

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 40329 / August 17, 1998

Investment Advisers Act of 1940
Release No. 1746 / August 17, 1998

Investment Company Act of 1940
Release No. 23392 / August 17, 1998

Administrative Proceeding File No. 3-9589

IN THE MATTER OF GEORGE E. BROOKS & ASSOCIATES, INC., MOREHEAD INVESTMENT ADVISORS, INC., AND GEORGE E. BROOKS, RESPONDENTS.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS

I.

In connection with previously instituted proceedings against George E. Brooks ("Brooks"), George E. Brooks & Associates, Inc. ("Associates"), and Morehead Investment Advisors, Inc. ("Morehead") (collectively referred to herein as "respondents"), pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), Sections 15(b), 19(h), and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("IC Act"),^[1] the respondents have submitted an Offer of Settlement ("Offer") solely for the purposes of these proceedings or any other proceeding brought by or on behalf of the Commission or in which the Commission is a party. In the Respondents' Offer, which the Commission has determined to accept, Brooks, Associates, and Morehead, prior to a hearing pursuant to the Commission's Rules of Practice, and without admitting or denying any of the factual assertions, findings, or conclusions contained herein, except as to the jurisdiction of the Commission over them and over the subject matter of these proceedings and as to the matters contained in findings II-A. and II-B. below, which are admitted, consent to the entry of this Order Making Findings and Imposing Remedial Sanctions ("Order").

II.

On the basis of this Order, the Order Instituting Public Proceedings Pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, Sections 15(b), 19(h), and 21C of the Exchange Act and Section 9(b) of the IC Act 1940 and the Offer, the Commission finds that:

A. Brooks was, at all relevant times, the principal shareholder and president of Associates and a principal shareholder and Chairman of Morehead. Associates was, at all relevant times, engaged in the business of an investment adviser. Morehead was, at all relevant times, engaged in the business of an introducing broker-dealer.

B. Brooks incorporated Morehead in October 1993, and thereafter registered it with the Commission as a broker-dealer. Morehead became a member of the National Association of Securities Dealers, Inc. ("NASD") in March 1994. Brooks arranged for Morehead to clear its transactions through a subsidiary of a New York Stock Exchange member firm. Morehead cleared its transactions through this firm until its clearing relationship was terminated by that firm pursuant to a letter dated October 24, 1995. The termination became effective upon Morehead establishing a successor clearing relationship, which it accomplished in January, 1996. Substantially all of Associates' clients were also customers of Morehead, and Brooks directed all of their trades.^[2]

Failure to Disclose Associates' Weak Financial Condition and Losses

C. Between 1990 and February 1996, Brooks held himself out to be an experienced and successful investment manager. In fact, Associates continually operated at a loss and operated with a negative net worth from at least December 31, 1993 through June 30, 1995. Associates' unaudited balance sheets reveal the following:

Date	Assets	Liability	Net Worth
12/31/93	\$52,287.16	\$215,792.98	\$(163,505.82)
12/31/94	\$94,574.78	\$276,197.79	\$(181,623.01)
06/30/95	\$13,523.79	\$215,322.13	\$(201,798.34)

During 1994 and 1995, Associates was insolvent in that its liabilities exceeded its assets and it, from time to time, was unable to meet its obligations as they came due in the ordinary course of business.

D. Associates' checkbook, canceled checks, and monthly statements reveal several "Notices of Insufficient Funds" received from banks during those two years. Among the obligations Associates was unable to satisfy were payments on several outstanding loans from local financial institutions.

E. Brooks and Associates did not disclose to their clients the insolvency of Associates and the continuing losses experienced by Associates.

Free Riding for the Benefit of Morehead and Associates

F. As Associates's financial condition continued to deteriorate, to generate profits for Morehead and some of its clients, during the period from June 1994 through October 1995, Brooks turned to a pattern of purchasing securities in accounts in which there were not sufficient funds to pay for the securities and which had no means of paying for the shares except through the sale of the same shares ("free riding"). Brooks's free riding shifted the risks of large market positions to his clearing firm. Some examples of his free riding for the benefit of Morehead and Associates include the following:

1. On July 10, 1995, Associates purchased 15,000 shares of Nextel Communications Inc. class A common stock, in Associates' error account at \$16.25 per share for a total price \$243,750. Brooks sold the shares the same day at \$17.25, realizing a profit of \$15,000. This transaction erased an existing \$13,000 deficit in that account. Associates did not have funds to pay for this stock or to purchase and carry it in a margin account.

2. In September and October 1995, Brooks allocated portions of large block trades to error accounts of Morehead and of Associates at the clearing firm. Brooks failed immediately to reverse trades booked to the error accounts and some trades were left open in the error accounts for several days. Neither Morehead nor Associates had capital to pay for such shares, and therefore this practice exposed the clearing firm to market risks.

3. Brooks established a series of securities positions in various proprietary accounts at the clearing firm beginning at the end of September 1995, as follows:

Date of Purchase	Quantity	Issue	Price Purchase
9/29/95	6,500	Integrated Device Technologies, Inc.	\$ 164,125
10/2/95	12,000	Starbucks Corp.	\$ 460,500
10/3/95	50,000	USAir	\$ 675,000
10/3/95	10,000	Apple Computer Corp.	\$ 383,375
10/4/95	5,000	Mid-Atlantic Medical	\$ 96,875

Total \$1,779,875

Neither Brooks, nor his companies, had the funds to pay for these purchases or the funds for initial or maintenance margin. On October 11, 1995, Brooks, at the urging of the clearing firm, commenced selling these securities. All of the above listed positions, with the exception of the 6,500 shares of Integrated Device Technologies, Inc. ("IDTI") and 6,000 shares of USAir, were liquidated on October 11, 1995, for settlement October 16, 1995, realizing a loss of \$79,753.08. The 6,000 shares of USAir were sold for settlement October 18, 1995, incurring a loss of \$3,000. The IDTI shares resulted in a large loss which remained unrealized in the clearing deposit account.

Free Riding for the Benefit of a Morehead Employee and Clients

G. Brooks and an employee of Morehead also engaged in free riding in a personal account of the employee. Brooks exercised discretionary power over this account, with the employee's knowledge and consent, for the purpose of generating profits to be taken by the employee in lieu of his \$3500 monthly salary. The employee, Morehead's president, placed only \$15,000 in his account. On September 27, 1995, Brooks purchased 15,000 shares of Value Health, Inc. for \$411,687.80, at a time when the employee had no ability to pay for these shares. Brooks sold 12,600 of these shares the same day for \$348,752.54 and sold the remainder of these shares on October 26, 1995 for \$52,746.44. On October 12, 1995, Brooks purchased 7,000 shares of IDTI stock for \$143,048.80 for the employee's account, at a time when the employee had no ability to pay for the shares. These shares were sold on October 20, 1995 for \$160,996.20.

H. Brooks also engaged in free riding in the accounts of certain clients. On June 30, 1994, Brooks, acting without the knowledge of the client, purchased 5,000 shares of Cisco Systems, Inc., stock for \$105,503.80 for a client, at a time when the client had no ability to pay for this stock. Brooks sold these shares twelve days later on July 11, 1994, for \$119,246.20, generating a profit for the client of \$13,742.40.

I. On September 12, 1995, Brooks, acting without the knowledge of the client, purchased 5,300 shares of Breed Technologies, Inc., stock for \$111,515.80 for a client, at a time when the client had no ability to pay for this stock. Brooks sold these shares the same day for \$114,392.87, generating a profit for the client of \$2,877.07.

Morehead's Net Capital Violations

J. During the period from on or about October 5, 1995 through October 16, 1995, Morehead effected transactions in and induced and attempted to induce the purchase and sale of securities (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) when Morehead, (1) held large proprietary securities positions, established by Brooks, in several accounts, and (2) did not have and did not maintain net capital of not less than \$5,000.

K. During the period from on or about December 31, 1995 through January 24, 1996, Morehead effected transactions in and induced and attempted to induce the purchase and sale of securities (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) when Morehead did not have and did not maintain net capital of not less than \$5,000.

Unsuitable Transactions

L. Brooks effected unsuitable trades for his clients with conservative investment objectives without informing them of the risks involved in the transactions. Brooks had substantially all of his investment advisory and brokerage clients execute documents giving him complete discretion over their accounts. After gaining discretionary authority, Brooks often sold off existing assets of his clients to create credit balances. He then used margin loans to obtain additional money to purchase stock. The stocks Brooks picked for his clients were speculative high-risk stocks. Brooks also failed to diversify his clients' investments and frequently placed large portions of his clients' funds in one or two stock positions. This

practice of using large margin loans to make undiversified investments in volatile stocks caused large losses for some of his clients. Brooks failed to disclose the significant risks of this practice to his clients, many of whom were elderly persons with little investment experience who had entrusted their savings to Brooks.

M. One client, a retired person 61 years of age, lost over \$30,000 when Brooks ignored her instructions to sell an unsuitable stock position which Brooks had purchased in her IRA account. This investment of over \$100,000 was placed in a single volatile stock. During the period from November 9, 1995 to December 19, 1995, the client, through her husband, gave Brooks repeated instructions to sell this stock. Brooks ignored the instructions. The stock declined in value during this period, resulting in losses of about \$30,000. Shortly before the stock was finally sold in December 1995, Brooks wrote a letter urging the client to continue to hold the stock.

N. Another client, a 64 year old widow with no investment background, lost \$280,000 during a ten-year period when her investments were under Brooks's management. Brooks initially convinced this client that he could manage her account in such a way as to produce funds necessary for her living expenses while preserving, and likely even increasing, her principal. Beginning in about 1990, when Brooks was associated with a broker-dealer other than Morehead, Brooks purchased stocks for this account using margin. Brooks did not inform this client of the additional risk of investing on margin. In 1994, this client began to receive margin calls. When questioned, Brooks falsely told the client that the margin calls were the result of operational errors and that he would take care of the problem. Brooks told the client to simply disregard the margin calls. The client continued to withdraw money from her account for living expenses believing that Brooks was living up to his original commitment to her that he could manage the account so as to produce funds for living expenses and preserve her principal. However, unknown to the client, the funds which were withdrawn were partially from her principal. Brooks never advised the client that the principal was being reduced. Eventually the account was completely depleted.

Failure to Make Required Filings

O. Associates' Form ADV currently lists its principal place of business, the address at which its required books and records are kept, and its address for service of process as 1100 S. Tryon Street, Suite 210, Charlotte, North Carolina. However, Associates' office has been located at 1944 Brunswick Avenue, Charlotte, North Carolina since May 1994. Associates also did not amend its Form ADV to disclose that the NASD had suspended, and later canceled, the membership of Morehead, an advisory affiliate. Brooks, Associates' president, failed to ensure that these required amendments were made.

P. Associates' fiscal year end is December 31. Associates' Form ADV-S for 1991 was not received by the Commission within 90 days of its fiscal year end. Additionally, Associates did not file Form ADV-S with the Commission for fiscal years ended December 31, 1992, 1993, 1994, and 1995. Brooks, Associates' president, failed to ensure that these filings were timely made.

Failure to Deliver Disclosure Brochure

Q. Associates failed to provide the required brochure, Part II of Form ADV or an alternate brochure containing at least the same information, to clients and failed annually to deliver, or offer in writing to deliver, the required written disclosure brochure to its clients. Brooks, Associates' president, failed to ensure that the required brochure was provided to clients.

Failure to Maintain Books and Records

R. Associates failed to maintain some of the books and records required of it under the Advisers Act. Morehead failed to maintain some of the books and records required of it under the Exchange Act. During its examinations of Associates and Morehead, the staff obtained documents from outside sources related to several client accounts, which had not been contained in the files of Associates and of Morehead when they were examined. These documents consisted of correspondence related to a complaint and arbitration proceeding against Brooks and others. The correspondence includes items related to Brooks's performance as an investment adviser and several items related to payments to a

bank on behalf of a client. Brooks removed the correspondence from the files of Associates and of Morehead prior to the examination by the staff.

Respondents Violated Provisions of the Advisers Act and Exchange Act

S. From at least December 31, 1993 to June 30, 1995, Associates committed violations of and willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-4(a)(1) thereunder as more particularly described in Paragraphs C through E above. Brooks, Associates' president, failed to ensure that Associates' weak financial condition and operating losses were disclosed to clients. Brooks caused and willfully aided and abetted such violations.

T. During the period from June 1994 through January 1996, Associates, Morehead and Brooks committed violations of and willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails: (1) to employ devices, schemes and artifices to defraud, (2) to make untrue statements of material facts and to omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and (3) to engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of securities, as more particularly described in Paragraphs F through I and L through N above.

U. During the period from in or about June 1992 through January 1996, Associates committed violations of and willfully violated, and Brooks caused violations and willfully aided and abetted violations of, Sections 206(1) and 206(2) of the Advisers Act in that they, by use of the mails and means and instrumentalities of interstate commerce, directly and indirectly, employed devices, schemes and artifices to defraud and engaged in transactions, practices, and a course of business which operated as a fraud and deceit upon clients and prospective clients. As part of the aforesaid conduct, Associates and Brooks, among other things, engaged in the conduct more particularly described in Paragraphs L through N above.

V. By reason of the conduct described in Paragraphs F through K above, Morehead committed violations of and willfully violated, and Brooks (with respect to the conduct described in Paragraphs F through K) caused violations and willfully aided and abetted violations of, Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.

W. From at least May 1994 through January 1996, Associates committed violations of and willfully violated Section 204 of the Advisers Act and Rule 204-1(b)(1) thereunder by failing promptly to file an amendment to Associates' Form ADV filed with the Commission, which subsequently became inaccurate in a material manner, in that Associates failed to amend Items 2, 3, and 5 of Part I of Form ADV, as more particularly described in paragraph O above. Brooks caused and willfully aided and abetted such violations.

X. From at least March 31, 1993 through March 31, 1996, Associates committed violations of and willfully violated Section 204 of the Advisers Act and Rule 204-1(c) thereunder by failing to file Form ADV-S with the Commission within 90 days of the end of Associates fiscal year, as more particularly described in paragraph P above. Brooks caused and willfully aided and abetted such violations.

Y. From at least January 1, 1994 to June 30, 1995, Associates committed violations of and willfully violated Section 204 of the Advisers Act and Rule 204-3(a) thereunder in that Associates failed to deliver a written disclosure statement meeting the requirements of said rule to each advisory client and prospective advisory client, as more particularly described in paragraph Q above. Brooks caused and willfully aided and abetted such violations.

Z. During the period from on or about January 1, 1994 through June 30, 1995, Associates committed violations of and willfully violated Section 204 of the Advisers Act and Rule 204-3(c)(1), as more particularly described in paragraph Q above. Brooks caused and willfully aided and abetted such violations.

AA. From at least January 1, 1994 through June 30, 1995, Associates committed violations of and willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder, in that while conducting business as an investment adviser, by use of the mails and means and instrumentalities of interstate commerce, Associates failed accurately to keep current certain records which are required by the Advisers Act and rules thereunder as described more particularly in paragraph R above. Brooks caused and willfully aided and abetted such violations.

BB. During the period from in or about January 1, 1994 through June 30, 1995, Morehead committed violations of and willfully violated Sections 17(a) and 17(b) of the Exchange Act and Rule 17a-4 thereunder, as more particularly described in Paragraph R above. Brooks caused and willfully aided and abetted such violations.

CC. Respondents Brooks, Associates, and Morehead have submitted sworn financial statements and other evidence and have asserted their financial inability to pay disgorgement plus prejudgment interest or a civil money penalty. The Commission has reviewed the sworn financial statements and other evidence provided by Brooks, Associates, and Morehead and has determined that they do not have the financial ability to pay disgorgement of \$41,700 plus prejudgment interest or a civil money penalty.

III.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in the Respondents' Offer.

ACCORDINGLY, IT IS HEREBY ORDERED:

A. Pursuant to Section 203(k) of the Advisers Act and Section 21C of the Exchange Act, that Brooks cease and desist from committing or causing any violation and any future violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and from causing any violation and any future violation of Sections 204, 206(1), 206(2), and 206(4) of the Advisers Act and Rules 204-1(b)(1), 204-1(c), 204-2(a)(7), 204-3(a), 204-3(c)(1), and 206(4)-4(a)(1) thereunder and of Sections 15(c)(3), 17(a), and 17(b) of the Exchange Act and Rules 15c3-1 and 17a-4 thereunder;

B. Pursuant to Section 203(k) of the Advisers Act and Section 21C of the Exchange Act, that Associates cease and desist from committing or causing any violation and any future violation of Sections 204, 206(1), 206(2), and 206(4) of the Advisers Act and Rules 204-1(b)(1), 204-1(c), 204-2(a)(7), 204-3(a), 204-3(c)(1), and 206(4)-4(a)(1) thereunder and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

C. Pursuant to Section 21C of the Exchange Act, that Morehead cease and desist from committing or causing any violation and any future violation of Sections 10(b), 15(c)(3), 17(a), and 17(b) of the Exchange Act and Rules 10b-5, 15c3-1, and 17a-4 thereunder;

D. That Brooks be barred from association with any broker, dealer, investment adviser, investment company or municipal securities dealer;

E. That Brooks, Associates, and Morehead, shall be liable for, and pay disgorgement of \$41,700 plus prejudgment interest, but that the payment of such amount shall be waived and a civil money penalty will not be imposed based upon their demonstrated inability to pay;

F. That the Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondents Brooks, Associates, and Morehead, provided accurate and complete financial information at the time such representations were made; (2) determine the amount of disgorgement and prejudgment interest to order; (3) determine the amount of civil penalty to be imposed; and (4) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondents' offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than

whether the financial information provided by Respondents Brooks, Associates, and Morehead was fraudulent, misleading, inaccurate or incomplete in any material respect, the amount of disgorgement and prejudgment interest to order, the amount of civil penalty to be imposed and whether any additional remedies should be imposed. Respondents Brooks, Associates, and Morehead may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding;

G. That Associates' registration with the Commission as an investment adviser is hereby revoked; and

H. That Morehead's registration with the Commission as a broker-dealer is hereby revoked.

By the Commission.

Jonathan G. Katz
Secretary

FOOTNOTES

[1]: This proceeding was instituted on April 27, 1998.

[2]: These persons are referred to herein as "clients."