INITIAL DECISION RELEASE NO. 131

ADMINISTRATIVE PROCEEDING
FILE NO. 3-9317

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INITIAL DECISION
September 3, 1998

In the Matter of PARNASSUS INVESTMENTS, JEROME L. DODSON, MARILYN CHOU, and DAVID L. GIBSON

APPEARANCES:
Karen G. Kwong and John S. Yun for the Division of Enforcement, Securities and Exchange Commission
Richard M. Phillips, Neil S. Lang and Holly S. Haskew for the Respondents

BEFORE: Robert G. Mahony, Administrative Law Judge

I. INTRODUCTION

The Securities and Exchange Commission (Commission) initiated this proceeding by an Order Instituting Proceedings (OIP) on May 29, 1997, pursuant 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).

The OIP sets out three allegations. First, it alleges that the four named Respondents[1] overstated the net asset value (NAV) of the Parnassus Fund (Fund) from December 1990 to January 1993 (the relevant period), thereby willfully aiding and abetting the Fund's violations of Rule 22c-1, promulgated pursuant to Section 22 of the Investment Company Act, when sales and redemptions of Fund shares were made at the overstated NAV. According to the OIP, the overvaluations were caused by the Board of Trustees' (Board or Trustees) decisions regarding the Fund's investment in Margaux, Inc. (Margaux). Second, the OIP alleges that Parnassus Investments and Dodson improperly directed the Fund to make a $100,000 loan. Third, and finally, the OIP alleges that Parnassus Investments and Dodson improperly used soft dollar credits from 1989 to 1995.

A hearing was held in San Francisco, California on September 22- 26, 1997. The Division filed its Post Hearing Brief and Proposed Findings of Fact and Conclusions of Law on February 18, 1998, Respondents filed their Post Hearing Brief and Proposed Findings of Fact and Conclusions of Law on April 8, 1998, and the Division filed its Reply Brief and Supplemental Findings of Fact and Conclusions of Law on April 28, 1998.[2]

The Division requests that cease and desist orders be entered against all Respondents, that Parnassus Investments and Dodson be ordered to pay $10,000 each in civil penalties, and that Respondents Gibson and Chou be ordered to pay $5,000 each in civil penalties.

II. FINDINGS OF FACT

a. Respondents[3]

Respondent Dodson founded Parnassus Investments in 1984 and is currently its president. (Tr. 180, 187.) He and his wife jointly own all of its common stock. (Tr. 180.) Dodson is also president

of the Fund and a member of its Board of Trustees (Trustees), as well as the Fund's portfolio manager. (Tr. 180.) Dodson is a graduate of the University of California at Berkeley and possesses a Masters of Business Administration degree from Harvard. (Tr. 182.) He was founder and Chief Executive Officer of Continental Savings of America. (Tr. 185.)

Respondent Gibson is and has been an independent Trustee of the Fund since 1986. (Tr. 189, 545.) Gibson is a licensed attorney who specializes in tax and business matters. (Tr. 544-45.) Gibson was formerly tax counsel and Director of Public Affairs for Crown Zellerbach. (Tr. 544-45.) He was formerly both a director and an officer of California Wine Company and Ceracon Incorporated. (Tr. 544-45.) Gibson received an undergraduate business degree from Columbia Tech, a law degree from Washington University, a Masters of Law in Taxation from the College of William and Mary, and a Masters of Business Administration from Golden Gate University. (Tr. 543.)

Respondent Chou was an independent Trustee of the Fund from 1984 to 1995. (Tr. 426.) She left the Fund's Board in 1995 and presently has no connection with the securities industry. (Tr. 426.) Chou is executive vice president of a medical device company called Xintec Corporation. (Tr. 423.) She is also the company's chief financial officer. Chou was formerly an officer and owner of a real estate organization known as Dana Properties. (Tr. 423.) Chou graduated from San Francisco State University and received a Ph.D. in sociology from the University of California at Berkeley. (Tr. 420.)

b. Parnassus Investments

Parnassus Investments, formerly known as Parnassus Financial Management, is an investment advisor registered with the Commission pursuant to the Advisers Act. (Tr. 181.) Parnassus Investments directs the investments of the Fund and provides the Fund with management, administrative, transfer agency and distribution services necessary for the operation of the Fund. (Tr. 384.) Parnassus Investments is also the distributor of the Fund's shares which are sold with a maximum commission or "load" of 3.5%. (Div. Ex. 112 at 11.)

c. Parnassus Fund

The Fund is a diversified open-end investment company registered with the Commission under the Investment Company Act. (Tr. 187.) The Fund's principal objective is long-term capital growth. (Resp. Ex. 61 at 6.) It adheres to a contrarian investment policy, whereby it purchases stocks that are currently "out of favor with the investment community," but exhibit good future prospects and solid intrinsic value. (Div. Ex. 110 at 6.) The price of each share is set for purposes of sales and redemptions according to the Fund's total NAV[4] divided by the number of outstanding shares. (Div. Ex. 112 at 12.) The Fund's NAV is calculated each business day by the Fund or its agent according to the current value of each investment in the Fund's portfolio. (Div. Ex. 112 at 12.)

The Fund's prospectus, dated May 1, 1989, limited the types of "equity securities" in which the Fund could invest to stocks and convertible instruments. (Div. Ex. 112 at 7.) The Fund's statement of additional information, dated May 1, 1988, prohibited loans, except repurchase agreements, without prior shareholder approval. (Div. Ex. 111.) Dodson was aware of the investment policies in the Fund's statement of additional information. (Tr. 202-03.) In particular, Parnassus Investments and Dodson were aware of the Fund's restrictions on loans. (Tr. 203-04.)

d. The Fund's Investment in Margaux

Margaux was a manufacturer and marketer of large, energy- efficient refrigeration units for grocery stores and supermarkets. (Tr. 70, 558.) Margaux's innovative technology conserved energy by producing more constant temperatures in refrigeration display cases. (Tr. 70.) During the relevant period, its most important customer was Food Lion, Inc. (Food Lion), one of the fastest growing supermarket chains in the United States. (Tr. 80-81, 165, 231.) In 1989, Margaux became the exclusive provider of refrigeration equipment to Food Lion nationally. (Tr. 176.) Beginning in 1986,

Margaux's common stock traded on the National Association of Securities Dealers Automated Quotation System (NASDAQ). (Tr. 87.)

Among the Fund's investments was an accumulation of Margaux common stock shares. (Tr. 153.) Dodson became aware of Margaux in 1986 through research provided by Shearson Lehman Hutton. (Tr. 208.) Believing Margaux met the desired criteria for prospective investments, Dodson caused the Fund to make significant purchases of Margaux common stock. (Tr. 208-10.) By early 1989, the Fund held 640,000 shares of Margaux at an average cost of $1.26 per share. (Tr. 223-24, 247; Resp. Ex. 2 at 3.)

On March 20, 1989, Margaux and its wholly owned subsidiary Engineered Refrigeration Systems (ERS) filed petitions for relief pursuant to Chapter 11 of the Bankruptcy Code. (Tr. 25, 211.) At the time, Margaux and ERS owed $1.9 million to Citizens and Southern Bank, their primary secured lender. (Div. Ex. 6 at 3.) Dodson, although aware of Margaux's current financial condition, had no advance knowledge of Margaux's intention to file for bankruptcy. (Tr. 212-13.) Despite the bankruptcy, Dodson believed Margaux was still "undervalued" and caused the Fund to purchase another 250,000 Margaux common stock shares at $0.28 per share just two days after the bankruptcy petitions were filed. (Tr. 230-31; Div. Ex. 153.)

On April 10, 1989, Citizens and Southern Bank obtained an order from the bankruptcy court protecting its security interest by prohibiting Margaux from spending its cash on hand. (Tr. 69, 236.) Shortly thereafter, Stephen Clark, Margaux's chief executive officer, contacted Dodson who was traveling out of the country and informed him that Margaux was in urgent need of new capital in order to remain a going concern. (Tr. 27-28, 235-36.) Dodson agreed to provide Margaux with a portion of the new capital, then thought to be $500,000. (Tr. 237-39, 246.) Clark and Dodson agreed that the transaction would be characterized as a debenture which would be convertible into Margaux common stock after obtaining approval from the bankruptcy court. (Tr. 75.) On April 14, 1989, the bankruptcy court authorized Margaux and ERS to borrow - on a subordinated basis - up to $450,000 from a group of lenders that included the Fund. (Div. Ex. 6 at 3.) Subsequently, Dodson caused the Fund to lend $100,000 to Margaux and ERS pursuant to a loan agreement. (Tr. 237-39, 246; Div. Ex. 2.) Dodson signed the loan agreement on behalf of the Fund and Parnassus Investments. (Div. Ex. 2 at 12-13.) In exchange for the $100,000, the Fund received a Note and Security Agreement, both dated April 28, 1989. (Div. Exs. 1, 3.) Despite Clark and Dodson's agreement regarding conversion rights, neither the Note nor the Security Agreement contained any provision for conversion into common stock. (Div. Exs. 1, 2.)

Dodson was aware that any proposed conversion right was subject to the approval of the bankruptcy court. (Tr. 242.) Nevertheless, in a letter to the Fund's shareholders, dated July 24, 1989, Dodson characterized the Note as "the $100,000 convertible debenture you see in the portfolio." (Div. Ex. 124 at 2.) On September 14, 1989, Margaux and ERS submitted a Reorganization Plan to the bankruptcy court. The Reorganization Plan, approved by the bankruptcy court on October 5, 1989, provided that "prior to payment . . . [the Note] may be converted to common stock of Reorganized Margaux . . . ."[5] (Div. Ex. 22 at 5.) At this point, the Fund held a subordinated convertible note with a face value of $100,000, which paid interest at the rate of 12% per year and was convertible at the holder's option into 1.5 million shares of Margaux common stock, fifteen shares for every dollar (approximately $0.06 per share).[6] (Tr. 118, 250, 287.) All of the 1.5 million shares were restricted stock that had not been registered for sale with the Commission. (Div. Ex. 32.) Without registration, the stocks could not be publicly sold for at least two years.[7] At the time the conversion right was approved, Margaux's unrestricted common stock was trading on the NASDAQ at approximately $0.44 per share. (Div. Ex. 50 at 2.)

e. Valuing the Note: The Switch from Face Value to Conversion Price

Initially, the Trustees voted to carry the Note on the Fund's books at its $100,000 face value.[8] (Tr. 127, 258-59.) The Fund carried the Note at face value through December 31, 1989 in its annual report. (Div. Ex. 126 at 12.) On January 9, 1990, Dodson decided that the Note should be

valued at its conversion price,[9] i.e., the NASDAQ market price of Margaux common stock times the number of shares into which the Note was convertible. Gibson and Chou agreed to the change despite the fact that they cannot recall any significant development in Margaux's business in the nine days between December 31, 1989 and January 9, 1990. (Div. Ex. 53; Tr. 465-66, 562.) Dodson stated that he believed the change in valuation better reflected Margaux's "fair value." (Tr. 261.) At the time of the change in valuation, Dodson conceded that he was not aware that the relevant shares of Margaux common stock were restricted. (Tr. 264.) Gibson considered the restriction of "[n]o particular importance," while Chou was unaware and/or lacked adequate understanding of the concept of restricted stock. (Tr. 580-81, 537.) From January 1990 until Margaux was delisted in August 1990, the Note was priced at its conversion value. (Tr. 275-76.) In August 1990, the Trustees added a 10% premium to the price of the Margaux common stock shares underlying the Note. (Tr. 276, 639.) Dodson and the Trustees claimed that because the Note was convertible the premium accurately reflected the added value of the interest stream payments and seniority of the Note over common stock in the event of Margaux's liquidation. (Tr. 276, 476.)

Shortly after it was valued as converted, the Note was shown as being worth $375,000 in the Fund's quarterly report for the period ending March 31, 1990. (Div. Ex. 127 at 1.) For the year ending December 31, 1990, the Fund's 1990 Annual Report shows the Note as being worth $562,500. Thus, the Note produced an "unrealized gain" for the year of $462,500. (Div. Ex. 127 at 1.) Of that gain, $46,500 was attributable to the 10% premium, while $416,000 was attributable to valuing the 1.5 million restricted shares of Margaux common stock as converted at $0.344 per share. (Div. Ex. 130.)

f. The Decision to "Fair Value" the Margaux Holdings

For the fiscal year ending March 31, 1990, Margaux showed a loss of $2.353 million and a negative net worth of $485,000. (Div. Ex. 6 at 22-23.) Because of the negative net worth, on August 29, 1990, Margaux was delisted from the NASDAQ exchange.[10] (Tr. 87, 154, 275-76, 576.) Prior to delisting, the Fund carried the Margaux investment at the recorded closing NASDAQ price, or in the absence of such price, at the mean between the last recorded bid and asked quote. (Tr. 457-58.) The last available NASDAQ "market quote" for Margaux common stock shares was $0.344 per share. (Tr. 278-79.) After delisting, Margaux stock was quoted only in the National Daily Quotation Bureau's "pink sheets." (Tr. 67, 278.)

In December 1990, consistent with Section 2(a)(41) of the Investment Company Act, Dodson recommended to the Trustees that the Margaux holdings be valued at "fair value" rather than market value. (Tr. 261, 342.) To determine fair value, Accounting Series Release (ASR) 113 required the Trustees to value the 1.5 million restricted Margaux shares at "the amount which the owner might reasonably expect to receive for them upon their current sale" by applying a discount from the price of unrestricted Margaux shares "except for most unusual circumstances." (Div. Ex. 144.) The Trustees were further instructed by ASR 118 to value the 565,000 unrestricted Margaux shares then held by the Fund according to what the Fund "might reasonably expect to receive for them upon current sale," and to disclose in the Fund's annual reports any methodology or factors that were used to perform fair valuations and to document the information considered in the Board minutes for independent review by the Fund's outside auditors. (Div. Ex. 145.) See, Conclusions of Law, infra.

Dodson believed that "selling [the Margaux holdings] on the open market was not a real test of [Margaux's] fair value or current value." (Tr. 284.) Rather, Dodson believed fair value to be based on what the Fund might receive if Margaux's "true" value were realized in a sale in an active, orderly market. (Tr. 231- 32, 310, 406-08; Div. Ex. 154 at 4.) Respondents admit, however, that during the relevant period there was no orderly, liquid market for Margaux common shares. (Tr. 475.) Further, a transaction such as the one favored by Dodson would have required a sale of the entire company or at least a controlling position therein. (Tr. 489, 584; see also Report of Abe Halati, Respondents' Expert, at 5.) Even if the Note was converted, however, the Fund's stake in

Margaux represented less than 15% of the outstanding shares of the company. Therefore, the Fund was unable to affect a sale of Margaux or a controlling position therein. Insofar as relevant to this proceeding, efforts to find a buyer for Margaux ended in late 1990 when the only entity to express any interest failed to put a bid on the table. (Tr. 51- 53; Report of John M. Lacey, Division's Expert, at 20.)

g. Fair Valuing the Margaux Holdings: The Board of Trustees Meetings

(i) December 19, 1990

The Trustees made their initial fair valuation of the Fund's 565,000 unrestricted Margaux shares and the Note during the December 1990 Board meeting. (Div. Ex. 64 at 5-6.) Dodson informed the Trustees that Margaux's revenues for the nine months ending December 31, 1990 were estimated to be $14 million and that net income for the same period would be just $50,000. (Div. Ex. 64 at 5; Div. Ex. 65.) He also informed the Trustees that Margaux projected $21 million in revenues for the full calendar year of 1991, along with net income of $1 million after deducting interest expenses. (Div. Ex. 64 at 5; Div. Ex. 65.) Further, Dodson reported to the Trustees that the most recent pink sheet prices for Margaux were in the range of "$0.05 to $0.10 per share."[11] (Tr. 495.) Dodson, however, believed that Margaux was too thinly traded to be valued solely or primarily on the basis of the pink sheet bid and asked quotations. (Tr. 278, 342.)

The Trustees determined that the price for the Margaux shares as reported in the pink sheets "[did] not constitute a true measure of the value of the Margaux securities held by the Fund" and resolved to maintain the value of the Margaux common stock at $0.344 per share. (Resp. Ex. 190; Tr. 286, 342-43.) Although the minutes do not reflect any such analysis, Dodson testified that the Trustees' determination represented a market assessment of Margaux's value that both fully discounted the impact on Margaux of its reorganization in bankruptcy, its current financial difficulties, and its future prospects. (Tr. 579.) Further, Dodson and the Trustees noted that in addition to the quantitative financial data available, they considered of critical importance Margaux's refrigeration technology, its management, and its relationship with its principal customer, Food Lion. (Tr. 340-44, 470, 579.)

(ii) March 20, 1991

In a letter dated February 20, 1991, Margaux informed Dodson of its financial results for the final nine months of 1990. Margaux had a net loss of $283,000 - instead of a $50,000 profit - in the final nine months of 1990. Margaux also notified Dodson that it had revised downward its projected earnings for the calendar year of 1991 from $1 million to $505,000. Margaux further disclosed to Dodson that it had to renegotiate its unsecured debt repayment schedule because it could not make the payments and that it would be unable to pay-off the $425,000 in convertible notes that were coming due. (Div. Ex. 68.) At the March 20, 1991 Board meeting, the Trustees discussed Margaux's operating results for the nine months ending December 31, 1990. (Tr. 321; Div. Ex. 170.) The Trustees also received a report from Deloitte & Touche, the Fund's auditors. (Tr. 322-23.) In large part because Margaux was so thinly traded, the auditors considered the valuation of the Margaux holdings the most sensitive area of judgment in the financial statements. (Tr. 613.) The auditors reviewed the valuation and the methodologies employed by the Trustees in arriving at that valuation, finding them in accordance with generally accepted accounting procedures.[12] (Tr. 613, 616.) At the close of their Board meeting, the Trustees chose not to adjust their valuation of the Margaux holdings.

(iii) July 10, 1991

On April 22, 1991, Margaux announced that it had made a $16,000 profit for the quarter ending March 31, 1991.[13] (Div. Ex. 72.) The Trustees claim to have spent only a short time discussing Margaux at the July 10, 1991 Board meeting because there had been, according to Dodson, "no significant developments." (Tr. 325.) Yet, there is no reflection of any discussion of Margaux in the

minutes of the July 1991 Board meeting. (Div. Ex. 74.) Following the Board meeting, the valuation of the Fund's Margaux holdings remained unchanged.

(iv) December 18, 1991

On August 2, 1991, Margaux announced a $45,000 net loss for the quarter ending June 30, 1991.[14] (Div. Ex. 75.) On November 1, 1991, Margaux announced it had a further net loss of $349,000 for the quarter ending September 30, 1991.[15] (Div. Ex. 76.) At the December 18, 1991 meeting, Dodson testified that the Trustees had extensive discussions regarding Margaux's financial statements and its methodology for fair valuing the Margaux holdings. (Tr. 343.) He delivered to the Trustees a memorandum containing an income statement of Margaux for 1991, a Margaux budget forecast for 1992, and a form 10-Q of Margaux, dated November 8, 1991. (Div. Ex. 79.) Dodson acknowledged that the results for 1991 had been less than favorable and failed to meet Margaux's prior projections. (Tr. 343.) Moreover, he reported that Margaux was behind schedule in its efforts to diversify its client base: the Food Lion account continued to represent 65% of Margaux revenues. (Div. Ex. 79.) The Trustees, nonetheless, citing positive cash flow, an improved financial forecast for 1992,[16] and continued strong business fundamentals, declined to change their valuation of the Fund's Margaux holdings. (Div. Ex. 79; Tr. 342-44, 505.)

(v) March 11, 1992

In March 1992, Margaux announced it had suffered a $927,000 net loss for the year of 1991 on revenues of $19,451,000.[17] (Div. Ex. 81.) The auditors from Deloitte & Touche returned and gave a presentation to the Trustees similar to that from March 1991. (Tr. 345; Resp. Ex. 181.) The Trustees were told that the valuation of the Margaux holdings, although it continued to warrant special attention, "appear[ed] reasonable." (Resp. Ex. 181.) Similar to July 1991, there is no reflection of any discussion of Margaux in the minutes of the March 1992 Board meeting. Despite Margaux's failure to meet management's financial projections,[18] the valuation of the Fund's Margaux holdings remained unchanged. (Div. Ex. 81.)

(vi) July 29, 1992

At the July 29, 1992 Board meeting, Dodson reported that Margaux's results of operations for the six months ended June 30, 1992 had improved when measured against the results for the same period for the previous year. (Div. Ex. 84, 85.) Margaux had earned a profit, reporting a net gain before taxes of $367,000.[19] (Div. Ex. 84.) Dodson told the Board that on a fully diluted basis, the second quarter earnings annualized to $0.08 a share.[20] (Div. Ex. 85.) Moreover, the Trustees were told Margaux was in a position to benefit from a tax loss carryforward and increased Food Lion expansion. (Div. Ex. 85.) The Board, however, also discussed Margaux's dependence on its relationship with Food Lion and the continued "thin market" for Margaux shares. (Div. Ex. 85.) After giving some consideration to increasing the valuation of the Fund's Margaux holdings, the Trustees determined to maintain the current valuation. (Div. Ex. 85.)

(vii) December 16, 1992

At the December 16, 1992 Board meeting, the Trustees discussed the impact on Margaux of extremely negative publicity regarding Food Lion. (Tr. 354, 523-25.) The Trustees worried that the negative publicity might adversely affect Margaux's prospects. (Tr. 354-55, 523-25.) At the time of the Board meeting, Dodson was unable to obtain any information regarding the continued viability of Food Lion's expansion plans, the one factor that clearly would have had a serious impact on Margaux's prospects. (Tr. 356.)

Dodson also informed the Trustees that in the September or October of that year he received a call from Clarke who told him of a potential buyer's indication of interest in the Fund's Margaux holdings. (Tr. 353.) The buyer was not identified and no formal offer was made, but the inquiry, according to Dodson, was "somewhere around $0.25 to $0.30 a share." (Tr. 353.) Dodson,

however, told the Trustees that he informed Clarke that the Fund was not interested in selling its holdings for less than $0.34 a share. (Tr. 353.)

The Trustees also discussed Margaux's recent operating results. (Tr. 351-52.) The Board focused on earnings for the first three quarters of the year. Margaux reported net income of $557,000 on revenues of $20,984,000 for the three quarters ending September 30, 1992. This compares to a net loss of $378,000 on revenues for $14,894,000 for the same period the previous year. (Div. Ex. 86.) Balancing the favorable and unfavorable news, the Trustees ultimately determined to maintain its valuation of Margaux at $0.344 per share until the impact of the adverse publicity could be evaluated. (Resp. Ex. 52; Tr. 355-56, 526-27.)

h. Changing the Fair Value of the Margaux Holdings

On December 24, 1992, Food Lion issued a press release announcing reductions in its planned expansion. (Resp. Ex. 53; Tr. 358.) When he became aware of the press release after the first of the year, Dodson attempted to contact Margaux's president, Clarke, to determine what impact the announcement would have on Margaux. (Tr. 357-58.) Clarke, however, was on vacation until January 14, 1993, and could not be reached. (Tr. 358.)

On or about January 8, 1993, Dodson became aware of a research memorandum issued by Morgan Stanley, dated January 8, which, in light of the recent adverse publicity and curtailment of expansion plans, downgraded Food Lion shares from buy to a hold. (Resp. Ex. 186.) On January 14, 1993, Dodson reached Clarke and confirmed what was already known, that Food Lion would be scaling back its expansion plans. (Tr. 359.) After speaking to Clarke, Dodson immediately began a new analysis of the factors used to value Margaux. (Tr. 359-60.)

Later that same day, after speaking to Chou and Gibson regarding the recent events, Dodson determined that the Margaux holdings needed to be revalued. (Tr. 360.) The carrying value of the Margaux stock was reduced from $0.344 to $0.20 per share based on Margaux's "prospects for the future." (Resp. Ex. 57.) According to a pricing memorandum to the Margaux file authored by Dodson, the price reduction reflected, among other things, "Food Lion's moratorium on signing leases, diminished sales in Food Lion's Texas supermarkets and unfavorable publicity about Food Lion." (Resp. Ex. 57.) The memorandum stated that Margaux's 1992 earnings could "easily support a stock price of $0.344 a share," but that the prospects for 1994 were less clear due to uncertainty about how many Food Lion stores would open and whether Margaux could make up for lost Food Lion business with other customers. (Resp. Ex. 57; Tr. 359.) At the March 24, 1993 Board meeting, the Trustees, after having been briefed by Dodson on the latest developments regarding Margaux, ratified the January 14, 1993 reduction in Margaux's carrying value to $0.20 per share. (Div. Ex. 98; Tr. 530-31.) The Trustees also reduced the 10% premium on the Note to zero. (Div. Ex. 98; Tr. 360.)

i. Subsequent Developments Regarding Margaux

From January 14, 1993 and until July 12, 1994, the Fund valued its Margaux holdings at $0.20 per share. On July 12, 1994, the Fund further reduced the carrying value of its Margaux holdings to $0.15 per share as a result of Margaux's earnings problems connected to a decline in its Food Lion business and uncertain future prospects. (Tr. 372-73, 533-34.) In the fall of 1994, Margaux reached an agreement to sell its assets. (Resp. Ex. 82; Tr. 96, 375-76, 534.) The sale produced a net price of $0.27 per share. (Tr. 96, 376, 534.)

j. Soft Dollar[21] **Allegations**

Between January 1989 and June 1995, the Fund earned $186,844 in soft dollar credits as a result of directing brokerage commissions to a national wirehouse firm. (Div. Ex. 148; Resp. Ex. 89.) The Fund used a portion these soft dollar credits to purchase products and services for itself. (Div. Ex. 99.) Among the purchases was $104,792 in computers, one-half of which was used for fund

accounting and transfer agent functions - services the Fund was paying Parnassus Investments to perform. (Div. Ex. 50, 148; Resp. Ex. 89.) Parnassus Investments also purchased Advent software and updates, the primary purpose of which is accounting, with $14,629 in soft dollars. (Resp. Ex. 89.) Parnassus Investments failed to disclose in its Forms ADV that it was using the Fund's soft dollar credits to purchase these non- research related products and services. (Div. Exs. 160-72.)

Dodson initially believed using soft dollars to pay for fund accounting and transfer work was proper under the securities laws. (Tr. 297, 384-85.) In December 1993, however, Dodson conceded that the purchases related to transfer agent activities did not fall within the safe harbor of Rule 28(e) of the Securities Exchange Act of 1934 (Exchange Act), but defended the practice because it benefited shareholders by reducing the cost of transfer agent services. (Div. Ex. 93; Resp. Ex. 89.) He continued to maintain that using soft dollar credits for fund accounting activities was entirely proper under Rule 28(e). (Div. Ex. 93; Resp. Ex. 89.) According to Dodson, when Parnassus Investments negotiated with the Board to provide fund accounting and transfer agent services it agreed to charge below market rates to the Fund in exchange for permission to use soft dollar credits to defray the costs of the two services. (Tr. 385-86; Div. Ex. 93; Resp. Exs. 89, 164.) Nevertheless, after receiving a deficiency letter from the Commission in February of 1994, Dodson and Parnassus Investments repaid $66,000 to the Fund. (Tr. 398; Div. Ex. 96.) Dodson voluntarily repaid the money because he did not want his integrity questioned and he thought it was the "the proper thing [to do.]"[22] (Tr. 399.)

IV. Conclusions of Law

a. The Loan to Margaux Violated Sections 13(a)(3) and 21(a)

Section 13(a)(3) of the Investment Company Act protects investors by requiring mutual funds to limit their investment risks to the types disclosed. It provides that "[n]o registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities . . . deviate from any investment policy which is changeable only if authorized by shareholder vote, or deviate from any policy recited in its registration statement pursuant to Section 8(b)(3)." 15 U.S.C. 80a- 13(a)(3).[23] Section 21(a) provides a similar protection by prohibiting registered investment companies from lending money or property if "the investment policies of such registered investment company, as recited in its registration statement and reports filed under this title, do not permit such a loan..." 15 U.S.C. 80a-21(a).

The Fund's statement of additional information, dated May 1, 1988, clearly limited loans to repurchase agreements. Additionally, the Fund's prospectus, dated May 1, 1989, limited the types of "equity securities" in which the Fund could invest to stocks and convertible instruments.

In April 1989, in exchange for a Note and Security Agreement, the Fund lent $100,000 to Margaux and its subsidiary ERS. At the time, neither document contained any provision for conversion into common stock. On October 5, 1989, the bankruptcy court approved Margaux's Reorganization Plan which provided that the Note could be converted into Margaux common stock at a ratio of fifteen shares per $1 of note. Thus, when the Fund lent $100,000 to Margaux and ERS it executed a straight loan, and until the bankruptcy court approved the Reorganization Plan over five months later the Fund was in possession of a straight debt instrument.

When he signed the loan agreement on behalf of Parnassus Investments, Dodson was aware that neither the Note nor the Security Agreement contained a stock conversion feature. On September 17, 1997, pursuant to the Division's Motion for Partial Summary Disposition, I concluded that the Note constituted an unauthorized loan and that the Fund was in violation of Sections 13(a)(3) and 21(a) of the Investment Company Act until the Note became convertible. (PH Tr. 4-5.) The findings and conclusions of the September 17, 1997 prehearing conference that relate to the issue of whether the $100,000 Note represented an unauthorized loan are incorporated by reference herein.

To establish an aiding and abetting violation, the Division need only demonstrate: (i) a primary violation of the securities laws, (ii) the aider or abettor's general awareness or reckless disregard of their participation in an improper transaction, and (iii) the aider and abettor's knowing and substantial assistance of the conduct constituting the securities violation. See, e.g., Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir.), cert. denied, 449 U.S. 919 (1980); IIT v. Cornfield, 619 F.2d 84, 94-97 (5th Cir. 1975).

The ruling on the Division's Motion for Partial Summary Disposition established the primary securities violation of Sections 13(a)(3) and 21(a). With respect to the second element, Parnassus Investments and Dodson were aware of the Fund's prohibitions on loans and knew or recklessly disregarded the fact that until the conversion feature on the Note was approved by the bankruptcy court, the Note represented an unauthorized loan. With respect to the third and final element, I conclude that it was Parnassus Investments and Dodson who knowingly caused the Fund to enter into an unauthorized loan in violation of Sections 13(a)(3) and 21(a) of the Investment Company Act. Thus, it is clear that the elements of aider and abettor liability are satisfied. I conclude, therefore, that Parnassus Investments and Dodson aided and abetted the Fund's violation of Sections 13(a)(3) and 21(a) of the Investment Company Act.

b. The Fund Violated Rule 22c-1 Because Respondents Did Not Use a Current Sale Methodology to Fair Value the Fund's Margaux Holdings

(i) Rule 22c-1's Requirement For Using a Current Net Asset Value

Respondents are charged with willfully aiding and abetting a Rule 22c-1 violation, which allowed the Fund to sell and redeem shares at a price other than the correctly calculated NAV. Section 22(c) of the Investment Company Act empowers the Commission to make rules regarding the prices at which mutual funds may buy and sell redeemable shares. Rule 22c-1(a) mandates that mutual funds use their current NAV in selling and redeeming shares:

No registered investment company issuing any redeemable security, no person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and no principal underwriter of, or dealer in, any such security shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security . . . .

17 C.F.R. 270.22c-1(a) (emphasis added).

To calculate the current net asset value required by Rule 22c-1, mutual funds must follow Rule 2a-4 under the Investment Company Act. Rule 2a-4 sets forth the definition of "current net asset value" and provides that:

The current net asset value of any redeemable security issued by a registered investment company used in computing periodically the current price for the purpose of distribution, redemption, and repurchase means an amount which reflects calculations . . . made in accordance with the following, with estimates used where necessary or appropriate:

(1) Portfolio securities with respect to which quotations are readily available shall be valued at current market value, and other securities and assets shall be valued at fair value as determined in good faith by the board of directors of the registered company . . .

17 C.F.R. 270.2a-4(a)(1) (emphasis added).[24]

(ii) ASR Guidelines

In 1969 and 1970, the Commission, responding to a need to make clear what constituted "fair value... in good faith," published ASRs 113 and 118 (now codified within Section 403 and 404 of

the Codification of Financial Reporting Policies), as a guideline to assist registrants having to deal with good faith valuation questions.

ASR 113 deals with the problem of valuing "restricted securities." ASR 113 describes the valuation problem created by restricted securities:

It is critically important that an investment company properly value its portfolio securities. It is obvious, for example, that any distortion in the valuation of a restricted security held by an investment company will distort the price at which the shares of the investment company are sold or redeemed . . . .

. . . Section 2(a)(41) of the Investment Company Act and Rule 2a-4 thereunder requires that in determining net asset value, "securities for which market quotations are readily available" must be valued at current market value while other securities and assets must be valued at "fair value as determined in good faith by the board of directors."

Readily available market quotations refers to reports of current quotations for securities similar in all respects to the securities in question. No such current public quotations can exist in the case of restricted securities. For valuation purposes, therefore, restricted securities constitute securities for which market quotations are not readily available. Accordingly, their fair market values must be determined in good faith by the board of directors and this obligation necessarily continues throughout the period these securities are retained in the company's portfolio.

> Accounting Series Release No. 113, Investment Company Act Release No. 5847, SEC Accounting Rules (CCH) 3758-61, at 3682-86 (Oct. 21, 1969).

ASR 113 also describes the accounting treatment to be afforded to restricted securities:

Restricted securities are often purchased at a discount, frequently substantial, from the market price of outstanding unrestricted securities of the same class. This reflects the fact that securities which cannot be readily sold in the public market place are less valuable than securities which can be sold, and also the fact that, by the direct sale of restricted securities, sellers can avoid the expense, time and public disclosure which registration entails. As a general principle, the current fair value of restricted securities would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale. This depends on their inherent worth, without regard to the restrictive feature. Consequently, the valuation of restricted securities at the market quotations for unrestricted securities of the same class would, except for the most unusual circumstances, be improper.

Id. (emphasis added). In the past, the Commission has interpreted ASR 113 as requiring a meaningful discount from the current price of the unrestricted shares that have an active trading market. See, e.g., Robert F. Lynch, 46 S.E.C. 5 (1975) (finding violation of anti-fraud provisions based upon investment adviser's valuation of restricted securities at the active trading price of unrestricted shares).

Fourteen months after ASR 113, the Commission again addressed what constituted "fair value . . . in good faith." ASR 118 sets forth standards for valuing securities and requires mutual funds to disclose any practice that differs from ASR 118's standards:

In some circumstances value can be determined fairly in more than one way. Hence, the standards set forth below should be considered guidelines, one or more of which may be appropriate in circumstances of a particular case. These standards should be followed, and a company's stated valuation policies should be consistent with them. Any variation from the standards should be disclosed in the financial statements or notes thereto even though the variation is in accordance with the company's stated valuation policy. In addition, any deviation from a stated valuation

policy, whether or not in conformity with the standards, should be disclosed in the financial statements or notes thereto.

Accounting Series Release No. 118, Investment Company Act Release No. 6295, SEC Accounting Rules (CCH) 3750-57, at 3678-82 (Dec. 23, 1970).

ASR 118 follows ASR 113's lead in using a current sale principle to derive a current fair value:

No single standard for determining "fair value . . . in good faith" can be laid down, since fair value depends upon the circumstances of each individual case. As a general principle, the current "fair value" of an issue of securities being valued by the board of directors would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale.

Id. (emphasis added). Methods which are in accord with the current sale principle are multiples of earnings or a discount from market of a similar freely traded security or a combination of these methods. Id. Factors that directors should consider in a good faith valuation include:

1) the fundamental analytical data relating to the investment, 2) the nature and duration of restrictions on disposition of the securities, and 3) an evaluation of the forces which influence the market in which these securities are purchased and sold. Among the more specific factors which are to be considered are: type of security, financial statements, cost at date of purchase, size of holding, discount from market value of unrestricted securities of the same class at time of purchase, special reports prepared by analysts, information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting securities, price and extent of public trading in similar securities of the issuer or comparable companies, and other relevant matters.

Id. ASR 118 also states that directors should take into account all indications of value available to them in determining fair value and that the information and judgment factors considered should be documented in the directors' meeting minutes. Id.

(iii) Good Faith and Current Sale Analysis

Good faith is the touchstone of the valuation process when determining the "fair value" of thinly traded, unlisted securities. To prevail on the charge that Rule 22c-1 under the Investment Company Act was violated because Respondents failed to properly fair value the Fund's Margaux holdings, the Division must, among other things, demonstrate that Respondents failed to act in good faith. For the reasons set forth below, I conclude that Respondent Dodson, Chou, and Gibson did not fair value the Fund's Margaux holdings in good faith within the meaning of ASRs 113 and 118.

The "current sale" principle set forth in ASRs 113 and 118 is the standard to measure Respondents exercise of good faith in their decisions associated with the attempts to fair value the Margaux holdings.

The American Institute of Certified Public Accountants (AICPA) defines current sale as an "orderly disposition over a reasonable period of time." AICPA, Audit and Accounting Guide, Audits of Investment Companies 2.32, at 26 (3d ed. 1987). Respondents argue that "orderly disposition" requires a reasonable market in which there are competing buyers and sellers and that the Commission never intended securities whose prices are not readily available to be priced on a basis resembling a "fire sale." Obviously, Respondents are correct in that fire sale pricing was never the intention of the Commission. However, while it is clear that the current sale principle recognizes a reasonable time frame in which to arrange sales, it does not ignore the fact that a security may suffer from a thin market or other unenviable variables. Regarding the definition of current sale and orderly disposition as applied to this proceeding, I find the testimony of the Division's expert, John M. Lacey, persuasive: "[Current sale] is the price that a reasonable buyer would be willing to

pay for the stock of Margaux and the loan to Margaux, given the existing thin market for the stock and existing low-interest-rate loan and its convertibility into restricted stock which is thinly traded." (Rebuttal Report of John M. Lacey, Division's Expert, at 5.)

(a) ASR 113: Valuing the Restricted Margaux Shares

The Division contends that had the Fund chosen to convert the Note into 1.5 million shares of restricted Margaux stock or if the Fund had been correct in its decision to value the Note as converted, ASR 113 guidelines would have applied. Thus, the Division argues that the 1.5 million restricted shares into which the Note was convertible had to be discounted to derive a current sale price. Respondents, on the other hand, contend that ASR 113 does not apply because it does not deal with the pricing of securities which, like Margaux, have no market. While ASR 113 does warn that "the valuation of restricted securities at the market quotations for unrestricted securities of the same class would, except for the most unusual situations, be improper," nowhere does it specifically exclude from its guidelines securities that have no active trading market.

During the relevant period, there is no evidence that establishes that Respondents ever discussed any unusual situation that would justify valuing the restricted securities at the same price as the unrestricted securities or that they considered discounting the restricted shares in accordance with ASR 113. Respondents counter that there was no reason to value the restricted shares differently from the unrestricted shares since both could only be sold in connection with a change in control of the company. Respondents' argument ignores the fact that the Fund did not own Margaux or even come close to a controlling interest therein. The Fund did not have the power to sell or force a sale of Margaux. Consequently, the Note and the 565,000 Margaux common shares were distinct investment vehicles. As such, Respondents were required to consider, for each investment, in good faith, the guidelines and factors listed in ASRs 113 and 118. Respondents, however, failed to do so. The Board's decisions to value the restricted securities at the same price as the unrestricted securities were little more than rubber stamp approvals of Dodson's recommended valuations. The justifications for the valuation of the Note are inadequate and evident nowhere in the contemporaneous record of the relevant period. I conclude Respondents failed to consider the standards imposed by ASR 113, and thus did not fair value the Note in good faith.

From January 9, 1990 until Margaux was delisted in August 1990, the Note was valued as if converted and the share price for the restricted shares was the same as the unrestricted shares listed on the NASDAQ, subject to a $0.50 per share price cap.[25] For the year ending December 31, 1990, the Fund's 1990 Annual Report shows the Note as being worth $562,500. Respondents' decision to value the Note as if converted rather than at face value, thus, produced an unrealized gain for the year of $462,500.[26] Respondents insist there was no need to discount the price of the restricted shares. The Division, on the other hand, contends that the Respondents should have discounted the price of the restricted shares. I credit the Division's contention and conclude that the failure to discount the restricted shares caused the Fund to overstate its NAV. The Division's expert, Glenn R. Daniel, suggests that a reasonable discount for the restricted shares realized upon conversion of the Note would have been 50%. (Report of Glenn R. Daniel (Daniel Report), Division's Expert, at 12.) I conclude that a discount of this magnitude is appropriate because it reflects the thin market for the stock and the significant liquidity constraints imposed by the restricted feature.

After applying the 50% discount, and assuming arguendo that Respondents correctly fair valued the unrestricted Margaux shares at $0.344 per share, the current selling price for the restricted shares would be $0.172 per share. To derive a per share NAV impact from the failure to discount the restricted shares, the number of Fund shares outstanding at the end of each quarter is divided into the total NAV impact of $258,000 ($562,500 Note valuation minus $46,500 premium minus 50% discount). The calculations reveal that, over the course of the relevant period, the NAV impact of a 50% discount ranged from a high of $0.20 per share on December 31, 1990 to $0.14 per share on December 31, 1992.[27] Respondents' failure to apply a restricted share discount on the 1.5 million shares resulted in overstatement of the NAV and thereby violated Rule 22c-1 by

allowing transactions in Fund shares at prices that were not based on the Fund's current NAV.[28] Further, Respondents' actions and decisions while serving as Trustees to the Fund caused the violation. Finally, Respondents failure to apply a restricted share discount demonstrated a reckless disregard for the proper computation of NAV. Having found all three elements satisfied, I conclude that Respondents Parnassus Investments, Dodson, Chou, and Gibson aided and abetted the Fund's violation of Rule 22c-1. See, e.g., Investors Research Corp., 628 F.2d at 178.

(b) The 10% Premium

Respondents argue that adding a 10% premium to the price of the $100,000 Note and the shares into which it could be converted was based on common and acceptable business practices. Respondents contend that "[s]uch a premium reflects the fact that a convertible feature provides an investment with all of the potential for gain from an equity risk, but with the additional safety of a debt investment." (Report of Clarence Sampson (Sampson Report), Respondents' Expert, at 13.)

Several factors, however, indicate that adding a premium to the Note was improper. First, Respondents testified that their valuations of Margaux were explicitly tied to the sale of Margaux as a "going concern." Ignoring for the moment Respondents' awareness of the decided lack of interest in Margaux, the fact still remains that upon the company's sale the 12% coupon, part of the alleged basis for the premium, would become worthless because all interest payments would cease.[29] Second, when converted the 10% premium added $46,500 to the Note's value (1.5 million restricted shares x $0.031 per share). Such a large premium represented nearly fifty percent of the $100,000 protected by the Note. The record, however, indicates that the Trustees gave little, if any, serious consideration to the issue of the premium. The Trustees minutes, annual reports, and pricing memoranda are silent on whether a premium should have been added to the Note's conversion value and on the appropriate amount of such a premium. I conclude, therefore, that Respondents' attribution of the 10% premium violated ASR 118's requirements that "all indications of value" be considered and "judgment factors considered by the board" be documented in the board's minutes to justify a fair valuation analysis.

To determine the impact of the premium on per share NAV, the $46,500 is divided by the number of Fund shares outstanding at the end of each quarter to calculate the per share NAV adjustment. The calculations reveal that, over the course of the relevant period, the NAV impact of the premium overstatement ranged from a high of $0.04 per share on December 31, 1990 to a low of $0.02 per share on December 31, 1992. Because a Rule 22c- 1 violation occurs when NAV is misstated, I conclude that the Fund's overstatement of NAV by applying an improper 10% premium constituted a violation of that rule. Additionally, I conclude that the Fund's overstatement of NAV was caused by Respondents and demonstrated a reckless disregard for the proper computation of NAV. I conclude, therefore, that Respondents Parnassus Investments, Dodson, Chou, and Gibson aided and abetted the Fund's violation of Rule 22c-1.

(c) ASR 118: Valuing the Unrestricted Margaux Shares

ASR 118 recognizes that value can be fairly determined in a variety of ways. Yet, ASR 118, similar to ASR 113, requires the use of an estimated "current sale" price in fair valuing securities for which market quotations are not available. The Division alleges that Respondents violated the current sale principle by employing a valuation methodology based on what it terms the "long-term sale of the company approach." According to the Division, Respondents disregarded current conditions and improperly valued what the Fund did not own at the time - i.e., Margaux, the company - and never fair valued what the Fund did own - i.e., the $100,000 Note and 565,000 unrestricted common shares. Respondents counter that their valuation methodology was based on "the notion of a sale at a fair price, within a reasonable time frame, assuming the existence of a reasonable market in which there are both buyers and sellers." Sampson Report, at 8.

Respondents' valuation methodology clearly accorded great weight to certain intangibles possessed by Margaux. Several times during their testimony Respondents referred to Margaux's management,

innovative technology, and relationship with its principle customer as the basis for its valuation methodology. ASR 118, however, requires directors to take into account all indications of value available to them in determining fair value. To aid directors, ASR 118 sets forth a list of specific and general factors which should be considered when determining the fair value of an unlisted security. See Part IV.b.(ii), supra. ASR 118 also instructs directors to document in the minutes of the directors' meeting information and judgment factors considered in the valuation process. Failure to follow the guidelines imposed by ASR 118 when fair valuing unlisted securities raises the question of whether a director has acted in "good faith."

For reasons discussed below, I conclude that Respondents ignored or failed to give adequate consideration to a number of the general and specific factors set forth in ASR 118. First, Respondents failed to carefully consider or document the implications of Margaux's NASDAQ delisting on the value of its stock.[30] Unquestionably, the delisting reduced the liquidity of the outstanding shares and reflected that Margaux was experiencing significant financial troubles. The record, however, fails to show any discussion of the delisting and an illiquidity discount in accordance with consideration of ASR 118's general factors of "the nature and duration of restrictions on disposition of the securities" or "an evaluation of the forces which influence the market in which these are purchased and sold."

Second, Respondents' failed to give meaningful attention to the general factor of Margaux's "fundamental analytical data relating to the investment" or to the specific factor of Margaux's "financial statements," as required by ASR 118. Respondents had access to and discussed Margaux's financial statements and management's income projections. Nevertheless, despite years of continuing losses and the company's consistent failure to meet management's income projections, Respondents refused to adjust the valuation of the Fund's Margaux holdings.[31] Dodson indicated that the Trustees tended to discount management's income projections and the numerous instances when Margaux failed to meet them. Moreover, while acknowledging the significance of earnings, Dodson commented that current earnings were not necessarily "key things." (Tr. 292.) Dodson's comments are indicative of Respondents' general failure to accord meaningful and necessary attention to Margaux's fundamental analytical data and financial statements.

Third, Respondents gave little, if any, consideration to the transactions and bid and asked prices on the "pink sheets." Following the delisting, Respondents took the view that the pink sheet transactions "[did] not constitute a true measure of value." (Div. Ex. 64 at 6.) Respondents' expert, Mr. Sampson, stated that quotations in the pink sheets do not adequately establish fair value because the transactions are too sporadic and generally involve only a small amount of shares. Additionally, Mr. Sampson contends that the pink sheet prices are "often impacted by factors other than the pure desire to complete an exchange at fair value - such as uninformed risk-taking by a buyer, an emergency need for cash by the seller, or a desire to reinvest in another security which (to the seller) has a better potential." Sampson Report at 4-5.

Admittedly, pink sheet prices are not the definitive amounts to be used when establishing the fair value of thinly traded, unlisted securities. Nonetheless, pink sheet transactions cannot be summarily dismissed or ignored altogether. ASR 118 expressly requires consideration of the general factor of market influences and the specific factor of "information as to any transactions or offers with respect to the security." Clearly, the pink sheet transactions represent market transactions for Margaux shares in the market that existed for them at that time. Moreover, as pointed out by the Division's expert, Mr. Lacey, the factors that motivate pink sheet transactions are exactly the same factors that may motivate trades on recognized exchanges and in NASDAQ trading. (Rebuttal Report of John M. Lacey, Division's Expert, at 4.) The record contains no evidence that Respondents ever attempted any analyses to test the reliability of the pink sheet prices to confirm Dodson's belief that they did not represent Margaux's true value. On the other hand, the Division presents persuasive evidence that the prices on the pink sheet bore a rational relation to Margaux's quarterly financial results. (Daniel Report at 12-13, 51-53; Daniel Rebuttal Report at 1, 13- 15.)

Fourth, for the majority of the relevant period, Respondents ignored ASR 118's specific factor of "existence of merger proposals." This is important because Respondents' valuation methodology anticipated a future sale of Margaux. Yet, from December of 1990 until at least the fall of 1992 Respondents ignored the decided lack of interest in Margaux among outside suitors.[32] Respondents' decision to ignore the fact that Margaux was not in demand as an investment opportunity is at odds with its decision to use a "sale of the company" valuation.

In short, when valuing the Fund's Margaux holdings, Respondents ignored or failed to give adequate consideration to numerous general and specific factors set forth by ASR 118. I conclude that Respondents valued the Margaux holdings not according to what the Fund could receive under current, albeit unfavorable, conditions, but according to what the Fund might receive if the so-called "true" value were realized upon sale of the entire company or a controlling portion therein.

The Fund carried the 565,000 unrestricted Margaux shares on its balance sheet at $194,219. (Div. Ex. 130 at 12.) In light of Margaux's precarious financial condition, the Division's expert, Mr. Daniel, suggests an illiquidity discount of 25%, which would reduce the Fund's total NAV by $48,554.75. (Daniel Report at 12.) Respondents are critical of the Division's suggested illiquidity discount and contend that no such discount is warranted. Upon detailed review of the expert testimony, I credit the opinion of Mr. Daniel. To determine the per share NAV impact of the 25% discount, $48,554.75 is divided by the outstanding Fund shares. Calculations reveal that the per share NAV impact of the discount ranged from a high of $0.04 per share on December 31, 1990 to a low of $0.03 per share on December 31, 1992. Because a Rule 22c-1 violation occurs when NAV is misstated, I conclude that the Fund's overstatement of NAV by not applying an illiquidity discount to the 565,000 unrestricted shares constituted a violation of that rule. Additionally, I conclude that the Fund's overstatement of NAV was caused was by Respondents and, similar to the failure to impose a restricted share discount and the improper premium, demonstrated a reckless disregard for the proper computation of NAV. Therefore, I conclude that Respondents Parnassus Investments, Dodson, Chou, and Gibson aided and abetted the Fund's violation of Rule 22c-1.

c. Parnassus Investments and Dodson Caused Soft Dollar Violations

The Division charges that Parnassus Investments and Dodson violated Section 207 of the Advisers Act and that Parnassus Investments, aided and abetted by Dodson, violated of Section 17(e) Investment Company Act by acquiring, in return for Fund brokerage commissions (i.e., soft dollars), computer hardware that was used to provide accounting and transfer agent services to the Fund.

An investment adviser has a duty to disclose to clients all material information which might incline an investment adviser consciously or unconsciously to render advice which is not disinterested. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963). A fact is material if there is a substantial likelihood that a reasonable investor would consider it important. Basic, Inc. v. Levinson, 485 U.S. 224, 231-232 (1988). Soft dollar arrangements are material because of the potential conflict of interest arising from an adviser's receipt of some benefit in exchange for directing brokerage on behalf of client accounts. See Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 909 (Dec. 23, 1993); Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 23170, 35 SEC Docket 905, 909 (Apr. 23, 1986) (hereinafter "1986 Soft Dollar Release"). Moreover, disclosure of soft dollar arrangements is specifically required by Form ADV. See S Squared Technology Corp., 62 SEC Docket 1560, 1564 (Aug. 7, 1996). Form ADV embodies mandatory disclosure requirements to ensure that material information regarding brokerage placement practices and policies is disclosed to investors. See Investment Adviser Requirements Concerning Disclosure. Recordkeeping, Applications for Registration and Annual Filings, Advisers Act Release No. 664, 16 SEC Docket 901 (Jan. 30, 1979); Disclosure of Brokerage Placement Practices By Certain Regulated Investment Companies and Certain Other Issuers, Advisers Act Release No. 665, 16 SEC Docket 837 (Jan. 30, 1979).

As relevant here, Section 17(e)(1) of the Investment Company Act makes it unlawful for an affiliated person of a registered investment company, when acting as an agent for the investment company, to receive any compensation (other than salary or wages) for the purchase or sale of any property to or for the registered investment company. 15 U.S.C. 80a-17(e)(1). Section 207 of the Advisers Act provides that it shall be unlawful for any person to willfully make any untrue statement of material fact in any registration, application, or report filed with the Commission, or to willfully omit to state in any such application or report any material fact required to be stated therein.[33] 15 U.S.C. 80b-7. A person violates Section 207 by filing false amendments to Form ADV or false Forms ADV S. Stanley Peter Kerry, 61 SEC Docket 431 (Jan. 25, 1996). Violations of Section 207 do not require a showing of scienter. S Squared Technology Corp., 62 SEC Docket at 1566-67 (citing Kingsley, Jennison, McNulty & Morse, 50 SEC Docket 383, 415 (Nov. 14, 1991), aff'd, 51 S.E.C. 904 (Dec. 23, 1993)).

(i) Parnassus Investments and Dodson's Actions Fall Outside of Section 28(e)'s Safe Harbor

Section 28(e) of the Exchange Act establishes a "safe harbor" for persons who exercise investment discretion over beneficiaries' or clients' accounts to pay for research and brokerage services with commission dollars generated by account transactions. 15 U.S.C. 78bb(e). The statutory safe harbor was adopted in 1975, when Congress unfixed commission rates. Section 28(e) was intended to allay the concerns of investment advisers and full-service brokers that an environment of fully negotiated commissions would prohibit the payment of anything other than the lowest possible commission rate.[34]

Subparagraph (3) of Section 28(e) defines the brokerage and research services that are protected. The statute states that a person provides brokerage and research services insofar as he:

(A) furnishes advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities;

(B) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or

(C) effects securities transactions and performs functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.

Of the $104,792 in soft dollar credits used to purchase computers, one-half was used for brokerage or research-related functions. The other one-half, however, was used for fund accounting and transfer agent functions - services the Fund was paying Parnassus Investments to perform. Parnassus Investments also purchased fund accounting software with $14,629 in soft dollars. Together, these uses of Fund generated soft dollars totaled approximately $67,000.

The touchstone for determining when a service is within the definition of Section 28(e)(3) is whether it provides lawful and appropriate assistance to the money manager in the performance of his investment decision-making responsibilities. 1986 Soft Dollar Release, 35 SEC Docket at 907 (emphasis added). This determination pivots on whether the disputed product or service aids the money manager in his investment decision making process versus operating the Fund. The accounting and transfer agent services at issue did not assist Parnassus Investments or Dodson in the performance of their investment-making responsibilities, but rather aided in the administrative functions and operations of the Fund.[35] I conclude, therefore, that the services at issue do not fall within the definition of "research services" and are not covered by the safe harbor provisions set forth in Section 28(e).

(ii) Parnassus Investments and Dodson violated Section 17(e)(1)

Dodson contends that soft dollar arrangements outside Section 28(e)'s safe harbor do not automatically constitute a breach of fiduciary duty. (Respondents Post Hearing Brief at 81 (citing Kingsley, Jennison, McNulty & Morse, Inc., 50 SEC Docket at 405)). He maintains that neither he nor Parnassus Investments realized any benefit from using the disputed computer hardware that performed the transfer agent and fund accounting services. He stresses that the Fund's soft dollar arrangement was fully disclosed to the Trustees and that they agreed to the arrangement in order to avoid an increase in Fund transfer agent and accounting fees. Absent a benefit to Parnassus Investments or himself, Dodson argues that the use of brokerage commissions in this case did not constitute "compensation" within the meaning of Section 17(e).

The essence of a violation of Section 17(e)(1) is the mere receipt of compensation in connection with the purchase or sale of property to or from the investment company. United States v. Deutsch, 451 F.2d 98, 109 (2d Cir. 1971), cert. denied, 404 U.S. 1019 (1972). It is not necessary to show that a person was actually influenced by receipt of the compensation, that the receipt of the compensation caused economic injury to the investment company, or that the violator acted with scienter. Id.; Investors Research Corp., 46 S.E.C. 1209 (1978), aff'd in part and vacated in part, 628 F.2d 168 (D.C. Cir. 1980); cert. denied, 449 U.S. 919 (1981). Additionally, the fact that "a soft dollar arrangement outside of Section 28(e) is disclosed would not cure a violation of Section 17(e)(1) because that provision reflects the Congressional determination that disclosure alone is not adequate protection in the investment company field." 1986 Soft Dollar Release, 35 SEC Docket at 911. Finally, and most important, the term "compensation" under Section 36(b) and other provisions of the Investment Company Act has been broadly construed to include any economic benefit paid directly or indirectly to an adviser. Id. at 907 n.46; Steadman Securities Corp., 46 S.E.C. 896, 910 (1977) rev'd on other grounds, 603 F.2d 1126 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981).

The soft dollar arrangement created a potential conflict of interest and may well have affected Parnassus Investments' ability to choose the Fund's broker-dealer with the complete objectivity that Section 17(e)(1) demands. The use of Fund brokerage to obtain below market transfer agent and accounting products and services may have benefited the Fund, but, nonetheless, also constituted a form of "compensation" proscribed by Section 17(e). Therefore, I conclude that Parnassus Investments violated Section 17(e)(1) and that Dodson caused and aided and abetted Parnassus Investment's violation of such.

(iii) Parnassus Investments and Dodson violated Section 207

The Division also alleges that Parnassus Investments and Dodson were required, but failed, to disclose in its Forms ADV that it received non-research related products and services from brokers in exchange for soft dollar credits earned by the Fund. Items 12 and 13 of Part II of the Form ADV require registrants to disclose soft dollar arrangements with broker-dealers. For investment advisers who have discretionary authority to select the broker- dealers to be used to execute trades in client accounts, Item 12.B. requires a description of the factors considered in selecting the brokers and determining the reasonableness of their commissions. Also, Item 12.B. requires advisers to describe the "products, research and services" received from brokers, if the value of the products, research and services are a factor in selecting the broker. See 1986 Soft Dollar Release, 35 SEC Docket at 909.

Parnassus Investment's answer in its Form ADV in effect in June 1992 stated that, normally, broker-dealers were chosen on the basis of "best execution." The Form ADV, however, also stated that Parnassus Investments was:

authorized to consider whether [the] broker provides research services and commissions paid to such brokers may be higher than another broker would have charged. Registrant will use judgment

in determining that the amount of commissions paid is reasonable in relation to the value of the brokerage and research services provided and need not place a dollar value on such services.

Thus, I find that Parnassus adequately described the factors considered in selecting brokers and determining the reasonableness of the commissions.

Parnassus Investments, however, also had a duty to describe any "products, research, and services" that were received from brokers, if the value of the benefits were a factor in its selection of a broker-dealer.[36] At the hearing, Dodson testified that Parnassus Investments chose broker-dealers solely on the basis of best execution. I am not persuaded, however, that Parnassus Investments would grant itself the power to "consider . . . research services," and then not consider those research services as a factor in selecting its broker-dealers. I conclude that Parnassus Investments has not overcome the presumption that receipt of non-research and non-brokerage products or services, except where nominally valued, is a factor in the selection of brokers. Thus, although the June 1992 Form ADV disclosed Parnassus Investment's consideration of soft dollar arrangements, it was deficient in that it did not adequately describe the products, research and services received from broker-dealers.

Item 13.A. of part II of the Form ADV requires that an investment adviser disclose and describe any arrangement whereby it is paid in cash by or receives some economic benefit, including non-research services, from a non-client in connection with giving advice to clients. These disclosure requirements are designed to "assist clients in determining whether to hire an adviser or continue a contract with an adviser, and permit them to evaluate any conflicts of interest inherent in the adviser's arrangements for allocating brokerage." Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. at 909. Parnassus Investment's "no" answer in its Form ADV in effect in June 1992 was false. Parnassus Investments was in fact receiving economic benefit from a broker- dealer, a non-client, in the form of soft dollar credits.

I conclude that Parnassus Investments and Dodson willfully violated Section 207[37] in that they willfully made untrue statements of material fact in Parnassus Investments Form ADV and failed to disclose the existence of a soft dollar arrangement and the products, research, and services received from that arrangement.

IV. Sanctions

The Division asks for cease and desist orders against each of the Respondents and civil monetary penalties

The starting point for assessing what sanction is appropriate in the public interest requires consideration of many factors, including deterrence and:

[t]he 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 his occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)), aff'd on other grounds, 450 U.S. 91 (1981). The Court of Appeals for the District of Columbia explained that "[t]he `public interest' standard is obviously very broad, requiring that the Commission consider a full range of factors bearing on the judgment about sanctions that the expert agency ultimately must render." Blinder, Robinson & Co. v. SEC, 837 F.2d 1099, 1110 (D.C. Cir. 1988). The severity of sanctions depends on the facts of each case and the value of the sanction in preventing a recurrence of the violative conduct. Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Leo Glassman, 46 S.E.C. 209, 211 (1975); Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976). Sanctions should demonstrate to the particular respondent, the

industry, and the public generally that egregious conduct will merit a harsh response. Arthur Lipper Corp. v. SEC, 547 F.2d 171, 184 (2d Cir. 1976).

a. Cease and Desist Proceedings

Sections 203(k) of the Advisers Act and 9(f) of the Investment Company Act authorize the Commission to issue a cease and desist order if it finds that any person "is violating, has violated, or is about to violate any rule or regulation." The Commission may enter a cease and desist order against "such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation."

As concluded above, Parnassus Investments and Dodson caused and aided and abetted the Fund's violation of Sections 13(a)(3) and 21(a) of the Investment Company Act. Also, Parnassus Investments, Dodson, Gibson, and Chou caused and aided and abetted the Fund's violation of Rule 22c-1 of the Investment Company Act, and Parnassus Investments and Dodson committed violations relating to Parnassus Investment's use of soft dollar credits. Accordingly, it is appropriate to order Respondents to cease and desist from committing or causing any violations or future violations.[38]

b. Civil Money Penalty

Sections 203(i) of the Advisers Act and 9(d) of the Investment Company Act authorize the Commission to assess civil money penalties against any person who has willfully aided, abetted, counseled, commanded, induced, or procured a violation of any provision of the Exchange Act, the Investment Company Act, or the Advisers Act.

The assessment of a penalty depends on a finding that such an assessment is in the public interest. The factors that may be considered in determining the penalty amount are: (1) whether the act or omission for which the penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other person(s) resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether the respondent previously has been found by the Commission, another regulatory agency or a self-regulatory organization to have violated federal or state securities laws or the rules of a self-regulatory organization or has been enjoined or convicted by a court of competent jurisdiction of violations of such laws or rules; (5) the need to deter respondent and others from committing such acts or omissions; and (6) such other matters as justice may require. New Allied Development Corp., 63 SEC Docket 807, 821 n.33 (Nov. 26, 1996); First Securities Transfer System, Inc., 60 SEC Docket 441, 446 (Sept. 1, 1995).

Respondents' actions did not involve fraud, but rather violations of technical provisions of the securities laws. Respondents' actions resulted in minimal harm to others and afforded them no unjust enrichment. Furthermore, prior to this proceeding, Respondents had never been the subject of an enforcement proceeding. Finally, I find the need for civil penalties to serve as a deterrent against future violation is wholly unnecessary.

Therefore, I conclude that a civil penalties are not appropriate in this case.

V. Record Certification

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. 201.351(b) (1997), I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on July 30, 1998.

ORDER

IT IS ORDERED that, pursuant to Section 203(k) of the Investment Advisers Act of 1940 and Section 9(f) of the Investment Company Act of 1940, Parnassus Investments and Jerome L. Dodson cease and desist from committing or causing any violations or future violations of Sections 13(a)(3), 21(a), and 17(e)(1) of the Investment Company Act of 1940 and Section 207 of the Investment Advisers Act of 1940.

IT IS FURTHER ORDERED that, pursuant to Section 203(k) of the Investment Advisers Act of 1940 and Section 9(f) of the Investment Company Act of 1940, that Parnassus Investments, Jerome L. Dodson, David L. Gibson, and Marilyn M. Chou cease and desist from committing or causing any violations or future violations of Rule 22c-1 promulgated under Section 22(c) of the Investment Company Act of 1940.

This order shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. 201.360 (1997). Pursuant to that rule, a petition for review of this initial decision may be filed within twenty-one days after service of the decision. It shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 360(d)(1) within twenty-one days after service of the initial decision upon him, unless the Commission, pursuant to Rule 360(b)(1), determines on its own initiative to review this initial decision as to any party. If a party timely files a petition for review, or the Commission acts to review as to a party, the initial decision shall not become final as to that party.

Robert G. Mahony
Administrative Law Judge

FOOTNOTES

[1]: Respondents Dodson, Chou, and Gibson served as the Parnassus Fund's Board of Trustees.

[2]: Citations to exhibits offered by the Division and the Respondent will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively. "Tr. __" refers to the transcript of the hearing and "PH Tr. __" refers to the transcript of the prehearing held on September 17, 1997.

[3]: Prior to this action, none of the Respondents had been the subject of an enforcement action.

[4]: The Fund's total NAV is calculated by taking the value of the Fund's investments and then deducting any liabilities. (Div. Ex. 112 at 12.)

[5]: The Reorganization Plan also extended the Note's maturity from April 1990 to April 30, 1991, and subordinated the Note to Margaux's primary and secured revolving line of credit. (Div. Ex. 22.)

[6]: At this time, Margaux was paying other commercial lenders a large premium over the 12% it agreed to pay the Fund. Margaux reported in its December 31, 1991 Form 10-K that it was paying a weighted average interest of 27.5% for short-term borrowing. (Div. Ex. 13.)

[7]: The Note's convertibility, if exercised, would entail a minimum two-year holding period from the date of conversion before the shares could be freely traded, and only then in quarterly amounts limited by the greater of trailing 90 day volume or 1% of shares outstanding. Were the Fund to be deemed an affiliate of Margaux, the minimum timeframe over which the 1.5 million restricted common shares could be sold would be twelve quarters, or three years from the end of the initial two-year holding period from the date of the Note's conversion. (Report of Robert Conner, Division's Expert, at 5.)

[8]: One day prior to it becoming convertible, the Trustees chose to continue valuing the Note at face value, citing a "thin" trading market. The Fund's minutes, dated October 4, 1989, read:

RESOLVED, that the secured debt of Margaux, Incorporated in the principal amount of $100,000 currently owned by the Fund shall continue to be valued by the Fund at $100,000, notwithstanding the fact that such debt may shortly become convertible into common stock at a significantly lower price, because the thin market for Margaux Incorporated common stock does not produce a reliable value for that security . . . .(Div. Ex. 50 at 2-3.)

[9]: Dodson recommended and the Trustees adopted a $0.50 per share price cap on the conversion price. (Res. Ex. 7; Tr. 261- 62.)

[10]: Margaux was delisted when its shareholder equity dropped below the required minimum threshold of $375,000. (Tr. 275-76.)

[11]: During the relevant period, Margaux's stock traded at prices ranging from a low of $0.01 per share to a high of $0.15 per share. (Div. Exs. 9, 13, 17, 18.)

[12]: Under cross examination, Mr. Marco Vanderlaan, the audit manager of the Fund from Deloitte & Touche, clarified that any reports to the Trustees did not reflect upon whether the Trustees were in compliance with the guidelines imposed by ASR 118. (emphasis added) (Tr. 648.)

[13]: Margaux had originally forecast 1991 net income at $1 million after deducting interest expenses. (Div. Ex. 64.) Soon thereafter, that number was revised downward but was still forecast to be $505,000. (Div. Ex. 68.)

[14]: Supra, note 13.

[15]: Supra, note 13.

[16]: The source for the improved financial forecast was Margaux's management.

[17]: At the time of the meeting, Dodson and the Trustees were aware of Margaux's operating results for 1991, despite the fact that Margaux's Form 10-K was not filed until March 31, 1992. (Tr. 347-50.)

[18]: As previously noted, at the December 1990 Board meeting, Dodson told the Trustees that Margaux expected $21 million in revenues in 1991, with a net income of $1 million (later revised downward to $505,000) after deducting interest expenses. (Div. Ex. 64.)

[19]: For the same six month period the previous year, Margaux had reported a net loss before taxes of $29,000. (Div. Ex. 84.)

[20]: If earnings for the full six month period are annualized, that figure that drops to $0.06 per share. (Div. Ex. 84.)

[21]: Soft dollars can be described as follows:

When investment managers buy or sell stock, the price of executing the transaction includes price paid or received for the stock and the brokerage commission. The brokerage commission includes: actual costs of the trading function; principally executing the trade; clearing; settling; custody; and the brokerage firm's profit. The brokerage firm may give up part of their profit to provide credits for investment managers or consultants who use these credits to pay for research and/or other costs associated with the investment process. The commission dollars that a brokerage firm relinquishes in this manner are termed "soft dollars." Mari-Anne Pisarri, Soft Dollars and Directed Brokerage, SC49 ALI- ABA 185, 211 (1998).

[22]: Additionally, in early 1994, the Fund amended its Statement of Additional Information to explicitly state:

[T]he Advisor may use brokerage commissions to acquire computer software and hardware (including peripherals) for use with the Fund's transfer agent and fund accounting work if such use benefits fund shareholders by reducing expenses. (Div. Ex. 99.)

[23]: Section 8(b)(3) of the Investment Company Act refers to policies that are designated as "fundamental."

[24]: Rule 2a-4 essentially adopts the definition of "value" set forth in Section 2(a)(41)(B) of the Investment Company Act. 15 U.S.C. 80-2(a)(41)(B)(i), (ii).

[25]: Although the Fund's pricing of the Note during this period seems to mirror the type of conduct criticized by ASR 113, it occurred outside of the relevant period set forth in the OIP and will not be addressed.

[26]: Of that amount, $46,500 was attributable to the 10% premium, while $416,000 was attributable to valuing the 1.5 million restricted shares of Margaux common stock as converted at $0.344 per share.

[27]: Throughout this opinion NAV impact per share has been rounded to the nearest penny.

[28]: Respondents argue that even if one were to disregard the Trustees' valuations and to accept the Division's valuation of the Margaux common stock and the Note, the impact on the Fund's NAV would be immaterial on the basis of the total return, the standard measure of mutual fund performance. In support of their position, Respondents cite language from Rule 22c-1(b) and SEC v. Steadman, 967 F.2d 636 (D.C. Cir. 1992). Rule 22c-1(b) requires investment companies to compute NAV at least once daily. The rule, however, sets forth three exceptions. The first exception provides relief from the daily pricing requirement on days where changes in the value of an investment company's portfolio securities will not "materially affect" the current NAV of the investment company's redeemable securities. See Rule 22c- 1(b)(1)(i). I conclude that Rule 22c-1(b)(1)(i) addresses the frequency of an investment company's pricing requirements and cannot be read to impose a "materiality" test when pricing a security for the purposes of Rule 22c-1(a).

In Steadman, the D.C. Circuit refused to accept the Commission's contention that "a penny a share [is] per se material . . . because mutual funds are priced and reported in newspapers to a penny a share." 967 F.2d at 643. Steadman, however, did not analyze the relevant language of Rule 22c-1 but, instead, discussed the concept of materiality as it exists under the antifraud provisions of the federal securities laws. Therefore, I disregard the dicta found in Steadman. Rule 22c-1 is a pricing provision, not an antifraud provision. It involves computing NAV, rather than making representations concerning NAV. Mispricing, standing alone, constitutes a violation of Rule 22c- 1. Therefore, I concur with the Division's contention that Rule 22c-1 does not contain a materiality element.

[29]: Further support for the proposition that the $12,000 annual interest stream income was not deserving of a $46,500 premium can be found in the fact that Margaux's primary lender, Lighthouse Financial, was receiving 25% annual interest. This indicates that in an arms-length transaction a third party buyer would demand that the Note be substantially discounted in order to compensate for the lower interest stream. Any premium that approached the discounted value would likely meet with resistance from potential buyers. (Report of Robert E. Conner, Division's Expert, at 7-8.)

[30]: Chou testified that Margaux's delisting was "significant" and expressed concern with the fact that the Trustees now had to fair value Margaux. At no time, however, did Chou indicate that the Trustees had considered the implications of the delisting beyond the added duty to fair value Margaux. (Tr. 459.)

[31]: Respondents were also aware that Margaux had to renegotiate the unsecured debt repayment schedule set forth in the Reorganization Plan because it could not make the required payments and that it would be unable to pay-off the $425,000 in convertible notes that were coming due.

[32]: In late September 1990, Margaux's chief financial officer commented that efforts to sell the company revealed that "[n]obody is interested in this industry."

[33]: Section 204 of the Advisers Act and Rule 204-1 thereunder require periodic filing and amendment of Forms ADV by investment advisers. Pursuant to Rule 204-1(d), a Form ADV or an amendment thereto is a "report" within the meaning of Section 207.

[34]: To the extent that an investment adviser receives compensation pursuant to a disclosed soft dollar arrangement within the Section 28(e) safe harbor, the Commission has stated that the prohibition in Section 17(e)(1) of the Investment Company Act does not apply. See 1986 Soft Dollar Release, 35 SEC Docket at 911 n.55. Section 28(e), however, does not excuse an investment adviser from Form ADV disclosure obligations. The safe harbor protects an investment adviser only from charges of breach of fiduciary duty for failing to obtain the lowest available commission rate where the amount of commissions is reasonable in relation to the value of brokerage and research services provided. Id. at 907.

[35]: The 1986 Soft Dollar Release provides:

Computer hardware is [an] . . . example of a product which may have a mixed use . . . . [I]f the computer will be used in assisting the money manager in a non-research capacity (e.g., bookeeping or other administrative functions), that portion of the cost of the computer would not be within the safe harbor.

[36]: There is a presumption that receipt of non-research and non- brokerage products or services, except where nominally valued, is a factor in the selection of brokers. Disclosure of Brokerage Placement Practices By Certain Regulated Investment Companies and Certain Other Issuers, Advisers Act Release No. 665, 16 SEC Docket at 842 n.6.

[37]: Willfulness does not require that a Respondent have a specific intent to violate the law or an awareness that the law is being violated. Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. at 911 n.28 (citations omitted).

[38]: Cease and desist proceedings are remedial in nature and not subject to the five-year statute of limitations imposed by 28 U.S.C. 2462 and Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996). Therefore, I reject Respondents' contention that the instant proceeding is time-barred.