In the Matter of ACCOUNT MANAGEMENT CORPORATION, PETER DE ROETTH and RICHARD C. ALBRIGHT

Admin. Proc. File No. 3-8857

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934, Release No. 36314;
INVESTMENT ADVISORS ACT OF 1940 Release No. 1529

September 29, 1995

TEXT:

ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, IMPOSING SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (the "Advisers Act") against Account Management Corporation ("AMC"), a registered investment adviser, and pursuant to Section 21C of the Exchange Act and Sections 203(f) and 203(k) of the Advisers Act against Peter de Roetth ("de Roetth") and Richard C. Albright ("Albright"), persons associated with AMC.

II.

In anticipation of the institution of these proceedings, AMC, de Roetth and Albright have submitted Offers of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, AMC, de Roetth and Albright, and each of them, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100, et seq., and without admitting or denying any of the findings of fact or conclusions of law contained herein, but admitting the jurisdiction of the Commission over them and the subject matter of this proceeding, consent to the issuance of this Order Instituting Proceedings, Making Findings, Imposing Sanctions and a Cease-and-Desist Order (the "Order").

III.

FINDINGS

On the basis of this Order and the Offers of Settlement submitted by AMC, de Roetth and Albright, the Commission makes the following findings:

A. FACTS

1. Respondents

a. AMC has been registered with the Commission as an investment adviser since 1964 (File No. 801-3548). It is located in Boston, Massachusetts, and is jointly owned and controlled by de Roetth and Albright. As of June 30, 1994, AMC had approximately $ 95 million under management.

b. De Roetth, a resident of Boston, Massachusetts, has been continuously associated with AMC since 1964, serving as its president.

c. Albright, a resident of Wayland, Massachusetts, has been continuously associated with AMC since 1964, serving as its vice president.

2. AMC's Business

a. Clients

During the relevant period, n1 AMC had sixty-five client accounts under management. Forty-five of AMC's client accounts, holding approximately $ 93.5 million, were assessed an annual management fee of from 1% to 1.5% of client assets under management (the "fee-paying clients"). These accounts ranged in size from $ 100,000 to $ 34 million in assets under management. Most of these clients had been with AMC for twenty years or longer. The remaining twenty client accounts, holding in the aggregate approximately $ 1.4 million, were not assessed a management fee (the "gratis clients"). For the most part, these clients were close friends of either de Roetth or Albright, most of whom opened accounts with assets averaging less than $ 5,000.

> n1 Hereinafter, all findings relate to the period January 1992 through June 1993, unless a different time period is specified.

b. Investment Strategies

AMC's primary investment strategy was to buy and hold small capitalization stocks to achieve long-term appreciation. In its Form ADV, AMC described its "timing of purchases and sales" as, "typically . . . a long period of accumulation, often 6-12 months or more, followed by a holding period of several years (preferably 5 to 10) and then a gradual distribution . . . ." AMC executed this strategy, in part, by reviewing planned initial public offerings ("IPOs") of common stock and by purchasing a substantial number of shares issued in connection with select IPOs in which AMC could obtain a substantial number of shares at a price AMC considered attractive.

In addition to this long-term strategy, and as a result of its search of the IPO market for long-term investment opportunities, AMC occasionally purchased and sold securities on a short-term basis. Primarily, such short-term trading involved "hot IPOs" in which AMC had no long-term investment interest. n2 In significant part because of its ongoing presence as a buyer of IPOs for long-term investment, selling syndicate members would offer AMC an opportunity to purchase shares in certain "hot IPOs." It was AMC's practice to flip the "hot IPOs" on the same day or within two or three days of the purchases for a short-term profit. n3

> n2 "Hot issues" or "hot IPOs" are securities of an initial public offering that trade at a premium in the secondary market when such trading commences. Usually, an underwriter knows through indications of interest (suggesting that investor demand exceeds the offering supply) prior to secondary market trading if an IPO is likely to be a "hot issue."

> n3 "Flipping" is the practice of buying a "hot issue" and then selling it within a short period of time into a rising market, earning a quick profit on the transactions.

c. AMC's Inadequate Disclosure of Its Allocation Policy

During the relevant eighteen month period, AMC bought and promptly sold thirty-four "hot IPOs" thereby generating short-term trading profits of approximately $ 337,000. n4 These short-term investment opportunities were allocated among AMC's clients exclusively according to the discretion of de Roetth and Albright. De Roetth and Albright did not seek over time to distribute the shares of "hot IPOs" equitably to all eligible accounts. n5 Instead, de Roetth and Albright intentionally favored a small group of accounts, predominantly gratis clients. For example, AMC participated in over forty IPOs with

the expectation that the issue would be "hot." All but three were profitable as anticipated. Of the profits earned in these issues, approximately 65%, or $ 218,460 was generated for the accounts of gratis clients. While only twenty of the thirty-three eligible fee-paying clients were given investment opportunities in twenty-one of the forty "hot IPOs" AMC participated in, the gratis clients participated in all of such "hot IPOs." De Roetth and Albright determined which gratis clients would receive shares of a "hot IPO" based on their subjective judgment as to which of those clients needed money at the time.

> n4 AMC purchased shares issued in 40 "hot IPOs," 34 of which were promptly sold for a profit, three of which were sold somewhat later for a loss, and three of which were held for long-term investment.

> n5 "Eligible accounts," as used in this Order means those AMC accounts which, in light of their investment objectives, legal restrictions, instructions to AMC or other relevant considerations, were eligible to purchase "hot IPOs." Twelve AMC customer accounts (all members of the same family), which in the aggregate held more than half of the assets under AMC's management, were not eligible to invest in "hot IPOs."

AMC did not adequately disclose its policy for allocating shares of "hot IPOs." The "hot IPOs" were scarce investment opportunities that could not be purchased in sufficient quantity for all eligible accounts. When allocating shares of a "hot IPO," de Roetth and Albright did not consider the appropriateness of the IPO for each eligible account. Although it referred to the discretionary exercise of investment power for clients, AMC's Form ADV did not describe the factors that de Roetth and Albright employed in exercising their discretion to allocate investment opportunities, including "hot IPOs," among AMC's clients.

d. Free Riding

Between January 1989 and June 1993, de Roetth and Albright ordered numerous trades for gratis clients' accounts that were frequently effected by free riding. n6 From January 1989 until the end of April 1990, de Roetth and Albright made sixty-seven purchases of "hot IPOs" for fourteen gratis clients under circumstances where the accounts had insufficient cash to effect the purchases as of the trade or settlement dates thereof. For example, AMC caused one gratis client to purchase $ 35,000 worth of stock in a "hot issue," when the cash balance in the account was less than $ 1.00. That same day, the account sold all of the stock for a total of $ 43,800. No funds were added to the account before the settlement date of the purchases. Thus, the stock purchase was effectively financed by the sale of the stock, and a profit of $ 8,800 was generated. AMC caused another gratis client to purchase a "hot IPO" for $ 8,750. The next day, the account sold the stock for $ 10,875. The advisory account with AMC was not opened until three days later with a deposit of $ 50. Thus, the initial stock purchase was financed by its sale, and a profit of $ 2,125 was generated.

> n6 "Free riding" is the practice whereby a stock is purchased without sufficient funds available to pay for it, the stock is sold prior to the settlement date of the purchase, and the proceeds of the sale are used to pay for the original purchase. United States v. Tager, 788 F.2d 349, 350 (6th Cir. 1986).

Most of AMC's client accounts were maintained at one custodian bank (the "custodian bank"). AMC had an omnibus account with the custodian bank that was comprised of a separate subaccount for each client. In April 1990, AMC was advised by the custodian bank that securities purchases in subaccounts were impermissible unless the subaccount had sufficient cash as of the settlement date to effect the purchase, irrespective of the balance in the omnibus account. Notwithstanding the custodian bank's notice, after April 1990, AMC caused free riding in the subaccounts to occur on an additional thirteen occasions for seven gratis clients. n7 Other than flipping "hot IPOs," very little activity occurred in the gratis clients' accounts.

> n7 In most instances where free riding took place, the "hot IPOs" were purchased through one broker/dealer and sold through a different broker/dealer.

B. LEGAL ANALYSIS

1. Violations of Section 206(2) of the Advisers Act

Section 206(2) of the Advisers Act makes it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. n8 Section 206 of the Advisers Act establishes a statutory fiduciary duty for investment advisers to act for the benefit of their clients. In the Matter of Chancellor Capital Management, Inc., Investment Advisers Act Rel. No. 1447 (October 18, 1994) citing Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). Advisers, as fiduciaries, have an affirmative duty to exercise the utmost good faith in dealings with clients. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963). This duty includes a duty of loyalty to each client.

> n8 Violations of Section 206(2) of the Advisers Act do not require that the respondent acted with "scienter," that is, intent to deceive, defraud, or manipulate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963); SEC v. Steadman, 967 F.2d 636, 643 n. 5 (D.C. Cir. 1992) (Advisers Act Section 206(2)).

Section 203(e) of the Advisers Act authorizes the Commission to sanction any investment adviser who "has willfully violated any provisions of the . . . Securities Exchange Act of 1934 . . . [the Advisers Act] . . . the rules or regulations under any of such statutes . . . [and] has willfully aided, [and] abetted . . . the violation by any other person of any provision of the . . . Securities Exchange Act of 1934 . . . [and the Advisers Act] . . . ."

Section 203(f) of the Advisers Act authorizes the Commission to sanction any person associated with an investment adviser n9 who "has willfully aided, [and] abetted . . . the violation by any other person of any provision of . . . [the Advisers Act] . . . ."

> n9 Section 202(a)(17) of the Advisers Act defines the term "person associated with an investment adviser" as "any partner, officer, or director of such investment adviser . . . or any person directly or indirectly controlling or controlled by such investment adviser . . . ."

Aiding and abetting liability can be established upon the showing of: (1) a securities law violation by a primary violator; (2) knowledge of the violation; and (3) substantial assistance in the achievement of the primary violation. IIT, International Inv. Trust v. Cornfeld, 619 F.2d 909, 922 (2d. Cir. 1980); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47-48 (2d Cir. 1978), cert. denied, 439 U.S. 1039 (1978).

AMC willfully n10 violated Section 206(2) of the Advisers Act by engaging in transactions, practices, or courses of business which operated as a fraud or deceit upon its clients. AMC breached its fiduciary duties to its clients by consistently allocating short-term trading opportunities in "hot IPOs" to a limited group of eligible accounts, without adequately disclosing this practice.

> n10 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Acts. See Tager v. SEC, 344 F.2d 5 (2d Cir. 1965).

De Roetth and Albright, AMC's principals, established AMC's allocation practices and were responsible for its disclosure concerning those practices. De Roetth and Albright thereby substantially assisted AMC's violation of Section 206(2) of the Advisers Act. By their actions, de Roetth and Albright willfully aided and abetted AMC's violation of Section 206(2) of the Advisers Act by directing allocations of "hot IPOs" to a limited group of eligible accounts, without adequate disclosure.

Section 203(k) of the Advisers Act authorizes the Commission to issue orders requiring persons to cease and desist from committing or causing violations of the Act where those persons knew or should have known that their acts or omissions would contribute to such violations. De Roetth and Albright knew or

should have known that their acts and omissions would contribute to AMC's violations of Section 206(2) of the Advisers Act. Accordingly, de Roetth and Albright caused AMC's violations of Section 206(2) of the Advisers Act.

2. Violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U Thereunder

Section 7(c) of the Exchange Act makes it unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer in contravention of the rules and regulations prescribed by the Board of Governors of the Federal Reserve System (the "Board of Governors"). Such rules and regulations include Regulation T, promulgated under the Exchange Act, which limits the terms under which brokers and dealers may extend credit to customers for the purchase of securities.

The broker/dealers who executed trades in AMC client accounts without sufficient funds available to pay for the purchases extended credit in violation of Regulation T promulgated under the Exchange Act. Thus, the broker/dealers who sold securities to AMC's clients and received payment only from the later sale of those securities violated Section 7(c) of the Exchange Act and Regulation T thereunder.

Section 7(d) of the Exchange Act makes it unlawful for any person not subject to Section 7(c) to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security, in contravention of the rules and regulations prescribed by Board of Governors. Such rules and regulations include Regulation U, promulgated under the Exchange Act, which limits the terms on which banks may extend credit for the purpose of purchasing securities. When the custodian bank allowed purchases in AMC subaccounts without sufficient funds available to pay for the purchases, it violated Section 7(d) of the Exchange Act and Regulation U thereunder.

Section 11(d) of the Exchange Act, in relevant part, makes it unlawful for a member of a national securities exchange or for any person who transacts a business in securities through a member or otherwise, to use the jurisdictional means to extend "credit to or for a customer on any security . . . which was a part of a new issue in the distribution of which he participated as a member of a selling syndicate or group within thirty days prior to such transaction . . . ." Broker/dealers who were members of the selling syndicates for IPOs who also executed trades in "hot IPOs" for AMC client accounts without sufficient funds available to pay for the purchases extended credit in violation of Section 11(d) of the Exchange Act.

Section 203(e) of the Advisers Act authorizes the Commission to sanction any investment adviser who "has willfully violated any provisions of the . . . Securities Exchange Act of 1934 . . . [the Advisers Act] . . . [and] has willfully aided, [and] abetted . . . the violation by any other person of any provision of the . . . Securities Exchange Act of 1934 . . . [and the Advisers Act] . . . ." Section 203(f) of the Advisers Act authorizes the Commission to sanction any person associated with an investment adviser n11 who has "willfully aided, [and] abetted . . . the violation by any other person of any provision of . . . [the Exchange Act] . . . ." Aiding and abetting liability can be established as discussed in Section III.B.1., above.

n11 See supra, n. 9.

AMC, de Roetth and Albright knew the balances in clients' accounts prior to ordering purchases of "hot IPOs." They knew when client accounts had insufficient funds available to cover the initial purchases and they nevertheless placed the orders in those circumstances. De Roetth and Albright knew that free riding in subaccounts was impermissible. Moreover, AMC, de Roetth and Albright rendered substantial assistance by causing the purchases to be made in accounts with insufficient funds. Thus, they willfully aided and abetted and caused the broker/dealers' violations of Sections 7(c) and 11(d) of the Exchange Act and Regulation T thereunder, and the custodian bank's violations of Section 7(d) of the Exchange Act and Regulation U thereunder.

Section 21C of the Exchange Act authorizes the Commission to issue orders requiring persons to cease and desist from committing or causing violations of the Act where those persons knew or should have known that their acts or omissions would contribute to such violations. AMC, de Roetth and Albright knew or should have known that their acts and omissions would contribute to the broker/dealers' and custodian bank's respective violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U thereunder. Accordingly, AMC, de Roetth and Albright caused violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U thereunder.

Based on the foregoing, the Commission finds that:

1. AMC willfully violated Section 206(2) of the Advisers Act; and willfully aided and abetted and caused violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U thereunder;

2. de Roetth willfully aided and abetted and caused AMC's violations of Section 206(2) of the Advisers Act; and willfully aided and abetted and caused violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U thereunder; and

3. Albright willfully aided and abetted and caused AMC's violations of Section 206(2) of the Advisers Act; and willfully aided and abetted and caused violations of Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U thereunder.

VI. ORDER

Accordingly, IT IS HEREBY ORDERED pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act that AMC, de Roetth and Albright cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act, Sections 7(c), 7(d) and 11(d) of the Exchange Act and Regulations T and U promulgated thereunder;

IT IS FURTHER ORDERED that AMC, de Roetth and Albright be, and hereby are, censured;

IT IS FURTHER ORDERED that, within ten days of the entry of this Order, pursuant to Section 203(i) of the Advisers Act, AMC shall pay a civil money penalty in the amount of $ 100,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the U.S. Securities and Exchange Commission; (C) sent by certified mail to the Office of the Comptroller, U.S. Securities and Exchange Commission, 450 5th Street, N.W., Stop 2-5, Washington, D.C. 20549; and (D) submitted under cover letter which identifies AMC, de Roetth and Albright as the Respondents in these proceedings, the file number of these proceedings and the Commission's case number, a copy of which cover letter and money order or check shall be sent to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Suite 600, Boston, Massachusetts, 02108; and

IT IS FURTHER ORDERED that AMC shall comply with the following undertaking contained in its Offer of Settlement that AMC:

within thirty days from the entry of this Order, mail a copy of this Order, together with a cover letter in a form acceptable to the staff of the Commission, to all of its current clients by registered or certified mail, return receipt requested, and shall continue, from the effective date of this Order until the expiration of twelve months to provide a copy of this Order to all prospective investment advisory clients not less than forty-eight hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five business days after entering into the contract.

By the Commission.