In the Matter of ALFRED C. RIZZO

Admin. Proc. File No. 3-6322; (801-15,751)

SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISORS ACT OF 1940, Release No. 897

January 11, 1984

TEXT:

ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND (f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND FINDINGS AND ORDER OF THE COMMISSION

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a proceeding pursuant to Section 203(e) and (f) of the Investment Advisers Act of 1940 ("Advisers Act") be instituted with respect to Alfred C. Rizzo ("Rizzo") to determine whether he willfully violated Section 17(b) 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, and Section 206 of the Advisers Act in connection with his publication of the Dynamic Growth Letter. Accordingly, IT IS ORDERED that a proceeding pursuant to Sections 203(e) and (f) of the Advisers Act be, and hereby is, instituted.

Simultaneously with the institution of this proceeding and prior to trial and before the presentation of evidence, Rizzo has submitted an Offer of Settlement. Under the terms of his Offer of Settlement, Rizzo, without admitting or denying any of the facts or the allegations contained herein and on the understanding that nothing herein shall constitute an adjudication of any issue of fact or law, consents to the issuance of this Order of the Commission.

After due consideration of the Offer of Settlement, the Commission has determined that it is appropriate and in the public interest to accept the Offer of Settlement and to order the sanction and undertakings contained in the Offer of Settlement.

II. RESPONDENT

Rizzo is an investment adviser registered with the Commission pursuant to Section 203(c) of the Advisers Act with his principal offices in Albany, New York.

III. FACTS

A. At all relevant times, Rizzo published the Dynamic Growth Letter ("Letter"), a monthly newsletter containing investment information and advice about various issuers of securities.

B. On January 28, 1982, Rizzo completed an issue of the Letter, which he authored, describing Major Exploration, Inc. ("Major"), an oil and gas exploration company with its principal operations in Texas. Major's common stock and warrants are registered with the Commission pursuant to Section 12(g) of the Exchange Act.

C. Rizzo based the article on Major primarily on an interview with the president of Major, Major's 1981 Annual Report, a report on Major purportedly prepared by "Quality Reports, Inc.," and similar information, almost all of which was supplied to Rizzo by Major. As is explained in paragraph D below, Rizzo accepted the veracity of the information that Major had supplied to him, and did not independently verify that information, other than by providing a copy of the article to Major's president for review and comment prior to publication.

D. The article about Major contained the following materially false and misleading statements:

1. The Letter contained a detailed table which showed the "proven" and "probable" estimated reserves for each of Major's leases in Texas, with total "proven" reserves for all properties estimated at in excess of $232 million and total "probable" reserves estimated at in excess of $2.4 billion. In fact, Major's leases in Texas had total "proven" oil and gas reserves of less than $3 million. Further, in 1981 and 1982, there was insufficient geologic information about Major's properties to estimate their "probable" reserves. Rizzo accepted as accurate Major's oil and gas reserve estimates and reported them in the Letter even though he knew that Major had purchased its Texas properties in the summer of 1981 for only three million dollars and that the reserve estimates in the Letter were $1.4 billion larger than estimates Major had disseminated a few months earlier. Rizzo also accepted, without independent verification, Major's statement that in the intervening period it had purchased additional acreage, that it had a high percentage rate of successfully drilled wells, and that the price of gas had risen dramatically.

2. The Letter represented that "[i]n the fall of 1981, Major signed a $54,000,000 agreement with COLORADO-PACIFIC, Inc., of Denver, Colorado, which requires CP to provide the capital to drill 11 wells per year for the next 5 years on the company's Gold River Prospect." In fact, Colorado Pacific had signed a $50,000 option agreement which, if the option were fully exercised by Colorado Pacific, would permit CP to invest up to $3.1 million over several years to develop the Gold River lease. Rizzo had no reasonable basis for believing that Colorado Pacific had agreed to invest $54 million in the development of Major's properties since, through a friend, he knew of the existence of a Dun and Bradstreet report on Colorado Pacific, which showed that the company had approximately $1 million in assets.

3. The Letter estimates, in a table headed "Pro-Forma Financial Projections" that Major's revenues in 1986 would equal $64 million and the Company's 1986 net income would reach $33.2 million. These projections, supplied to Rizzo by Major, were based upon projections of revenue from Major's purported oil and gas reserves and purported revenue to be received under the agreement with Colorado Pacific.

E. Because the Letter was in fact a recommendation of Major by Rizzo, * the Letter characterized Major as a "special situation" because of its "potential for attracting the kind of institutional sponsorship that can sharply advance the price[] of [Major's] stock." Further, the Letter compared Major to another oil and gas exploration company whose stock had increased rapidly in value. The Letter also presented Rizzo's "conclusions" about Major, which included the claim that Major had "[a]cquired $2.4 billion identifiable reserves" and that "[i]f projected production revenues are realized, shareholder equity may increase 15 times in the next 5 years."

** The Letter suggested that potential investors "judge [major] for yourself" and concluded by strongly urging investors to obtain Major's 1981 Annual Report, for which purpose the Letter printed Major's address and telephone number.*

F. On or about January 28, 1982, Rizzo authorized Major to reprint and disseminate the issue of the Letter about Major. Subsequently, on or about February 23, 1982, Rizzo distributed a substantially similar version of this issue to the subscribers to the Letter. Major circulated the Letter about the company to the approximately 26,000 names on a mailing list that Rizzo rented to Major for the purpose of this distribution and for consideration of $1750.

G. In the Letter, Rizzo failed to disclose that he was supposed to receive material amounts of revenue from the very issuer about which an article was written.

IV. FINDINGS AND CONCLUSIONS

On the basis of this Order and the Offer of Settlement, the Commission finds that:

A. Rizzo willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 206 of the Advisers Act in that (1) he drafted and disseminated to the subscribers to the Letter an article about Major without a reasonable independent basis for the investment advice therein; (2) he authorized Major to reprint and disseminate the article about Major without a reasonable independent basis for the investment advice therein; and (3) failed to disclose that he was supposed to receive

contemporaneous revenue from the issuer about which an article was written in the Letter.

B. As a registered investment adviser, Rizzo was required to have a reasonable basis for his investment advice. This duty follows from the "delicate fiduciary nature of an investment advisory relationship," a relationship that requires the investment adviser to "furnish to clients on a personal basis competent . . . advice regarding the sound management of their investments." Securities and Exchange Commission v. Capital Gains Research Bureau, Inc, 375 U.S. 180, 191 and 187 (1963). Rizzo had no such reasonable basis, but rather, despite Major's incredible claims, relied almost solely on Major's management for his information. In the words of the court in Securities and Exchange Commission v. Blavin, 557 F. Supp. 1304, 1314 (E.D. Mich. 1983), "a reader of an investment newsletter has a right to expect the investment adviser to do more than merely reprint . . . glowing financial news gleaned from financial reports or conversations with companies or officers." While a company serves as a valuable source of information in connection with providing investment advice to clients, in situations such as Major's, where the company is small, speculative and relatively unknown, an investment adviser is obligated to corroborate such information from independent sources in connection with providing investment advice. See Securities Act Release No. 5168 (July 7, 1971) ("information received from little known companies or their officials . . . must be treated with great caution as these are the very parties that may be seeking to deceive.")

C. In fact, the steps Rizzo could have taken, but did not take, to discover that the information he had received from Major was false were simple, inexpensive and obvious. First, Rizzo could have asked to see the reserve study that Major claimed supported its huge estimates. Since the relevant study is inconsistent on its face with Major's claims, this step would have alerted Rizzo to the misrepresentations. Second, Rizzo could have telephoned the Texas Railroad Commission, the public repository of all information on oil and gas production in that State. Again, this call would have alerted Rizzo to the misrepresentations since the Texas Railroad Commission would have told him that virtually no oil or gas had ever been produced from Major's properties and that the Texas Railroad Commission believed that Major had overstated the initial potential of its largest well. Third, Rizzo could have consulted a Dun and Bradstreet report, as he admitted a friend of his did, to learn the size of Colorado Pacific, the company Major claimed, and Rizzo reported, had made a $54 million commitment to develop one of Major's leases. Since the report shows Colorado Pacific's assets at under $1 million, again, by this simple step, Rizzo could have been alerted to the inaccuracy of the information supplied by Major and included in the Letter.

D. Rizzo willfully violated Section 17(b) of the Securities Act and Section 206 of the Advisers Act by failing to disclose in the article on Major in the Letter that Major had agreed contemporaneously to pay $1750 for the rental of Rizzo's mailing list. This disclosure obligation existed even though Major never paid the $1750 to Rizzo.

V.

On the basis of this Order and the Offer of Settlement, IT IS ORDERED THAT:

A. Rizzo be and hereby is censured;

B. Rizzo shall (1) within thirty (30) days of the entry of this Order, adopt and implement, and thereafter maintain policies and procedures to ensure that, with respect to articles for the Letter which contain investment advice, he will have a reasonable independent basis after reasonable inquiry for that advice and (2) disclose to readers of the Letter when its author receives compensation from the rental of a mailing list to issuers about which articles are published in the Letter.

C. Respondent shall deliver an affidavit to the Commission within one month from the date of this Order, indicating that Respondent has adopted and intends to maintain the policies and procedures in Section B above which the Commission has ordered Respondent to adopt.

By the Commission