respondent's request presented "extraordinary circumstances"); Carleton Wade Fleming, Jr., 52 S.E.C. 409, 415 (1995) (holding that NASD's refusal to grant a continuance was improper where counsel had withdrawn and respondent was required to proceed and present his case for three days of hearing, without assistance of counsel, despite NASD Code of Procedure provision granting a right to be heard by counsel); James Elderidge Cartwright, 50 S.E.C. 1174, 1178 (1992) (holding that NASD's refusal to grant a continuance was unreasonable where respondent was ill on the hearing date and demonstrated his inability to proceed, and NASD Code of Procedure gave the respondent the right to be heard in person and by counsel).

This proceeding is not one of those "rare" cases. Dearlove received notice of the charges no later than October 5, 2005, when he was served with the OIP, and had three and a half months to prepare for the hearing. The schedule here provided 121 days from service of the OIP to completion of the hearing; 82 days for the parties to review the transcript and submit post-hearing briefs; and 92 days for the law judge to prepare and file an initial decision. 158/ This schedule was consistent with the guidelines in Rule 360(a)(2). In fact, it afforded the parties more time than allotted. Moreover, at a pre-hearing conference on October 28, 2005, Dearlove's counsel agreed with the law judge's statement that this case did not "just drop[] on [counsel's] desk" for the first time on October 5, 2005, when Dearlove was served with the OIP. Dearlove's counsel acknowledged that he had been formally involved in this proceeding since at least 2003 when the Division took Dearlove's investigative testimony. In Dearlove's counsel's words, he was no "stranger[]" to any of the issues raised in the proceeding.

On appeal, Dearlove cites his failure to find and review Helms's testimony prior to the hearing as the only evidence that the denial of a postponement prejudiced his case. 159/ Any prejudice resulting from the omission of this evidence has been cured by our admission of this testimony under Rule 452. In any event, our review of Helms's testimony leads us to conclude that this testimony is irrelevant to the issues of Dearlove's liability. 160/

In our order denying Dearlove's motion for interlocutory review, we rejected Dearlove's claim that the complexity of the case and large size of the investigative file justified a postponement. Observing that many Commission proceedings involve complicated issues resulting in voluminous files, we stated that we already had considered the complexity of the case when, pursuant to Rule 360(a)(2), we selected the 300-day timeline for issuing the initial decision. We considered and rejected Dearlove's argument that the law judge believed the only "barrier" to his postponement request was the 300-day deadline, stating that "[t]he deadlines for issuing initial decisions are not [absolute] 'barriers' to requests for postponements." 161/ The law judge considered the 300-day deadline as one of several factors in determining whether to grant a request for a postponement and denied the postponement request only after weighing all of the

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158/ For a 300-day timeline, Rule 360(a)(2) provides that there should be 120 days from the date of service of the OIP to completion of the hearing, 60 days for the parties to obtain the transcript and submit post-hearing briefs; and 120 days after briefing for the law judge to prepare and file an initial decision. 17 C.F.R. § 201.360(a)(2).

159/ Cf. DWS Sec. Corp., 51 S.E.C. 814, 822-23 (1993) (finding no due process violation in NASD's refusal to grant applicants' requests for a continuance; applicants, who had approximately two months to prepare for their initial hearing before NASD, failed to explain how they were specifically prejudiced by the denial of their requests).

160/ See supra note 92 and accompanying text.

161/ Dearlove, Order Denying Application for Interlocutory Review, supra note 146, at 3-4 n.10.

relevant factors. 162/ Moreover, under Rule 360(a)(3), a law judge who decides that it will not be possible to issue an initial decision within the time specified in the OIP should consult with the chief law judge who, in turn, may submit a motion to us requesting an extension. 163/ Rule 360(a)(3) states that the motion should "explain[] why circumstances require an extension and specify[] the length of the extension." It further provides that we may authorize an extension if we determine that "additional time is necessary or appropriate in the public interest." Although the law judge did not avail himself of these procedures, the option to do so provided some flexibility if he decided that the case required more than 300 days to complete.

The record does not support Dearlove's contention that his hearing preparation was frustrated by the Division's late production of adequate witness and exhibit lists. The law judge required the Division to amend its witness and exhibit lists because those lists were deficient. 164/ To minimize any possible prejudice, the law judge modified his scheduling order to give Dearlove several extra weeks to identify his proposed exhibits and fact witnesses. Although Dearlove also complains about what he characterizes as the Division's "eleventh-hour" inclusion of allegations not specified in the OIP, the law judge refused to entertain those allegations. Dearlove cannot now claim that they caused him any harm.

The record shows that the delays Dearlove encountered in obtaining documents from third parties were foreseeable. The law judge encouraged Dearlove to submit his applications for document subpoenas at an early date, but Dearlove delayed doing so for one month.

Furthermore, we reject Dearlove's use of the balancing test in Mathews. The Supreme Court has stated that it has "never viewed Mathews as announcing an all-embracing test for deciding due process claims." 165/ As discussed above, Ungar supplies the proper analytical framework. We, as well as the federal courts, have used Ungar's principles in assessing a due process challenge to the denial of a postponement. Dearlove has not offered any grounds to justify a departure from this well-established practice, and we perceive no basis for doing so.

162/ See Rule 161(b)(1), 17 C.F.R. § 201.161(b)(1) (setting forth several factors the decisionmaker must consider in determining whether to grant an extension of time).

163/ 17 C.F.R. § 201.360(a)(3). See, e.g., Raymond James Fin. Serv., Inc., Securities Act Rel. No. 8597 (July 29, 2005), 85 SEC Docket 4318, 4320 (granting forty-five-day extension "[i]n light of the complexity of the case, the scheduling conflict identified by the Chief Administrative Law Judge, and the reasonableness of the requested extension").

164/ Gregory M. Dearlove, CPA, Order Following Prehearing Conference, Admin. Proc. File No. 3-12064 (Dec. 9, 2005).

165/ Dusenbery v. United States, 534 U.S. 161, 168 (2002).

Even if we were to find that Mathews supplies the proper analysis, we believe application of Mathews' three-factor balancing test also leads to the conclusion that the process provided to Dearlove was adequate. Although the nature of the private interest affected, i.e., Dearlove's right to practice before the Commission, militates in Dearlove's favor, the other factors do not. As demonstrated above, the risk that Dearlove was erroneously deprived of his right to practice was negligible: he received notice of the allegations against him, a full administrative hearing, the opportunity to respond to the allegations, and the opportunity for our review of the proceedings. In addition, the government's interest in the timely resolution of its administrative hearings was balanced against Dearlove's need for a meaningful process, as evidenced by the many concessions made by the law judge in Dearlove's favor detailed above. Mathews does not require us to provide more process than Dearlove received. 166/

D. Commission Rule of Practice 360

In the June 2003 release adopting Rule 360(a)(2), we rejected a "one-size-fits-all" approach to timely disposition of administration proceedings. 167/ As a result, we established three different deadlines for the completion of administrative proceedings. Moreover, as discussed above, Rule 360(a)(3) allows for the possibility of an extension of time where circumstances warrant. Although it is true that two of eleven commenters suggested that the proposed timeline implicated due process concerns, neither one offered any case authority holding that an agency's establishment of deadlines for the timely disposition of cases violates due process, and our research has uncovered no such authority. In response to these commenters' concerns, we amended Rule 230(d) to provide for the earlier production of the investigative record to respondents. Under Rule 230(d), the Division of Enforcement is required to make its investigative file available to a respondent within seven days after service of the OIP, or, in this case, by October 12, 2005. The Division notified Dearlove that the investigative file was available for his review on October 5, 2005, one week before it was required to do so by Rule 230(d). In sum, we find Dearlove's due process challenge to these proceedings to be without merit.

166/ See Mathews, 424 U.S. at 333 ("The fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner.") (internal quotations omitted).

167/ See Rules of Practice, Securities Act Rel. No. 8240 (June 11, 2003), 80 SEC Docket 1463.

XI. Conclusion

We find that Dearlove engaged in improper professional conduct within the meaning of Rule of Practice 102(e)(1)(iv)(B)(2) and that he caused Adelphia's violations of Exchange Act Section 13(a) and related rules. We therefore deny Dearlove the privilege of appearing or practicing before the Commission with a right to reapply after four years, and we order him to cease and desist from causing violations of Exchange Act Section 13(a) and related rules.

An appropriate order will issue. 168/

By the Commission (Chairman COX and Commissioners ATKINS, NAZARETH, and CASEY).

Nancy M. Morris
Secretary

168/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No.557244 / January 31, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 2779 / January 31,22008

Admin. Proc. File No. 3-12064

In the Matter of

GREGORY M. DEARLOVE, CPA

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that, effective immediately:

A. Gregory M. Dearlove cease and desist from causing any violation of the reporting provisions of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 12b-20.

B. Gregory M. Dearlove is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After four years from the date of this order, Dearlove may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. A preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Dearlove's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. An independent accountant. Such an application must satisfy the Commission that:

(a) Dearlove, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Dearlove, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision or, if the Board has not conducted an inspection, has received an unqualified report relating to his, or the firm's, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions;

(c) Dearlove has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Dearlove acknowledges his responsibility, as long as Dearlove appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews, and quality control standards.

D. The Commission will consider an application by Dearlove to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Dearlove's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary