

1990

# Johnson-Bowles Company INC., and Marlen Vernon Johnson v. The Division of Securities and the Utah Department of Commerce, the State of Utah : Reply Brief

Utah Court of Appeals

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R. Paul Van Dam; Attorney General; David N. Sonnenreich; Assistant Attorney General; Attorneys for Respondents.

John Michael Coombs; Craig F. McCullough; Callister, Duncan & Nebeker; Attorneys for Petitioners.

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Reply Brief, *Johnson-Bowles Company v. The Division of Securities and the Utah Department of Commerce*, No. 900558 (Utah Court of Appeals, 1990).

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UTAH COURT OF APPEALS  
BRIEF

UTAH  
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DOCKET NO.

90055-8CA

IN AND BEFORE THE UTAH

COURT OF THE APPEALS

JOHNSON-BOWLES COMPANY, INC., and  
MARLEN VERNON JOHNSON,

Petitioners,

v.

The DIVISION OF SECURITIES and  
the UTAH DEPARTMENT OF COMMERCE,  
STATE OF UTAH,

Respondents.

REPLY BRIEF OF  
PETITIONERS

Case No. 900558-CA

Rule 29(b)(15) priority

Appeal from Final Agency Action of the Division of Securities,  
Utah Department of Commerce, State of Utah  
(Division of Securities Case Nos. SD-89-46BD and SD-89-47AG)

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FILED

JUL 10 1991

COURT OF APPEALS

**FILED**

JUL 10 1991

*Mary T. Noonan*  
Mary T. Noonan  
Clerk of the Court  
Utah Court of Appeals

IN THE UTAH COURT OF APPEALS

-----ooOoo-----

Johnson-Bowles Company, Inc., )  
and Marlen Vernon Johnson, )  
 )  
Petitioners, )  
 )  
v. )  
 )  
The Division of Securities and )  
Utah Department of Commerce, )  
State of Utah, )  
 )  
Respondent. )

ORDER.

Case No. 900558-CA

-----

This matter is before the court upon appellant's Motion for Reconsideration of June 18, 1991 Order and Supporting Memorandum, filed 24 June 1991.

Now therefore, IT IS HEREBY ORDERED that Exhibits NN and RR in the addendum of appellant's reply brief are stricken, subject to petitioners' prevailing on a renewed motion for the panel to take judicial notice of such exhibits.

Dated this 10<sup>th</sup> day of July 1991.

BY THE COURT:

*Reginal W. Garff*  
Reginal W. Garff, Judge

CERTIFICATE OF MAILING

I hereby certify that on the 10th day of July, 1991, a true and correct copy of the foregoing ORDER was deposited in the United States mail to the parties listed below:

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Assistant Attorney General  
Fair Business Enforcement Unit  
115 State Capitol  
Salt Lake City, UT 84114

Dated this 10th day of July, 1991.

By Suei Knighton  
Deputy Clerk



MAY 30 1991

Mary T. Noonan  
Clerk of the Court  
Utah Court of Appeals

ATTORNEYS FOR PETITIONERS

## 1

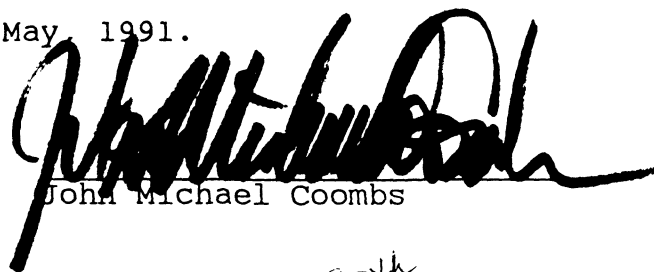
State of Utah and he has personal knowledge of that set forth herein.

2. Each of the exhibits attached to Petitioners' Reply Brief are true and correct copies of what they purport to be. Accordingly, as contemplated in this Court's Order of January 22, 1991, the Court may take judicial notice of such exhibits for purposes of this appeal.

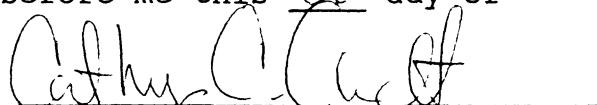
3. In the event the Court questions the authenticity of exhibits relating to the NASD arbitration between Johnson-Bowles and OTRA Clearing, it is welcome to confirm the authenticity thereof with Ms. Virginia Hall, c/o Arbitration Department, NASD, Inc., 425 California Street, Room 1400, San Francisco, California 94104. The arbitration was denominated as Otra Clearing, Inc. v. Johnson-Bowles and Marlen V. Johnson, NASD Case No. 757.

FURTHER SAYETH AFFIANT NAUGHT.

DATED this 30 day of May, 1991.

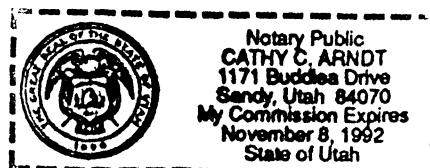
  
John Michael Coombs

SUBSCRIBED and SWORN to before me this 30<sup>th</sup> day of May, 1991.

  
Notary Public  
Residing at Salt Lake City, UT

My Commission Expires:

November 8, 1992

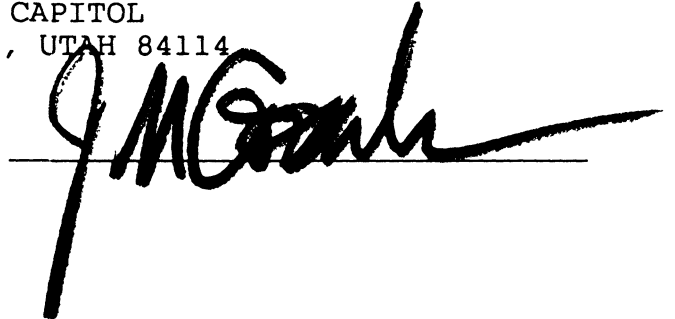


In re: Johnson-Bowles Company, Inc., and Marlen V. Johnson v.  
The Division of Securities and the Utah Department of  
Commerce, State of Utah, Case No. 900558-CA

PROOF OF SERVICE

The undersigned hereby certifies that on the 30<sup>th</sup> day of May, 1991, (s)he hand-delivered a true and correct copy of the foregoing AFFIDAVIT to:

DAVID N. SONNENREICH, ESQ.  
ASSISTANT ATTORNEY GENERAL  
FAIR BUSINESS ENFORCEMENT UNIT  
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A handwritten signature in black ink, appearing to read "D. N. Sonnenreich", is written over a horizontal line.

1000.01A:AFDVT.5

**FILED**

IN THE UTAH COURT OF APPEALS

JAN 20 1991

-----ooOoo-----

Johnson-Bowles Company, Inc.,  
and Marlen Vernon Johnson,

Petitioner,

v.

The Division of Securities and  
Utah Department of Commerce,  
State of Utah,

Respondents.

ORDER

Case No. 900558-CA

*Mary T. Noonan*  
Mary T. Noonan  
Clerk of the Court  
Utah Court of Appeals

The above-entitled matter is before the Court upon petitioner's Motion to Supplement the Record filed 31 December, 1990. Respondent's objection to the motion was filed 9 January, 1991.

Now therefore, IT IS HEREBY ORDERED that the motion is denied. Such denial is without prejudice to 1) petitioner's ability to renew the motion before the panel to whom this case is assigned for disposition on the merits and 2) such panel's prerogative to take judicial notice of the supplemental materials referred to if such panel determines they are relevant and that it may appropriately do so.

Dated this 22<sup>d</sup> day of January, 1991.

BY THE COURT:

  
\_\_\_\_\_  
Gregory K. Orme, Judge

CERTIFICATE OF MAILING

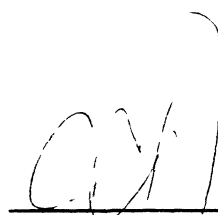
I hereby certify that on the 27<sup>th</sup> day of January, 1991, a true and correct copy of the foregoing Order was mailed to each of the following:

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Julia C. Whitfield  
Deputy Clerk

JOHNSON-BOWLES COMPANY, INC., and  
MARLEN VERNON JOHNSON,

Petitioners,

**REPLY BRIEF OF  
PETITIONERS**

**v.**

The DIVISION OF SECURITIES and  
the UTAH DEPARTMENT OF COMMERCE,  
STATE OF UTAH,

Case No. 900558-CA

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Rule 29(b)(15) priority

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## TABLE OF CONTENTS

	<u>Page No.</u>
RESPONDENTS AND THEIR COUNSEL HAVE RECKLESSLY AND REPEATEDLY MISSTATED THE RECORD AND FACTS IN THEIR OPPOSING BRIEF. . . . .	1
COUNTERPOINT I - PART OF THE FINDINGS OF FACT ARE "CLEARLY ERRONEOUS." NONETHELESS, THE CONCLUSIONS OF LAW ARE NEITHER "CORRECT," "REASONABLE" NOR "RATIONAL." . . . .	5
A. Paragraph 14 of the findings of fact is "clearly erroneous." . . . .	5
B. The conclusions of law are erroneous under the "correctness of error" and/or the "reasonableness/rationality" standards. . . . .	9
COUNTERPOINT II - THE DIVISION MISCONSTRUES PETITIONERS' CONSTITUTIONAL ARGUMENTS. . . . .	9
A. Petitioners were subject to discipline by the NASD had they failed to honor their NASD contracts. . . . .	11
B. Petitioners were also subject to discipline by the NASD for failing to honor a prospective "buy-in." . . . .	11
C. Expecting Johnson-Bowles to defend several NASD disciplinary actions and otherwise arbitrate \$500,000 worth of potential "buy-ins" is an irrational and ludicrous alternative. . . . .	13
COUNTERPOINT III -THE ALJ's DENIAL OF PETITIONERS' SEVERAL MOTIONS WAS ERROR. . . . .	14
A. Converting the administrative adjudicative proceedings from informal to formal was error. . . . .	14
B. The ALJ's denial of Petitioners' Rule 12(b)(1) motion was fundamental error. . . . .	14
C. Petitioners' Rule 12(b)(6) Motion should have been granted as to Count I, the Division's	

"dishonest or unethical business practices" claim. . . . .	15
D. The Failure to either Grant or Consider Other Motions of Petitioners was Error. . . . .	19
COUNTERPOINT IV - THE DIVISION FAILED TO PROVE THAT PETITIONERS PURCHASED STOCK DURING A TIME PERIOD IN WHICH EITHER MARCH ORDER WAS IN EFFECT. . . . .	21
COUNTERPOINT V - THE DIVISION'S ORDER SUSPENDING PETITIONERS' LICENSES FOR ONE YEAR AND PLACING THEM ON PROBATION FOR TWO YEARS IS IRRATIONAL AND UNREASONABLE IN LIGHT OF THE FACT THAT NO VIOLATION OCCURRED AND NO ONE SUSTAINED OR COULD HAVE SUSTAINED DAMAGE FOR PETITIONERS' CONDUCT. . . . .	23
CONCLUSION . . . . .	24
PROOF OF SERVICE . . . . .	26

#### EXHIBITS

	<u>Page No.</u>
Exhibit LL - §40, NASD Rules of Fair Practice. . . . .	3
Exhibit MM - Judge Anderson's April 8, 1991, Memorandum Decision in <u>Carlson v.</u> <u>Bagley Securities</u> . . . . .	3
Exhibit NN - Excerpt from Otra's testimony at an NASD arbitration hearing. . . . .	5
Exhibit OO - Rule 144, General Rules and Regulations of the Commission . . . . .	8
Exhibit PP - <u>In the Matter of the Application</u> <u>of Nassau Securities</u> . . . . .	12
Exhibit QQ - Notice of Newly Discovered Facts and Evidence. . . . .	13
Exhibit RR - NASD Arbitration Award entered against Petitioners. . . . .	13
Exhibit SS - August 23, 1990, Request for Agency Review. . . . .	20



Exhibit TT	-	Certified Copy of U.S.A. Medical Prospectus and Certificate of Registration. . . . .	20
Exhibit UU	-	Rule 261, General Rules and Regulations of the Commission. . . . .	23

## STATUTES AND RULES

### Page No.

#### SECURITIES ACT OF 1933:

Section 5, Securities Act of 1933, Vol. 1, Fed. Sec. L. Rep. (CCH) ¶567 at p. 1576, Rel. #1422 (11/21/90).....	2,18
--	------

#### SECURITIES ACT OF 1934:

Section 3(a)(5), Securities Exchange Act of 1934, Vol. 2, Fed. Sec. L. Rep. (CCH) ¶20,136 at p. 15,052.....	3
---	---

#### NASD RULES OF FAIR PRACTICE:

§40, Private Securities Transactions, NASD Manual (CCH) ¶2200, pp. 2186-87, Rel. #289 (July 1988).....	3
Article III, §1, <u>NASD Rules of Fair Practice</u> .....	12
<u>NASD Rules of Fair Practice</u> .....	3,10,15

#### GENERAL RULES AND REGULATIONS OF THE COMMISSION:

Rule 144 of the General Rules and Regulations of the Commission, Reg. §230.144, Vol. 1, Fed. Sec. L. Rep. (CCH) ¶2705A.....	8
Rule 144(d)(3)(iv).....	8
Rule 261, General Rules and Regulations of the Commission..	22,23

UTAH RULES OF CIVIL PROCEDURE:

Rule 12(b)(1), Utah Rules of Civil Procedure.....	14,15
Rule 12(b)(6), Utah Rules of Civil Procedure.....	16
Rule 15(b), Utah Rules of Civil Procedure.....	8

UTAH STATUTES:

<u>Utah Code Ann.</u> §61-1-12.....	22
<u>Utah Code Ann.</u> §61-1-13(15)(a), as amended 1989.....	7
<u>Utah Code Ann.</u> §61-1-13(16)(a), as amended 1990.....	7
<u>Utah Code Ann.</u> §61-1-14.....	22
<u>Utah Code Ann.</u> §61-1-14(3).....	4,21
<u>Utah Code Ann.</u> §61-1-7.....	2,18
<u>Utah Code Ann.</u> §76-6-406.....	25
<u>Utah Code Ann.</u> §76-8-509.....	25

DIVISION RULES:

Division Rule R177-6-1g.....	19
------------------------------	----

OTHER REFERENCES:

Article I, Section 10 of the Constitution.....	17
Article 8, Uniform Commercial Code.....	18

CASES CITED

Page No.

<u>Bevans v. Industrial Commission</u> , 131 Utah Adv. Rep. 99, 790 P. 2d 573, 576 (Ut. Ct. of App. 1990).....	9
<u>Brewster v. Maryland Securities Commissioner</u> , 548 A.2d 157 (Md. App. 1988).....	18

<u>Carlson v. Bagley Securities, Inc., et al.</u> , U.S. District Court Case No. 89-C-1062A.....	3
<u>Friedman &amp; Co.</u> , 45 S.E.C. 393 (1973).....	11
<u>Gonzalez v. Freeman</u> , 334 F.2d 570 (D.C. Cir. 1964).....	16
<u>Grace Drilling v. Board of Review</u> , 110 Utah Adv. Rep. 34, 776 P.2d 63, 68 (Ut. Ct. of App. 1990).....	9
<u>Grayson Roper Ltd. v. Finlinson</u> , 782 P.2d 467, 470 (Utah 1989).....	6
<u>In re: Shaskan &amp; Company, Inc</u> , SEC Docket 775 (May 28, 1976).....	11
<u>In the Matter of Capital Leasing Corp.</u> , (1964) Securities Act Release No. 33-4714, 42 S.E.C. 232, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,128.....	23
<u>In the Matter of the Application of Nassau Securities Service</u> , November 19, 1964, SEC Ex. Act. Release No. 7464, 42 S.E.C. 445, ['64-'66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,158.....	12
<u>Lowenschuss v. The Options Clearing Corp., et. al.</u> , (Del. Ch. Ct., Dec. 21, 1989), [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,675 at p. 98,156-157.....	15
<u>Pro-Benefit Staffing, Inc. v. Board of Review</u> , 106 Utah Adv. Rep. 34, 775 P.2d 439, 442 (Ut. Ct. of App. 1989).....	9
<u>Saunders v. Sharp</u> , 154 Utah Adv. Rep. 5, 6, ____ P.2d ____ (Utah 1991).....	6
<u>Scharf v. BMG Corp.</u> , 700 P.2d 1068, 1070 (Utah 1985).....	6
<u>SEC v. Ralston Purina Company</u> , 346 U.S. 119 (1953).....	20
<u>State ex rel., M.S. v. Slata</u> , 155 Utah Adv. Rep. 23, 24 ____ P.2d ____ (Ct. of App. 1991).....	6
<u>State v. Moore</u> , 147 Utah Adv. Rep. 28, 32, 802 P.2d 732 (Ct. of App. 1990).....	6
<u>Steadman v. Securities &amp; Exchange Commission</u> , (U.S. Sup. Ct., Feb. 15, 1981) 450 U.S. 91, 67 L.Ed. 2d 69, 101 S.Ct. 999, ['81 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶97,878.....	22

<u>Tabby's International, Inc. v. SEC</u> , (5th Cir. 1973), 479 F.2d 1080, 1083, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,014.....	23
<u>Toomer v. Witsell</u> , 334 U.S. 385 (1948).....	16
<u>Vali Convalescent v. Division of Health Care Financing</u> , 140 Utah Adv. Rep. 21, 27, 797 P.2d 438 (Ut. Ct. of App. 1990).....	9
<u>Viacom International, Inc. v. Icahn</u> , (S.D. NY, 1990) 747 F.Supp. 205, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,473.....	25
<u>Western Capital &amp; Securities, Inc. v. Knudsvig</u> , (Ut. Ct. of App. Case No. 88-0198-CA, February 7, 1989), 101 Utah Adv. Rep. 65, 768 P.2d 989, ['89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,337.....	15

#### OTHER AUTHORITIES

#### Page No.

Nowalk, Rotunda & Young, <u>Constitutional Law</u> , Hornbook Series, West Publishing Company, St. Paul, Minn. (1978), pp. 276.....	16
1 T. Hazen, <u>The Law of Securities Regulation</u> §10.3 at 531 (2d ed. 1990).....	3

This Reply Brief is submitted on behalf of Petitioners Johnson-Bowles Co., Inc., and Marlen V. Johnson. For convenience, Respondents are together referred to herein as the "Division." Along with their principal brief, Petitioners filed an Addendum comprising Exs. A through KK. For continuity, all exhibits attached hereto continue as Exs. LL through UU.<sup>1</sup>

RESPONDENTS AND THEIR COUNSEL HAVE RECKLESSLY AND REPEATEDLY MISSTATED THE RECORD AND FACTS IN THEIR OPPOSING BRIEF.

The Division's opposing brief is riddled with misstatements of the evidence and record. For instance, while it is undisputed that Petitioners did not directly violate the Division's March 1989, Orders prohibiting offers or sales and, while Petitioners were never even charged with such, the Division repeatedly deceives the Court by stating that they did.<sup>2</sup>

Not content with these deceptions, the Division further asserts that not only did Petitioners "knowingly violate" its orders, they "helped others to violate" such orders. Division

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<sup>1</sup> Certain exhibits attached hereto relate to matters which have occurred since the date Petitioners' brief was filed in January, 1991. As per this Court's Order of January 22, 1991 on file herein, the Court may take judicial notice of these additional exhibits.

<sup>2</sup> See e.g., p. 5, Division's Opposing Brief, entitled "Nature of the Case"; p. 13, "Course of Proceedings and Disposition Below," deliberately ignoring that the Division amended its petitions in July 1989, to delete the very claim that Petitioners directly violated the Division's March 1, 1989, Summary Order; p. 14, "Summary of Argument", stating that, "by purchasing U.S.A. Medical stock from six Utah sellers," Petitioners "willfully violated the Division's order . . . ."; p. 45, "The Johnsons' behavior constituted as direct and willful a violation of a Division order as can be imagined." Cf. p. 75, Petitioners' brief.

brief, p. 5. On the contrary, the Securities Advisory Board expressly found that Petitioners did not "solicit" their sellers. Ex. EE, ¶12, p. 6.<sup>3</sup> Thus, the record is clear that Petitioners "helped" no one do anything. At the same time, the Division has filed no cross-appeal, complaining about the very findings and conclusions it and its counsel drafted behind Petitioners' backs.<sup>4</sup>

Most disturbing and pernicious is the Division's repeated reference on page after page of its brief to Petitioners' unsolicited "purchasing" to complete outstanding NASD contracts as "trading". See e.g., pp. 35-36, Division brief. The Division thus seeks to deceive the reader into believing that Petitioners truly did violate the Division's March 1989, Orders directly. On the contrary, Petitioners were never even charged with "trading". See Ex. L and p. 75, Petitioners' brief. Furthermore, Don Sorensen, Johnson-Bowles' CPA, testified that Johnson-Bowles' last trade in U.S.A. Medical occurred on February 2, 1989, nearly one month before the Division issued its Summary Order. R. 1042; p. 183, lines 4-6, Hearing Transcript. Petitioners admittedly purchased nearly 400,000 shares of

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<sup>3</sup> In other words, Petitioners did not violate the registration provisions of §5, Securities Act of 1933, or Utah's counterpart, Utah Code Ann. §61-1-7, because they neither offered, sold, nor made an offer to buy any securities. Section 5, Securities Act of 1933, Vol. 1, Fed. Sec. L. Rep. (CCH) ¶1567 at p. 1576, Rel. #1422 (11/21/90).

<sup>4</sup> See pp. 79-81, Petitioners' brief.

U.S.A. Medical stock (out of 26 million shares issued and outstanding) from 7 individuals "during March 1989." However, private, unsolicited purchases between informed, consenting adults is not "trading" because such transactions are "off-market". If the Division is correct and an "off-market," unsolicited, private purchase is tantamount to "trading", then anyone who has ever bought or sold stock privately should register as a securities broker-dealer.<sup>5</sup>

In its Statement of Facts, the Division further deceives the Court as to the very definition and purpose of "short selling", all as if such were relevant to Petitioners' liability. Division's brief, p. 6, n. 6. On the contrary, Judge Aldon J. Anderson recently addressed this issue in Carlson v. Bagley Securities, Inc., et al., U.S. District Court Case No. 89-C-1062A, Memorandum Opinion (DC Utah April 8, 1991), a true and correct copy of which is attached hereto as Ex. MM. Therein, Judge Anderson states:

The authority of a broker-dealer to sell short is well established in the securities industry. See 1 T. Hazen, The Law of Securities Regulation §10.3 at 531 (2d ed. 1990). Despite plaintiffs' assertion that the practice is "selling nothing", the ability of

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5            See definition of "dealer" which excludes a person buying or selling for his or her own account, Section 3(a)(5), Securities Exchange Act of 1934, Vol. 2, Fed. Sec. L. Rep. (CCH) ¶20,136 at p. 15,052. In addition, a person such as Petitioner Johnson who is associated with an NASD member such as Johnson-Bowles is permitted under the NASD Rules of Fair Practice to engage in private securities transactions. See §40, Private Securities Transactions, NASD Manual (CCH) ¶2200, pp. 2186-87, Rel. #289 (July 1988), a true and correct copy of which is attached hereto as Exhibit LL.

a broker-dealer to sell short from a trading account performs an important function in balancing supply and demand in the over-the-counter market. [Emphasis added.]

The Division's relentless deceit upon this Court is further exemplified in ¶11, p. 10, Division brief. Therein, the Division states that there was "no gap in coverage" between the Temporary Stop Trading Order and the Permanent Stop Trading Order. This brazen statement is so contrary to the facts and law that Rule 33 sanctions should be imposed on Respondents and their counsel. By statutory interpretation, the Summary Order of March 1, 1989 -- a relative of the Temporary Restraining Order -- could only be effective 10-days. Utah Code Ann. §61-1-14(3), Ex. C.<sup>6</sup> In fact, the Division's permanent default order was not issued until March 29, 1989, nearly 3 weeks after the March 1, Summary Order had expired by operation of law. ¶¶'s 7 and 9, p. 4-5, Findings of Fact; R. 1132-1133, Ex. EE. Yet, throughout the Division's opposing brief, it erroneously states that there was no hiatus in the orders.<sup>7</sup>

Not content with the foregoing misstatements of the evidence and record, the Division proceeds with:

There is nothing in the record that clearly establishes whether Otra Clearing House [sic] made its buy-in before the Division issued its

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<sup>6</sup> Utah Code Ann. §61-1-14(3) unambiguously states: "The executive director may not extend any summary order for more than ten business days." In this case, the Summary Order was never extended.

<sup>7</sup> See also pp. 40-44, Division's brief, in which it reiterates this false assertion.



Stop Trading Order (or before Otra became aware of the Order).

Division brief, p. 11, ¶12. Despite this statement, Marlen Johnson testified to the contrary at the hearing. P. 88, lines 3-25, Hearing Transcript; R. 947.<sup>8</sup>

Finally, the Division repeatedly engages in the crudest form of logical fallacy known to man: it misstates each of Petitioners' arguments, thereby enabling it to refute arguments Petitioners never made.<sup>9</sup>

#### COUNTERPOINT I

PART OF THE FINDINGS OF FACT ARE "CLEARLY ERRONEOUS." NONETHELESS, THE CONCLUSIONS OF LAW ARE NEITHER "CORRECT," "REASONABLE" NOR "RATIONAL."

A. Paragraph 14 of the findings of fact is "clearly erroneous".

Petitioners have no dispute with the findings of fact in the August 13, 1990, Order other than paragraph 14 thereof. This is because the parties stipulated to the remainder of the findings on July 8, 1990. Ex. CC, Petitioners' Addendum.

Paragraph 14 of the findings, R. 1135, Ex. EE, states:

14. On March 20, 1990, Respondent Marlen

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<sup>8</sup> Furthermore, since the hearing, Otra's president, John M. Whitesides, has testified at an NASD arbitration hearing between Petitioners and Otra that Otra knew about the Division's Summary Order. See Ex. NN hereto, lines 1-13, page 169 of the transcript of such arbitration hearing of which this Court may take judicial notice.

<sup>9</sup> Petitioners also object to being recklessly lumped together by the Division as "the Johnsons." Johnson-Bowles is not Marlen V. Johnson's alter ego and either one's liability herein is not contingent upon the alleged conduct of the other.

V. Johnson purchased 54,000 shares of U.S.A. Medical Corporation securities from Mr. Sax. During the instant proceeding, Respondent testified that he purchased those securities for an entity known as January Corporation as the means to possibly satisfy a pending NASD arbitration proceeding between Respondent Johnson-Bowles Company, Inc. and OTRA Clearing, Inc. regarding the March 1, 1989, buy-in of U.S.A. Medical Corporation securities by OTRA Clearing, Inc. On March 29, 1990, Respondent Marlen Vernon Johnson -- through January Corporation -- sold the 54,000 shares to a firm known as Sorensen, Chiodo & May.

To demonstrate that findings of fact are "clearly erroneous," an appellant must "marshall the evidence" in support of such findings.<sup>10</sup>

Petitioners have not "marshalled the evidence" in support of the entire findings because they have no dispute with the findings other than ¶14. Petitioners thus "marshall the evidence" in support of ¶14 of the August 13, 1990, Findings as follows:

(1) In March 1990, a year after Petitioner Johnson's March 1989 purchases, Petitioner Johnson testified he purchased, for January Corporation, 54,000 shares of U.S.A. Medical from Richard Sax for the purpose, if necessary, of satisfying an outstanding NASD contract with OTRA Clearing,

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<sup>10</sup> Scharf v. BMG Corp., 700 P.2d 1068, 1070 (Utah 1985); State v. Moore, 147 Utah Adv. Rep. 28, 32, 802 P.2d 732 (Ct. of App. 1990); State ex rel., M.S. v. Slata, 155 Utah Adv. Rep. 23, 24, \_\_\_ P.2d \_\_\_ (Ct. of App. 1991). In Saunders v. Sharp, 154 Utah Adv. Rep. 5, 6, \_\_\_ P.2d \_\_\_ (Utah 1991), the Utah Supreme Court held that if the appellant fails to marshall the evidence, the appellate court assumes the that the record supports the findings of the trial court and proceeds to review the accuracy of the lower court's conclusions of law and the application of that law in the case. Grayson Roper Ltd. v. Finlinson, 782 P.2d 467, 470 (Utah 1989).

Inc., a dispute subject of NASD arbitration (R. 1012-1013, 1017, 959-960; p. 153, lines 18-25, p. 154, lines 1-19, p. 158, lines 23-24, p. 100, lines 13-25, p. 101, lines 1-24, Hearing Transcript);

(2) On March 29, 1990, Petitioner Johnson, through January Corporation, gave Johnson-Bowles' CPA's, Sorensen, Chiodo & May, a security interest in such 54,000 shares as collateral security for a pre-existing accounting bill of \$15,000 (R. 1017; p. 158, lines 3-19, Hearing Transcript);

(3) While January Corporation's cost basis in the stock was \$4,290, the so-called "pledge" to Sorensen, Chiodo & May was accounted for by way of a stock confirmation showing a charge of \$30 (R. 1018; p. 159, lines 5-19, Hearing Transcript);

(4) Petitioners stipulated to the authenticity of all documents pertaining to this innocuous transaction (R. 1147-1153); and,

(5) Petitioner Johnson testified at the hearing that the transaction was not intended as a "sale" of anything (R. 1013, 1017, 1018, and 1026; p. 154, lines 16-19, 158, lines 10-14, p. 159, lines 10-13, p. 167, lines 15-23, Hearing Transcript).

The Division put on no evidence that January Corporation's March 1990 "pledge" of 54,000 shares was anything other than what Mr. Johnson testified it to be, namely, collateral security (and good faith) for a pre-existing and outstanding accounting fee.<sup>11</sup>

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<sup>11</sup> Furthermore, if the "pledge" was indeed a "sale," why did the parties have no arrangement as to the extent it reduced the \$15,000 debt? The fact is, the transaction had no effect on reducing the debt. Thus, it could not be a "sale" as it was not a disposition for "value." See former Utah Code Ann. §61-1-13(15)(a), as in effect, 1989, now amended as §13(16)(a). More importantly, the "public" was certainly not harmed by this transaction, nor are Sorensen, Chiodo & May complaining.

In fact, the Division had an opportunity to cross-examine Don Sorensen in this regard and it failed to do so, leaving Mr. Johnson's prior testimony intact and unrebutted. R. 1045-1049; pp. 186-190, Hearing Transcript.

The findings in ¶14 were neither contemplated in nor embraced by the Division's July 19, 1989 Amended Petitions. R. 161-168; Ex. L. To be sure, January Corporation is not a party to these proceedings. Moreover, the Division made no motion under Rule 15(b), Utah Rules of Civil Procedure, to amend its Amended Petitions to conform to such "evidence".

The foregoing constitutes the sum of all "marshalled" evidence by which the Securities Advisory Board, in secret and clandestine conjunction with the Division's counsel, Mark J. Griffin, "found" ¶14 of the August 13, 1990, Findings of Fact. As a result, there is no evidence to support a finding that January Corporation's use of 54,000 shares of U.S.A. Medical as collateral security on an outstanding accounting fee was a "sale" of securities by Johnson or Johnson-Bowles.<sup>12</sup>

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Significantly, Rule 144 of the General Rules and Regulations of the Commission, Reg. §230.144, Vol. 1, Fed. Sec. L. Rep. (CCH) ¶2705A, a true and correct copy of which is attached hereto as Ex. OO, provides a "safe harbor" under which certain transactions in securities are not deemed to be unlawful distributions of securities. Rule 144(d)(3)(iv) sets forth conditions under which a pledgee may "tack" the holding period of the pledgor for purposes of subsequently selling pledged stock to satisfy a debt or other obligation. CCH at p. 2783-84. Under the Rule, a pledge of securities is not a sale. In addition, the transaction in issue is not an ordinary pledge situation. A typical pledge involves putting up stock as collateral -- at the outset -- in exchange for the borrowing of money. Such did not occur here as Sorensen, Chiodo & May had already advanced money in the form of services rendered and the 54,000 shares were put up after the fact to make the accountants, as prior creditors, feel secure.

Based on the foregoing, ¶14 is not supported by "substantial evidence." Grace Drilling v. Board of Review, 110 Utah Adv. Rep. 34, 776 P.2d 63, 68 (Ut. Ct. of App. 1990).

B. The conclusions of law are erroneous under the "correctness of error" and/or the "reasonableness/rationality" standards.

If "findings" are "clearly erroneous," it follows, a fortiori, that conclusions of law based thereon must be erroneous.

Nonetheless, even if findings of fact are not "clearly erroneous" and not against the clear weight of evidence, the "conclusions" may be erroneous under the "correctness of error standard." Bevans v. Industrial Commission, 131 Utah Adv. Rep. 99, 790 P. 2d 573, 576 (Ut. Ct. of App. 1990). Because this case further requires review of mixed questions of law and fact, review boils down to whether the conclusions of law are "reasonable and rational." Pro-Benefit Staffing, Inc. v. Board of Review, 106 Utah Adv. Rep. 34, 775 P.2d 439, 442 (Ut. Ct. of App. 1989). Based on Petitioners' brief, they are not.<sup>13</sup>

## COUNTERPOINT II

### THE DIVISION MISCONSTRUES PETITIONERS' CONSTITUTIONAL ARGUMENTS

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<sup>13</sup> The conclusions of law also fail under the correction-of-error standard applicable to undisputed facts. Vali Convalescent v. Division of Health Care Financing, 140 Utah Adv. Rep. 21, 27, 797 P.2d 438 (Ut. Ct. of App. 1990).

Contrary to the Division's baldfaced assertions, the "heart" of this appeal is not an argument that the Division's March 1989 Orders conflict with the NASD Rules of Fair Practice. Division brief, p. 21-26.<sup>14</sup> Petitioners have never contended they were required to violate a Division order to fulfill their NASD obligations. Such was not put forth by Petitioners because it isn't true. On the contrary, the Summary Order merely sought to prevent innocent Utah residents from acquiring "tainted" U.S.A. Medical stock, an objective clearly within the police power of the Division. This is undisputed and it is irrelevant to this appeal.

Not content with one mischaracterization on this score, the Division compounds its sophistry: Petitioners have never argued that NASD Rules "preempt" the Division's March 1, 1989 Summary Order. Division brief, p. 21. What is "preempted" is an NASD member's obligation to comply with the NASD Rules of Fair Practice vis-à-vis the Division's irrational interpretation of its regulatory authority and purpose. For instance, the Division claims that dishonoring NASD executory contracts is "honest and ethical": the NASD takes an opposite view. See p. 13, ¶17, and pp. 25-26, Petitioners' brief. Accordingly, all of Point II of the Division's brief, being based on false premises, is illogical and fallacious.

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Furthermore, contrary to the Division's assertions, the record is clear that this argument also was not, by any means, the basis of Petitioners' motion for summary judgment. Id.

A. Petitioners were subject to discipline by the NASD had they failed to honor their NASD contracts.

The Division further deceives this Court by contending that Petitioners cite no authority for the proposition that had they failed to honor their NASD contracts, they could have been expelled by the NASD and fined. Division brief, p. 22. On the contrary, In re: Shaskan & Company, Inc., and Friedman & Company, authority cited in Petitioners' brief, stand for this very proposition. See pp. 25-26, Petitioners' Brief. Further, at page 93 of the hearing transcript, R. 952, Mr. Johnson testified that Ken Schaeffer, Assistant Director of the NASD in Denver told him that, "we had to honor the contracts under any circumstances, or the NASD would take charge and we would be fined." Division brief, p. 22, note 20. While the Division had a year and a half to contact Mr. Schaeffer and obtain an affidavit or other evidence from the NASD to the contrary, no evidence was adduced at the hearing to rebut the foregoing law and evidence.

B. Petitioners were also subject to discipline by the NASD for failing to honor a prospective "buy-in."

On page 23, Division brief, the Division articulates its grand solution to this entire case: Johnson-Bowles should have allowed \$500,000 worth of "buy-ins" and then Petitioners would not have been subjected to NASD sanctions. Ironically, this

brilliant solution would have created more problems than ever.<sup>15</sup> For instance, the Petitioners, not having over \$500,000 with which to honor such "buy-in" could have been subjected to disciplinary action by the NASD for the failure to honor a "buy-in." In the Matter of the Application of Nassau Securities Service, November 19, 1964, SEC Ex. Act. Release No. 7464, 42 S.E.C. 445, ['64-'66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,158, Ex. PP hereto, is directly on point. In Nassau, the SEC, on appeal from the NASD, held that the failure of an NASD member who made a short sale to pay a \$325 balance arising out of a "buy-in" executed by the purchaser was a violation of the NASD rules requiring members to observe "high standards of commercial honor and just and equitable principles of trade."<sup>16</sup> Consequently, the censure, fine and assessed costs imposed by the NASD was upheld. The claim by the applicant that its refusal was based on suspected fraud was not justified since the applicant along with some other 16 dealers, participated in making a market in the stock, was aware of the factors which it claims suggested a manipulation, and when notified of the "buy-in," it attempted to get another extension for delivery.

Regardless of Nassau, an NASD disciplinary action was in fact initiated against Johnson-Bowles in the NASD Denver office

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<sup>15</sup> It would also have furthered the fraud because the U.S.A. Medical criminals were happily sitting with sell orders on the other side of every prospective "buy-in."

<sup>16</sup> In other words, Article III, §1, NASD Rules of Fair Practice, Ex. H, Petitioners' Addendum.



in September, 1989, NASD Complaint No. DEN-914. This complaint was the result of Johnson-Bowles' failure to honor the March 1, 1989 "buy-in" undertaken by Otra. Such action was brought to the attention of the ALJ as set forth on pp. 822 through 825, Vol. III, of the record, Ex. QQ hereto. Unfortunately for Petitioners, it was ignored.

C. Expecting Johnson-Bowles to defend several NASD disciplinary actions and otherwise arbitrate \$500,000 worth of potential "buy-ins" is an irrational and ludicrous alternative.

The Division claims that if "buy-ins" were made at prices Johnson-Bowles felt was too high, it could have sought NASD arbitration. Division brief, p. 24. Ironically, this occurred with respect to the Otra Clearing, Inc., "buy-in" and yet Petitioners have not prevailed. For example, at January end, 1991, a panel of three NASD arbitrators made an arbitration award against Petitioners in an amount now totaling \$108,000.00, an amount Otra Clearing is now seeking to convert into a judgment. A true and correct copy of the arbitration award, of which this Court may take judicial notice, is attached hereto and incorporated by reference as Ex. RR. Thus, the alternative that Petitioners should have gone out-of-business and defended several NASD arbitrations and several NASD disciplinary actions, as opposed to doing what they did, is clearly irrational, unreasonable, illogical, and naive. As evidenced by the record,

Petitioners' fears of facing \$500,000 worth "buy-ins" were legitimate and not a pipe dream.

### COUNTERPOINT III

#### THE ALJ'S DENIAL OF PETITIONERS' SEVERAL MOTIONS WAS ERROR.

A. Converting the administrative adjudicative proceedings from informal to formal was error.

The Division devotes several pages to the argument that the ALJ's order converting the proceedings from informal to formal was correct. Division brief, pp. 26-28. The Division adds nothing to the arguments presented in Petitioners' principal brief at pages 23-24. Conversion was not "in the public interest" simply because Johnson-Bowles' conduct had no impact or effect on "the public." Further, in order to usurp the express right to a trial de novo in the district court, the movant must show that the defending party will not be prejudiced. The Division failed to carry its burden on both accounts.<sup>17</sup>

B. The ALJ's denial of Petitioners' Rule 12(b)(1) motion was fundamental error.

The fundamental error of the ALJ's August 29, 1989, Order denying Petitioners' Rule 12(b)(1) motion is succinctly set forth on page 4 thereof, top. (See R. 152, top; Ex. N,

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There is no reason to believe the Securities Advisory Board hearing this case had any greater expertise than a Third Judicial District Court judge. Cf. Division brief, p. 16-17, note 15. This is evident from the results. Further, the panel was not composed of a lawyer, but two industry and two lay persons, the latter of whom may have known nothing about securities law.

Petitioners' Addendum.) Therein, the ALJ premises his decision on the following:

Respondents' assertion that the NASD rules of conduct [sic] should be accorded the force and effect of federal law . . . is not well-founded.

This conclusion defies Western Capital & Securities, Inc. v. Knudsvig, (Ut. Ct. of App. Case No. 88-0198-CA, February 7, 1989), 101 Utah Adv. Rep. 65, 768 P.2d 989, ['89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,337. More recent authority confirms this error. Lowenschuss v. The Options Clearing Corp., et. al., (Del. Ch. Ct., Dec. 21, 1989), [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,675 at p. 98,156-157 (a state has no subject matter jurisdiction over violations of the Securities Exchange Act of 1934, including violations of any rules and regulations promulgated thereunder). [Emphasis added.] If a state has no power or authority to enforce or interpret NASD Rules of Fair Practice, it certainly has no authority or power to regulate NASD members regarding federal, NASD business in a manner diametrically inconsistent therewith.

Had the ALJ properly concluded that the NASD Rules of Fair Practice have force and effect of federal law, Petitioners' Rule 12(b)(1) motion would have been granted.

C. Petitioners' Rule 12(b)(6) Motion should have been granted as to Count I, the Division's "dishonest or unethical business practices" claim.

With regard to the ALJ's Rule 12(b)(6) ruling, the Division wholly ignores arguments 4A, B, D, H-N in Petitioners' brief. See Division brief, pp. 30-36.<sup>18</sup> While the Division discusses Petitioners' arguments 4F and G, rebuttal is not merited.<sup>19</sup> Instead of addressing Petitioners' other points, the Division dwells on Petitioners' privileges and immunities argument. On this score, the Division claims that Johnson-Bowles is not a citizen of these United States and therefore the privileges and immunities clause offers it no protection. If so, what country is Johnson-Bowles supposed to be a citizen of? And what about Petitioner Johnson?<sup>20</sup> Further, Petitioners do not belabor this argument because according to their research, the privileges and immunities clause is intimately related to the equal protection clause of the 14th Amendment and involves a similar analysis.<sup>21</sup> Because Petitioners are indeed citizens of

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<sup>18</sup> Cf. Petitioners' brief, pp. 43-63.

<sup>19</sup> This is also the case with the Division's irrelevant reference to criminal aiding and abetting. Division brief, pp. 18-19, note 17. The Division has never charged Petitioners' sellers with criminal conduct and aiding and abetting cannot lie without a principal violation. Further, the finding that Petitioners didn't "solicit" their sellers renders the Division's argument frivolous. See pp. 55-59 and 70-75, Petitioners' brief.

<sup>20</sup> To be sure, authority holds that federal licensees have property rights under the Constitution. Gonzalez v. Freeman, 334 F.2d 570 (D.C. Cir. 1964) (due process is involved in suspending a federal licensee's right to enter contracts).

<sup>21</sup> Nowalk, Rotunda & Young, Constitutional Law, Hornbook Series, West Publishing Company, St. Paul, Minn. (1978), pp. 276 (discussing Toomer v. Witsell, 334 U.S. 385 (1948), and explaining that the test to determine a violation of the Article IV privileges and immunities clause is whether there are valid reasons for a state to make distinctions based on one's state citizenship and whether the degree of discrimination bears "a close relation" to these reasons).

these United States and the State of Utah, Petitioners' privileges and immunities argument has not been rebutted.<sup>22</sup>

On page 33, the Division again mischaracterizes Petitioners' argument. Petitioners have not argued that "the order suspending their licenses was an illegal ex post facto law under Article I, Section 10 of the Constitution." What they have argued is that they had no notice that purchasing securities in private transactions at a time when the Division's March Orders may not have been in effect was sanctionable conduct impairing their livelihoods. Simply put, the attempt to discipline Petitioners, after the fact, has the effect of an ex post facto law. While the Division further argues that the prohibition against ex post facto laws only applies to criminal penalties, the Division ignores the fact that administrative adjudicative proceedings may be considered quasi-criminal.

On page 34, Division brief, the Division once again misstates Petitioners' argument. Petitioners have never argued that they had a constitutional right to sell U.S.A. Medical stock during the effectiveness of the Division's March Orders. What was argued is that Petitioners have a constitutional right not to have federal executory contracts arbitrarily interfered with by a state entity. The issue is not whether Petitioners had any right to "offer or sell" any U.S.A. Medical stock during the pendency

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This case is also one of reverse-discrimination by a state because Petitioners have been targeted only because they are Utah citizens.

of a "stop order," because they never did.<sup>23</sup> To be sure, Johnson-Bowles' last "trading" transaction in U.S.A. Medical stock was on February 2, 1989. The ministerial "delivery" of securities under Article 8, U.C.C., is not the same as entering into new contracts for the "offer or sale" thereof.

The Division fails to distinguish Brewster v. Maryland Securities Commissioner, 548 A.2d 157 (Md. App. 1988), a "dishonest and unethical practices" case. Petitioners have cited this case for principle that in order to be disciplined for such alleged misconduct requires notice (i.e., reference to "business practice, custom and usage"). Id. at p. 159-160. For example, registration of an unsolicited, "off-market" purchase is not -- and never has been -- required. Thus, by suspending all exemptions from registration, such a transaction is unaffected.<sup>24</sup> In short, nothing in the "business practice, custom or usage" of the securities industry would give a person notice that the Division deemed the mere purchase of securities on an unsolicited basis as requiring registration.

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23 The Division also argues that Petitioners violated the SEC's 10-day suspension order issued on March 6, 1989. Division brief, p. 42, note 36. This argument begs the same question and is not supported by evidence that Petitioners purchased stock sometime "during March 1989." Further, this argument is frivolous because buying stock from six Utah residents is not interstate conduct triggering application of the SEC's order. Moreover, Petitioners were never charged with violating the SEC's 10-day suspension order. To be sure, the Securities Advisory Board never found that Mr. Johnson's purchase from New York resident Sheldon Flateman was a violation of the SEC's 10-day suspension order.

24 This is confirmed by the plain language of §5 (the registration provisions) of the Securities Act of 1933 which only requires registration for an "offer to buy" securities (i.e., a solicitation). The same is even more evident in the Utah Uniform Securities Act which only requires registration for "offers or sales". See Utah Code Ann. §61-1-7. Thus, if unsolicited purchases need not be registered under state and federal securities law, it is certainly preposterous to require an exemption for them.

D. The Failure to either Grant or Consider Other Motions of Petitioners was Error.

Respecting Petitioners' motion for summary judgment, the Division contends that the motion was not granted because "'dishonest or unethical conduct' was certainly not disputed." Division brief, p. 38. This is not what occurred. The Division itself made a cross-motion for summary judgment. Yet, the ALJ denied both motions for summary judgment, determining that the issue of "solicitation" was a material issue of fact necessary to impose liability under Division Rule R177-6-1g. R. 597-608; Ex. AA. Ironically, subsequent to the ALJ's decision denying both motions for summary judgment, the Securities Advisory Board "found" that:

. . . there is no sufficient evidence to find that respondents or any of their agents solicited any of the above named seven (7) individuals to sell their U.S.A. Medical Corporation securities.

Paragraph 12, page 6, last sentence, Findings of Fact and Conclusions of Law, R. 1134, Ex. EE.

In light of the Board's findings of no "solicitation," and assuming the ALJ's summary judgment decision, Ex. AA, is otherwise correct, the proceedings should be reversed and vacated.

The Division next argues that other procedural objections posed by the Petitioners' brief are moot. Division brief, pp. 38-40. This is not true. The Division further

contends that two motions made by the Petitioners on August 20, 1990 and supported by an affidavit are also moot. This is because Petitioners allegedly "waived" their objections by failing to raise such in their August 23, 1990, Request for Agency Review before the Department of Commerce. Division brief, p. 39. As with other reckless assertions in the Division brief, this too is an outrageous falsehood. As set forth on pages 6, bott., 7, top, of Petitioners' August 23, 1990, Request for Agency Review, R. 857 bott., 858, top, Ex. SS hereto, Petitioners specifically sought a ruling from Director Buhler on such motions. See also Argument 8, pp. 78-81, Petitioners' brief.

Lastly, since Petitioners filed their principal brief, the Division has approved a registration of the securities of U.S.A. Medical (now known as Life Concepts, Inc.). A Division Certified Copy of the Prospectus and Certificate of Registration announcing the effectiveness of the registration statement are together attached hereto as Ex. TT. An examination of the Prospectus reveals that the Division has not required anything to be disclosed to the public about U.S.A. Medical that would have affected Petitioners' decision to purchase U.S.A. Medical securities during March 1989. Thus, the absence of an effective registration statement on U.S.A. Medical's securities in March 1989 had no bearing on Petitioners' conduct as mere purchasers. See Petitioners' argument 4M on pp. 60-62 of their brief, citing SEC v. Ralston Purina Company, 346 U.S. 119 (1953).



#### COUNTERPOINT IV

THE DIVISION FAILED TO PROVE THAT  
PETITIONERS PURCHASED STOCK DURING  
A TIME PERIOD IN WHICH EITHER  
MARCH ORDER WAS IN EFFECT.

The Division argues that its March 1989 Orders were in effect throughout March 1989, namely, at all times when Petitioners admittedly purchased U.S.A. Medical stock. Division brief, pp. 40-44. This argument is neither the law nor is it supported by the record. The law is clear that the Division's Summary Order of March 1, 1989, was only valid for ten (10) days. Further, it was not extended for an additional ten day or lesser period as permitted under Utah Code Ann. §61-1-14(3), Ex. C. The Division deliberately misleads the Court by quoting the portion of the statute whereby the order can be made permanent. Reading the statute from the Division's perspective, it would be ludicrous for a statute to provide that a "permanent order" may be extended for any period of up to but not exceeding ten (10) days.

While Petitioners did receive notice of the March 1, Summary Order, Ex. J, they were not a respondent therein and they were not aware that they could have, even if they wanted to, made a written request that the matter be set down for a hearing. In fact, the Petitioners never received any notice that the matter was set for hearing or scheduled to be made permanent on or about March 29, 1989. The Order was thus made permanent three weeks

after its expiration and without notice or opportunity to be heard. As a result, it is undisputed that there were nearly three weeks during March 1989 in which no Division order suspending exemptions was in place. At the same time, the Stipulation entered into between the Petitioners and the Division sets forth that Petitioners purchased stock subject of the Amended Petitions "during March." R. 1156; p. 3, ¶12, Ex. CC, Petitioners' Addendum. The Division put on no evidence as to exactly when such purchases occurred and contrary to the Division's disingenuous contentions, the burden is not on the Petitioners to prove a negative; nor is it their burden to prove that they acted "honestly or ethically." Steadman v. Securities & Exchange Commission, (U.S. Sup. Ct., Feb. 15, 1981) 450 U.S. 91, 67 L.Ed. 2d 69, 101 S.Ct. 999, ['81 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶97,878 (discussing the prosecutor's burden of proof in SEC administrative proceedings). The conclusions of law are thus "incorrect" because the Division failed to carry its burden (i.e., it failed to show that Petitioners' conduct in any way undermined its orders).

In nearly two pages of discussion, the Division mistakenly analogizes its power and authority to permanently suspend exemptions with the SEC's authority to suspend registration statements. The SEC's authority to suspend registration statements is analogous to Utah Code Ann. §61-1-12, not §61-1-14. Yet the Division cites SEC Rule 261 for the

proposition that the SEC may suspend all exemptions on a permanent basis. On the contrary, Rule 261, a true and correct copy of which is attached hereto as Ex. UU, solely involves the SEC's ability to permanently suspend a registered exemption such as the Regulation A exemption.<sup>25</sup> Rule 261, promulgated under Regulation A, only applies to an exemption conferred by the filing of a registered exempt offering statement. This false argument is typical of the reckless deception repeatedly used by the Division to stack the deck and otherwise mislead this Court.

#### COUNTERPOINT V

THE DIVISION'S ORDER SUSPENDING  
PETITIONERS' LICENSES FOR ONE YEAR  
AND PLACING THEM ON PROBATION FOR  
TWO YEARS IS IRRATIONAL AND UNREASONABLE  
IN LIGHT OF THE FACT THAT NO VIOLATION  
OCCURRED AND NO ONE SUSTAINED OR COULD  
HAVE SUSTAINED DAMAGE FOR PETITIONERS' CONDUCT.

The Division's final argument is that the sanction imposed was reasonable in light of "severity and willful nature" of Petitioners' conduct. This statement alone begs the question of this entire appeal. To be sure, who has been harmed?

The Division argues that Petitioners profited "to the tune of more than \$500,000," and this false assumption allegedly justifies its pound of flesh. The fallacy here is that avoiding being defrauded out of \$500,000 is not the same as making a

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<sup>25</sup> See e.g., Tabby's International, Inc. v. SEC, (5th Cir. 1973), 479 F.2d 1080, 1083, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,014; In the Matter of Capital Leasing Corp., (1964) Securities Act Release No. 33-4714, 42 S.E.C. 232, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,128.

"profit" of \$500,000. In fact, the Division seriously takes the position that it would have preferred seeing \$500,000 go into the pockets of the U.S.A. Medical criminals, namely, those on the other side of every prospective "buy-in." This is precisely what would have occurred had "buy-ins" been effectuated through the market. Ironically, such would have undermined the objectives underlying the Division's Orders more than anything Petitioners did or ever could have done.

#### CONCLUSION

The Division fails to recognize Petitioners' upstanding and noble responsibility in having exposed the entire U.S.A. Medical stock fraud and doing everything possible to see that it attained a price it was worth, namely zero. The Division ignores that U.S.A. Medical's price was artificial and that no one should be forced by state government to further a fraud, let alone to the extent of \$500,000. The Division also ignores that protecting oneself from a fraud is not the same as "profiting", a conclusion of law so bizarre as to be incomprehensible.

Mitigating one's damages -- damages caused by others -- is not a "dishonest or unethical business practice." Acting in good faith to protect other innocent parties, specifically one's fellow NASD members, from sustaining hundreds of thousands of dollars in damage is also not "dishonest or unethical." In addition, single-handedly uncovering and exposing an egregious fraud and otherwise handing government a fraud case

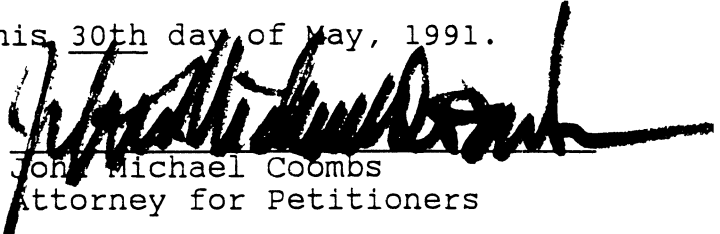
against others on a silver platter can hardly be "dishonest or unethical." The irony of this case is that Petitioners' noble conduct -- far from furthering any fraud -- frustrated the fraud.

At the same time, the Division contends by default that, extorting Petitioners with a \$50,000 fine when government has no power or authority to impose a fine of even 50¢ is apparently "honest or ethical" and certainly not tantamount to government misconduct, let alone a crime. Thus, the real question is: who is the most "dishonest or unethical", the Petitioners, who mitigated theirs and others' damages in good faith, thereby preventing the criminals in the scheme from reaping \$500,000 or more in illegal profits or, the Division, who committed the crime of extortion and blackmail upon Petitioners? In Viacom International, Inc. v. Icahn, (S.D. NY, 1990) 747 F.Supp. 205, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,473, the U.S. district court for the Southern District of New York defined extortion as "the use of wrongful means to achieve a wrongful objective." The Court held that "both elements occur whenever one exploits fear to obtain property to which one has no lawful claim." Viacom at CCH p. 97,482. While criminal extortion is hardly "honest or ethical", seeking \$50,000 for fear of impairing Petitioners' livelihoods is precisely what the Division and its counsel have done in this case with impunity. See e.g., Utah Code Ann. §76-6-406. Cf. Utah Code Ann. §76-8-509. See also p. 17, ¶29, Petitioners' brief. Petitioners submit that an

investigation of the Division and Attorney General's office should be ordered and felony extortion charges brought against all culpable parties.

Based on the foregoing, the August 13, 1990, Findings of Fact, Conclusions of Law and Order should be reversed and vacated.

Respectfully submitted this 30th day of May, 1991.

  
John Michael Coombs  
Attorney for Petitioners

PROOF OF SERVICE

The undersigned hereby certifies that on the 30th day of May, 1991, (s)he hand-delivered two (2) true and correct copies of the foregoing REPLY BRIEF OF PETITIONERS with attendant exhibits to:

Earl S. Maeser, Director  
Utah Division of Securities  
Utah Department of Commerce  
160 East 300 South, Second Floor  
P.O. Box 45802  
Salt Lake City, Utah 84145-0802

and two (2) of the same to:

R. Paul Van Dam  
Attorney General  
David N. Sonnenreich  
Assistant Attorney General  
Fair Business Enforcement Unit  
115 State Capitol Building  
Salt Lake City, Utah 84114

1000.01A:REPLY.1-8 (FOOT.5-6)

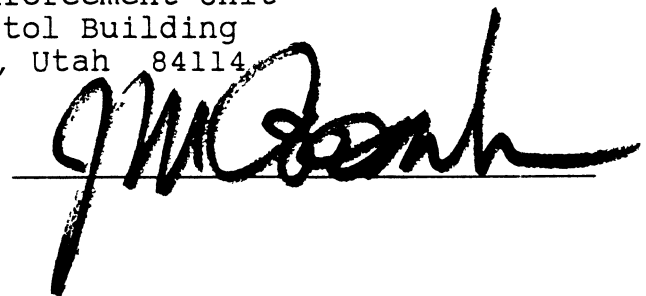


EXHIBIT "LL"

● ● ● **Selected NASD Notices to Members**

85-89 Adoption of New Rule of Fair Practice Relating to Permission for Members to Alter Their Methods of Operation Under SEC Rule 15c3-3 ("Customer Protection Rule")

(December 31, 1985)

¶ 2199 **Approval of Change in Exempt Status Under SEC Rule 15c3-3**

**Sec. 39.** (a) *Application*—For the purposes of this section, the term "member" shall be limited to any member of the Association who is not designated to another self-regulatory organization by the Securities and Exchange Commission for financial responsibility pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17d-1 promulgated thereunder.

(b) A member operating pursuant to any exemptive provision as contained in subparagraph (k) of SEC Rule 15c3-3 under the Securities Exchange Act of 1934 ("Rule 15c3-3"), shall not change its method of doing business in a manner which will change its exemptive status from that governed by subparagraph (k)(1) or (k)(2)(b) to that governed by subparagraph (k)(2)(a), or from subparagraph (k)(1), (k)(2)(a) or (k)(2)(b) to a fully computing firm that is subject to all provisions of Rule 15c3-3, or commence operations that will disqualify it for continued exemption under Rule 15c3-3 without first having obtained the prior written approval of the Association.

(c) In making the determination as to whether to approve, deny in whole or in part an application made pursuant to subsection (b), the Association staff shall consider among other things the type of business in which the member is engaged, the training, experience and qualifications of persons associated with the member, the member's procedures for safeguarding customer funds and securities, the member's overall financial and operational condition and any other information deemed relevant in the particular circumstances and the time these measures would remain in effect.

[Adopted effective November 7, 1985.]

¶ 2200 **Private Securities Transactions**

**Sec. 40.** (a) *Applicability*—No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this section.

(b) *Written Notice*—Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

(c) *Transactions for Compensation*—

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice pursuant to Subsection (b) shall advise the associated person in writing stating whether the member:

- (A) approves the person's participation in the proposed transaction, or
- (B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to Subsection (c)(1), the transaction shall be recorded on the books and records of



the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member

(3) If the member disapproves a person's participation pursuant to Subsection (c)(1), the person shall not participate in the transaction in any manner directly or indirectly

(d) *Transactions Not For Compensation*—In the case of a transaction or a series of related transactions in which an associated person has not and will not receive any selling compensation, a member which has received notice pursuant to Subsection (b) shall provide the associated person prompt written acknowledgement of said notice and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction

(e) *Definitions*—For purposes of this section, the following terms shall have the stated meanings

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Article III, Section 28 of the Rules of Fair Practice transactions among immediate family members (as defined in the Interpretation of the Board of Governors on Free-Riding and Withholding) for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded

(2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions, finder's fees securities or rights to acquire securities, rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise, or expense reimbursements

[Adopted effective November 12, 1985 ]

● ● ● **Cross Reference**

Article III, Sec 1 —Business Conduct of Members	§ 2151
Article III, Sec 28 —Transactions for Personnel of Another Member	§ 2178

● ● ● **Selected NASD Notice to Members**

85-21 Solicitation of Comments on Proposed Rule on Private Securities Transactions	(March 29, 1985)
85-54 Propose New Rule of Fair Practice Relating to Private Securities Transactions	(August 13, 1985)
85-84 New Rule of Fair Practice Relating to Private Securities Transactions	(December 18, 1985)

[The next page is 2189 ]

EXHIBIT "MM"

FILED  
UNITED STATES  
DISTRICT COURT  
DISTRICT OF UTAH

✓ APR 8 7 4 PM '91

MARKUS J. DIMMER  
CLERK

BY \_\_\_\_\_  
DEPUTY CLERK

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH  
CENTRAL DIVISION

JOHN E. CARLSON and LINDA D.  
CARLSON,

Plaintiffs,

vs.

BAGLEY SECURITIES, INC., EDWARD  
DALLIN BAGLEY, EDWARD BRYAN  
BAGLEY, LISA BAGLEY, and  
CAROLYN CREAMER BAGLEY, and  
JOHN DOES V through X,  
INDIVIDUALS,

Defendants.

Case No: 89-C-1062A

MEMORANDUM OPINION

(In lieu of findings of fact  
and conclusions of law pursuant  
to Fed. R. Civ. P. 52(a))

Judge Aldon J. Anderson

On January 17-18, 1991, a bench trial was held in the above matter. Plaintiffs John E. Carlson and Linda D. Carlson were represented by Ronald E. Nehring, Thomas M. Melton and Stephanie A. Beam. Defendants Bagley Securities, Inc., Edward Dallin Bagley, Edward Bryan Bagley, Lisa Bagley and Carolyn Creamer Bagley were represented by Richard J. Leedy. The parties presented documentary and sworn testimony. The trial was continued until February 12, 1991 at which time the court heard closing arguments and took the matter under advisement. Having thoroughly reviewed the evidence and the extensive briefing of the parties, the court is prepared to issue its ruling.

97

## I. Facts

Plaintiffs John E. Carlson and Linda D. Carlson ("the Carlsons") are residents of Minnesota. In early 1989, Mr. Carlson became aware of a company called Dial-A-Gift through conversations with Robert Lorsbach, a Salt Lake City stockbroker associated with Aesir Securities. The Carlsons had previously invested in stocks through Lorsbach while he was associated with another brokerage house. Lorsbach recommended Dial-A-Gift stock to the Carlsons as a potential investment but could not personally execute the sale because Aesir Securities was not yet registered to transact business in Minnesota. Lorsbach suggested that they could contact Todd Knowles who was working at Bagley Securities and was registered in Minnesota to make the trade. (Tr. Vol I, pp. 4-8).<sup>1</sup>

In early April 1989, Carlson telephoned Knowles to inquire if Knowles would purchase for him approximately \$80,000 in Dial-A-Gift shares at the quoted price of \$4 per share. At Lorsbach's suggestion, Carlson told Knowles he wanted the stock certificates to be delivered to him. Knowles agreed and told Carlson that he

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<sup>1</sup>All citations to the transcript are to the reporter's partial transcript of trial. For ease of reference, each partial transcript will be designated as follows:

January 17, 1991, a.m.	--	Volume I
January 17, 1991, p.m.	--	Volume II
January 18, 1991, a.m.	--	Volume III
January 18, 1991, p.m.	--	Volume IV

could expect to receive the stock certificates within ten days to two weeks after the trade. (Tr. Vol. I, pp. 8-10, Vol. IV p. 49). Lorsbach was also in communication with Knowles. Lorsbach gave Knowles a price quote on Dial-A-Gift shares at Aesir Securities and told Knowles that he could purchase the stock from Aesir. (Tr. Vol. IV p.44).

Todd Knowles attempted to fill Carlson's order but because of tight market conditions was able to purchase only a portion of the requested shares. (Tr. Vol. I, p. 13, Vol. IV p. 49). Lorsbach was in contact with Knowles on a daily basis and continued to press Knowles to fill the order.

Because of the difficulty in filling the order by purchasing the shares on the market, Bagley Securities decided to become a market maker in Dial-A-Gift and to short the remaining shares to Carlson. Carlson and Lorsbach claim that Knowles did not disclose that Bagley Securities intended to short the shares. (Tr. Vol. I p. 34, Vol. II p. 28). Knowles claims that Lorsbach agreed to the short sale and further agreed that Bagley Securities could deliver the certificates as the short was covered. (Tr. Vol. IV pp. 56-58). Bagley Securities sold Carlson a total of 17,500 Dial-A-Gift shares of which 4,700 were purchased by Bagley Securities from other market makers (agency trades), and 12,800 were shorted to Carlson from the trading account of Bagley Securities (principal

trades). Carlson paid Bagley Securities a total of \$79,159 for the shares. (Tr. Vol. IV pp. 68-74, Exb.47).

By early May, 1989, Carlson became concerned that he had not yet received the certificates. Over the next two weeks, Carlson repeatedly asked Knowles and Bagley Securities to explain the delay. After each request, Carlson was told that the certificates were on their way. (Tr. Vol. I pp. 22-25).

By letter dated May 23, 1989, Bagley Securities informed Carlson that Bagley Securities had purchased 17,500 shares of Dial-A-Gift stock from Midwest Clearing Corporation and that Carlson would receive the securities as soon as Bagley received them from Midwest. (Ex. 30)' Carlson called Lorsbach after receiving the May 23rd letter. Lorsbach told Carlson that he couldn't believe that they had purchased the shares. (Tr. Vol. I, p. 30) Based upon the reassurances in the letter, Carlson was willing to give Bagley more time to produce the certificates.

Carlson's patience eventually wore thin and by letter dated June 20, 1989 demanded delivery of the certificates within five days. (Doc. 31). Bagley Securities responded with a letter from counsel dated July 5, 1989 which alleged that a fraudulent distribution of Dial-A-Gift shares had occurred and informed Carlson that Bagley Securities would not deliver the certificates until the allegations were disproved. Bagley Securities did not

offer to return Carlson's money. (Exb. 28).

On November 29, 1989, plaintiffs filed suit against Bagley Securities.<sup>2</sup> In December, 1989, Carlson learned that Bagley Securities had attempted to make partial delivery of the stock by transferring 17,200 shares of Dial-A-Gift stock into his account at National Securities. Carlson refused delivery because the price quotes for the shares had significantly fallen. (Tr. Vol. I, p.40).

## II. Analysis

In their first amended complaint, plaintiffs allege fourteen separate causes of action including violations of federal and state securities laws, conversion, breach of contract, negligence and breach of fiduciary duty. Plaintiffs seek compensatory and punitive damages under various statutory and common law provisions.

### A. Plaintiffs' Claims Under Federal Securities Laws

Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful for "any person [t]o use or employ, in connection with the purchase or sale of any security, . . . any manipulative or

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<sup>2</sup>The complaint was later amended to include claims against Edward Dallin Bagley ("Dal Bagley"), Edward Bryan Bagley, Lisa Bagley and Carolyn Creamer Bagley as officers and directors of Bagley Securities.

deceptive device" that violates SEC rules. 15 J.S.C. §78j(b). Rule 10b-5 gives meaning to this prohibition. It makes it illegal "for any person . . . to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made . . . not misleading . . . in connection with the purchase or sale of any security." 17 C.F.R. §240.10b-5 (1990).

Plaintiffs allege that Bagley Securities and Dal Bagley violated Rule 10b-5 by failing to disclose that Bagley Securities intended to short the Dial-A-Gift shares to Carlson and by failing to deliver the certificates as requested by Carlson. Plaintiffs claim that at the time Bagley Securities issued the confirmation slips evidencing each trade, Bagley Securities knew or should have known that it could not provide the certificates requested by the Carlsons. In support of their claim, plaintiffs identify a series of alleged misrepresentations and omissions which plaintiffs claim are actionable under Rule 10b-5.

First, plaintiffs claim that Bagley Securities had a duty to disclose that Bagley Securities was shorting the Dial-A-Gift shares to the Carlsons. While acting on behalf of the Carlsons, Bagley Securities made both principal and agency trades. An agency trade is one in which a broker goes out in the market and purchases shares from third parties on behalf of the customer. A principal



trade is one in which the broker sells the shares to the customer from the firm's trading account. Bagley Securities sold Carlson 4,700 shares on an agency basis and 12,800 shares from its trading account. (Tr. Vol. III pp. 85-90, Vol. IV pp. 83-86). Because Bagley Securities did not hold an inventory of Dial-A-Gift shares in its trading account, the account was short 12,800 shares.

Although Knowles claims that Lorsbach was aware of Bagley Securities' plan to short the sale, Lorsbach claims that he was unaware of such a plan. However, Lorsbach testified that Bagley Securities' "decision to sell long or short is their choice." Tr. Vol II p. 28).

The authority of a broker-dealer to sell short is well established in the securities industry. See 1 T. Hazen, The Law of Securities Regulation § 10.3 at 531 (2d ed. 1990). Despite plaintiffs' assertion that the practice is "selling nothing," the ability of a broker-dealer to sell short from a trading account performs an important function in balancing supply and demand in the over-the-counter market. However, because the practice can be abused by unscrupulous broker-dealers, short selling is highly regulated. Id. at 532; 17 C.F.R. § 240.15c3-1, 15c3-3 (1990).

Carlson did not independently investigate Dial-A-Gift as an investment but relied on Lorsbach's advice. (Tr. Vol. I, p. 46). Lorsbach claimed, and Carlson acknowledged that Lorsbach dealt with

Knowles as Carlson's agent. The evidence showed that Lorsbach worked as a registered representative for Aesir Securities which controlled a large block of Dial-A-Gift shares and would have been aware of tight market conditions. The court believes that Lorsbach was aware, either by conversation with Knowles or by logical inference from the surrounding conditions, that Bagley Securities intended to short the shares. As Carlson's agent, Lorsbach's knowledge is imputed to Carlson.

Plaintiffs also claim that Bagley Securities violated Rule 10b-5 by failing to deliver the certificates as promised. Although short sales are highly regulated by the SEC and the National Association of Securities Dealers ("NASD"), the court is unaware of any rule which requires a market maker to cover a short position and deliver certificates to a customer within a specific time frame. Instead, NASD Rule 15c3-3 states that

[n]othing stated in this rule shall be construed as affecting the absolute right of a customer of a broker or dealer to receive in the course of normal business operations following demand made on the broker or dealer, the physical delivery of certificates for: (1) Fully-paid securities to which he is entitled . . . .

NASD Rule 15c3-3(1), NASD Manual (CCH 1989).

Plaintiffs rely on a series of cases before the Securities and Exchange Commission in support of their argument that such conduct violates Rule 10b-5. These administrative proceedings resulted in disciplinary action against broker-dealers who sold short to their

customers and failed to cover the shorts within a reasonable time. However, in each case cited by plaintiffs, the dealer shorted the stock without any intention to cover the transaction and appropriated the customer's funds for the broker's own use. See In re Sebastian, 38 S.E.C. 865 (1959) ("Registrant's sale of the securities without informing the customer that the securities were pledged and would not promptly be released from such lien constituted a misrepresentation of a material fact and the sale operated as a fraud and deceit upon the purchaser."); In re Bliedung, 38 S.E.C. 518 (1958) (broker-dealer "had no intention of filling their orders promptly and [] he intended using their funds in his other business activities"); In re Shaver & Co. 36 S.E.C. 92 (1954) (broker-dealer appropriated customers' funds with no intention of filling orders); In re Ankeny, 29 S.E.C. 514 (1949) ("The record thus makes it plain that Ankeny had no real intention of filling his customers' orders promptly"). The present case may be distinguished in at least two ways. First, the evidence suggested that at the time of the transaction, Bagley Securities fully intended to cover the short and deliver the shares. Second, there is no evidence that Bagley Securities appropriated the Carlson's funds for its own use at the time of the short sale. Bagley Securities was required to maintain sufficient funds in a reserve account at Midwest Clearing to cover the short in its

trading account. Because Bagley Securities would not receive the benefit of these funds until the short was covered, Bagley Securities would have little to gain by promising delivery without intending to deliver.

While the failure of a broker-dealer to disclose that he is a market maker states a claim under Rule 10b-5 Bischoff v. G.K. Scott & Co., Inc. 687 F. Supp. 746, 751 (E.D.N.Y. 1986), the court has found no authority which states that a market maker is required to disclose whether it is short or long in its trading account. After each trade was executed by Bagley Securities for the Carlson account, Bagley Securities sent Carlson a confirmation slip. Each slip identified Bagley Securities as a market maker in Dial-A-Gift stock.<sup>3</sup>

Plaintiffs claim that after the confirmation slips were issued and after the Carlsons had made payment in full for the securities, Bagley Securities made certain misrepresentations concerning its intention to deliver the certificates. For a misrepresentation or omission to be actionable under § 10(b) and Rule 10b-5, the challenged statement must have been made "in connection with the

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<sup>3</sup>Each confirmation slip showed the date of the trade, the quantity and price of shares purchased. Confirmation slips documenting agency or long trades showed that a commission was charged on the transaction. Those confirmation slips evidencing principal or short trades showed that no commission was charged or billed to the Carlsons. Each slip carried the notation, "WE ARE A MARKET MAKER IN THIS SECURITY." (Exbs. 4-11).

purchase or sale of . . . [a] security." 15 U.S.C. §78j(b); 17 C.F.R. § 240.10b-5. In order to satisfy the "in connection with" requirement, there must be an actual purchase or sale of a security that is connected with a challenged statement. Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723, 737-38 (1975). Statements which occur after the actual purchase of a security cannot form the basis for liability under Rule 10b-5. Ballan v. Wilfred American Educational Corp., 720 F. Supp. 241, 250 (E.D.N.Y. 1989); Konstantinakos v. F.D.I.C., 719 F. Supp. 35, 38 (D. Mass. 1989); Perez-Rubio v. Wyckoff, 718 F. Supp. 217, 236 (S.D.N.Y. 1989); Seattle-First National Bank v. Carlstedt, 678 F. Supp. 1543, 1547 (W.D. Okl. 1987).

Shortly after the sales were made, Carlson began to inquire as to when he might expect delivery of the certificates. Bagley Securities avoided a direct reply to Carlson's requests until May 23, 1989 when Dal Bagley wrote Carlson that Bagley Securities had purchased 17,500 shares of Dial-A-Gift stock through Midwest Clearing Corporation. In fact, when the letter was written, Bagley Securities had not yet covered the short in the trading account. However, these subsequent misrepresentations are not actionable under Rule 10b-5.

## B. Plaintiffs' Claims Under the Utah Uniform Securities Act

Plaintiffs' claims under state securities laws are based on the same conduct alleged as violations of Rule 10b-5. Section 61-1-22(1)(b) of the Utah Uniform Securities Act provides that any person who:

offers, sells, or purchases a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth of omission, is liable to the person selling the security to or buying the security from him . . . .

Utah Code Ann. § 61-1-22(1)(b) (Supp. 1989).

As discussed above, the misrepresentation by Bagley Securities of its intent to deliver the certificates occurred after the sale had been made. Plaintiffs have failed to identify any other untrue statement or omission of a material fact by which means Bagley Securities offered or sold Dial-A-Gift shares. Therefore, plaintiffs' claims under state securities laws must be denied.

## C. Plaintiffs' Common Law Causes of Action

### 1. Fraud

Plaintiffs claim that the confirmation slips and subsequent representations by Bagley Securities, including the May 23, 1989 letter to Carlson, were intentional or reckless misrepresentations

which induced the Carlsons to advance funds or to forego further inquiry into the whereabouts of their stock certificates. Plaintiffs' claim for fraud against defendants must fail because plaintiffs have failed to show by clear and convincing evidence that defendants falsely represented a material fact to induce the plaintiffs to purchase Dial-A-Gift stock. See Schwartz v. Tanner, 576 P.2d 873, 875 (Utah 1978) ("The elements of actionable fraud to be proved are a false representation of an existing material fact, made knowingly or recklessly for the purpose of inducing reliance thereon, upon which plaintiff reasonably relies to his detriment.").

## 2. Conversion

Plaintiffs claim that Bagley Securities converted their property, namely the money paid and certain Dial-A-Gift shares, to its own use. Plaintiffs' claim for conversion is not a proper remedy because plaintiffs were never in actual possession of the Dial-A-Gift certificates which were to be purchased for them. See Benton v. State, 709 P.2d 362, 365 (Utah 1985) ("A conversion is an act of wilful interference with a chattel, done without lawful justification by which the person entitled thereto is deprived of its use and possession.").

### 3. Breach of Contract

However, plaintiffs' ninth cause of action, for breach of contract against Bagley Securities, is a proper remedy. When Carlson instructed Knowles to purchase the shares, Bagley Securities was aware that Carlson wanted to receive the actual stock certificates. Dal Bagley understood that when Bagley Securities sold the Carlsons the shares, Bagley had an enforceable contract with Carlson to deliver the shares. The terms of that contract were established by the oral communications between Bagley Securities and Carlson, either directly or through Lorschbach his agent.

Each confirmation slip sent to Carlson established the exact quantity and price of shares he was to receive from Bagley Securities. Although a specific date was not set for the delivery of the shares, it was clear that Carlson was to receive the actual certificates. Utah law provides as follows:

Unless otherwise agreed, the transferor of a certificated security or the transferor, pledgor, or pledgee of an uncertificated security on due demand must supply his purchaser with any proof of his authority to transfer, pledge, or release or with any other requisite necessary to obtain registration of the transfer, pledge, or release of the security . . . . Failure within a reasonable time to comply with a demand made gives the purchaser the right to reject or rescind the transfer, pledge, or release.

Utah Code Ann. § 70A-8-316 (Supp. 1990). Carlson repeatedly demanded delivery of the Dial-A-Gift certificates and was entitled



to receive them within a reasonable time.

The determination of a reasonable date for delivery must be made in light of all the facts and circumstances. Carlson entered his order for the Dial-A-Gift shares on the advice of Lorsbach. Lorsbach represented to Knowles that the stock was available from Aesir Securities. However, the early trading experience of Bagley Securities showed that large blocks of Dial-A-Gift shares were difficult to obtain at the price which was then being quoted. When Bagley Securities was unable to fill Carlson's order, Lorsbach pressured Knowles to complete the transaction or cancel the order. The logical inference is that Carlson expected the shares to rise in value in the near future. When Bagley Securities decided to short the shares, Bagley Securities gambled that it would be able to obtain the shares to cover the short and to make a profit on the transaction.

Bagley Securities claims that it was impossible to deliver the certificates as requested by Carlson. A contractual obligation to perform may be discharged "if an unforeseen event occurs after formation of the contract and without fault of the obligated party, which event makes performance of the obligation impossible or highly impracticable." Western Properties v. Southern Utah Aviation, Inc., 776 P.2d 656, 658 (Utah Ct. App. 1989) (footnotes omitted). The burden of demonstrating impossibility of performance

is on the defendant. Holmgren v. Utah-Idaho Sugar Co., 582 P.2d 856, 861 (Utah 1978). In the present case, the short supply and rising price of Dial-A-Gift shares was not an unforeseen but a specifically contemplated possibility.

When asked about his efforts to cover the short created by the sale to Carlson, Dal Bagley testified that he became a market maker and quoted the highest bid for the stock. He also testified that he unsuccessfully attempted to purchase or borrow shares from Olsen & Company. However, Dal Bagley admitted that he would have been able to acquire the necessary shares to cover the short if he had been willing to pay enough money. (Tr. Vol. II pp. 102-103).

Bagley Securities identified itself as a market maker by listing its name in the Pink Sheets published by the National Quotation Bureau. However, Bagley Securities did not list a bid or asked price for Dial-A-Gift shares. Although there was some testimony that all market makers should be called before a stock is purchased or sold, the only way that a prospective seller of Dial-A-Gift shares would know of Bagley Securities' bid price would be by telephoning Bagley Securities. Dal Bagley himself testified that a broker is required to call only three market makers for a price. (Tr. Vol. III p. 12).

Dal Bagley testified that he did not cover the short because he and other market makers would be injured. He also testified

that the decision to cover the short would be made by someone who sold him the stock. (Tr. Vol. III pp. 9-12). Dal Bagley's testimony suggests that he was simply unwilling and not unable to purchase the stock on the open market to meet his the obligation to deliver the certificates to Carlson. It was not until November, 1989, after the price of Dial-A-Gift shares drastically fell, that any attempt was made to deliver the certificates. Bagley Securities has failed to carry its burden of demonstrating impossibility of performance.

The testimony at trial concerning a reasonable period of time for the delivery of stock certificates was uncertain. While some witnesses suggested that certificates might be delivered in a few weeks, other witnesses testified that extenuating circumstances might delay the delivery for several months. The evidence showed, however, that the delay in this case was unreasonable and resulted in a material breach of the contract between the plaintiffs and Bagley Securities.

In connection with their breach of contract claim, plaintiffs have requested rescission of the contract. This remedy is specifically authorized by Utah Code Ann. § 70A-8-316 and seeks to place each party in the position it was in before the contract was made.

### III. Conclusion

The evidence at trial showed that at the time the Dial-A-Gift shares were shorted to the Carlsons, Bagley Securities fully intended to deliver the requested certificates. While Bagley Securities did make subsequent misrepresentations concerning the certificates, these misrepresentations are not actionable under federal or state securities laws.

However, Bagley Securities did fail to perform its contractual obligation to deliver the certificates within a reasonable time. Plaintiffs have requested and are entitled to reject or rescind the transaction. The evidence showed that plaintiffs paid Bagley Securities a total of \$79,159.00 for Dial-A-Gift shares and that no certificates were delivered. Judgment will be entered against Bagley Securities in that amount. All other claims are dismissed.

IT IS SO ORDERED.

DATED this 8 day of April, 1991.

BY THE COURT:

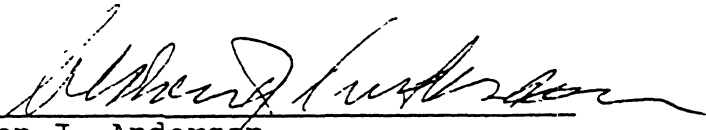
  
Aldon J. Anderson  
United States Senior Judge

EXHIBIT "NN"

ORIGINAL

BEFORE THE NATIONAL ASSOCIATION  
OF SECURITIES DEALERS, INC.

-oOo-

IN THE MATTER OF THE	:	
ARBITRATION BETWEEN:	:	
	:	VOLUME I
OTRA CLEARING, INC.,	:	Tape-recorded Proceedings
	:	From:
Claimant,	:	December 13, 1990
	:	
vs.	:	
	:	NASD No. 90-00757
JOHNSON-BOWLES COMPANY,	:	
INC., and MARLEN VERNON	:	
JOHNSON,	:	
	:	
Respondents.	:	

-oOo-

REPORTER'S TRANSCRIPT OF TAPE-RECORDED PROCEEDINGS

NASD REPRESENTATIVE: Jenny Hall  
PANEL: Jack Welch, Chairman; Ned Bennion;  
Peggy Peterson

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<u>INDEX</u>		<u>Page</u>
<u>WITNESSES</u>		
JOHN M. WHITESIDES		
Direct Exam by Mr. Van Wagoner		59
Cross Exam by Mr. Coombs		171
Redirect Exam by Mr. Van Wagoner		227
Recross Exam by Mr. Coombs		228
KAREN SIEFERT		
Direct Exam by Mr. Van Wagoner		231
Cross Exam by Mr. Coombs		250
LINDA KOHLES		
Direct Exam by Mr. Van Wagoner		256
Cross Exam by Mr. Coombs		276
MICHAEL J. CHIODO		
Direct Exam by Mr. Van Wagoner		289
Cross Exam by Mr. Coombs		315
Redirect Exam by Mr. Van Wagoner		321
RUSSELL HADEN		
Direct Exam by Mr. Coombs		326
Cross Exam by Mr. Van Wagoner		352
Redirect Exam by Mr. Coombs		357
MARLEN VERNON JOHNSON		
Direct Exam by Mr. Coombs		370
Cross Exam By Mr. Van Wagoner		421
Redirect Exam by Mr. Coombs		466
GAIL WEGGELAND		
Direct Exam by Mr. Coombs		475
Cross Exam by Mr. Van Wagoner		503
Redirect Exam by Mr. Coombs		521
Recross Exam by Mr. Van Wagoner		522

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# EXHIBITS

<u>Number</u>	<u>Description</u>	<u>Page Discussed</u>
A-1	Submission Agreements	12
C-1	OTRA Statement	78,82,83,233
C-2	OTRA Confirm Comparison	82,83,84,235

1	C-3	Contra Confirmation	82
2	C-4	Pink Sheets, USA Med Quotes	100,281,511
3	C-5	Notice of Buy-in	109,111,114, 197,236,252
4	C-6	Buy-in Report	113,114,198, 240
6	C-7	Letter from NASD 12/3/90	118,200,274
7	C-8	Daily Buy-in Rpt. 2/22/89	119,125
8	C-9	OTRA Form	124,209,242
9	C-10	OTRA Form	125,209,243,
10	C-11	Buy-in Ticket	126,209,213, 245
11	C-12	Buy-in Ticket	126,209,213
12	C-13	Customer Sell	127,246,257, 477,485
14	C-14	Customer Sell	127,246,247, 253,478,479, 482,485
16	C-15	Customer Sell	128,130,211, 213,257,262, 278
18	C-16	Customer Buy	129,130,131, 247,262,477, 478,479
20	C-17	No verbal identification	133
21	C-18	OTRA document	133,247,547, 548,555
22	C-19	Firm Trading Report	146,547,548, 555
24	C-20	File Inventory Summary Feb.	300,318
25	C-21	File Inventory Summary Mar.	302,318



1	C-22	File Inventory Summary Apr.	302,318
2	C-23	Outline Jameson Position	304
3	C-24	Findings & Conclusions Greene	359,401,530
4	C-25	Findings & Conclusions Division of Securities	360,362,427
5	C-26	Client Ledger Report	366
6	C-27	Securities Blue Slip	449,527
7			
8	R-1	Pink Sheets	100
9	R-2	OTRA Stmt. P.B. Jameson	193,217,218, 291,315,328, 335,337,547
10			
11	R-3	Letter from Johnson-Bowles to Otra 2/15	201,202,241
12	R-4	NASD Manual pg. 2095	208,478
13	R-5	NASD Subpoena	327
14	R-6	Promissory Note	336
15	R-7	No verbal identification found	
16	R-8	State Order, Securities Div.	405,488
17	R-9	No verbal identification found	
18	R-10	Letter from Johnson-Bowles	410,510,512, 513,533,534
19			
20	R-11	SEC Release	414
21	R-12	NASD Board of Governors Interpretation	481,509
22	R-13	Utah Uniform Securities Act	557
23	R-14	Buy-In Case	560

24  
25

1           THE WITNESS: Well, I realized I hadn't gotten  
2 the money. And I realized that -- we realized that this  
3 whole USA Medical thing was up in the air. And to be  
4 very honest, we weren't sure who was on first, who was  
5 on second, whatever. We knew the fact that the State of  
6 Utah had suspend it and the S.E.C. had suspended it.

7           The S.E.C. in turn lifted its suspension. So we  
8 had to make an assumption the S.E.C. had looked at it  
9 and said well, there's nothing to -- I mean we have  
10 looked at our suspension and that the stock in fact  
11 would be, you know, trading again or active again. And  
12 that if nothing else, Marlen needed some time to work  
13 out the money.

14          I, you know, it's a situation -- the brokerage  
15 business is an incredibly dollar and cent-oriented  
16 thing, but it's based upon a good old boy's hand  
17 shake. I mean these traders will trade millions of  
18 dollars a day on each other's word. And a contract is a  
19 contract.

20          And there are people in this industry that OTRA  
21 will not trade with, we will not let our correspondents  
22 trade with, because they're not nice people. And there  
23 are people in this industry that if they bought a  
24 million dollars worth of stock from us, we wouldn't bat  
25 an eye, because they are reputable people and we have

EXHIBIT "OO"

[¶ 2705A] **Persons Deemed Not to Be Engaged in a  
Distribution and Therefore Not Underwriters**

**Preliminary Note to Rule 144**

Rule 144 is designed to implement the fundamental purposes of the Act, as expressed in its preamble, "To provide full and fair disclosure of the character of the securities sold in interstate commerce and through the mails, and to prevent fraud in the sale thereof." The rule is designed to prohibit the creation of public markets in securities of issuers concerning which adequate current information is not available to the public. At the same time, where adequate current information concerning the issuer is available to the public, the rule permits the public sale in ordinary trading transactions of limited amounts of securities owned by persons controlling, controlled by or under common control with the issuer and by persons who have acquired restricted securities of the issuer.

Certain basic principles are essential to an understanding of the requirement of registration in the Act.

1. If any person utilizes the jurisdictional means to sell any non-exempt security to any other person, the security must be registered unless a statutory exemption can be found for the transaction.

2. In addition to the exemptions found in Section 3, four exemptions applicable to transactions in securities are contained in Section 4. Three of these Section 4 exemptions are clearly not available to anyone acting as an "underwriter" of securities. (The fourth, found in Section 4(4), is available only to those who act as brokers under certain limited circumstances.) An understanding of the term "underwriter" is therefore important to anyone who wishes to determine whether or not an exemption from registration is available for his sale of securities.

The term underwriter is broadly defined in Section 2(11) of the Act to mean any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking. The interpretation of this definition has traditionally focused on the words "with a view to" in the phrase "purchased from an issuer with a view to . . . distribution." Thus, an investment banking firm which arranges with an issuer for the public sale of its securities is clearly an "underwriter" under that Section. Individual investors who are not professionals in the securities business may also be "underwriters" within the meaning of that term as used in the Act if they act as links in a chain of transactions through which securities move from an issuer to the public. Since it is difficult to ascertain the mental state of the purchaser at the time of his acquisition, subsequent acts and circumstances have been considered to determine whether such person took with a view to distribution at the time of his acquisition. Emphasis has been placed on factors such as the length of time the person has held the securities and whether there has been an unforeseeable change in circumstances of the holder. Experience has shown, however, that reliance upon such factors as the above has not assured adequate protection of investors through the maintenance of informed trading markets and has led to uncertainty in the application of the registration provisions of the Act.

It should be noted that the statutory language of Section 2(11) is in the disjunctive. Thus, it is insufficient to conclude that a person is not an underwriter solely because he did not purchase securities from an issuer with a view to their distribution. It must also be established that the person is not offering or selling for an issuer in connection with the distribution of the securities, does not participate or have a direct or indirect participation in any such undertaking, and does not participate or have a participation in the direct or indirect underwriting of such an undertaking.

In determining when a person is deemed not to be engaged in a distribution several factors must be considered.

First, the purpose and underlying policy of the Act to protect investors requires that there be adequate current information concerning the issuer, whether the resales of securities by persons result in a distribution or are effected in trading transactions. Accordingly, the availability of the rule is conditioned on the existence of adequate current public information.

Secondly, a holding period prior to resale is essential, among other reasons, to assure that those persons who buy under a claim of a Section 4(2) exemption have assumed the economic risks of investment, and therefore are not acting as conduits for sale to the public of unregistered securities, directly or indirectly, on behalf of an issuer. It should be noted that there is nothing in Section 2(11) which places a time limit on a person's status as an underwriter. The public has the same need for protection afforded by registration whether the securities are distributed shortly after their purchase or after a considerable length of time.

A third factor, which must be considered in determining what is deemed not to constitute a "distribution," is the impact of the particular transaction or transactions on the trading markets. Section 4(1) was intended to exempt only routine trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions. Therefore, a person reselling securities under Section 4(1) of the Act must sell the securities in such limited quantities and in such a manner as not to disrupt the trading markets. The larger the amount of securities involved, the more likely it is that such resales may involve methods of offering and amounts of compensation usually associated with a distribution rather than routine trading transactions. Thus, solicitation of buy orders or the payment of extra compensation are not permitted by the rule.

In summary, if the sale in question is made in accordance with *all* of the provisions of the rule, as set forth below, any person who sells restricted securities shall be deemed not to be engaged in a distribution of such securities and therefore not an underwriter thereof. The rule also provides that any person who sells restricted or other securities on behalf of a person in a control relationship with the issuer shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter thereof, if the sale is made in accordance with *all* the conditions of the rule.

**Reg. § 230.144.** (a) *Definitions.* The following definitions shall apply for the purposes of this rule.

(1) An "affiliate" of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.

(2) The term "person" when used with reference to a person for whose account securities are to be sold in reliance upon this rule includes, in addition to such person, all of the following persons:

(i) Any relative or spouse of such person, or any relative of such spouse, any one of whom has the same home as such person;

(ii) Any trust or estate in which such person or any of the persons specified in paragraph (a)(2)(i) of this section collectively own ten percent or more of the total beneficial interest or of which any of such persons serve as trustee, executor or in any similar capacity; and

(iii) Any corporation or other organization (other than the issuer) in which such person or any of the persons specified in paragraph (a)(2)(i) of this section are the beneficial owners collectively of ten percent or more of any class of equity securities or ten percent or more of the equity interest.

(3) The term “restricted securities” means:

(i) securities that are acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering; or

(ii) securities acquired from the issuer that are subject to the resale limitations of Regulation D (§ 230.501 through § 230.506 of this chapter) or Rule 701(c) (§ 230.701(c) of this chapter) under the Act; or

(iii) securities that are subject to the resale limitations of Regulation D and acquired in a transaction or chain of transactions not involving any public offering; or

(iv) securities that are acquired in a transaction or chain of transactions meeting the requirements of Rule 144A (§ 230.144A of this chapter). [Amended in Release No. 33-6862 (§ 84,523) effective April 30, 1990, 55 F.R. 17933.]

**.10 Annotations of rulings under paragraph** 2706.3081; 2706.38; 2706.382; 2706.385; (a) of Rule 144—See ¶ 2706.222; 2706.223; 2706.412; 2706.4153; 2706.5012; 2706.5013; 2706.2235; 2706.3039; 2706.307; 2706.308; 2706.5061; 2706.735 and 2706.83.

(b) *Conditions to be Met.* Any affiliate or other person who sells restricted securities of an issuer for his own account, or any person who sells restricted or any other securities for the account of an affiliate of the issuer of such securities, shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter thereof within the meaning of Section 2(11) of the Act if all of the conditions of this rule are met.

(c) *Current Public Information.* There shall be available adequate current public information with respect to the issuer of the securities. Such information shall be deemed to be available only if either of the following conditions is met:

(1) *Filing of Reports.* The issuer has securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, has been subject to the reporting requirements of Section 13 of that Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports); or has securities registered pursuant to the Securities Act of 1933, has been subject to the reporting requirements of Section 15(d) of the Securities Exchange Act of 1934 for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports. The person for whose account the securities are to be sold shall be entitled to rely upon a statement in whichever is the most recent report, quarterly or annual, required to be filed and filed by the issuer that such issuer has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer was required to file such reports) and has been subject to such filings requirements for the past 90 days, unless he knows or has reason to believe that the issuer has not complied with such requirements. Such person shall also be entitled to rely upon a written statement from the issuer that it has complied with such reporting requirements unless he knows or has reason to believe that the issuer has not complied with such requirements. [As amended in Release No. 34-5452 (§ 9928) effective March 15, 1974.]

(2) *Other Public Information.* If the issuer is not subject to Section 13 or 15(d) of the Securities Exchange Act of 1934, there is publicly available the information concerning the issuer specified in paragraph (a)(5)(i) to (xiv), inclusive, and paragraph (a)(5)(xvi) of Rule 15c2-11 (§ 240.15c2-11 of this chapter) under that Act or, if the issuer is an insurance company, the information specified

in Section 12(g)(2)(G)(i) of that Act [Amended in Release No 33-6862 (§ 84,523), effective April 30, 1990, 55 F R 17933 ]

.30 Annotations of rulings under paragraph 2706 4912, 2706 4915, 2706 4916, 2706 4917, (c) of Rule 144.—See § 2706 141, 2706 2237, 2706 492, 2706 4921, 2706 494, 2706 495, 2706 2241, 2706 328, 2706 49, 2706 4901, 2706 496, 2706 497, 2706 5151, 2706 58, 2706 4902, 2706 4903, 2706 491, 2706 4911, 2706 581, 2706 70, 2706 86, 2706 88 and 2706 92

(d) *Holding Period for Restricted Securities.* If the securities sold are restricted securities, the following provisions apply.

(1) *General rule.* A minimum of two years must elapse between the later of the date of the acquisition of the securities from the issuer or from an affiliate of the issuer, and any resale of such securities in reliance on this section for the account of either the acquiror or any subsequent holder of those securities, and if the acquiror takes the securities by purchase, the two-year period shall not begin until the full purchase price or other consideration is paid or given by the person acquiring the securities from the issuer or from an affiliate of the issuer.

(2) *Promissory Notes, Other Obligations or Installment Contracts.* Giving the issuer or affiliate of the issuer from whom the securities were purchased a promissory note or other obligation to pay the purchase price, or entering into an installment purchase contract with such seller, shall not be deemed full payment of the purchase price unless the promissory note, obligation or contract:

- (i) provides for full recourse against the purchaser of the securities;
- (ii) is secured by collateral, other than the securities purchased, having a fair market value at least equal to the purchase price of the securities purchased, and
- (ii) shall have been discharged by payment in full prior to the sale of the securities.

(3) *Determination of Holding Period.* The following provisions shall apply for the purpose of determining the period securities have been held:

(i) *Stock Dividends, Splits and Recapitalizations.* Securities acquired from the issuer as a dividend or pursuant to a stock split, reverse split or recapitalization shall be deemed to have been acquired at the same time as the securities on which the dividend or, if more than one, the initial dividend was paid, the securities involved in the split or reverse split, or the securities surrendered in connection with the recapitalization;

(ii) *Conversions.* If the securities sold were acquired from the issuer for a consideration consisting solely of other securities of the same issuer surrendered for conversion, the securities so acquired shall be deemed to have been acquired at the same time as the securities surrendered for conversion;

(iii) *Contingent Issuance of Securities.* Securities acquired as a contingent payment of the purchase price of an equity interest in a business, or the assets of a business, sold to the issuer or an affiliate of the issuer shall be deemed to have been acquired at the time of such sale if the issuer or affiliate was then committed to issue the securities subject only to conditions other than the payment of further consideration for such securities. An agreement entered into in connection with any such purchase to remain in the employment of, or not to compete with, the issuer or affiliate or the rendering of services pursuant to such agreement shall not be deemed to be the payment of further consideration for such securities.

(iv) *Pledged Securities.* Securities which are bona fide pledged by an affiliate of the issuer when sold by the pledgee, or by a purchaser, after a default in the obligation secured by the pledge, shall be deemed to have been acquired when they were acquired by the pledgor, except that if the securities were pledged without recourse they shall be deemed to have been acquired by

the pledgee at the time of the pledge or by the purchaser at the time of purchase.

(v) *Gifts of Securities.* Securities acquired from an affiliate of the issuer by gift shall be deemed to have been acquired by the donee when they were acquired by the donor.

(vi) *Trusts.* Where a trust settlor is an affiliate of the issuer, securities acquired from the settlor by the trust, or acquired from the trust by the beneficiaries thereof, shall be deemed to have been acquired when such securities were acquired by the settlor.

(vii) *Estates.* Where a deceased person was an affiliate of the issuer, securities held by the estate of such person or acquired from such estate by the beneficiaries thereof shall be deemed to have been acquired when they were acquired by the deceased person, except that no holding period is required if the estate is not an affiliate of the issuer or if the securities are sold by a beneficiary of the estate who is not such an affiliate.

**NOTE:** While there is no holding period or amount limitation for estates and beneficiaries thereof which are not affiliates of the issuer, paragraphs (c), (h) and (i) of the rule apply to securities sold by such persons in reliance upon the rule.

(viii) *Rule 145(a) transactions.* The holding period for securities acquired in a transaction specified in Rule 145(a) shall be deemed to commence on the date the securities were acquired by the purchaser in such transaction. This provision shall not apply, however, to a transaction effected solely for the purpose of forming a holding company.

[Amended in Release No. 33-6862 (¶ 84,523), effective April 30, 1990, 55 F.R. 17933.]

**.40 Annotations of Rulings under paragraph (d) of Rule 144.**—See ¶ 2706.153, 2706.185; 2706.2236; 2706.3001; 2706.3042; 2706.3051; 2706.308; 2706.3510, 2706.391, 2706.41 thru 2706.421, 2706.429, 2706.4410, 2706.625, 2706.641, 2706.642, 2706.732, 2706.810, 2706.93

(e) *Limitation on amount of securities sold.* Except as hereinafter provided, the amount of securities which may be sold in reliance upon this rule shall be determined as follows:

(1) *Sales by affiliates.* If restricted or other securities are sold for the account of an affiliate of the issuer, the amount of securities sold, together with all sales of restricted and other securities of the same class for the account of such person within the preceding three months, shall not exceed the greater of (i) one percent of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer, or (ii) the average weekly reported volume of trading in such securities on all national securities exchanges and/or reported through the automated quotation system of a registered securities association during the four calendar weeks preceding the filing of notice required by paragraph (h), or if no such notice is required the date of receipt of the order to execute the transaction by the broker or the date of execution of the transaction directly with a market maker, or (iii) the average weekly volume of trading in such securities reported through the consolidated transaction reporting system contemplated by Rule 11Aa3-1 under the Securities Exchange Act of 1934 (§ 240.11Aa3-1) during the four-week period specified in subdivision (ii) of this paragraph.

[Amended in Release No. 33-5717 (¶ 80,601), June 8, 1976, 41 F. R. 24702; Release No. 33-5979 (¶ 81,731), effective September 25, 1978, 43 F. R. 43711; Release No. 33-5995 (¶ 81,759), effective November 15, 1978, 43 F. R. 54230; Release No. 34-16589 (¶ 82,455), effective April 5, 1980, 45 F. R. 12377.]



(2) *Sales by persons other than affiliates.* The amount of restricted securities sold for the account of any person other than an affiliate of the issuer, together with all other sales of restricted securities of the same class for the account of such person within the preceding three months, shall not exceed the amount specified in paragraphs (e)(1)(i), (1)(ii) or (1)(iii) of this section, whichever is applicable, unless the conditions in paragraph (k) of this rule are satisfied. [Amended in Release No. 33-5979 (§ 81,731), effective September 25, 1978, 43 F. R. 43711; Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230; Release No. 33-6032 (§ 81,992), effective March 12, 1979, 44 F. R. 15612; Release No. 33-6286 (§ 82,821), February 6, 1981, effective March 16, 1981, 46 F. R. 12195.]

(3) *Determination of Amount.* For the purpose of determining the amount of securities specified in paragraphs (e)(1) and (2) of this rule, the following provisions shall apply:

(i) Where both convertible securities and securities of the class into which they are convertible are sold, the amount of convertible securities sold shall be deemed to be the amount of securities of the class into which they are convertible for the purpose of determining the aggregate amount of securities of both classes sold;

(ii) The amount of securities sold for the account of a pledgee thereof, or for the account of a purchaser of the pledged securities, during any period of three months within two years after a default in the obligation secured by the pledge, and the amount of securities sold during the same three-month period for the account of the pledgor shall not exceed, in the aggregate, the amount specified in subparagraph (1) or (2) of this paragraph, whichever is applicable. [Amended in Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230.]

(iii) The amount of securities sold for the account of a donee thereof during any period of three months within two years after the donation, and the amount of securities sold during the same three-month period for the account of the donor, shall not exceed, in the aggregate, the amount specified in subparagraph (1) or (2) of this paragraph, whichever is applicable; [Amended in Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230.]

(iv) Where securities were acquired by a trust from the settlor of the trust, the amount of such securities sold for the account of the trust during any period of three months within two years after the acquisition of the securities by the trust, and the amount of securities sold during the same three-month period for the account of the settlor, shall not exceed, in the aggregate, the amount specified in subparagraph (1) or (2) of this paragraph, whichever is applicable; [Amended in Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230.]

(v) The amount of securities sold for the account of the estate of a deceased person, or for the account of a beneficiary of such estate, during any period of three months and the amount of securities sold during the same period for the account of the deceased person prior to his death shall not exceed, in the aggregate, the amount specified in subparagraph (1) or (2) of this paragraph, whichever is applicable; *Provided*, That no limitation on amount shall apply if the estate or beneficiary thereof is not an affiliate of the issuer; [Amended in Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230.]

(vi) When two or more affiliates or other persons agree to act in concert for the purpose of selling securities of an issuer, all securities of the same class sold for the account of all such persons during any period of three months shall be aggregated for the purpose of determining the limitation on the

amount of securities sold; [Amended in Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230]

(vii) Securities sold pursuant to an effective registration statement under the Act or pursuant to an exemption provided by Regulation A under the Act or in a transaction exempt pursuant to Section 4 of the Act and not involving any public offering need not be included in determining the amount of securities sold in reliance upon this rule [As amended in Release No. 33-5432 (§ 79,633), effective March 15, 1974, 39 F. R. 6069]

**.50 Annotations of rulings under paragraph (e) of Rule 144.**—See ¶ 2706 2201, 2706 2231, 2706 2241, 2706 3025, 2706 303, 2706 3031, 2706 3033, 2706 3034, 2706 3035, 2706 3036, 2706 3037, 2706 304, 2706 3042, 2706 3043, 2706 3047, 2706 305, 2706 3051, 2706 3052, 2706 3053, 2706 3054, 2706 3055, 2706 3056, 2706 306, 2706 328, 2706 3853, 2706 412, 2706 481, 2706 50, 2706 501, 2706 5011, 2706 5012, 2706 5014, 2706 502, 2706 503, 2706 504, 2706 505, 2706 506, 2706 5060, 2706 5061, 2706 64, 2706 642, 2706 652, 2706 723, 2706 732, 2706 86, 2706 88, 2706 92, 2706 93

(f) *Manner of sale* The securities shall be sold in “brokers’ transactions” within the meaning of section 4(4) of the Act or in transactions directly with a “market maker,” as that term is defined in section 3(a)(38) of the Securities Exchange Act of 1934, and the person selling the securities shall not (1) solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with such transaction, or (2) make any payment in connection with the offer or sale of the securities to any person other than the broker who executes the order to sell the securities. The requirements of this paragraph, however, shall not apply to securities sold for the account of the estate of a deceased person or for the account of a beneficiary of such estate provided the estate or beneficiary thereof is not an affiliate of the issuer; nor shall they apply to securities sold for the account of any person other than an affiliate of the issuer, provided the conditions of paragraph (k) of this rule are satisfied. [Amended in Release No. 33-5979 (§ 82,731), effective September 25, 1978, 43 F. R. 43711; Release No. 33-6286 (§ 82,821), February 6, 1981, effective March 16, 1981, 46 F. R. 12195.]

**.60 Annotations of rulings under paragraph (f) of Rule 144.**—See ¶ 2706 2241, 2706 2262, 2706 2237, 2706 328, 2706 4231, 2706 656, 2706 6561, 2706 86, 2706 90, and 2706 92

(g) *Brokers’ Transactions.* The term “brokers’ transactions” in Section 4(4) of the Act shall for the purposes of this rule be deemed to include transactions by a broker in which such broker—

(1) does no more than execute the order or orders to sell the securities as agent for the person for whose account the securities are sold, and receives no more than the usual and customary broker’s commission,

(2) neither solicits nor arranges for the solicitation of customers’ orders to buy the securities in anticipation of or in connection with the transaction; provided, that the foregoing shall not preclude (i) inquiries by the broker of other brokers or dealers who have indicated an interest in the securities within the preceding 60 days, (ii) inquiries by the broker of his customers who have indicated an unsolicited bona fide interest in the securities within the preceding 10 business days; or (iii) the publication by the broker of bid and ask quotations for the security in an inter-dealer quotation system provided that such quotations are incident to the maintenance of a bona fide inter-dealer market for the security for the broker’s own account and that the broker has published bona fide bid and ask quotations for the security in an inter-dealer quotation system on each of at least twelve days within the preceding thirty calendar days with no more than four business days in succession without such two-way quotations,

*Note to Subparagraph g(2)(ii).* The broker should obtain and retain in his files written evidence of indications of bona fide unsolicited interest by his

customers in the securities at the time such indications are received. [As amended in Release No. 33-5452 (§ 79,633), effective March 15, 1974.]

**.70 Annotations of rulings under paragraph (g) of Rule 144.**—See § 2706.215, 2706.2237, 2706.4172, 2706.444, 2706.6561, 2706.6563, 2706.6565, 2706.6567, 2706.86, and 2706.92  
2706.285, 2706.328, 2706.387, 2706.388,

(3) after reasonable inquiry is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution of securities of the issuer. Without limiting the foregoing, the broker shall be deemed to be aware of any facts or statements contained in the notice required by paragraph (h) below

**Notes.** (i) The broker, for his own protection, should obtain and retain in his files a copy of the notice required by paragraph (h).

(ii) The reasonable inquiry required by paragraph (g)(3) of this section should include, but not necessarily be limited to, inquiry as to the following matters:

a. The length of time the securities have been held by the person for whose account they are to be sold. If practicable, the inquiry should include physical inspection of the securities;

b. The nature of the transaction in which the securities were acquired by such person;

c. The amount of securities of the same class sold during the past three months by all persons whose sales are required to be taken into consideration pursuant to paragraph (e) of this section;

d. Whether such person intends to sell additional securities of the same class through any other means;

e. Whether such person has solicited or made any arrangement for the solicitation of buy orders in connection with the proposed sale of securities;

f. Whether such person has made any payment to any other person in connection with the proposed sale of the securities; and

g. The number of shares or other units of the class outstanding, or the relevant trading volume.

(h) **Notice of proposed sale.** If the amount of securities to be sold in reliance upon the rule during any period of three months exceeds 500 shares or other units or has an aggregate sale price in excess of \$10,000, three copies of a notice on Form 144 shall be filed with the Commission at its principal office in Washington, D. C.; and if such securities are admitted to trading on any national securities exchange, one copy of such notice shall also be transmitted to the principal exchange on which such securities are so admitted. The Form 144 shall be signed by the person for whose account the securities are to be sold and shall be transmitted for filing concurrently with either the placing with a broker of an order to execute a sale of securities in reliance upon this rule or the execution directly with a market maker of such a sale. Neither the filing of such notice nor the failure of the Commission to comment thereon shall be deemed to preclude the Commission from taking any action it deems necessary or appropriate with respect to the sale of the securities referred to in such notice. The requirements of this paragraph, however, shall not apply to securities sold for the account of any person other than an affiliate of the issuer, provided the conditions of paragraph (k) of this rule are satisfied. [Amended in Release No. 33-5307 (§ 79,001), effective November 1, 1972, 37 F. R. 20577; Release No. 33-5452 (§ 79,633), effective March 15, 1974, 39 F. R. 6069; Release No. 33-5452A, effective March 15, 1974, 39 F. R. 8914; Release No. 33-5560 (§ 80,066), effective March 15, 1975, 40 F. R. 6487; Release No. 33-5995 (§ 81,759), effective November 15, 1978, 43 F. R. 54230; Release No. 33-6286 (§ 82,821), February 6, 1981, effective March 16, 1981, 46 F. R. 12195.]

**.80 Annotations of rulings under paragraph (h) of Rule 144.**—See ¶ 2706.2237; 2706.301; 2706.3011; 2706.3012; 2706.3015; 2706.417; 2706.419; 2706.500; 2706.59; 2706.611; 2706.635; and 2706.636.

(i) *Bona Fide Intention to Sell.* The person filing the notice required by paragraph (h) shall have a bona fide intention to sell the securities referred to therein within a reasonable time after the filing of such notice.

(j) *Non-exclusive rule.* Although this rule provides a means for reselling restricted securities and securities held by affiliates without registration, it is not the exclusive means for reselling such securities in that manner. Therefore, it does not eliminate or otherwise affect the availability of any exemption for resales under the Securities Act that a person or entity may be able to rely upon. [Added in Release No. 33-6032 (¶ 81,992), effective March 12, 1979, 44 F. R. 15612.]

(k) *Termination of certain restrictions on sales of restricted securities by persons other than affiliates.* The requirements of paragraphs (c), (e), (f) and (h) of this rule shall not apply to restricted securities sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has not been an affiliate during the preceding three months, provided a period of at least three years has elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer. In computing the three-year period for purposes of this provision, reference should be made to paragraph (d) of this section. [Amended in Release No. 33-6286 (¶ 82,821), effective March 16, 1981, 46 F.R. 12195; Release No. 33-6488 (¶ 83,429), effective October 31, 1983, 48 F.R. 44770; and Release No. 33-6862 (¶ 84,523), effective April 30, 1990, 55 F.R. 17933.]

**.90 Annotations of rulings under Rule 144 generally.**—See ¶ 2706.221; 2706.223; 2706.2235; 2706.228; 2706.3012; 2706.39; 2706.4171; 2706.611; 2706.795.

[Adopted in Release No. 33-5223 (¶ 78,487), effective April 15, 1972, 37 F. R. 596; Release No. 33-5307 (¶ 79,001) effective November 1, 1972, 37 F. R. 20577; Release No. 33-5452 (¶ 79,633), effective March 15, 1974, 39 F. R. 6069; Release No. 33-5452A, effective March 15, 1974, 39 F. R. 8914; Release No. 33-5560 (¶ 80,066), effective March 15, 1975, 40 F. R. 6487; Release No. 33-5613 (¶ 80,293), effective September 11, 1975, 40 F. R. 44541; Release No. 33-5517 (¶ 80,601), June 8, 1976, 41 F. R. 24701; Release No. 33-5979 (¶ 81,731), effective September 25, 1978, 43 F. R. 54230; Release No. 33-6032 (¶ 81,992), effective March 12, 1979, 44 F. R. 15612; Release No. 33-6180 (¶ 82,426), effective February 25, 1980, 45 F. R. 6362; Release No. 34-16589 (¶ 82,455), effective April 5, 1980, 45 F. R. 12377; Release No. 33-6286 (¶ 82,821), February 6, 1981, effective March 16, 1981, 46 F. R. 12195; Release No. 33-6389 (¶ 83,106), effective April 15, 1982, 47 F. R. 11251; Release No. 33-6488 (¶ 83,429), effective October 31, 1983, 48 F. R. 44770; Release No. 33-6768 (¶ 84,231), effective May 20, 1988, 53 F. R. 12918; and Release No. 33-6862 (¶ 84,523), effective April 30, 1990, 55 F.R. 17933.]

#### [¶ 2705AA] Private Resales of Securities to Institutions

##### *Preliminary Notes to Rule 144A*

1. This section relates solely to the application of Section 5 of the Act and not to antifraud or other provisions of the federal securities laws.

2. Attempted compliance with this section does not act as an exclusive election; any seller hereunder may also claim the availability of any other applicable exemption from the registration requirements of the Act.

3. In view of the objective of this section and the policies underlying the Act, this section is not available with respect to any transaction or series of transactions that, although in technical compliance with this section, is part of a plan or scheme to evade the registration provisions of the Act. In such cases, registration under the Act is required.

EXHIBIT "PP"

that there was no undue delay in the Commission (Chairman COHEN and Commission Members QUENS, and BUDGE), Commissioner WHELAN, and the Commission will issue. patting.

**¶ 77,158 In the Matter of the Application of Nassau Securities Service.**

Securities Exchange Act Release No. 7464. November 19, 1964. Findings and opinion of the Commission in full text.

**NASD—Disciplinary Action on Member Upheld—Refusal to Pay Balance Arising Out of Buy-in Not Justified.**—The failure of a NASD member who made a short sale to pay a balance arising out of a buy-in executed by the purchaser was a violation of the NASD rules requiring members to observe "high standards of commercial honor and just and equitable principles of trade." Consequently, the censure, fine and assessed costs imposed by the NASD was upheld. The claim by the applicant that its refusal was based on suspected fraud was not justified since the applicant along with some other 16 dealers, participated in making a market in the stock, was aware of the factors which it claims suggest a manipulation, and when notified of the buy-in, attempted to get another extension for delivery.

See ¶ 25,681, "Exchange Act—Securities Associations" division, Volume 2.

Irving Garber, for Nassau Securities Service.

Marc A. White and Lloyd J. Derrickson, for the National Association of Securities Dealers, Inc.

Nassau Securities Service ("applicant"), a member of the National Association of Securities Dealers, Inc. ("NASD"), a registered securities association, has applied pursuant to Section 15A(g) of the Securities Exchange Act of 1934 for review of disciplinary action taken against it by the NASD.<sup>1</sup>

On the basis of a complaint filed by another member, James Anthony & Co., Inc. ("complainant"), charging applicant with failure to settle a \$325 balance arising out of a "buy-in" executed by complainant under Section 59 of the NASD Uniform Practice Code,<sup>2</sup> the NASD found that applicant violated Section 1, Article III of the NASD Rules of Fair Practice, which requires a member in the conduct of his business to "observe high standards of commercial honor and just and equitable principles of trade." Applicant was censured, fined \$1,000 and assessed costs of \$256.67. Applicant and the NASD filed briefs with us and we heard oral argument.

<sup>1</sup> Under Section 15A(h) of the Act, which defines the nature of our review, we must dismiss these proceedings if we find that applicant engaged in the conduct found by the NASD and that such conduct violated the NASD rule and was inconsistent with just and equitable principles of trade, unless we further find that the penalties imposed by the NASD are excessive or oppressive having due regard to the public interest, and should be cancelled or reduced.

Our findings are based upon an independent review of the record.

**[Buy-in Procedure]**

On October 24, 1962, applicant made a short sale of 100 shares of stock of Cryplex Industries, Inc. ("Cryplex") to complainant at \$6.75 a share, for settlement on October 30. Complainant had other transactions in Cryplex, one of which was a sale by it on October 25, for settlement on October 31, of 100 shares to Hampstead Investing Corp. ("Hampstead") at \$7 per share. Under date of October 31, one day after the settlement date for the sale by applicant, complainant, in accordance with the NASD buy-in procedure, notified applicant that if delivery was not made by November 1 complainant would buy-in the shares on the market for applicant's account. Applicant requested and received an extension of time from complainant, and on November 2 it purchased 100 Cryplex shares from another dealer at \$8.25 per share. Subse-

<sup>2</sup> Section 59 of the NASD Practice Code provides in substance that where a seller has not performed its part of a contract for the sale of securities by the date delivery is due, the buyer, after giving due notice, may purchase, i.e., "buy-in," in the open market and for the account and risk of the seller, the securities which were to have been delivered.

quently, under date of November 9, at which time delivery had not yet been made on any of these transactions, Hampstead wrote complainant notifying it that unless its shares were delivered to it by 2:15 P. M. November 13, Hampstead would buy-in complainant. Complainant informed applicant on the morning of November 13 that if applicant did not deliver its shares by that afternoon, and that if Hampstead executed its buy-in against complainant, complainant would deem that buy-in a close-out of its contract with applicant, thus, in effect, executing its buy-in against applicant. Applicant failed to deliver the shares by the afternoon of November 13, and on that day Hampstead executed its buy-in against complainant by purchasing the Cryplex shares at \$10 per share and complainant sent a confirmation to applicant notifying it of the execution of the buy-in against complainant and the consequent close-out of applicant's transaction. On November 14, applicant received late delivery of the 100 Cryplex shares which it had purchased on November 2 and tendered them to complainant.<sup>3</sup> The tender was refused as too late. Subsequently, Hampstead was paid the balance owed it by complainant, but applicant has not paid complainant the \$325 difference between its contract price and the buy-in price.

Applicant claimed before the NASD and here that the market for Cryplex stock was manipulated, and that the buy-in procedure was being used as a part of the manipulation scheme. In support of this contention it stated that the price of \$10 per share was an unreasonably high price in relation to the company's earnings,<sup>4</sup> and that it had been told by another dealer that "they're going to box" applicant in on the stock. It further asserted that the circumstances here are very similar to

those in two previous instances where it was bought-in on other securities at very high prices, after which the prices of such securities dropped substantially and some of the dealers involved went out of business and could not be located, and that it had reported those situations to the NASD without any results.<sup>5</sup> It states that it refused to pay complainant in order to force the NASD to make an investigation of the Cryplex market.

The NASD asserts that applicant's obligation to complainant is clear, and that applicant offered no evidence to support the claim of manipulation and in fact was itself making a market in Cryplex and appeared in the sheets with an offer of \$10 per share when the buy-in took place.

In this case we are called upon to decide whether under all the circumstances applicant's refusal to pay the \$325 balance arising out of a buy-in effected in accordance with the NASD rules was without equitable excuse or justification.<sup>6</sup> We conclude that it was. Applicant, although claiming before us and the NASD that it suspected fraud in the trading of Cryplex, was itself, along with some 16 other dealers, participating in the making of a market in Cryplex during the period involved and at that time it was aware of most of the factors which it claims suggest a manipulation.<sup>7</sup> Furthermore, the record indicates that applicant, when bought-in by complainant, did not communicate its asserted suspicions of fraud to complainant. Rather, applicant sought to secure another extension of time in which to make delivery of the shares.

Applicant's contention that complainant should have "accommodated" it by staying the buy-in a second time is unreasonable. To have granted applicant's request would have meant as indicated by the District

<sup>3</sup> The NASD noted that applicant did not require its seller to guarantee delivery on the settlement date even through complainant's notice of buy-in had been previously received and even though applicant admitted that, on previous occasions, he had been the subject of buy-ins.

<sup>4</sup> Applicant recites that a report of the issuer showed earnings of one cent per share for the year ending September 30, 1962. The issuer had made a public offering of 80,000 shares at \$3.75 per share in April 1962.

<sup>5</sup> Recent price quotations for Cryplex have been in the range of \$1.50 to \$2 per share. A number of the dealers quoting prices for Cryplex stock in 1962, including Hampstead, are not now in business. Hampstead, which

had been one of the underwriters in the Cryplex public offering in 1962, withdrew its broker-dealer registration in April 1964.

<sup>6</sup> See *Elliot Evans Company*, Securities Exchange Act Release No. 7378 (July 29, 1964); *Franklin & Company*, 38 S. E. C. 113, 116 (1957).

<sup>7</sup> In response to the admonition of the Chairman of the subcommittee of the Board of Governors that applicant had a duty to stop trading Cryplex if it suspected a manipulation, applicant stated that it was, at that time, attempting to trade its way out of a short position. However, we note that applicant was entering offers as well as bids and its bids were consistently among the lowest, facts that would not indicate a desire on its part to purchase shares in order to cover a short position.

Committee that complainant, already bought-in by its vendee, would be assuming applicant's obligation.

Although applicant asserts that it is not attempting to avoid the obligation and indicates that it has offered to put the \$325 in escrow pending an investigation of the Cryplex market, it admits that it never made such an offer to complainant and it did not attempt to communicate with complainant in order to seek a satisfactory solution. Although applicant claims that it suspected fraud it was not justified in resorting to non-payment of an obligation owed to a fellow member of the NASD as a lever to secure an investigation.

We conclude that applicant had no equitable justification for its refusal to honor its obligation to complainant, and that ap-

plicant's conduct was inconsistent with just and equitable principles of trade and contrary to the requirements of Section 1, Article III of the NASD Rules. Under all the circumstances we cannot find that the penalty of censure and a \$1,000 fine imposed by the NASD is excessive or oppressive having due regard to the public interest.

Accordingly, IT IS ORDERED that the application for review of the disciplinary action taken by the National Association of Securities Dealers, Inc. against Nassau Securities Service be, and it hereby is, dismissed.

By the Commission (Chairman COHEN and Commissioners WOODSIDE, OWENS and BUDGE), Commissioner WHEAT not participating.

[REDACTED]  
and Surety Company; Farmington Valley Insurance Company.

Investment Company Act Release No. 4082, November 19, 1964. Findings and opinion of the Commission in full text.

**Transactions Between Affiliated Persons—Exchange of Securities—Prohibition.**—A sale by an affiliate of an affiliated person of a registered investment company and purchase of other securities from the investment company incident to a plan of merger involving the affiliated persons are prohibited by Section 17(a) of the Investment Company Act. However, the transfer effecting the exchange of securities was exempted from the prohibition where requirements of Section 17(b) of the Act, as to reasonableness and fairness, were met.

See ¶ 48,134, 48,137, "Investment Companies—Affiliates; Functions, Directors" division of Volume 3.

**Transactions Between Affiliated Persons—Exemption from Prohibition.**—A sale to and purchase of securities from a registered investment company by an affiliated person of an affiliated person of the investment company through an exchange of securities incident to a plan of merger involving the affiliated persons were held exempted by Section 17(b) of the Investment Company Act from the prohibition of transactions between affiliates under Section 17(a) of the Act. The terms of the proposed transactions, including the consideration to be paid or received, were reasonable and fair and did not involve overreaching by any person concerned and the proposed transaction was consistent with the policy of the registered investment company and the general purposes of the Act.

See ¶ 48,162—48,164, "Investment Companies—Affiliates; Functions; Directors" division, Volume 3.

**Affiliated Person—Definition.**—An insurance company was determined to be an affiliated person of a registered investment under Section 2 (a) (3) of the Investment Company Act, since the investment company held 5.09% of its outstanding voting securities. A company owned by the insurance company as part of a plan of merger and exchange of stock also was held to be an affiliated person of the insurance company under the Act.

See ¶ 47,112, "Investment Companies—Definitions" division of Volume 3.

**Diversified Company—Limitations.**—A registered diversified investment company would meet the 10% limitations of Section 5 (b) (1) of the Investment Company Act



EXHIBIT "QQ"

EDIV 27

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COMMERCE

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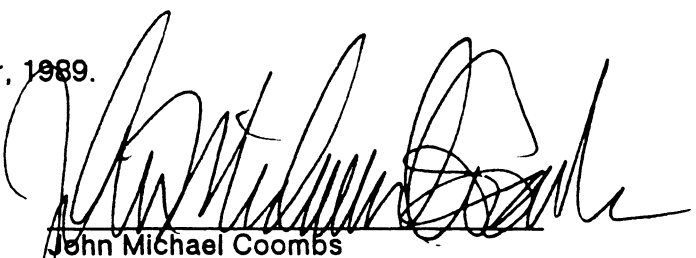
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The newly discovered facts, events, and evidence, comprise the following: The NASD and Oтра Clearing, Inc., a California NASD member, have brought a disciplinary complaint against Respondents before the NASD Business District Conduct Committee,

District No. 3, alleging that Respondents' failure to honor trades with Otra in the securities of U.S.A. Medical constitute violations of the Rules of Fair Practice of the NASD and/or the Government Securities Rules of the NASD, the provisions of the federal securities laws, and/or the rules of the Municipal Securities Rule-making Board. The NASD Disciplinary Action is denominated by Complaint No. DEN-914 and entitled Otra Clearing, Inc. v. Johnson-Bowles Company, Inc., and Marlen Vernon Johnson. Such has been brought in reliance on Art. IV, §2 of the NASD Rules of Fair Practice, entitled "Complaints by public against members for violations of rules". NASD Manual, Rules of Fair Practice (CCH) ¶2202. The Division is requested to take judicial notice of the foregoing disciplinary proceedings in accordance with the Utah Rules of Evidence as contemplated in §63-46b-8(1)(b)(iv), Utah Code Ann. The foregoing is significant in that it evidences the undeniable conflict between federal securities laws and the instant state administrative adjudicative proceedings as Respondents have continuously and consistently alleged throughout these entire proceedings to no avail. In other words, the foregoing evidences that Respondents could not comply with their federal Exchange Act obligations and at the same time not violate state law as contemplated in the instant state administrative proceedings. [Emphasis added.] The foregoing further evidences the undeniable conflict the instant proceedings pose between state and federal law. Further, it is significant that the NASD/Otra disciplinary action, which seeks to revoke or suspend the NASD registration of Respondents, is not brought as an ordinary NASD arbitration matter. On the contrary, such is brought to discipline Respondents for alleged violations of federal law -- federal violations which allegedly justify putting Respondents out of business for reasons diametrically opposite to those alleged in the instant administrative proceedings. The foregoing further evidences

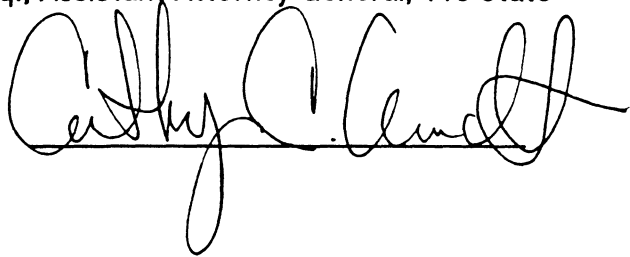
that the Division's representations at the hearing on Respondents' Rule 12(b)(1) Motion on July 14, 1989, that the NASD would not discipline Respondents for not honoring ~~E~~<sup>A</sup>ct trades is patently erroneous and false as Respondents have further contended all along. A true and correct copy of the NASD Notice of Complaint is attached hereto and incorporated by reference as Exhibit "A".

DATED this 2<sup>nd</sup> day of November, 1989.

  
John Michael Coombs  
Attorney for Respondents

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 2<sup>nd</sup> day of November, 1989, (s)he mailed a true and correct copy of the foregoing NOTICE OF NEWLY DISCOVERED EVIDENCE by regular mail, postage prepaid to John C. Baldwin, Director and Kathleen C. McGinley, Director of Broker-Dealer Section, Securities Division, Utah Department of Commerce, 160 East 300 South, P.O. Box 45802, Salt Lake City, Utah 84145-0802; Administrative Law Judge J. Stephen Eklund, Esq., Department of Commerce, 160 East 300 South, P.O. Box 45802, Salt Lake City, Utah 84145-0802; Craig F. McCullough, Esq., Callister, Duncan, & Nebeker, Co-Counsel to Respondents, 8th Floor, Kennecott Bldg., 10 East South Temple Street, Salt Lake City, Utah 84133; and Mark J. Griffin, Esq., Assistant Attorney General, 115 State Capitol Building, Salt Lake City, Utah 84114.



J:NOTICE.1

# National Association of Securities Dealers, Inc.

## NOTICE OF COMPLAINT

Complaint No.: DEN-914

Date Filed: October 25, 1989

Origin:

To: *Name and Address of Respondent(s):*

Johnson-Bowles Company, Inc., 430 East 400 South, Salt Lake City, UT 84111  
and Marlen Vernon Johnson, 430 East 400 South, Salt Lake City, UT 84111

From: *OTRA CLEARING, INC.*

116 North Maryland, Suite 120  
Glendale, California 91206

You are hereby notified that a complaint has been filed by Otra Clearing, Inc., a true copy of which is attached hereto, alleging that you have violated the Rules of Fair Practice of the NASD, and/or the Government Securities Rules of the NASD, the provisions of the federal securities laws, and/or the rules of the Municipal Securities Rulemaking Board.

All individual respondents named in this proceeding are reminded of the requirement to immediately update their application for registration (Form U-4) upon receipt of this notice of complaint to reflect that they have been named a respondent in this complaint.

ANSWER: Pursuant to Article II Section 3(a) of the Code of Procedure applicable to disciplinary actions involving members and associated persons, you are required to submit to the District Business Conduct Committee, three (3) copies of a written answer to said complaint within twenty (20) calendar days of the date of this notice on the forms enclosed herewith. The answer should be complete and responsive to each allegation contained in the complaint. If applicable, extenuating or mitigating circumstances should be discussed in the answer in order to give the Committee, benefit of this information. In complaints involving multiple respondents, copies of the answers submitted by each respondent will be mailed to all other respondents.

HEARING: If you desire and indicate such in your answer, a hearing on this matter will be held at least ten (10) calendar days after notice of its time and place has been sent to you.

EVIDENCE AT HEARING: Upon respondent's request, the NASD staff's witness list and proposed exhibits for the hearing shall be made available to the respondent no later than five business days before the hearing. Similarly, a respondent shall submit to the NASD staff its proposed exhibits and witness list no later than five business days prior to the hearing.

OFFER OF SETTLEMENT: Pursuant to Article II Section 11 of the Code of Procedure you may propose an offer of settlement to Otra Clearing, Inc. Such offer must be in writing and contain a detailed restatement of the complaint, a consent to findings of fact and violations, a proposed sanction to be imposed, and a waiver of all rights of appeal.

Questions regarding the above should be directed to:

Cynthia King Sadick, Senior Regional Attorney, (303) 298-7234

(Name, Title, Telephone No.)

*100-1825*  
*100-1825*  
District Director  
for District No. 3

cc: NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.  
1735 K STREET, N.W., WASHINGTON, D.C. 20006

"A"

EXHIBIT "RR"



Arbitration

National Association of  
Securities Dealers, Inc.  
425 California St., Rm. 1400  
San Francisco, CA 94104  
(415) 781-3343  
FAX: (415) 362-9946

January 14, 1991

John Michael Coombs, Esq.  
72 East 400 South, Ste. 220  
Salt Lake City, UT 84111

Subject: NASD Arbitration Number 90-00757  
OTRA Clearing, Inc. vs. Johnson Bowles Company, Inc. and Marlen  
Vernon Johnson

Dear Mr. Coombs:

In accordance with the NASD Code of Arbitration Procedure, a decision in the above-captioned matter has been reached by the arbitrators and is enclosed.

Any questions regarding this decision should be directed to me. The parties must not contact the arbitrators directly.

Very truly yours,

*Virginia Hall*

Virginia Hall  
Arbitration Administrator  
415-781-3343

VH:REH:LC09A  
Enclosure

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

In the Matter of the Arbitration Between	)	
	)	
Otra Clearing, Inc.	)	
Claimant	)	
	)	AWARD
vs.	)	
	)	NASD # 90-00757
Johnson-Bowles Company, Inc.	)	
Marlen Vernon Johnson	)	
Respondents	)	
	)	

**SUMMARY OF ISSUES**

Claimant alleged Respondents failed to fulfill a contract for the purchase and sale of 150,000 shares of U.S.A. Medical common stock. Claimant alleged that Johnson-Bowles was a market maker for this stock and, as such, was obligated to complete the transaction. Claimant further alleged that it was compelled to buy-in the shares on behalf of Respondent Johnson-Bowles, and that it suffered a monetary loss from Respondents' failure to pay for the buy-in. Claimants alleged violations of federal securities laws and the NASD rules of Fair Practice.

Respondents denied all allegations of wrong-doing, and asserted that a scheme to perpetrate a stock fraud was undertaken by third parties which victimized Respondents and left them unable to complete the transaction. Respondents further asserted that rulings of the State of Utah Division of Securities and of the U.S. District Court for the Central Division of Utah rendered the further trading of USA Medical illegal in the State of Utah, thus relieving them of the obligation to complete the transactions at the time. Respondents alleged that a later attempted delivery of the shares to Claimant was refused.

**DAMAGES AND RELIEF REQUESTED**

Claimant requested actual damages of \$89,600.00, punitive damages of \$100,000.00, plus interest, attorneys' fees and costs of arbitration.

Respondents requested dismissal of all claims and an award of attorneys' fees.

**DAMAGES AND RELIEF AWARDED**

This claim was filed with the NASD on March 14, 1990. A pre-hearing telephone conference was held October 31, 1990, and lasted one (1) session. On December 13 and 14, 1990, the



undersigned arbitrators heard the controversy between the parties as set forth in submissions to arbitration signed by Claimant on March 13, 1990, by Johnson-Bowles Company on May 7, 1990, and by Marlen Johnson on December 13, 1990. The hearing was conducted in Salt Lake City, Utah and lasted four (4) sessions. The arbitration panel, having considered the pleadings, the testimony, and the evidence presented at the hearing, has determined in full and final resolution of the issues submitted as follows:

1. Respondents Johnson-Bowles and Marlen Johnson are jointly and severally liable for and shall pay to Claimant the sum of \$89,600.00 plus interest at the rate of 10% from February 23, 1989 to date of payment.
2. The claim for punitive damages is dismissed.
3. The parties shall each bear their respective costs including attorneys' fees.
4. In accordance with Section 44 of the NASD Code of Arbitration Procedure, the NASD shall retain the \$1,000.00 filing fee previously deposited by the Claimant as an assessment of forum fees. Respondents are jointly and severally assessed forum fees of \$4,000.00, payable to the NASD.

#### OTHER ISSUES

This claim was ordered to arbitration by Order dated March 1, 1989, in Case No. 89-C-157-G in the United States District Court for the District of Utah, Central Division.

#### ARBITRATORS CONCURRING

DATE SERVED: 1/14/91

\_\_\_\_\_  
Jack R. Welch

  
\_\_\_\_\_  
E.Y. Bennion

\_\_\_\_\_  
Peggy Peterson

**AFFIDAVIT OF SERVICE**

**National Association of  
Securities Dealers, Inc.**  
425 California St., Rm. 1400  
San Francisco, CA 94104  
(415) 781-3343  
FAX: (415) 362-9946

State of California        )  
                                  )  
County of San Francisco    )       ss.

I, Rhene M. Ong, hereby declare, depose and state under penalty of perjury that:

1. I am over eighteen years of age, am not a party to the arbitration proceedings, and am employed by the National Association of Securities Dealers, Inc. in San Francisco, California.

2. On January 14, 1991, I enclosed a true, accurate and complete copy of:

**AWARD SERVED:**

NASD Arbitration Number 90-00757

OTRA Clearing, Inc. vs. Johnson Bowles Company, Inc. and Marlen Vernon Johnson

in a properly addressed wrapper, with postage prepaid, and deposited it in a post office or official depository under the exclusive care and custody of the United States Postal Service within this state. The addressee(s) and the address(es) to which the above document(s) was/were sent is/are:

John Michael Coombs, Esq.  
72 East 400 South, Ste. 220  
Salt Lake City, UT 84111

Christopher Condie, Esq.  
Van Wagoner & Stevens  
215 South State Street  
Suite 500  
Salt Lake City, UT 84111

3. The address(es) set forth in paragraph 2 is/are the address(es) designated for that purpose by a party/parties to the arbitration or its/their counsel or is/are the last known address(es) thereof.

4. I declare under penalty of perjury, pursuant to 28 U.S.C. 1746, that the foregoing is true.

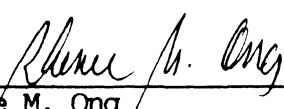
  
\_\_\_\_\_  
Rhene M. Ong  
Secretary

EXHIBIT "SS"



Utah Code Ann. §61-1-23, §63-46b-14, and/or §63-46b-16. Respondents interpret the UAPA and the corollary Department of Commerce Rules as requiring this request for agency review before judicial review is either permissible or available. By filing this Request, Respondents further do not intend to waive a ruling by the ALJ (or anyone else) on their pleadings filed August 20, 1990 relative to the August 13, Order. This is because under applicable rules, Respondents have no choice but to file this Request on or before today, August 23, 1990. Respondents have also not furnished a copy of this Request to the ALJ in that they understand that the matter is out of his hands and he will not be participating in any decision on this Request. Respondents also incorporate herein by reference as Exhibit "A", a true and correct copy of the official transcript of the July 16, 1990, proceedings before the Securities Advisory Board and the ALJ.

#### BRIEF

The following will serve as Respondents' Brief in support of this Request for Agency Review. Respondents make reference to the various memorandums in support of and in reply to the motions and subsequent orders issued by the ALJ in the record. The orders from which agency review is sought are numbered hereinbelow and the pleadings to which the reviewing or presiding officer is directed to refer to in each regard are further referenced below. The pleadings referenced below are in no way intended to be exhaustive of what is otherwise in the record and which should be considered in ruling on this Request. The reviewing officer is also directed to hear the tapes of any oral argument that occurred, as applicable to otherwise ensure that the ALJ did not err. Based on the foregoing, and, for the sake of convenience, the reviewing officer is directed to the following in the record.

1. Order Granting The Division's Motion to Convert

07/14/89

000 503

05/30/89

With respect to this ruling, a ruling which determined the rights of Respondents throughout the remainder of the proceedings (and which prejudiced them accordingly), Respondents further submit that the Division promulgated its own set of rules whereby actions such as those brought against Respondents would strictly be designated as informal proceedings. Even in light of its own rules which the Division is obligated to follow, the Division still elected to bring the proceedings as informal at the outset and, while it never had or stated any legitimate grounds to convert, Respondents submit that it otherwise waived any right or other ability to convert the proceedings to formal. Further, the ALJ's order granting the motion to convert is erroneous in that its only effect is to deprive Respondents of a trial de novo in the district court without any other basis in law or fact. For instance, so-called "cost-effectiveness" cannot be a basis for such order in that, after 1½ years of costly and time consuming litigation, the Division has spent a fortune of the taxpayers' money in this litigation and a trial de novo in the district court would have been simpler, more efficient, cheaper, and swifter. Furthermore, if the ALJ is correct in his order granting the motion to convert, there would never be a circumstance when any informal proceeding could not be converted to formal simply because, like a spoiled child, that is what the Division, or any other agency, desires. The ALJ's Order is thus further contrary to what the legislature has provided by statute, namely, allowing those such as Respondents with the right to a trial de novo.

## DATES

- 08/29/89

Reference is made to: Respondents' Supporting Memorandum

07/03/89

Reference is also made to: Affidavit in Support of 12(b)(1) Motion.

07/13/89

Reference is further made to: Respondents' letter or Reply Memorandum to the ALJ.

07/13/89

Reference is further made to Respondents' Brief in Support of Request for Agency Review of the ALJ's 8/29/89 order dated September 11, 1989, and Respondents' Reply Memorandum in Support of Request for Agency Review dated October 6, 1989. The reviewing officer is requested to address all issues presented in such memorandums and pleadings, item by item, more especially those that the ALJ neglected to address.

3. Order Denying Respondent's 12(b)(6) Motion

12/18/89

Reference is made to: Respondents' Supporting Memorandum.

09/27/89

Reference is further made to Respondents Reply Memorandum.

10/25/89

Respondents assign error on the basis of any one or all of the arguments presented in the foregoing pleadings and request that the reviewing officer address all arguments posed therein, item by item. There are also several Constitutional issues that the ALJ wholly neglected to address and which should be addressed for purposes of judicial appeal.

4. Order Granting the Division's Motion to Dismiss Respondents' Counterclaim.  
(Separate from the order in #3 above.)

12/18/89

Reference is made to the Respondents' Opposing Memorandum.

11/09/89

5. Order Denying Respondents' Motion for Summary Judgment.

03/23/90

Reference is made to: Respondents' Supporting Memorandum.

11/28/89

(b)(7) - 2005

their Reply Memorandum.

12/21/89

their Objection and Motion to Strike.

12/21/89

Respondents' counsel's Rule 56(f) Affidavit  
In Opposition to Petitioner's Motion for Partial  
Summary Judgment.

12/21/89

Reference is further made to: Affidavits of the five (5) Utah residents from whom Respondents purchased the stock in issue, filed November 28, 1989, with the ALJ, including the 11/29/89 affidavit of Carl Smith. Reference is further made to the Affidavit of Bruce Eatchel dated December 20, 1989 and Respondents' Supporting Affidavit dated November 27, 1989.

The Order Denying Respondents' Motion for Summary Judgment was erroneous in that the ALJ was indeed competent to rule on the merits and his ruling should have been the subject of a Request for Agency Review and subsequent Judicial Review as opposed to proceeding unnecessarily with a trial on July 16, 1990. Respondents believe that the August 13, 1990, Order was pre-ordained and in the interest of expediting the process, the ALJ could have made the same ruling relative to Respondents' Motion for Summary Judgment. The fact of the matter is that there was no issue of fact for a trial and the ALJ was just as competent as the Securities Advisory Board to make an ultimate ruling. The ALJ's 3/23/90, which concluded the contrary, was thus error and needlessly resulted in a trial on July 16, 1990.

However, most significantly, the ALJ erred in that Respondents should have been granted summary judgment dismissing the proceedings on the basis of the arguments presented in the above-referenced pleadings. For instance, Respondents cannot be liable, as a matter of law, for aiding and abetting in that they neither created (nor participated in)

000006



the problem which caused exemptions to be unavailable nor did they solicit their sellers as a matter of law —thereby not "substantially participating" in any underlying wrong. In addition, Respondents are otherwise within the class of persons (i.e., purchasers) that registration statutes were enacted to protect. Thus, the Division's aiding and abetting theory is fundamentally and logically flawed. See the law cited by Respondents in the above memorandums and the Schvaneveldt case quoted in Exhibit "A" attached hereto and incorporated by reference. Further see the transcript of Mr. David R. King's expert testimony in Exhibit "A" hereto. See also Kerbs v. Fall River Industries, Inc., 502 F.2d 731 (1974), the leading 10th Circuit case on aiding and abetting in the securities law context.

6. Findings of Fact, Conclusions of Law and Order.

08/13/90

See the entire transcript attached hereto as Exhibit "A".

In support of Request for Agency Review of this particular order, reference is made to the transcript of the proceedings held on July 16, 1990, which evidence that the August 13, Order is not supported in the least by the evidence. A true and correct copy of the official transcript of the July 16, 1990, hearing, with Respondents' counsel's corrections, is attached hereto and incorporated by reference into the record as Exhibit "A". Specifically, the Findings of Fact are superfluous and unsupported by the record; the Conclusions of Law do not follow from the Findings or the record of proceedings; and the Order, including the Sanction, is neither supported by the Findings of Fact nor the Conclusions of Law.

In further support of review of this particular Order, Respondents incorporate by reference their August 20, 1990, Objection to the form of content of such order, their counsel's supporting affidavit dated August 20, and their Demand for Disclosure of how and

08/13/90

by whom the August 13, Order was prepared, also dated August 20. Respondents are prejudiced on appeal by the August 13, Findings of Fact, Conclusions of Law, and Order ("Order") in its present form. This is because the appellate court must defer to the finder of fact and may only overturn such Order in the event it concludes that no reasonable person could have made the findings set forth in such Order. Because the Order is grossly one-sided and "padded" with ridiculous material which is not reflective of what actually occurred on July 16, 1990, Respondents are infinitely prejudiced on appeal. In addition, considering that the Securities Advisory Board acted as a de facto jury, there should be no findings of fact or conclusions of law, simply a verdict and corollary sanction analogous to a sentencing. In such event, it would be the transcript which would alone go up on appeal all by itself, not the prejudicial and biased Order in addition thereto (which will now get the most attention).

#### CONCLUSION

Based on the foregoing and Utah Code Ann. §63-46b-12(1)(b)(ii), Respondents pray for reversal of the Orders referred to above and for an order dismissing and vacating the proceedings, more especially the August 13, 1990, Order, as a matter of law.

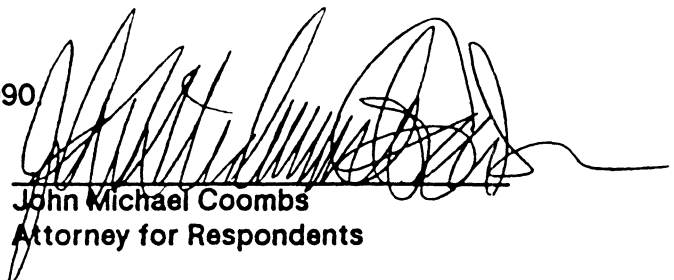
In accordance with applicable Department of Commerce Rules, this document is intended to serve, on the basis of the portions of the record referred to, as a Brief in Support of Respondents' Request for Agency Review. Again, the citations to the record are not exclusive of what the reviewing officer should direct his attention to in ruling on this Request.

The parties seeking review have further signed this Request as required under Utah Code Ann. §63-46b-12(b)(i). Respondents further waive oral argument in that they

1 2 3 4 5 6 7 8 9 10 11 12

believe their arguments are sufficiently presented in the record and in the ALJ's tape recordings of oral argument on each motion. The reviewing officer is also respectfully requested to listen to the tape recorded proceedings of formal hearings heard on each of the foregoing motions, as applicable.

DATED this 23rd day of August, 1990



John Michael Coombs  
Attorney for Respondents

JOHNSON-BOWLES, COMPANY, INC.,  
Respondent



By: Maflen V. Johnson  
Its: President



Maflen V. Johnson, Respondent

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 23rd day of August, 1990, (s)he hand-delivered a true and correct copy of the foregoing REQUEST FOR AGENCY REVIEW OF ENTIRE RECORD AND SUPPORTING BRIEF to John C. Baldwin, Director and Kathleen C. McGinley, Director of Broker-Dealer Section, Securities Division, Utah Department of Commerce, 160 East 300 South, P.O. Box 45802, Salt Lake City, Utah 84145-0802; Mark J. Griffin, 115 State Capitol, Salt Lake City, Utah 84114; and Craig F. McCullough, Esq., of Callister, Duncan & Nebeker, Co-Counsel to Respondents, 8th Floor, Kennecott Bldg., 10 East South Temple Street, Salt Lake City, Utah 84133.

J:REQUEST.9-11

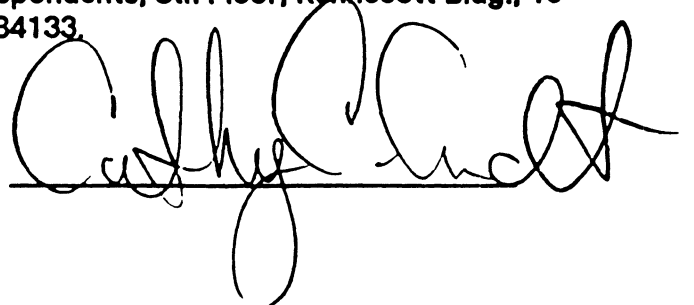
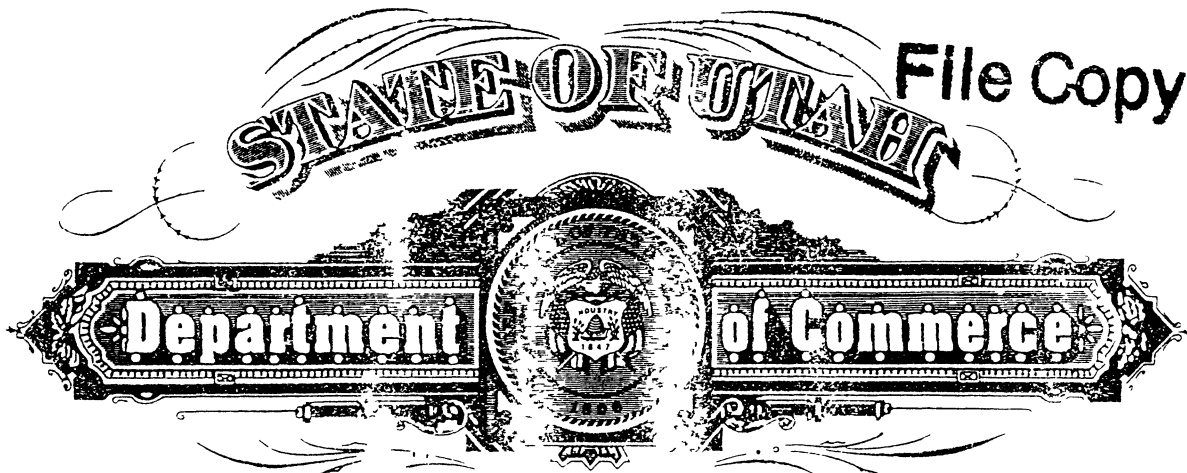


EXHIBIT "TT"



SECURITIES DIVISION

## CERTIFICATE OF REGISTRATION

(Not transferable)

File Number 3334-14/A05794-21

THIS CERTIFIES THAT USA MEDICAL CORPORATION ("USA") whose address is 2020 South 1900 West, Ogden, Utah 84401, has complied with the requirements of §61-1-10 of the Utah Uniform Securities Act, and is granted this registration FROM March 1, 1991 TO February 29, 1992 (Unless sooner revoked by this Division as provided by law).

This certificate applies only to previously distributed securities currently held by bona fide purchasers who purchased the securities in the public market. USA shall provide the Division copies of its shareholder list at pre-determined intervals throughout the effectiveness of this registration. Within two weeks of the effective date, USA shall provide each current shareholder a copy of its final prospectus. USA shall advise current shareholders to disseminate information contained in the prospectus to prospective purchasers and brokers through whom sales are solicited.

STATE OF UTAH } ss  
COUNTY OF SALT LAKE

I, THE UNDERSIGNED, DIRECTOR OF THE SECURITIES DIVISION OF THE DEPARTMENT OF COMMERCE DO HEREBY CERTIFY THAT THE ANNEXED AND FOREGOING IS A TRUE AND FULL COPY OF AN ORIGINAL DOCUMENT ON FILE IN MY OFFICE AS SUCH DIRECTOR.  
WITNESS MY HAND AND SEAL OF SAID DIVISION

THIS 14th DAY OF May 1991  
BY Earl S. Maeser  
Earl S. Maeser, Director

UTAH SECURITIES DIVISION

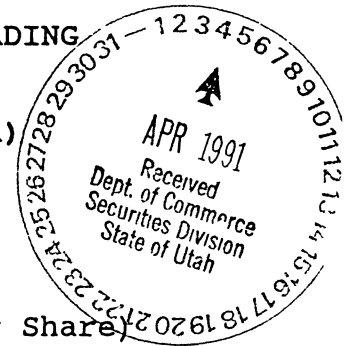
Earl S. Maeser  
DIRECTOR

Noted in Division, L.C.  
217 South 1900 West, Suite 100  
Salt Lake City, Utah 84143

SAA

**PROSPECTUS**  
**FOR REGISTRATION PRIOR TO SECONDARY TRADING**

**LIFE CONCEPTS, INC.**  
**(Formerly U.S.A. Medical Corporation)**  
**(A Wyoming Corporation)**  
**2020 South 1900 West**  
**Ogden, Utah 84401**



26,352,500 Shares Outstanding  
Common Capital Shares (Par Value \$.001 Per Share)

(ALTHOUGH 26,352,500 AMOUNT OF SHARES REPRESENT THE OUTSTANDING SHARES AS OF DECEMBER 31, 1989, THE COMPANY BELIEVES THAT NOT ALL OF THE OUTSTANDING SHARES ARE HELD BY BONA FIDE PURCHASERS. THE ATTORNEY'S OPINION AS TO LEGALITY OF THE SHARES AND THE ATTORNEY'S OPINION AS TO TRADEABILITY OF THE SHARES APPLY ONLY TO THE SHARES THAT ARE HELD BY BONA FIDE PURCHASERS.)

Life Concepts, Inc., (formerly U.S.A. Medical Corporation), a Wyoming corporation (hereinafter the "Company"), was incorporated on January 12, 1979. The Company has manufactured and markets medical products which include general aspirators. (See "Description of Business" and "Risk Factors.")

Purchase of the shares of the Company's common stock (the "Shares") involve a high degree of risk to the public investors and shares should be purchased only by persons who can afford to lose their entire investment. (See "Risk Factors.") Although the Company is not a development stage corporation, it has had only limited operations since March 1989, there has been no public market for the shares of the Company in Utah for over one year, and there can be no assurance that a public market will develop. This prospectus relates only to securities that are offered to residents of the state of Utah through the "secondary trading" market.

THESE SECURITIES HAVE NOT BEEN REGISTERED WITH THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION BECAUSE THEIR SECONDARY TRADING IS BELIEVED TO BE EXEMPT FROM REGISTRATION UNDER SECTION 4(1) OF THE SECURITIES ACT OF 1933 AND RULE 144 PROMULGATED THEREUNDER BY THE SECURITIES AND EXCHANGE COMMISSION. THE SECURITIES ARE REGISTERED UNDER THE SECURITIES LAWS OF THE STATE OF UTAH.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR THE SECURITIES DIVISION OF ANY STATE NOR HAS THE COMMISSION OR ANY STATE PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. NEITHER THE UTAH SECURITIES DIVISION NOR ANY OFFICER OF THE STATE OF UTAH HAS PASSED UPON THE MERITS OF THESE SECURITIES OR UPON THE ACCURACY OR COMPLETENESS OF THIS PROSPECTUS. NO PERSON HAS BEEN AUTHORIZED TO MAKE ANY STATEMENTS NOT CONTAINED IN THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

**The Date of this Prospectus is March 1, 1991 (As amended to March 9, 1991)**

Brokers must provide this prospectus to purchasers and receive a signed "representation form" from purchasers for one year after the effective date of the prospectus.

STATE OF UTAH  
DEPT. OF COMMERCE  
SECURITIES DIVISION  
I, THE UNDERSIGNED, DIRECTOR OF THE  
SECURITIES DIVISION OF THE DEPARTMENT OF  
COMMERCE DO HEREBY CERTIFY THAT  
THE ANNEXED AND FOREGOING IS A TRUE AND FULL  
COPY OF AN ORIGINAL DOCUMENT ON FILE IN MY  
OFFICE AS SUCH DIRECTOR.

WITNESS MY HAND AND SEAL OF SAID DIVISION

THIS 14th DAY OF May 19 91  
BY Gail S. [Signature]

NO BROKER, DEALER, SALESMAN, AGENT OR ANY OTHER PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS. PRACTICES TO THE CONTRARY ARE A CRIMINAL OFFENSE. IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE COMPANY. UTAH BROKERS WHO MAKE A MARKET IN THE COMPANY'S STOCK DURING THE ONE-YEAR REGISTRATION PERIOD MUST COMPLETE FORM 10.2-1B AND FILE IT WITH THE UTAH SECURITIES DIVISION.

ANY AND ALL AMENDMENTS TO THIS PROSPECTUS WILL BE PROMPTLY FILED WITH THE UTAH SECURITIES DIVISION, DISTRIBUTED TO SHAREHOLDERS, AND MADE A PART OF ANY PROSPECTUS USED THEREAFTER. THE COMPANY WILL PROMPTLY NOTIFY THE UTAH SECURITIES DIVISION, MARKET MAKERS AND SECURITY HOLDERS IN WRITING OF ANY CHANGE IN THE MANAGEMENT, PURPOSE AND CONTROL OF THE ISSUER, OR ANY MATERIAL OR ADVERSE CONDITION AFFECTING THE COMPANY.

THE ONGOING INVESTIGATION BY THE UTAH DIVISION OF THE COMPANY'S SECURITIES MAY RESULT IN THE ISSUANCE OF AN ORDER BY THE DIVISION, AT SOME FUTURE DATE, STOPPING FURTHER TRADING IN THE SECURITIES OF THE COMPANY.

REGISTRATION OF THIS PROSPECTUS WITH THE UTAH SECURITIES DIVISION IS NEITHER A RECOMMENDATION NOR AN ENDORSEMENT OF ANY SECURITY, INDIVIDUAL, FIRM, OR CORPORATION.

Brokers effecting transactions in the Company's stock must provide Form 10.2-1B within five days of the execution of the first trade in the Company's stock.

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## TABLE OF CONTENTS

SUMMARY OF PROSPECTUS . . . . .	1
Purpose of Prospectus . . . . .	1
Risk Factors . . . . .	1
The Company . . . . .	1
The Offering Through Secondary Trading . . . . .	2
Capitalization . . . . .	2
Use of Proceeds . . . . .	2
Financial Summary . . . . .	2
RISK FACTORS . . . . .	2
DILUTION . . . . .	8
MARKET PRICE IN RELATION TO NET TANGIBLE BOOK VALUE . . . . .	9
USE OF PROCEEDS . . . . .	10
DESCRIPTION OF BUSINESS . . . . .	10
CORPORATE HISTORY . . . . .	10
INTEGRITY AND EXISTENCE OF CORPORATE DOCUMENTS . . . . .	10
PRODUCT DEVELOPMENT . . . . .	11
Government Regulation . . . . .	12
High Powered Surgical Aspirator and Surgical Cannula	
Market . . . . .	12
Rationale For High Powered Aspiration . . . . .	13
NEW MEDICAL PRODUCTS . . . . .	13
ACQUISITION OF OTHER PRODUCTS . . . . .	13
LITIGATION AND ADMINISTRATIVE ACTIONS . . . . .	14
PATENTS . . . . .	18
COMPETITION . . . . .	18
FINANCIAL STATUS . . . . .	18
OFFICES . . . . .	18
EMPLOYEES . . . . .	18
CAPITALIZATION AND DESCRIPTION OF SECURITIES . . . . .	19
MARKET PRICE OF SHARES . . . . .	
MANAGEMENT . . . . .	20
OFFICERS AND DIRECTORS . . . . .	20
COMPENSATION . . . . .	21
INDEMNIFICATION OF OFFICERS AND DIRECTORS . . . . .	21
FIDUCIARY RESPONSIBILITY . . . . .	22
TRANSACTIONS WITH MANAGEMENT . . . . .	23
PRINCIPAL SHAREHOLDERS . . . . .	23
DIVIDENDS . . . . .	27



PLAN OF DISTRIBUTION . . . . .	27
LEGAL MATTERS . . . . .	28
EXPERTS . . . . .	28
OTHER MATTERS . . . . .	29
EXHIBITS . . . . .	30
FINANCIAL STATEMENTS . . . . .	31

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## SUMMARY OF PROSPECTUS

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The following is intended merely to summarize certain material contained in this Prospectus and is qualified in its entirety by the information and the financial statements appearing elsewhere herein.

### Purpose of Prospectus

On March 1, 1989, the Utah Securities Division issued Orders which suspended secondary trading of the Company's common stock within the state of Utah. On September 1, 1989, the Division publicly announced its decision to allow shares of the Company's stock to resume trading as soon as the Division declares effective the registration statement filed with the Division on behalf of the Company. The Division's decision to permit trading in U.S.A. Medical stock to resume does not reflect any approval or disapproval of these securities, nor does it reflect any opinion about whether these securities have any value. At the date of this prospectus, the Division's investigation into irregularities of trading of the Company's stock is continuing. Such investigation may result in the issuance of an order by the Division, at some future date, stopping further trading in the securities of the Company.

### Risk Factors

The purchase of the Company's securities involves significant risks to an investor, including the fact that the Company has engaged in limited operations to date, stock certificates with forged signatures or certificates issued following transfer or cancellation of such certificates may exist, and other significant factors which make investment herein a highly speculative venture. (See "Risk Factors.")

### The Company

Life Concepts, Inc., formerly U.S.A. Medical Corporation and S.M.I., Inc., (the "Company"), is a Wyoming corporation incorporated on January 12, 1979. The Company merged with a Utah company, in December 1987, which was engaged in development and manufacturing of medical products. Questions exist concerning the legality of this merger. The Company has had limited operations since its inception. (See "Description of Business.")

The offices of the Company are presently located at 2020 South 1900 West, Ogden, Utah 84401.

### The Offering Through Secondary Trading

The Company's shares are not being offered by the Company and the Company will receive no proceeds from the sale of shares contemplated herein. The shares are being registered with the state of Utah and may be offered for sale by existing shareholders through brokers and market makers. Questions exist concerning whether some presently existing shareholders acquired their shares through a transfer of stock certificates with forged signatures.

### Capitalization

Date of Capitalization	December 31, 1990
Shares of Common Stock: Insiders	16,000,000
Shares of Common Stock: Publicly-Held	10,352,500
Par Value Per Share	\$.001
Book Value Per Share	(\$ .00784)

### Use of Proceeds

No proceeds will be received by the Company pursuant to this registration and prospectus.

### Financial Summary

The Company has had a limited operating history prior to this prospectus and has had only moderate revenue from operations during such period since inception. There is no assurance that the Company will ever have material revenues or that its operations will ever be profitable. (See the financial statements bound herein.)

As of December 31, 1990:

Total Assets . . . . .	\$ 31,618
Total Liabilities . . . . .	\$238,293
Shareholders' Equity . . . . .	(\$206,675)

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### **RISK FACTORS**

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1. Absence of Significant Operations, Income and Profit. Though the Company is not in the development stage, it is subject to all the risks inherent in the operation of a business which has limited capital resources, a limited history of operations and income, and no profitability. The Company's activities since organization have been limited to product development, national marketing and sales, organizational matters, and response to

litigation and administrative investigations. Unforeseen expenses, complications and delays are often associated with thinly capitalized companies and with the introduction of products. There is no assurance that products which are currently marketed, or may eventually be developed and marketed, by the Company will continue to be commercially accepted. (See "Description of Business.")

2. Absence of Patent Protection; Product Obsolescence. Patents have been filed in the name of the Company's president, Luke Glenn, who has assigned the patents to the Company. Any competitor of the Company using equipment and processes which are generally available could manufacture and market similar products. Moreover, new surgical products and devices are constantly being developed and introduced to the marketplace, which may have the effect of rendering obsolescent the products which the Company proposes to develop and market. (See "Business--Patent.")

3. Limited Experience and Potential Change of Management. The Company will be dependent upon the efforts and abilities of its officers. Luke Glenn and Ted Hillstead have had varying experience in the marketing of medical products which the Company markets, but have had limited experience in managing a publicly-held company. (See "Management.") Mr. Glenn is the only person who has been previously involved in executive management positions of medical product companies or had experience in medical product development, and manufacturing. (See "Remuneration of Officers and Directors.") In the spring of 1990, Mr. Glenn received an offer for a position with another company. Though he did not accept the position, failure of the Company to subsequently raise capital may result in his having to accept a permanent full-time position with another company. Unless the business of the Company changes through diversification of products or services, the loss or unavailability of the services of Mr. Glenn could have a materially adverse effect on the Company's business prospects and/or potential earning capacity because of his experience in product development and marketing and the services which he is expected to provide to the Company in those areas. The Company does not, at present, have any employment agreement with any of its officers, nor does the Company presently insure any of its officers against anticipated losses should their services be unavailable. Because of previous health complications, the Company cannot purchase key-man insurance on the life of Mr. Glenn.

If the Company acquires other products, assets or entities, the transaction will most likely be consummated through an issuance of additional stock. Such transaction may result in a change in control and or management of the Company.

4. Competition. The Company is engaged in a competitive business and is attempting to compete with major U.S. and foreign corporations who presently develop, manufacture and market medical and surgical devices and products of all types, including products

directly competitive with those currently marketed and proposed to be marketed by the Company. These firms are larger and have far greater resources, assets, technical staffs, and experience than those which are available to the Company. The Company is not at present, and will not in the foreseeable future, be a significant factor in the field in which it is engaged. Small firms such as the Company with limited resources are at a very serious disadvantage against established competitors. (See "Business--Competition.")

5. Government Regulation. In the manufacture and sale of its products, marketing and manufacturing by the Company will be subject to regulation by the Food and Drug Administration ("FDA"), including registration of its manufacturing establishment (which has been completed), listing of the products which it proposes to market and sell (completed), and the necessity of submitting a premarket notification with respect to each of its medical or surgical products (completed). The FDA could require that premarket approvals be obtained with respect to some of the Company's products, which would be costly, time consuming, and adversely affect the Company's ability to operate profitably. In 1987, the FDA made an inspection of Company's previous facilities. Certain information provided to prospectus shareholders may have been materially incomplete as to FDA rules and regulations. (See "Business--Government Regulation.")

6. No Feasibility Studies. The Company has relied and intends to continue to rely upon the judgment and conclusions of its management based solely upon their experience, which is, in essence, the limited experience of Luke Glenn, relative to the needs of the Company. No formal feasibility studies or reports have been obtained, nor are any such studies planned by the Company.

7. Limited Staff. The Company currently has no formally hired employees. Assuming the Company is successful in raising additional capital, the Company intends to employ each of its officers on a full-time basis with the exception of Mr. Hillstead (See "Management" and "Remuneration of Officers and Directors"), and to hire one full-time employee for secretarial and administrative work. (See "Transactions With Management.")

8. Additional Financing. Additional financing will be required. There can be no assurance that such financing will be available, or, if available, that it can be obtained on terms satisfactory to the Company. (See Paragraph 12 and "Business--Financial Status.")

9. Noncumulative Voting; Control by Management Stockholders. The present management claims to own approximately 59 percent of the issued and outstanding common stock of the Company. Disputes may arise about ownership of this and all other stock in the

Company. Inasmuch as there are no cumulative voting rights under the Company's Articles of Incorporation, the present management of the Company will remain in control of the Company since they will be able to elect all of the directors of the Company, and the purchasers of the publicly-traded shares will not be able to elect any of the directors of the Company. (See "Capitalization and Securities.")

10. Transactions with Officers, Directors and Principal Shareholders. Management and a shareholder have made loans to the Company. The Company's operations are located in a building owned by one of the directors. Management intends to temporarily employ Judy Glenn, wife of the President, as secretary and office manager. (See "Transactions With Management.")

11. No Dividends and None Anticipated. The Company has not paid any dividends upon its common stock since its inception, and by reason of its present financial condition and its contemplated financial requirements, does not contemplate or anticipate paying any dividends upon its common stock in the foreseeable future. (See "Dividends.")

12. Uncertainty of Funds from Possible Private Offering. The Company is considering a future private offering. The Company may attempt to obtain the services of an underwriter (stockbroker) to privately sell such shares on a "best efforts" basis, which means that there will be no binding or "firm" obligation on the part of the underwriter or any other person to buy any of the shares proposed to be sold. There is no assurance that such an underwriter can be engaged. Alternatively, the Company may attempt to sell such shares through the efforts of its officers and directors. In addition, the sale of such shares may be formulated so that none of the shares will be sold unless a specified minimum portion thereof are, in fact, sold. The Company may also consider merging with an existing private company. There can be no assurance that such private offering or merger will be completed and if it is not, the Company will have suffered the loss of the funds expended in pursuing such offering or merger. (See "Business--Financial Status.")

13. Possible Rule 144 Sale by Affiliates. The common shares presently owned by certain shareholders may be deemed to be "control securities" as such term is used in relation to Rule 144 under the Securities Act of 1933, as amended. Rule 144 provides that a person who is an affiliate of the Company may, within a three-month period, sell in "brokers transactions" (as defined by the Rule), an amount equal to the greater of 1 percent of the Issuer's outstanding securities of such class or the average weekly reported volume of trading in such securities during the four calendar weeks preceding the sale, if the conditions specified by the Rule are satisfied. If such person is not an "affiliate" of the issuer, as such term is defined by Rule 144, he may, after a

holding period of three years, in the case of restricted securities, sell the shares without a volume limitation. Because management currently owns 15 Million shares, future sales by such affiliates may have a depressing affect on the market price of the common shares, should a market for such shares exist.

14. "Qualified Opinion" From Independent Certified Public Accountant. As shown in the financial statements attached hereto, the current liabilities exceed current assets by \$226,021, and its total liabilities exceed total assets by \$206,675. These factors indicate that the Company may not be able to continue in existence unless it is able to receive adequate funding. For this reason, the independent certified public accountant for the Company has issued a "qualified opinion" as to the financial condition of the Company. (See "Financial Statements.")

15. Market Price of Shares Unreliable. The secondary trading of the Company's shares outside of Utah has experienced significant price fluctuations over the past two years. Since the order by the Utah Securities Division suspending secondary trading, there has been no public trading in the Company's stock in the state of Utah. Management believes that current price quotes, if any, may bear little or no relationship to the assets, earnings per share of the stock, or any other criteria of value applicable to the Company. Some shareholders have purchased stock based on speculation about market "short positions." "Short selling" or "short positions" occur when an investor sells shares of stock he does not own. Following the sale, the investor must deliver shares to the purchaser. The short seller hopes to purchase share from the market at a lower price than he sold it, thereby making a profit on the difference in price. Such short positions in the market have not been specifically identified and investment in these shares on that basis would be extremely speculative. Continuing price instability is probable. (See "Market Price of Shares")

16. Uncertainty of Litigation and Regulatory Action. The Company has been engaged in litigation which may result in large expenses to defend or pursue legal rights. Additionally, state and federal securities authorities have been investigating and continue to investigate alleged market manipulation of the Company's stock and the existence of stock certificates with forged signatures and certificates issued following the transfer or cancellation of such certificates. Such regulatory review may adversely affect the ability of the Company to raise needed capital, affect the stock price, or drain the Company's capital resources to maintain legal representation. Additionally, the ongoing investigation by the Utah Securities Division may result, at a future date, in the issuance of an order suspending trading in the Company's securities. (See "Business--Litigation and Administrative Actions.")

17. No Manual Exemption. Subsequent to the effectiveness of the registration statement, any transaction in the Company's securities by or through a Utah broker-dealer will not be exempt through a "manual exemption" and, instead, may only be exempt if there is compliance with the "secondary trading" exemption.

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## DILUTION

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The following graphs illustrate the comparative stock ownership of the Shares as of December 31, 1990. Acquisitions of entities or product rights through the issuance of additional stock would result in further ownership dilution to current shareholders.

Insiders

59%

Public  
Shareholders

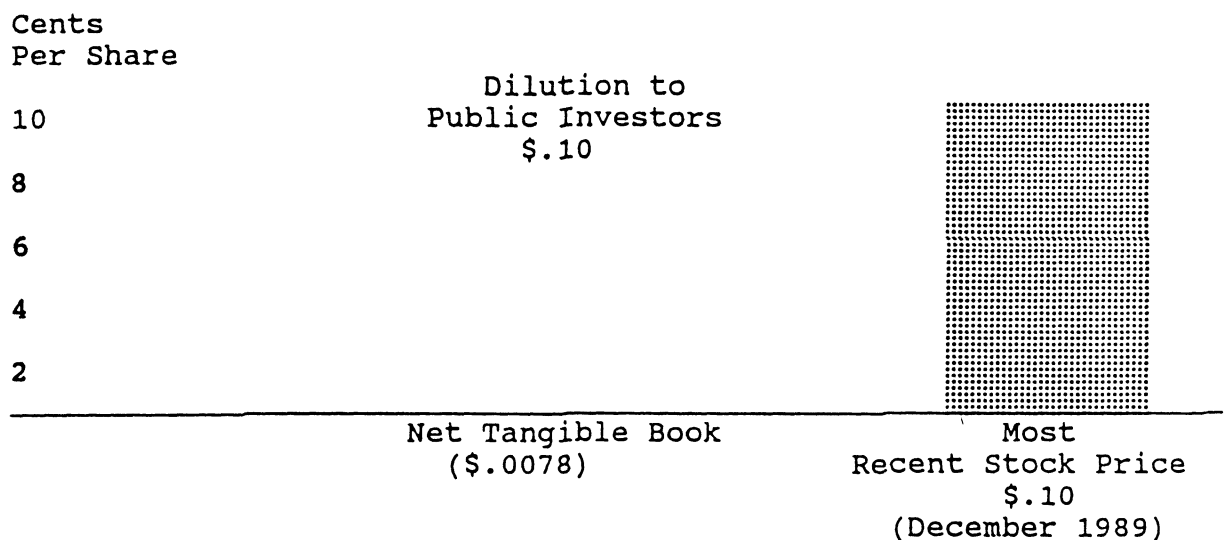
41%

At December 31, 1990, the Company had an aggregate of 26,352,500 shares of common stock outstanding with a net tangible book value as reflected on the Company's balance sheet of (\$206,675) or approximately (\$.0078) per share. Net tangible book value per share represents the amount of the Company's tangible assets less its liabilities, divided by the number of shares of common stock outstanding. Upon purchase of shares, and assuming no changes in the net tangible book value of the Company after December 31, 1990, the purchaser will own shares with negative book value. Public investors will most likely experience an immediate dilution in the net tangible book value per share of the common stock from the price per Share being offered on the secondary market. Uncertainty related to the existence of the stock certificates with forged signatures or certificates issued following the transfer or cancellation of such stock certificates may affect the value of stock.

Dilution in this case represents the difference between the public market trading price per share and the net tangible book value per share.

The following graphs illustrate the per share dilution based on a price as of December, 1989. (See "Capitalization and Description of Securities.")

#### MARKET PRICE IN RELATION TO NET TANGIBLE BOOK VALUE



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#### USE OF PROCEEDS

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This registration of shares will not result in any proceeds received by the Company.

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#### DESCRIPTION OF BUSINESS

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#### CORPORATE HISTORY

In approximately July of 1986, Luke Glenn and Ted Hillstead formed a partnership called "U.S.A. Medical". The partnership was formed to develop a machine called the "Maxim Aspirator", which is a high powered deep vacuum suction aspirator. Additionally, the partnership developed the suction cannula that is used in the aspirator system and marketed tubing and surgical clothing. Between July of 1986 and June of 1987, the partnership attended various trade and medical shows and were successful in manufacturing and selling the Aspirator and related products. In June of 1987, the partnership formed U.S.A. Medical Corporation, a privately-held Utah corporation. On December 7, 1987, the privately held corporation entered into an Agreement of Reorganization with SMI, Inc., a purportedly publicly held corporation. SMI, the surviving entity, was incorporated in Wyoming on January 12, 1979. Subsequent to the reorganization, SMI changed its name to U.S.A. Medical Corporation (the "Company"). Though management of SMI represented that the Company was publicly-held, current management believes that the Company's shares may have originally been held by a few undisclosed "control" persons and nominees, and that some or all of the signatures on the stock certificates of SMI at the time of the merger were forged. Uncertainty exists about the validity of the shares the Company issued following the merger. In March of 1991 the shareholders authorized a name change to Life Concepts, Inc.

#### INTEGRITY AND EXISTENCE OF CORPORATE DOCUMENTS

The Reorganization Agreement with SMI included SMI financials purporting assets worth \$162,092 which primarily consisted of stock in another corporation. Those shares have never been found and management believes that the existence of this asset was misrepresented. Additionally, following the reorganization, management never received bylaws, organizational minutes, board of director minutes, shareholder minutes, or bank records. The

Company has subsequently adopted new Bylaws and amended its Articles of Incorporation.

#### PRODUCT DEVELOPMENT

The Company was formed to design, manufacture and market high-powered surgical aspirators, precision surgical suction cannula, and other medical products such as tubing, masks, and garments. Though the aspirator may be used for a wide variety of fluid vacuation, it has primarily been purchased by doctors engaged in lipoplasty procedures. Initially, the firm's marketing efforts were directed primarily at plastic and reconstructive surgeons through professional symposiums and live-surgery demonstrations conducted around the country. Advertisements have also been placed in major scientific journals. The following table consists of sales estimates since formation of the original partnership:

<u>Period</u>	<u>Aspirator</u>	<u>Cannula</u>
July 1986 - December 31, 1986	1	50
Year 1987	50	1,500
Year 1988	30	400
1st Quarter 1989	6	50
2nd Quarter 1989	2	25
3rd Quarter 1989	2	10
4th Quarter 1989	1	5

The Company expected to sell 1,000 aspirators over a twelve (12) month period between 1988 and 1989, which, at a retail price of \$2,295, would have produced gross revenues of \$2.3 million before sales discounts. Sales of surgical suction hand-held cannula were expected to reach 3,500 units over the period resulting in additional revenue of \$625,000 before sales discounts. The combined revenue from these expected sales would be approximately \$2.9 million. After sales discounts, manufacturing cost, and corporate expenses the Company hoped to achieve a net profit of about \$500,000. Due to non-performance and possible stock manipulation by a "stock relations" firm which represented it would raise \$300,000 for the Company, and recent litigation, there has been a delay in the planned private placement. This private placement was to have provided capital necessary for the Company to expand its manufacturing and marketing plans and accomplish the above.

Because of the nature of the products and the interest in surgical procedures requiring aspirators, management believes that with the proper capital the above revenue projections could be obtained and increase each year, not including the addition of any new products that are hoped to be added to the Company's marketing mix: i.e., surgical compression garments, marking pens, cannula brushes and cleaners, re-injection systems, disposable canisters, electro-surgical knives, operating room safety equipment, etc. Revenue expectations have been based solely on the experience of management in the aspirator market and has not been supported by independent market research.

#### Government Regulation

To the best of the Company's knowledge, the FDA has refused to approve marketing of any surgical aspirators manufactured by any manufacturer for lipoplasty procedures. Nonetheless, the medical profession uses high powered aspirators for liposuction. The aspirator manufactured by the Company is approved by the FDA as a general high powered aspirator (Class I). Class I approval requires the Company to satisfy the "general control" provisions of the Federal Food, Drug and Cosmetic Act. Management is not aware of any product that has received classification beyond Class I. The aspirator manufactured by the Company is not approved by the FDA to be marketed as a liposuction device. A copy of the FDA conditional approval letter (hereinafter "FDA letter") is attached as an exhibit to this prospectus.

The Company provided oral and written information to brokers and prospective shareholders in 1988 and 1989 which may have violated the prohibition in the FDA letter against direct or indirect promotion of the aspirator as a liposuction device. If the Company has violated the prohibition, the FDA may sanction the Company and this may affect the marketability of the aspirator and the value of Company stock. The Company has not received any notice, letter, or other communication from the FDA threatening to take any action against the Company, nor has the FDA made any findings that the Company has violated the conditions contained in the FDA letter. The FDA is currently investigating possible violations.

#### High Powered Surgical Aspirator and Surgical Cannula Market

The market for high-powered aspirators and related products is primarily limited by the number of physicians who are and will become skilled in using the equipment. The growing number of medical specialists becoming involved with procedures using high-powered aspirators includes plastic surgeons, obstetricians/gynecologists, dermatologists, otolaryngologists, and general surgeons. Concurrently, an increasing number of other physicians with adequate training, facilities and necessary equipment are expected to begin to use high vacuum machines in the future. There

are close to 500,000 physicians in the United States alone, 200,000 of whom may eventually use high power vacuum machines. Management believes that the market outside the United States is even larger. The Company is currently conducting preliminary discussion with companies in foreign countries for establishing distributor/dealer outlets for its equipment.

#### Rationale For High Powered Aspiration

Before high-powered aspirators and suction cannula came onto the market, subcutaneous tissue and fluids was removed primarily by major surgery requiring extensive tissue cutting and long recuperation time. Today, with new technology and new cannula development, removal of tissue can be performed easily and safely with only a minor incision.

##### 1. Advantages of the Maxim Aspirator:

- a. One of the lowest cost high-powered aspirator on the market.
- b. Modern design - aesthetically pleasing.
- c. Portable - carry or pull.
- d. Self-contained tissue and fluid collection system to eliminate accidental exposure to HIV virus.
- e. Quiet operation.
- f. Remote foot-switch.
- g. Maintenance free - Oilless operation.

##### 2. Advantages of Coolite Suction Cannula:

- a. More comfortable handle - reduces wrist fatigue.
- b. Lightweight - easy to handle and 50% lighter than most of the competition.
- c. Quick-disconnect fitting - Easier and faster to change cannula, less risk of fluid and tissue emission.

#### NEW MEDICAL PRODUCTS

As aspirators become more widely used within the medical profession, new techniques and equipment applications are sure to result. Current experimentation in the transplantation of fatty tissue from one anatomical site to another (e.g. breast enlargement, facial reconstruction, buttock enhancement, etc.) are controversial and the subject of professional debate. As with many other surgical procedures in the past, however, it is possible that acceptable applications of such procedures will eventually be developed. The Company is currently investigating the new instrumentation and equipment design which will be required by these new reconstruction techniques.

Moreover, aspiration procedures have also been proven effective in the removal of non-malignant lipomata from the neck, arm, leg and abdominal sites with minimal trauma and post-operative scarring.

In early 1988, the Company began to offer a revolutionary new safety system for the collection and disposal of human blood and tissue for all of the aspiration machines it has and will manufacture. Because the HIV (AIDS) virus is known to be transferrable through human blood, sera and tissue, proposed and pending federal and state legislation will soon mandate that full protection from accidental exposure to these substances be assured for all health workers and for the public.

#### ACQUISITION OF OTHER PRODUCTS

The Company is currently negotiating for the acquisition of a business engage in marketing products which are unrelated to surgical procedures or medical services. While the Company believes that there is a fair probability of consummating the acquisition, the negotiations and due diligence by both parties are continuing. Any definitive agreements will be publicly announced and presented to the shareholders for ratification.

#### LITIGATION AND ADMINISTRATIVE ACTIONS

Shortly after the reorganization in December 1987, the Company changed its transfer agent from Efficient Transfer, Inc. to Standard Transfer and Registrar. On March 29, 1988, the Securities and Exchange Commission filed a complaint for permanent injunction in the United States District Court, District of Utah, Central Division, against Efficient Transfer, Inc. and Roger Coleman, d/b/a Efficient Transfer. Among other things, the Commission alleged that Efficient had falsified the shareholder list of the Company. On May 24, 1988, United States District Court Judge David K. Winder ruled that Roger Coleman had failed to make and keep current logs, tallies, journals, schedules, and other records relating to the stocks that his business was handling. During this period the Company, through its counsel, consulted other co-counsel to aid in working with the Securities and Exchange Commission to determine how the Company would be affected by Roger Coleman and Efficient Transfer acting as transfer agent prior to December of 1987. The Company continued discussions with the Securities and Exchange Commission and there was no definitive action taken by the Commission with regards to the Company. The Company's counsel determined that the prior relationship with Roger Coleman and Efficient Transfer was not material upon the operations and business of the Company. His opinion has not been approved or adopted by either the Securities & Exchange Commission or the Utah Securities Division.

From December of 1987 through January of 1989, the Company's shares experienced erratic fluctuations in price, possibly as a result of stock manipulation and "short selling" by some brokerage firms. On February 16, 1989 Johnson-Bowles Company, Inc. ("Johnson"), a Utah brokerage firm allegedly holding a major short position in the market, filed suit in the United States District Court (Utah) against the Company and a large number of Utah brokerage firms. Pursuant to the complaint, Johnson sought injunctive relief and monetary damages.

Johnson sought 1) a minimum of \$300,000 in monetary damages, 2) a court order declaring that the Company is without registration exemptions for its stock trading interstate and that all trading contracts with plaintiff are void, 3) a Temporary Restraining Order, 4) an Injunction against any shareholder meetings, 5) an Order mandating that the Company file a registration statement with the Securities and Exchange Commission, and 6) that the Company's stock be suspended from trading.

On February 21, 1989 Judge J. Thomas Greene granted Johnson a Temporary Restraining Order restraining Midwest Clearing Corporation from adjusting Johnson's accounts as it related to the Company's stock. A hearing for a permanent injunction was set for February 27.

After hearing Johnson's case in late February, the District Court denied any injunctive relief for Johnson. In denying the relief sought, the court stated the following as conclusions of fact and law:

1. With respect to Midwest Clearing, the Court does find and rules that the temporary restraining order which dissolved by its terms and any further injunctive relief against Midwest clearing is denied. The Court finds that it likely would cause interference with the prompt and accurate clearance and settlement of securities transactions and would negatively affect the goals of Section 17(a) of the Act to continue injunctive relief and restrain from the clearing functions of Midwest Clearing.

2. The Court finds that the stock of U.S.A. Medical was unlawfully issued, has never been registered with any proper regulatory authority, is not exempt from such requisite registration and has been and is continuing to be traded illegally.

3. The stock of U.S.A. Medical has been and continues to be traded as part of fraudulent scheme and device to manipulate and artificially inflate the price of that stock in violation of the securities laws.



4. The Court finds, however, that the plaintiff, Johnson-Bowles, knew or should have known about the alleged irregularities as to non-registration, non-exempt status and illegal trading of U.S.A. Medical stock, and that in fact Johnson-Bowles participated in trading in the stock after it became a market maker, and is charged with knowledge of these irregularities.

5. The Court finds that relative burden between Johnson-Bowles and other parties as well as damage to the public interest has not been shown by a preponderance of the evidence and that there is a failure of burden of proof to establish those elements.

On April 10, 1989 the Company filed an Answer to Johnson's complaint and counter-claimed against the brokerage firm. The counter claim sought minimum damages of \$100,000 and was based on the District Court's findings that Johnson knew about the non-registered status of the Company's stock and actually participated in the trading of the Company's stock in a manner which may have been illegal. On March 27, 1990, the suit was dismissed without prejudice. The Company is currently conducting research prior to proceeding with any claims against Johnson-Bowles, or parties believed to have participated in an illegal distribution of stock.

On January 29, 1991, Otra Securities Group Inc., a Delaware Corporation, and Otra Clearing, Inc., a Colorado corporation, filed a third-party complaint against Nathan Drage (current counsel to the Company), Richard Leedy (counsel to Standard Registrar), Michael Strand (a shareholder of the Company), Standard Registrar and Transfer (former transfers agent for the Company), U.S.A. Medical Corporation, and John Does 1-10, in the case of Burns v. Richfield Securities, et al. The Complaint alleges the parties conspired to artificially manipulate the price of the Company's shares in violation of state, federal and common laws. The above defendants have stated that they believe there is no merit to Otra's third-party complaint. Though the Company believes there is no merit to the suit, the Company will incur an unknown amount of legal fees to defend the suit and assert any counter claims.

On March 6, 1989 the Securities and Exchange Commission suspended trading of the Company's stock. The suspension was based upon questions regarding market activity by brokerage firms and individuals, control of the Company's shares, and the Company's financial information. The suspension expired on March 15, 1989.

On March 1, 1989 the Securities Division of the Department of Business Regulation of the State of Utah issued a Summary Order Denying the Availability of Exemptions From Registration. The denial of exemptions was based upon the following conclusions: 1) the failure to register securities, 2) failure to qualify for exemptions from registration, and 3) a scheme to defraud by persons

unknown and unnamed. The Company is informed that the third conclusion was based in part upon additional research and investigation by the Division. The Company worked with the Securities Division between March and August of 1989 to determine if their summary conclusions of fact were correct. P.G. McManus, the original incorporator of SMI is believed to have a history of securities violations. In July of 1990 James Averett pleaded guilty to a one count complaint accusing him of manipulating and artificially raising the price of the Company's stock. At the date of this prospectus, the Securities Division is continuing its investigation.

, By public release on September 1, 1989, the Division announced a settlement Agreement with the Company which would allow the Company secondary trading if it registered its shares. Until the time of this registration, the Company's stock was denied transactional exemptions within the state of Utah. The business of the Company is affected by Utah's administrative actions mainly to the extent that the Company has been limited in raising operational capital through the sale of securities within the state of Utah.

By letters dated March 9 and June 22, 1989, the Company placed stop transfer orders on stock certificates totaling 1,383,350 and 850,000 shares respectively. These are certificates which the Company believes may be held by undisclosed control persons or persons who are not bona fide purchasers. With regard to such stop transfers, the Company is in a very difficult situation. The only way management can protect the Company from stock manipulation by undisclosed control persons is to place stop transfer orders on certificates management believes to be held by such persons. Stop transfers, however, expose the Company to possible lawsuit by shareholders whose shares have received transfer restrictions. Additionally, the Company may be prevented from placing any stop transfer orders should the transfer agent require the posting of bonds. Consequently, if stock manipulation has occurred in the past, or does occur in the future, the Company is significantly limited in avoiding such manipulation.

In June 1990, the staff of the Securities & Exchange Commission notified the Company and its management that it is recommending that the SEC take enforcement action against the Company, Mr. Glenn, and Mr. Hillstead. No action has yet been taken and it is unclear whether any action will be taken, or what form the possible action may take, or what settlement may be reached.

The Company currently intends to register its common stock, or the Company, with the Securities and Exchange Commission when it has sufficient capital to do so.

## PATENTS

The Company's president filed for patent protection on the aspirator and related features on January 19, 1988. A U.S. patent (No. 4,857,063) was issued on August 15, 1989. In November 1987, the president assigned the patents to the Company, which assignment appears on the patent.

## COMPETITION

The high power aspirator market consists mainly of five manufacturers. These manufacturers may be better financed and better known in the market.

## FINANCIAL STATUS

The Company experienced losses of \$78,470, \$46,617, and \$34,692 during fiscal years 1988, 1989, and 1990 respectively. Additionally, the Company has no current assets available to meet its obligations. Consequently, the Company will have to seek additional capital through additional loans, a private placement, public offering, or merger.

## OFFICES

The Company has an informal agreement with one of its directors to provide approximately 2,400 square feet of office/manufacturing space. Management intends to conduct assembly activities at such location and believes that such facilities will be adequate for the Company for the foreseeable future. The director has designated a particular portion of the building for the Company, and will provide such space and equipment as may be reasonably required by the Company. The Company currently pays no rent for use of its office space but hopes to pay reasonable rent when the Company's financial condition allows it.

## EMPLOYEES

The Company has no full-time employees. The president devotes approximately ten percent of his time to the Company's operations and, when finances permit, will return to full-time employment by the Company and will be paid compensation which is deemed reasonable and is expected to be \$3,000 per month. (See "Compensation" and "Transactions With Management.")

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## CAPITALIZATION AND DESCRIPTION OF SECURITIES

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The capitalization of the Company as of December 31, 1990 is as follows:

Title of Class	Amount Authorized	Amount Outstanding as of 12/31/90
Common Stock \$.001 par value	50,000,000 Shares	26,352,500 Shares

With some possible exceptions, all shares are believed to be fully paid and non-assessable. All common shares are equal to each other with respect to voting, liquidation and dividend rights. Special meetings of the Shareholders may be called by the officers, directors, or upon the request of holders of at least ten percent of the outstanding voting shares. Holders of common shares are entitled to one vote at any meeting of the Shareholders for each common share they own as of the record date fixed by the Board of Directors. At any meeting of Shareholders, a majority of the outstanding shares of the Company entitled to vote, represented in person or by proxy, constitutes a quorum. A vote of the majority of the shares represented at a meeting will govern even if this is substantially less than a majority of the common shares outstanding. Holders of shares are entitled to receive such dividends as may be declared by the Board of Directors out of funds legally available therefor, and upon liquidation are entitled to participate pro rata in a distribution of assets available for such a distribution to Shareholders. There are no conversion, preemptive or other subscription rights or privileges with respect to any share. Reference is made to the Articles of Incorporation and By-laws of the Company as well as to the applicable statutes of the state of Wyoming for a more complete description of the rights and liabilities of holders of shares. It should be noted that the By-laws may be amended by the Board of Directors without notice to the Shareholders. The shares of the Company do not have cumulative voting rights, which means that the holders of more than fifty percent of the shares voting for election of directors may elect all the directors if they choose to do so. In such event, the holders of the remaining shares aggregating less than fifty percent will not be able to elect directors.

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## MARKET PRICE OF SHARES

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In the four month period prior to suspension of trading on March 1, 1989 by the Utah Securities Division, the shares of the Company fluctuated in price between \$.01 and \$1.00 (as adjusted for the 10 for 1 forward split in the first quarter of 1989). Possible explanations of the increase in price include legitimate speculation in the growth and earning capabilities of the Company, deceptive manipulation by undisclosed shareholders holding large positions in the stock, and/or legitimate speculation about "short positions" held by brokers which would be bullish for investors holding "long positions." A "long position" exists when an individual or firm holds stock in that individual's or firm's account. Estimates of the current market short ranges from 500,000 shares to 3,000,000 shares. The Company does not currently have reliable information to either confirm or deny such estimates.

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## MANAGEMENT

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### OFFICERS AND DIRECTORS

The term of office of each director is one year or until his successor is elected at the annual meeting of the Company, which will be held in February 1991. The term of office for each officer of the Company is at the pleasure of the Board of Directors. The Board of Directors has no nominating, auditing or compensation committee.

The following table states the name, address and positions held for each of the executive officers and directors of the Company.

Name and Residential Address	Title or Position
Luke H. Glenn 4016 Porter Ogden, UT 84403	President and Director
Ted W. Hillstead 601 Ogden Canyon Road Ogden, UT 84401	Secretary/Treasurer and Director

LUKE H. GLENN, President and Director, Ogden, Utah has been involved with the medical industry since 1970 after graduating from Weber State College, Ogden, Utah with a degree in Business Management and Economics. He took a position with Cutter Laboratories (a major manufacturer of medical devices and products used by hospitals worldwide) in 1970 as the Plant Quality Control Manager and was responsible for all quality activities including: quality engineering, statistical sampling, vendor approval, FDA compliance, sterile product control and good manufacturing practices (GMP) as outlined in the Food, Drug, and Cosmetic Act. From 1977 to 1984 he co-founded the G & H Company to develop, manufacture, and market vacuum/pressure systems. From 1984 to present he has been involved with the development, design, and marketing of high-powered surgical aspirators and precision suction cannula. In 1986 he co-founded U.S.A. Medical. He has traveled extensively around the United States marketing aspirators and cannula to plastic and reconstructive surgeons, clinics, and hospitals. Age 48.

TED W. HILLSTEAD, Secretary/Treasurer and Director, Ogden, Utah began his career in 1956 after graduating from the University of Wyoming with a degree in Mechanical Engineering. From 1956 to 1964 he was with the Marquardt Corporation, Ogden, Utah, developing, designing, and analyzing new jet engine systems. From 1964 to 1974 he was instrumental in the development of automated material handling systems for Kenway Engineering and in 1974 he founded Tareco Corporation, Ogden, Utah specializing in the design, fabrication, and installation of automated material handling equipment for such firms as Goodyear Tire and Rubber, Kennecott Copper Corporation, Steelcase Corporation, and Caterpillar Tractor Company. In July 1986 he co-founded U.S.A. Medical, Ogden, Utah. Age 53.

At a meeting of the Board of Directors held November 28, 1990, directors and shareholders representing over 60% of the shares outstanding, voted to terminate, with cause, David Ballard as an officer and director of the Company. The shareholders ratified this action at the Annual Shareholders meeting to be held in February of 1991.

#### COMPENSATION

When finances permit, Luke Glenn will devote his full-time efforts to the operations of the Company, for which Mr. Glenn will receive a monthly salary of approximately \$3,000.

The following persons have received compensation since January 1, 1989:

<u>Name</u>	<u>Position</u>	<u>Amount</u>
Luke Glenn	President, Director	\$10,914.98
Ted Hillstead	Secretary/Treasurer, Director	none
Judy Glenn	Former Director	\$ 500.00
David Ballard*	Former V.P, Director	stock

\*The Company and major shareholders are in the process of filing suit to cancel the certificates representing 1,000,000 shares.

The Company has no written employment agreement with any of its officers or directors and has no retirement, profit sharing, pension or insurance plans covering them. (See "Transactions With Management.")

#### INDEMNIFICATION OF OFFICERS AND DIRECTORS

Wyoming law expressly authorizes a Wyoming corporation to indemnify its officers and directors against claims or liabilities arising out of such persons' conduct as officers or directors if they acted in good faith and in a manner they reasonably believed to be in or not opposed to the best interests of the Company. The Company intends to indemnify its officers and directors to the full extent permitted by Wyoming law. INsofar as such INDEMNIFICATION MAY BE DEEMED TO INCLUDE ANY CLAIM OR LOSS ARISING OUT OF ANY VIOLATION OF FEDERAL SECURITIES LAWS OR REGULATIONS, THE COMPANY HAS BEEN INFORMED, THAT, IN THE OPINION OF THE SECURITIES AND EXCHANGE COMMISSION, SUCH INDEMNIFICATION IS AGAINST PUBLIC POLICY AS EXPRESSED IN THE SECURITIES ACT OF 1933, AND IS, THEREFORE, UNENFORCEABLE.

#### FIDUCIARY RESPONSIBILITY

The officers and directors are required to exercise good faith and integrity in handling the Company's affairs. Management of the Company has agreed to abide by this fiduciary duty. Each Shareholder of the Company or his duly authorized representative may inspect the books and records of the Company at any time during normal business hours. A Shareholder may be able to institute legal action on behalf of himself and all other similarly situated Shareholders to recover damages where the Company has failed or refused to observe the law. Shareholders may, subject to applicable rules of civil procedure, be able to bring a class action or derivative suit to enforce their rights, including rights under certain federal and state securities laws and regulations.

Shareholders who have suffered losses in connection with the purchase or sale of their interest in the Company due to a breach of fiduciary duty by an officer or director of the Company in connection with such sale or purchase, including the misapplication by any such officer or director of the proceeds from the sale of these securities, may be able to recover such losses from the Company. It should be noted that this is a rapidly developing and changing area of the law. Investors are urged to consult their own legal counsel.

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#### TRANSACTIONS WITH MANAGEMENT

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In November 1987, the president assigned the product patents to the Company.

The Company's secretary/treasurer currently leases office and warehouse space to the Company rent free.

Ted Hillstead, secretary/treasurer and a director of the Company, has made loans to the Company, or retired bank loans made to the Company, exceeding \$ 100,000.

When finances permit, the Company intends to hire Luke Glenn. Also, the Company intends to hire Judy Glenn, wife of the Company's president, as a secretary and office manager.

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#### PRINCIPAL SHAREHOLDERS

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As of the date of this prospectus, the following persons were shareholders who owned of record, or who was known by the Company to own beneficially, ten percent or more of the Company's common stock. As of the date of this prospectus, these shareholders express no intent on selling their shares; though they may choose to do so at a later time. Questions concerning the existence of stock certificates with forged signatures or certificates issued following the transfer or cancellation of such certificates create uncertainty about the accuracy of the information known to the Company. The following table presents such information in tabular form as of the date of this prospectus:



Title of Class	Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Common Stock (\$ .001 Par Value)	Luke Glenn	7,500,000 <sup>(1)</sup>	29.62%
	Ted Hillstead	7,500,000 <sup>(1)</sup>	29.62%

(1) These shares were acquired on December 7, 1987 in exchange for shares in U.S.A. Medical corporation, a privately-held Utah company. James Averett, former counsel to the Company, has claimed an ownership interest in 1,666,666 of the 15,000,000 shares held by Mr. Glenn and Mr. Hillstead. Due to the actions of Mr. Averett and their affect on the Company and management, Glenn and Hillstead intend to contest any ownership claims by Averett.

The following table sets forth the security ownership of management of the Company as of the date of this prospectus.

Title of Class	Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Common Stock (\$ .001 Par Value)	Luke Glenn (Beneficially and of record)	7,500,000	29.62%
	Ted Hillstead <sup>(1)</sup>	7,500,000	29.62%
	Directors and Officers as a Group	<u>15,000,000</u>	59.24%

In addition to the above persons, management believes that ownership by the next two largest shareholders should be disclosed:  
 Brian D. Burns<sup>(2)</sup> 1,859,500 7.00%

(1) Mr. Hillstead is the beneficial owner of these shares that are held in the name of Tareco.

(2) Shares held in the name of Brian D. Burns and Brian D. Burns DC PC Retirement are treated here as being owned by Dr. Burns. Dr. Burns loaned the Company \$25,000 in December of 1989. The loan was due in the first quarter of 1990. Mr. Glenn and Mr. Hillstead have agreed to each transfer 250,000 shares of their stock to Dr. Burns in exchange for Dr. Burns suspending any legal action to collect on the note until May 1991. Those additional shares would bring total ownership to 2,359,500 or 8.95%. An additional 1.5 million shares have been pledged to Dr. Burns (see

Mike Strand<sup>(3)</sup>

1,496,200

5.67%

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footnote 3), which brings the total number of shares under beneficial ownership or control to approximately 3.8 million or approximately 14.64%. Because of the large number of shares owned or controlled by Dr. Burns, the Company has requested, and Dr. Burns has given, consent to having his shares stamped with a legend which restricts the public sale of his shares to the volume guidelines of rule 144. This action by the Company should not be construed as any indication that the Company considers Dr. Burns to be a "control person."

<sup>(3)</sup> Shares held in the name of Michael Strand Family Partnership and John Dawson, are understood to be owned or controlled by Michael Strand. Of these shares, 986,200 shares are pledged to Brian D. Burns pursuant to an escrow agreement. An additional 500,000 shares have also been pledged to Dr. Burns. Mr. Strand is not an officer or director of the Company, but because of allegations of his previous involvement with the Company contained in a lawsuit filed in the United States District Court (which was subsequently dismissed), information regarding Mr. Strand is included herewith. Mr. Strand has been convicted of tax and securities fraud. The tax liability which served as the basis for the original charge has now been compromised civilly by the Internal Revenue Service to a sum less than \$2,000. By letter, Mr. Strand's attorney has provided the following statement for disclosure purposes:

Mr. Strand has been involved in the purchase and sale of over-the-counter stocks in the Salt Lake area for many years and has been associated with a variety of over-the-counter stock companies based in Salt Lake City.

In 1979, Mr. Strand was convicted in the United States District Court for the District of Utah for tax violations which involved failure to report certain income derived from a finders fee on his tax returns and fraud in the sale of securities. This conviction was appealed to higher Courts over a number of years, but the appeals were unsuccessful. Mr. Strand completed a satisfactory period of probation and has no further legal obligation in connection with that charge.

In May of 1987, Mr. Strand was convicted in the United States District Court for the District of Wyoming on Three Counts. One (1) of Conspiracy, one (1) of Mail Fraud, and one (1) of Aiding and Abetting, in connection with a project known as the Overland Dome Oil Field. This conviction has been appealed to the United States Court of Appeals for the Tenth

Management has not entered into any arrangements the operation of which may at a subsequent date result in a change in control of the Company. Management is currently exploring acquiring other products or entities. Such acquisitions would be accompanied through the issuance of additional stock which may result in a change of control. Except as set forth below, none of the Shares held by management is subject to transferability restriction, contractual or otherwise.

All shares held by present management are "restricted securities" within the meaning of Rule 144. Rule 144 allows the public resale without registration of restricted securities if certain conditions are satisfied. These conditions include the public availability of current information with respect to the Company, limitations on the volume of sales, and sales transacted through brokers. Information concerning the Company shall be deemed to be available only if the issuer is current in filing its reports with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, or, if the issuer is not subject to such reporting requirement, it has made publicly available the information concerning the issuer specified in clauses (1) to (14), inclusive, and clause (16) of Paragraph (a) (4) of Rule 15c2-11 under that Act. As of the date of this prospectus, the Company is not subject to the reporting requirements of the 1934 Act. Information is publicly available by contacting broker/dealers making a market in the Company's stock or by contacting the Company. Sales of securities of an affiliate, or a non-affiliate who has owned the stock for less than three years, are limited to one percent (1%) of the total outstanding shares of the issuer during the three months preceding the sale. Further, the securities must be sold in broker's transactions within the meaning of Rule 144. Pursuant to Paragraph (k) of Rule

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Circuit, who have remanded the case to the Trial Court for rulings on Mr. Strand's Motion for a directed verdict of acquittal. The Trial court has not yet ruled on these Motions and so the matter is still pending in both Courts. There has been no final adjudication in the case.

Because of the degree of communication between the Company and Mr. Strand since October 1990, the Company has requested, and Mr. Strand has consented to, having his shares stamped with a "soft 144" legend, thereby limiting his public sales of the Company's shares to 1% of the total shares outstanding during any given 90 day period. This action by the Company should not be construed as any indication that the Company considers Mr. Strand to be a "control person."

144, non-affiliates who have beneficially owned their shares for more than three years are not subject to the limitations described above regarding public availability of information, quantity of sales, and broker transactions. As of the date of this prospectus, Luke Glenn and Ted Hillstead is believed to have satisfied the two-year holding requirement of Rule 144 and are being registered pursuant to this document. The sale of such Shares may have a depressing effect upon the market price, if any.

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#### DIVIDENDS

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The Company is currently an undercapitalized business and no assurance can be given that it will generate earnings from which cash dividends can be paid. If earnings are generated, management may follow a policy of retaining all such earnings to finance the expansion of its business. Such a policy could be maintained so long as necessary to provide funds for the operations of the Company. Any dividends that may be paid in the future will be dependent upon the earnings and financial requirements of the Company and all other relevant factors.

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#### PLAN OF DISTRIBUTION

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This prospectus registers shares with the Utah Securities Division. The shares are not offered for sale by the Company, but by individuals, entities, brokers, etc. through secondary trading in the over-the-counter market of "Pink Sheet" companies.

The Division has ordered that Utah brokers who make transactions in the Company's stock must provide this prospectus to the purchasers and obtain from the purchaser a "Purchaser Representation" form. This disclosure and purchaser representation procedure must continue for one year after the date of this prospectus. Any broker-dealer making a market in, or effecting a trade in, the Company's stock must list such quote or transaction on the OTC Stock Bulletin Board.

Any broker-dealers effecting a trade in the Company's stock are prohibited from relying on the manual exemption provided at Sec. 61-1-14(2)(b) of the Utah Uniform Securities Act. Instead, the broker-dealer must rely on the transactional exemption from registration as provided in Sec. 61-1-14(2)(m) of the Act.

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## LEGAL MATTERS

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To the best knowledge of the Company, its officers and directors, other than disclosed herein, there are no material legal actions pending or judgments entered against the Company or its present officers and directors and no material legal actions are contemplated or threatened against such persons. Legal action against former officers, directors, transfer agents, promoters, agents, employees, or shareholders of the Company which may affect the value or transfer of shares of common stock are possible.

This prospectus has been prepared pursuant to a Settlement Agreement with the Utah Securities Division. The Division has required this registration of securities prior to allowing the Company's shares secondary trading. Negotiations with the Division and preparation of the prospectus was performed by Nathan W. Drage, P.C., 2445 West North Temple, Salt Lake City, Utah 84116. Mr. Drage was retained by the Company after the decision by the federal district court was rendered and after trading was suspended by the Utah Securities Division. In the opinion of Mr. Drage, shares that are owned by bona fide purchasers are deemed legally issued, fully-paid and non-assessable.

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## EXPERTS

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The financial statements of the Company for the period ended December 31, 1990 appearing in this prospectus have been examined by Tanner & Company, Certified Public Accountants, as indicated in the report contained herein. Such financial statements are included herein in reliance upon the said report, given upon authority of such person as an expert in accounting and auditing. Tanner & Company was retained as the Company's auditors in the spring of 1989.

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#### OTHER MATTERS

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The Company's transfer agent and registrar of its shares is Atlas Stock Transfer Corporation, 5899 South State, Murray, Utah.

The Company has filed a Registration Statement with the Utah Securities Division, Salt Lake City, Utah. The complete Registration Statement may be inspected at such office and copies may be obtained by the public at the Securities Division, 160 East 300 South, upon payment of the usual fees for reproduction.

The Company's fiscal year end is December 31.

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#### EXHIBITS

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The following exhibits are attached hereto and incorporated into this Prospectus:

Audited financial statements of the Company dated December 31, 1990, December 31, 1989 and December 31, 1988.

Financial statements of the Company dated December 31, 1987 have been excluded because management now believes that the information necessary to create such statements is either unavailable or unreliable.

Purchaser Representation Form

FDA Letter

Shareholder Letter - March 11, 1991

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**FINANCIAL STATEMENTS**

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**U.S.A. MEDICAL CORPORATION**

**Financial Statements -  
December 31, 1990 and 1989**

**(With Auditors' Report Thereon)**





## **INDEPENDENT AUDITORS' REPORT**

**TANNER & Co.**

CERTIFIED PUBLIC ACCOUNTANTS

675 East 500 South, Suite 640  
Salt Lake City, Utah 84102  
Telephone (801) 532-7444  
Fax (801) 532-4911

A PROFESSIONAL CORPORATION

**To the Board of Directors and Stockholders  
of U.S.A. Medical Corporation**

We have audited the accompanying balance sheet of U.S.A. Medical Corporation as of December 31, 1990 and 1989, and the related statements of operations, stockholders' (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of U.S.A. Medical Corporation as of December 31, 1990 and 1989, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As described in note 4 to the financial statements, the Company is party to various legal and regulatory actions. Those actions have resulted in a suspension of trading of the Company's stock and allege that the Company is in violation of the securities laws. The ultimate outcome of these uncertainties cannot presently be determined. Accordingly, the accompanying financial statements do not include any adjustments, if any, that might result from the outcome of these uncertainties.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. Because of significant operating losses and the excess of current liabilities over current assets, the Company's ability to continue as a going concern is dependent on attaining future profitable operations, restructuring its financing arrangements, and obtaining additional outside financing and/or capital. It is not possible to predict the outcome of future operations or whether the necessary alternative financing or additional capital may be arranged. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*Tanner T.S.*

Salt Lake City, Utah  
January 23, 1991

# U.S.A. MEDICAL CORPORATION

## Balance Sheet

December 31, 1990 and 1989

<u>Assets</u>	<u>1990</u>	<u>1989</u>
Current assets:		
Cash	\$ -	7,370
Accounts receivable	-	4,334
Marketable securities	-	590
Inventories	12,272	17,914
Prepaid expenses	-	5,151
Total current assets	<u>12,272</u>	<u>35,359</u>
 Property and equipment, at cost:		
Machinery and equipment	13,266	13,266
Furniture and fixtures	<u>10,225</u>	<u>10,225</u>
	23,491	23,491
Less accumulated depreciation	<u>9,600</u>	<u>6,854</u>
Property and equipment, net	<u>13,891</u>	<u>16,637</u>
 Patent costs, net of accumulated amortization of \$347 and \$101, respectively		
	<u>5,455</u>	<u>5,802</u>
	<u>\$31,618</u>	<u>57,798</u>

<u>Liabilities and Stockholders' (Deficit)</u>	<u>1990</u>	<u>1989</u>
Current liabilities:		
Notes payable	\$ 35,583	44,873
Accounts payable	55,467	46,444
Accrued liabilities	51,438	39,659
Advances from shareholders	<u>95,805</u>	<u>98,805</u>
Total current liabilities	<u>238,293</u>	<u>229,781</u>
Stockholders' (deficit):		
Common stock, \$.001 par value. 50,000,000 shares authorized; 26,352,500 shares and 25,352,500 shares issued and outstanding at December 31, 1990 and 1989, respectively	26,353	25,353
Additional paid-in capital	138,108	138,108
Accumulated (deficit)	<u>(371,136)</u>	<u>(335,444)</u>
Total stockholders' (deficit)	<u>(206,675)</u>	<u>(171,983)</u>
	<u>\$ 31,618</u>	<u>57,798</u>

See accompanying notes to financial statements.

# U.S.A. MEDICAL CORPORATION

## Statement of Operations

Years Ended December 31, 1990 and 1989

	<u>1990</u>	<u>1989</u>
Revenue	\$ 18,266	11,491
Cost of goods sold	<u>7,973</u>	<u>21,346</u>
Gross margin	<u>10,293</u>	<u>(9,855)</u>
Selling, general and administrative expenses	57,685	36,762
Net operating (loss)	<u>(47,392)</u>	<u>(46,617)</u>
Other income (expense)		
Loss on marketable securities	(590)	-
Gain on forgiveness of debt	<u>12,290</u>	<u>-</u>
	<u>11,700</u>	<u>-</u>
Net (loss)	<u>\$ (35,692)</u>	<u>(46,617)</u>
(Loss) per share	<u>\$ (.001)</u>	<u>(.002)</u>
Weighted average number of shares outstanding	<u>26,102,500</u>	<u>25,313,596</u>

See accompanying notes to financial statements.

**U.S.A. MEDICAL CORPORATION**

**Statement of Stockholders' (Deficit)**

**Years Ended December 31, 1990 and 1989**

	<u>Common Stock</u> <u>Shares</u>	<u>Amount</u>	<u>Additional</u> <u>Paid-in Capital</u>	<u>Accumulated</u> <u>(Deficit)</u>
Balance, January 1, 1989	25,312,500	\$25,313	128,148	(288,827)
Stock issued for cash on December 21, 1989 at \$.25 per share	40,000	40	9,960	-
Net (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(46,617)</u>
Balance, December 31, 1989	25,352,500	25,353	138,108	(335,444)
Stock issued for services at \$.001 per share	1,000,000	1,000	-	-
Net (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(35,692)</u>
Balance, December 31, 1990,	<u>26,352,500</u>	<u>\$26,353</u>	<u>138,108</u>	<u>(371,136)</u>

See accompanying notes to financial statements.

# U.S.A. MEDICAL CORPORATION

## Statement of Cash Flows

Years Ended December 31, 1990 and 1989

	<u>1990</u>	<u>1989</u>
<b>Cash flows from operating activities:</b>		
Net (loss)	\$(35,692)	(46,617)
Adjustments to reconcile net (loss) to net cash (used in) operating activities:		
(Increase) decrease in:		
Depreciation and amortization	3,093	2,847
Gain on forgiveness debt	(12,290)	-
Loss on marketable securities	590	-
Accounts receivable	4,334	4,897
Inventories	5,642	(1,303)
Prepaid expenses	5,151	-
Deposits	-	775
Increase (decrease) in:		
Accounts payable	9,023	7,497
Accrued liabilities	11,779	3,041
Common stock issued for services	<u>1,000</u>	<u>-</u>
Net cash (used in) operating activities	<u>(7,370)</u>	<u>(28,863)</u>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	-	(4,791)
Increase in patent costs	<u>-</u>	<u>(1,000)</u>
Net cash provided by (used in) investing activities	<u>-</u>	<u>(5,791)</u>
<b>Cash flows from financing activities:</b>		
Issuance of common stock	-	10,000
Net borrowings - short-term notes payable	<u>-</u>	<u>31,809</u>
Net cash provided by financing activities	<u>-</u>	<u>41,809</u>
 Net increase (decrease) in cash	 (7,370)	 7,155
Cash, beginning of period	<u>7,370</u>	<u>215</u>
Cash, end of period	<u>\$ -</u>	<u>7,370</u>
 <b>Noncash Investing and financing activities:</b>		
Marketable securities issued for debt	<u>\$ -</u>	<u>9,290</u>
Interest paid	<u>\$ -</u>	<u>3,410</u>

See accompanying notes to financial statements.

# **U.S.A. MEDICAL CORPORATION**

## **Notes to Financial Statements**

**December 31, 1990 and 1989**

### **(1) Summary of Significant Accounting Policies**

#### **Organization**

The Company was incorporated January 12, 1979 in the State of Wyoming under the name SMI, Inc. On December 7, 1987, the Company acquired all of the outstanding stock of U.S.A. Medical Corporation in a tax free exchange and changed its name to U.S.A. Medical Corporation. The Company is engaged in the manufacture, research and development of and sale of medical equipment.

#### **Inventories**

Inventories are comprised of completed products held for sale, parts and supplies and are valued at the lower of cost, determined using the first-in, first-out (FIFO) basis, or market.

#### **Depreciation**

Depreciation is calculated using the straight-line method based on estimated useful lives of 7 to 15 years.

#### **Patent Costs**

The Company incurred costs of \$5,903 in applying for patent rights. The Company amortizes these costs over the life of the patent.

#### **Income Taxes**

There have been no earnings through December 31, 1990 and, accordingly, no provision for income taxes is reflected in the accompanying financial statements. The Company at December 31, 1990 has a net operating loss carryforward of approximately \$370,000.

#### **(Loss) Per Common Share**

(Loss) per share of common stock is calculated based upon the weighted average number of common shares outstanding.

#### **Cash Flow Statement**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

#### **Reclassifications**

Certain of the 1989 amount have been reclassified to conform with the 1990 presentation.



# U.S.A. MEDICAL CORPORATION

## Notes to Financial Statements - Continued

### (2) Inventories

Inventories at December 31, 1990 and 1989 consist of the following:

	<u>1990</u>	<u>1989</u>
Finished goods	\$ -	8,585
Parts	12,272	8,529
Supplies	-	800
	<u>\$12,272</u>	<u>17,914</u>

### (3) Notes Payable

Notes payable at December 31, 1990 and 1989 consists of the following:

	<u>1990</u>	<u>1989</u>
Note payable to an individual with interest 12.5% due in January 1990, unsecured. The Company is in default on the note.	\$25,000	25,000
Note payable to two shareholders due March 1, 1989 with interest at prime + 3%, unsecured. The Company is in default on these notes.	10,583	10,583
Note payable to individuals payable upon demand without interest	-	9,290
	<u>\$35,583</u>	<u>44,873</u>

### (4) Contingencies

#### **Going Concern**

As shown in the accompanying financial statements, the Company incurred a net loss of \$35,692 during the year ended December 31, 1990 and as of that date, the Company's current liabilities exceeded its current assets by \$226,021 and its total liabilities exceeded its total assets by \$206,675. These factors create an uncertainty about the Company's ability to continue as a going concern.

## **U.S.A. MEDICAL CORPORATION**

### **Notes to Financial Statements - Continued**

#### **(4) Contingencies**

##### **Litigation**

The Company is a party in legal actions regarding the trading of Company stock. Currently, trading of the stock in the state of Utah has been suspended. The outcome of these actions is uncertain. Management is unable to determine an adjustment, if any, that the Company may incur relating to these uncertainties. Therefore, no adjustment to the financial statement has been made based on their possible outcome.

##### **Insurance Coverage**

The Company at December 31, 1990 does not have any insurance coverage.

#### **(5) Related Party Transactions**

The accounts receivable at December 31, 1989, include amounts due from the Company's president and his wife in the amount of \$2,417 for personal use of company credit cards.

The company purchases medical equipment from a company owned by an employee of the company. The Company has purchases and accounts payable to the related company at December 31, 1990 and 1989 of approximately \$2,700 and \$2,900, respectively.

The Company has also received unsecured non-interest bearing advances from shareholders totaling \$95,805 and \$98,805 at December 31, 1990 and 1989, respectively.

#### **(6) Concentration of Credit**

The Company primarily has sales in the medical equipment industry to individuals and business in the United States.

**U.S.A. MEDICAL CORPORATION**  
**Financial Statements - December 31, 1988**  
**(With Auditors' Report Thereon)**



## INDEPENDENT AUDITORS' REPORT

TANNER & Co.

CERTIFIED PUBLIC ACCOUNTANTS

376 East 400 South, Suite 200  
Salt Lake City, Utah 84111-2990  
Telephone (801) 532-7444

A F R E E      S E R V I C E      C O R P O R A T I O N

**To the Board of Directors and Stockholders  
of U.S.A. Medical Corporation**

We have audited the accompanying balance sheet of U.S.A. Medical Corporation as of December 31, 1988, and the related statements of operations, stockholders' equity (deficit), and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of U.S.A. Medical Corporation as of December 31, 1988, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As described in note 4 to the financial statements, the Company is party to various legal and regulatory actions. Those actions have resulted in a temporary suspension of trading of the Company's stock and allege that the Company is in violation of the securities laws. The ultimate outcome of these uncertainties cannot presently be determined. Accordingly, the accompanying financial statements do not include any adjustments, if any, that might result from the outcome of these uncertainties.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. Because of significant operating losses and the excess of current liabilities over current assets, the Company's ability to continue as a going concern is dependent on attaining future profitable operations, to restructure its financing arrangements, and obtaining additional outside financing and/or capital. It is not possible to predict the outcome of future

operations or whether the necessary alternative financing or additional capital may be arranged. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*Tanner & Co.*

Salt Lake City, Utah  
April 4, 1989, except for note 2 which is  
dated May 5, 1989

# U.S.A. MEDICAL CORPORATION

## Balance Sheet

December 31, 1988

### Assets

#### Current assets:

Cash	\$ 215
Accounts receivable (note 5)	9,231
Inventory (notes 1 and 2)	16,611
Prepaid expenses	<u>5,151</u>
Total current assets	<u>31,208</u>

#### Property and equipment, at cost (note 1):

Machinery and equipment	13,266
Furniture and fixtures	<u>5,601</u>
	18,867
Less accumulated depreciation	<u>4,275</u>
Property and equipment, net	<u>14,592</u>

Deposits	775
Patent costs (note 1)	<u>4,903</u>
	<u>\$ 51,478</u>

### Liabilities and Stockholders' Equity (Deficit)

#### Current liabilities:

Accounts payable (note 5)	\$ 38,947
Accrued liabilities	36,618
Notes payable to related parties (note 3)	<u>111,279</u>
Total current liabilities	<u>186,844</u>

#### Contingencies (note 4)

#### Stockholders' equity (deficit) (notes 4, 6 and 7):

Common stock, \$.001 par value. 50,000,000 shares authorized; 2,531,250 shares issued and outstanding	2,531
Additional paid-in capital	150,930
Accumulated (deficit)	<u>(288,827)</u>
Total stockholders' equity (deficit)	<u>(135,366)</u>

\$ 51,478

See accompanying notes to financial statements.

U.S.A. MEDICAL CORPORATION

Statement of Operations

Year Ended December 31, 1988

Revenue - sales	\$ 26,555
Cost of goods sold	<u>40,519</u>
Gross margin	<u>(13,964)</u>
Other expenses:	
General and administrative	31,850
Selling and distribution	17,453
Interest	4,041
Depreciation	<u>11,162</u>
	<u>64,506</u>
Net (loss)	<u>\$(78,470)</u>
(Loss) per share	<u>\$ (.031)</u>
Weighted average number of shares outstanding	<u>2,531 250</u>

See accompanying notes to financial statements.

**U.S.A. MEDICAL CORPORATION**  
**Statement of Stockholders' Equity (Deficit)**  
**Year Ended December 31, 1988**

	<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-In Capital</u>	<u>(Deficit)</u>
Balance, December 31, 1987 as previously reported	2,531,250	\$ 2,531	150,930	(11,633)
Prior period adjustment (note 6)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(198,724)</u>
Restated balance, December 31, 1987	2,531,250	2,531	150,930	(210,357)
Net (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(78,470)</u>
Balance, December 31, 1988	<u>2,531,250</u>	<u>\$ 2,531</u>	<u>150,930</u>	<u>(288,827)</u>

See accompanying notes to financial statements.



**U.S.A. MEDICAL CORPORATION**

**Statement of Cash Flows**

**Year Ended December 31, 1988**

Cash flows from operating activities:	
Net (loss)	\$(78,470)
Adjustments to reconcile net (loss) to net cash (used in) operating activities:	
Depreciation	11,162
Decrease in accounts receivable	4,235
Decrease in inventory	15,394
Decrease in prepaid expenses	344
Increase in deposits	(775)
Increase in accounts payable	4,909
Increase in accrued liabilities	<u>25,752</u>
Net cash (used in) operating activities	(17,449)
 Cash flows from investing activities	
 Cash flows from financing activities:	
Net borrowings - short term notes payable	<u>15,427</u>
 Net decrease in cash	(2,022)
 Cash, beginning of year	<u>2,237</u>
 Cash, end of year	<u>\$ 215</u>

See accompanying notes to financial statements.

# U.S.A. MEDICAL CORPORATION

## Notes to Financial Statements

December 31, 1988

### (1) Summary of Significant Accounting Policies

#### **A. Organization**

The Company was incorporated January 12, 1979 in the State of Wyoming under the name SMI, Inc. On December 7, 1987, the Company acquired all of the outstanding stock of U.S.A. Medical Corporation in a tax free exchange and changed its name to U.S.A. Medical Corporation. The Company is engaged in the manufacture, research and development of and sale of medical equipment.

#### **B. Inventories**

Inventories are comprised of completed products held for sale, parts and supplies and are valued at the lower of cost or market on a first-in, first-out (FIFO) basis.

#### **C. Depreciation**

Depreciation is calculated using the straight-line method based on estimated useful lives of 7 to 15 years.

#### **D. Patent Costs**

The Company has incurred \$4,903 in applying for patent rights. The Company will amortize these costs over the life of the patent once approval has been granted.

#### **E. Income Taxes**

There have been no earnings through December 31, 1988 and, accordingly, no provision for income taxes is reflected in the accompanying financial statements. The Company at December 31, 1988 has a net operating loss carryforward of approximately \$280,000.

#### **F. Income (Loss) Per Common Share**

Income (loss) per share of common stock is calculated based upon the weighted average number of common shares outstanding during the year ended December 31, 1988.

### (2) Inventories

Inventories at December 31, 1988 consist of the following:

Finished goods	\$10,509
Parts	5,722
Supplies	<u>380</u>
	<u>\$16,611</u>

## U.S.A. MEDICAL CORPORATION

### Notes to Financial Statements - Continued

#### (3) Notes Payable

Notes payable at December 31, 1988 consist of the following:

Note payable to a stockholder payable on demand without interest, unsecured	\$ 95,805
Note payable to two shareholders due March 1, 1989 with interest at prime + 3%, unsecured	<u>15,474</u>
	<u>\$111,279</u>

#### (4) Contingencies

##### A. Going Concern

As shown in the accompanying financial statements, the Company incurred a net loss of \$78,470 during the year ended December 31, 1988, and as of that date, the Company's current liabilities exceeded its current assets by \$155,636 and its total liabilities exceeded its total assets by \$127,779. In addition, the Company has a short term note payable to two stockholders in the amount of \$15,474 which is past due. Those factors create an uncertainty about the Company's ability to continue as a going concern.

##### B. Litigation

The Company is a party in legal actions regarding the trading of Company stock. Currently, trading of the stock in the state of Utah has been suspended. The outcome of these actions is uncertain. Management is unable to determine an adjustment, if any, that the Company may incur relating to these uncertainties. Therefore, no adjustment to the financial statement has been made based on their possible outcome.

##### C. Insurance Coverage

The Company at April 4, 1989 does not have any insurance coverage.

#### (5) Related Party Transactions

The accounts receivable include amounts due from the Company's president and his wife in the amount of \$2,417 for personal use of company credit cards.

The company purchases medical equipment from a company owned by a director of the company. The Company has accounts payable to the related company at December 31, 1988 of \$2,448.

The Company has two notes payable to stockholders totaling \$111,279 (see note 3).

## U.S.A. MEDICAL CORPORATION

### Notes to Financial Statements - Continued

#### (6) Prior Period Adjustment

During the year ended December 31, 1988, it was determined that costs which had in prior years been capitalized as development costs were in fact normal operation expenses and research and development expenses. These previously capitalized costs total \$198,724. The Company has charged the prior year's accumulated (deficit) for the \$198,724 and removed the capitalized development costs. This charge will increase the loss in the prior year by \$198,724 and increase the amount of loss per share by approximately \$.078 per share.

#### (7) Subsequent Events

On December 31, 1988, the Board of Directors authorized a 10 for 1 forward stock split. This action is pending the authorization by three-fourths of the outstanding shares of company stock.

Effective February 6, 1988, the Company acquired all of the outstanding stock of Impulse Corporation in exchange for 5,000,000 shares of Company stock in a tax free exchange. The following is summarized operating data for Impulse Corporation for the year ended December 31, 1988.

Sales	\$47,731
Cost of sales	<u>3,349</u>
Gross margin	44,382
Other income	<u>653</u>
Total income	45,035
Operating expenses	<u>45,961</u>
Net (loss)	<u>\$ (926)</u>

The following pro forma schedule shows the effect had the transaction taken place January 1, 1988:

	<u>USA Medical</u>	<u>Impulse Corporation</u>	<u>Pro Forma Combined</u>
Sales	<u>\$ 26,555</u>	<u>47,731</u>	<u>74,286</u>
Net (loss)	<u>\$(70,883)</u>	<u>(926)</u>	<u>(71,809)</u>
(Loss) per share	<u>(.028)</u>	<u>(.00)</u>	<u>(.01)</u>

On May 5, 1989, the Company entered into a loan agreement to meet its immediate operational needs whereby the Company will borrow \$41,000 between May 5, 1989 and July 15, 1989 to be repaid with interest at 12% per annum on December 1, 1989. The agreement also provides that the company pay a royalty of \$200 for each Maxim Aspirator sold between May 5, 1989 and December 1, 1989 to the lender of the funds.

**LIFE CONCEPTS, INC.**

**Secondary Trading Purchaser Representation**

The Utah Securities Division requires all brokers transacting the sale of Life Concepts, Inc. (the Company), formerly U.S.A. Medical Corporation, common stock within the state of Utah to have this form completed by the purchaser. The original shall be kept on file at the office of the broker/dealer.

The undersigned purchaser of the Company's common stock hereby represents and affirms the following:

1. I have purchased the securities with my own funds and not as a nominee for someone else, unless otherwise disclosed herein.

2. A prospectus dated March 9, 1991 has been delivered to me prior to my purchase and I understand the risks associated with purchasing these securities.

3. Name \_\_\_\_\_

Address \_\_\_\_\_

Phone Number \_\_\_\_\_

Purchase Date \_\_\_\_\_ Broker Firm \_\_\_\_\_

Social Security Number \_\_\_\_\_

4. Date \_\_\_\_\_

5. Signature \_\_\_\_\_

6. The undersigned broker has reviewed the "Summary of Prospectus" section (pages 1 and 2) of the Prospectus with the Purchaser.

\_\_\_\_\_  
Broker



DEPARTMENT OF HEALTH & HUMAN SERVICES

Public Health Service

AUG - 4 1986

Food and Drug Administration  
8757 Georgia Avenue  
Silver Spring MD 20910

Mr. Ted Hillstead  
Official Correspondent  
USA Medical Corporation  
1569 W. 2650 S. Suite 7  
Ogden, Utah 84401

Re: K862751  
USA Aspirator  
Dated: July 9, 1986  
Received: July 22, 1986

Dear Mr. Hillstead:

We have reviewed your Section 510(k) notification of intent to market the above device and we have determined the device to be substantially equivalent to devices marketed in interstate commerce prior to May 28, 1976, the enactment date of the Medical Device Amendments. You may, therefore, market your device subject to the general controls provisions of the Federal Food, Drug, and Cosmetic Act (Act) until such time as your device has been classified under Section 513. At that time, if your device is classified into either class II (Performance Standards) or class III (Premarket Approval), it would be subject to additional controls.

Our substantially equivalent decision is based on the device not being intended for use in suction lipectomy. Devices intended for this use are currently considered to be classified by statute in class III under the provisions of Section 513(f) of the Act. Any direct or indirect promotion of this device for suction lipectomy would first require that a premarket approval application (PMA) be approved or the device reclassified.

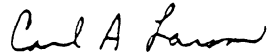
General controls presently include regulations on annual registration, listing of devices, good manufacturing practice, labeling, and the misbranding and adulteration provisions of the Act. In the future, the scope of general controls may be broadened to include additional regulations.

All regulations and information on meetings of the device advisory committees, their recommendations, and the final decisions of the Food and Drug Administration (FDA) will be published in the FEDERAL REGISTER. We suggest you subscribe to this publication so that you can convey your views to FDA if you desire and be notified of any additional requirements imposed on your device. Subscriptions may be obtained from the Superintendent of Documents, J.S. Government Printing Office, Washington, D.C. 20402. Such information also may be reviewed in the Dockets Management Branch (HFA-305), Food and Drug Administration, Room 4-62, 5600 Fishers Lane, Rockville, Maryland 20857.

Page 2 - Mr. Ted Hillstead

This letter does not in any way denote official FDA approval of your device or its labeling. Any representation that creates an impression of official approval of this device because of compliance with the premarket notification regulations is misleading and constitutes misbranding. If you desire advice on the labeling for your device or other information on your responsibilities under the Act, please contact the Office of Compliance, Division of Compliance Operations (HFZ-320), 8757 Georgia Avenue, Silver Spring, Maryland 20910.

Sincerely yours,



Carl A. Larson, Ph.D.

Director

Division of Surgical

and Rehabilitation Devices

Office of Device Evaluation

Center for Devices

and Radiological Health

LIFE CONCEPTS, INC.  
(Formerly U.S.A. Medical Corporation)  
2020 South 1900 West  
Ogden, Utah 84401

Annual Shareholder Meeting Report

March 11, 1991

Dear Shareholder:

An annual meeting of the shareholders of Life Concepts, Inc. (formerly U.S.A. Medical Corporation and S.M.I., Inc.) was held at 9:30 a.m. on March 9, 1991.

At the meeting the shareholders voted in favor of the following:

1) Election of Luke Glenn and Ted Hillstead to the Board of Directors;

2) Changing the Company's name from U.S.A. Medical Corporation to Life Concepts, Inc.;

3) Creation of a wholly-own Utah subsidiary and merger of that subsidiary for purposes of changing domicile; waiving the thirty day waiting period;

4) Ratified actions of the Board since the last annual meeting, including amendments to the Bylaws and termination of a director, and change of transfer agent to Atlas Stock and Transfer.

The Company also announced the signing of a preliminary agreement to merge or acquire Heiner Bottling Company in exchange for approximately 51% of the shares of the Company. Heiner bottles and markets mineral water from Northern Utah springs. Prior to consummation of that reorganization, Heiner is required to obtain audited financial information and the Company is to have another shareholder meeting to increase the number of shares authorized in order to complete the reorganization.

Ted Hillstead  
Secretary



# HEINER BOTTLING COMPANY



**ANNIE HEINER**

*Pure Rocky Mountain Mineral Water*

805 E. Como Springs Road  
P.O. Box 386  
Morgan, Utah 84050  
(801) 829-6779



## INTRODUCTION AND BRIEF HISTORY

**HEINER BOTTLING COMPANY** was formed to engage in the business of bottling mineral water for distribution throughout the western United States.

The springs that produce **ANNIE HEINER PURE ROCKY MOUNTAIN MINERAL SPRING WATER** are of volcanic origin. In the early 1870's Dr. Kohler of the Rush Medical College of Indiana came to the Morgan Valley. His attention was drawn to the Springs and he analyzed the water and found it to contain wonderful properties. As time passed, a Dr. T. S. Wadsworth and a Dr. C. F. Osgood made their homes in Morgan, and when they heard about the springs flowing freely under the rocks at **COMO SPRINGS**, they too analyzed the water and reached the same conclusion that Dr. Kohler had. The analysis done by Ford Chemical Laboratories confirmed that the water is a top quality **MINERAL SPRING WATER**.

The natural mineral spring water flows from twenty-one springs located at Como Springs in Morgan, Utah. To confirm the fact that this is of the highest quality, we have included a comparison of our water and Perrier which is the largest selling bottled mineral water in the world. These tests clearly show our water to be one of the best in the world.

Huish Chemical Company of Salt Lake has been distributing laundry and dish wash detergent throughout the western United States for over eight years. They have a network of over 160 brokers, and a fleet of trucks for distribution. Dan Huish has been working with us on the bottling company, and his company will assist us with the distribution and sales to the major grocery chains. The relationships already established between Huish and these chains will allow our distributors immediate access to the marketplace. also, with Huish's trucking network, we will be in places like California at less cost than the California bottlers.

Initially, the company will produce two sizes and three flavors of **ALL NATURAL MINERAL SPRING WATER**. We will have a ten ounce and a one liter size, in glass containers. The all natural flavors will be 1) Natural - no flavors added, 2) lemon-lime, 3) Cherry. Our Market research indicates the mix of the two sizes to approximately 60-40.

HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

KAY L. BOWEN & ASSOCIATES  
*CERTIFIED PUBLIC ACCOUNTANT*

# HEINER BOTTLING COMPANY



*Pure Rocky Mountain Mineral Water*

805 E. Como Springs Road  
P.O. Box 386  
Morgan, Utah 84050  
(801) 829-6779

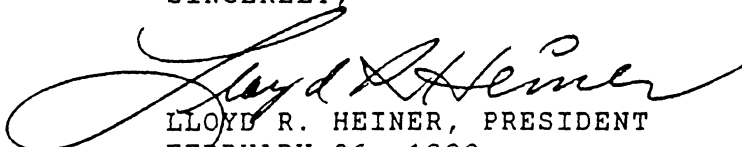


TO THE BOARD OF DIRECTORS  
AND STOCKHOLDERS  
HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

THE ACCOMPANYING BALANCE SHEET OF HEINER BOTTLING COMPANY ( A  
UTAH CORPORATION) AS OF DECEMBER 31, 1990, AND THE RELATED  
STATEMENTS OF INCOME, RETAINED EARNINGS, AND CASH FLOWS FOR THE  
THREE MONTHS THEN ENDED HAS BEEN PREPARED FROM THE BOOKS AND  
RECORDS OF THE COMPANY.

TO THE BEST OF MY KNOWLEDGE, THE INFORMATION PRESENTED IN THESE  
FINANCIAL STATEMENTS IS COMPLETE AND ACCURATE.

SINCERELY,

  
LLOYD R. HEINER, PRESIDENT  
FEBRUARY 26, 1990

HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

UNAUDITED BALANCE SHEET  
DECEMBER 31, 1990

ASSETS

Current Assets:

Cash	\$	2,175
Accounts receivable		3,559
Subscriptions receivable		3,163
Inventory - raw materials		15,974
Inventory - finished goods		<u>19,395</u>

Total Current Assets \$44,266

Property, Plant & Equipment:

Water rights - 500 acre feet	1,250,000
Leasehold improvements	179,398
Machinery and equipment	374,556
Furniture and fixtures	<u>13,924</u>
Total	1,817,878
Less accumulated depreciation	<u>10,825</u>

Total Property, Plant & Equipment \$1,807,050

Other Assets:

Pre-production costs	61,553
Less accumulated amortization	<u>3,268</u>

Total Other Assets 58,285

TOTAL ASSETS \$1,909,601

HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

UNAUDITED BALANCE SHEET  
DECEMBER 31, 1990

LIABILITIES AND STOCKHOLDERS EQUITY

Current Liabilities:

Accounts payable	\$	2,057
Notes payable - current portion		24,583
Accrued taxes and withholding payable		465
Advertising reserve		964
Accrued interest payable		<u>300</u>

Total Liabilities 28,369

Long-Term Liabilities:

Notes and mortgages payable	133,591
Notes payable - stockholders	<u>188,186</u>

Total Long-Term Liabilities 321,777

Stockholders Equity:

Common stock \$1.00 par value, 5,000,000 shares authorized, 1,030,000 shares issued and outstanding	1,030,000
Paid in capital	555,200
Retained earnings (deficit)	<u>&lt;25,745&gt;</u>

Total Stockholders Equity 1,559,455

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY \$1,909,601

HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

UNAUDITED STATEMENT OF INCOME AND RETAINED EARNINGS  
FOR THE THREE MONTH PERIOD ENDED DECEMBER 31, 1990

Sales	\$	1,888
Less cost of goods sold		<u>1,071</u>
Gross Income		817
Less Operating Expenses:		
Interest expense	4,772	
Rent expense	5,250	
Depreciation expense	8,121	
Amortization expense	2,451	
Telephone and utilities	738	
Office expense	358	
Janitorial and cleaning expense	22	
Vehicle expense	194	
Supplies expense	281	
Repairs and maintenance	72	
Taxes and licenses	<u>110</u>	
Total Operating Expenses		<u>22,369</u>
Net Income (Loss)		<21,552>
Add Interest Income		<u>389</u>
Net Income (Loss)		<21,163>
Retained Earnings - October 1, 1990		<u>&lt;4,582&gt;</u>
Retained Earnings - December 31, 1990		<25,745>
Earnings (Loss) Per Share	\$<.02>	

HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

UNAUDITED STATEMENT OF CASH FLOWS  
FOR THE THREE MONTH PERIOD ENDED DECEMBER 31, 1990

Cash Flows From Operating Activities:

Operations:

Net Income (Loss)	<21,163>
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Add (Deduct) Items Not Affecting Cash:

Depreciation and amortization expense	\$ 10,572
(Increase) in accounts receivable	5,321
(Decrease) in inventories	<6,097>
(Increase) in accounts payable	1,074
(Decrease) in accrued taxes and withholding payable	<21>
Increase in advertising reserve	176
Increase in accrued interest payable	<u>47</u>

Total	<u>11,072</u>
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Net Cash Provided (Used) From Operations	<10,091>
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Cash Flows From Investing Activities:

Purchase of fixed assets and preproduction costs	<26,620>
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Cash Flows from Financing Activities:

Increase in notes and mortgages payable	12,654
Increase in notes payable - stockholders	<u>14,750</u>

Cash Provided From Financing Activities	<u>27,404</u>
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Net Increase in Cash	<9,307>
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Cash Balance - October 1, 1990	<u>11,482</u>
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Cash Balance - December 31, 1990	<u><u>2,175</u></u>
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HEINER BOTTLING COMPANY  
COMO SPRINGS, UTAH

UNAUDITED NOTES TO THE FINANCIAL STATEMENT  
DECEMBER 31, 1990

Note 1 - Summary of Significant Accounting Policies:

Heiner Bottling Company was incorporated under the laws of the State of Utah on June 12, 1986. It was organized to engage in the business of bottling mineral water, from the mineral water springs at Como Springs in Morgan, Utah.

Revenue Recognition:

Sales are recorded when an order for the product has been received, and the product has been shipped from the plant, by common carrier or in the buyer's own trucks. Shipments made on the Company's own trucks are not recorded as sales, until the product is received by the purchasing Company.

Inventories:

Raw material inventories are recorded at cost, using the First-in, First-out Method of inventory valuation. Finished goods inventories are recorded using the Full Absorption Costing Method for manufacturing costs.

Repair parts and supplies are expensed in the period they are purchased.

Property, Plant & Equipment:

Property, plant and equipment are recorded at cost. The water rights were transferred to the Company, at incorporation, for capital stock. They were valued at \$2,500 per acre foot, as appraised by the Lester S. Froerer, on August 9, 1989.

Depreciation is provided using the following estimated periods of useful life, using a straight line method of depreciation.

Machinery and Equipment	5 - 15 years
Leasehold Improvements	25 years
Furniture and Fixtures	5 - 10 years

Expenditures, which materially extend the useful life of an asset, are capitalized as incurred. Normal maintenance and minor repairs are expensed.



#### Pre-production Costs:

Pre-production costs are the costs that were incurred in 1987-1990, before actual production began, that could not be assigned to a specific function, equipment installation or leasehold equipment expenditure. These costs can reasonably be expected to be recovered over the next five years, and thus, are being amortized over sixty months.

#### Note 2 - Notes and Mortgages Payable:

The Company obtained long-term financing from First Security Bank, with an SBA loan on April 25, 1990. The loan is at prime plus 2% and matures on April 25, 1997. The loan calls for monthly payments of principle and interest in the amount of \$2,702.00 per month. Collateral for the loan is the equipment and the inventory of the Company.

The Company also has a note payable on a van in the amount of \$9,250 dated December 31, 1990. The note is payable in monthly installments of \$255.71 with interest at 12.9%.

Also on December 31, 1990, the Company borrowed \$7,000.00 on its line of credit at Valley Bank and Trust Co.

#### Note 3 - Lease on Plant:

The Company leases its facility, a 14,000 square foot facility, and surrounding grounds for \$1,750.00 per month. The lease began on October 1, 1988 and extends for a period of five years, with three (3) five-year extensions on the lease available in the lease agreement.

#### Note 4 - Notes Payable - Stockholdings:

The amounts due Stockholders are advances, to the Company by the Stockholders, which draw no interest and are payable to the Stockholders from future earnings of the Company.

Also past due lease payments have been recorded as notes payable to Como Springs Corporation.

EXHIBIT "UU"

**¶ 2367] Statement Required in all Offering Circulars**

**Reg. § 230.259.** There shall be set forth on the cover page of every offering circular the following statement in capital letters printed in boldface roman type at least as large as ten-point modern type and at least two points leaded,

"THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION DOES NOT PASS UPON THE MERITS OF OR GIVE ITS APPROVAL TO ANY SECURITIES OFFERED OR THE TERMS OF THE OFFERING, NOR DOES IT PASS UPON THE ACCURACY OR COMPLETENESS OF ANY OFFERING CIRCULAR OR OTHER SELLING LITERATURE. THESE SECURITIES ARE OFFERED PURSUANT TO AN EXEMPTION FROM REGISTRATION WITH THE COMMISSION; HOWEVER, THE COMMISSION HAS NOT MADE AN INDEPENDENT DETERMINATION THAT THE SECURITIES OFFERED HEREUNDER ARE EXEMPT FROM REGISTRATION."

[Adopted in Release No. 33-3663, July 23, 1956, 21 F. R. 5739, amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

**¶ 2368] Reports of Sales Hereunder**

**Reg. § 230.260.** Within 30 days after the end of each six-month period following the date of the original offering circular (offering statement—Part II) required by § 230.256, or of the statement required by § 230.257, the issuer or other person for whose account the securities are offered shall file with the Regional Office of the Commission with which the offering statement was filed four copies of a report on Form 2-A containing the information called for by that form. A final report shall be made upon completion or termination of the offering and may be made prior to the end of the six-month period in which the last sale is made.

[Adopted in Release No. 33-3663, July 23, 1956, 21 F. R. 5739, amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

**¶ 2369] Suspension of Exemption**

**Reg. § 230.261.** (a) The Commission may, at any time after the filing of an offering statement, enter an order temporarily suspending the exemption, if it has reason to believe that— [Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

(1) no exemption is available under §§ 230.251 to 230.262 for the securities purported to be offered hereunder or any of the terms or conditions of §§ 230.251 to 230.262 have not been complied with, including failure to file any report as required by § 230.260;

(2) the offering statement or any other sales literature contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; [Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

(3) the offering is being made or would be made in violation of Section 17 of the Act;

(4) any event has occurred after the filing of the offering statement which would have rendered the exemption hereunder unavailable if it had occurred prior to such filing; [Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

(5) any person specified in paragraph (c) of § 230.252 has been indicted for any crime or offense of the character specified in subparagraph (3) thereof, or any proceeding has been initiated for the purpose of enjoining any such person from

engaging in or continuing any conduct or practice of the character specified in subparagraph (4) of such paragraph;

(6) any person specified in paragraph (d) of § 230.252 has been indicted for any crime or offense of the character specified in subparagraph (1) thereof, or any proceeding has been initiated for the purpose of enjoining any such person from engaging in or continuing any conduct or practice of the character specified in subparagraph (2) of such paragraph; or

(7) the issuer or any promoter, officer, director or underwriter has failed to cooperate, or has obstructed or refused to permit the making of an investigation by the Commission in connection with any offering made or proposed to be made hereunder.

(b) Upon the entry of an order under paragraph (a) of this section the Commission will promptly give notice to the persons on whose behalf the offering statement was filed (1) that such order has been entered, together with a brief statement of the reasons for the entry of the order, and (2) that the Commission, upon receipt of a written request within 30 days after the entry of such order, will, within 20 days after the receipt of such request, set the matter down for hearing at a place to be designated by the Commission. If no hearing is requested and none is ordered by the Commission, the order shall become permanent on the thirtieth day after its entry and shall remain in effect unless or until it is modified or vacated by the Commission. Where a hearing is requested or is ordered by the Commission, the Commission will, after notice of an opportunity for such hearing, either vacate the order or enter an order permanently suspending the exemption. [Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

(c) The Commission may, at any time after notice of and opportunity for hearing, enter an order permanently suspending the exemption for any reason upon which it could have entered a temporary suspension order under paragraph (a) of this rule. Any such order shall remain in effect until vacated by the Commission.

(d) All notices required by this rule shall be given to the person or persons on whose behalf the offering statement was filed by personal service, registered or certified mail or confirmed telegraphic notice at the addresses of such persons given in the offering statement. [Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

[Adopted in Release No. 33-3663, July 23, 1956, 21 F. R. 5739; amended by Release No. 33-3935, July 11, 1958, 23 F. R. 4455; and Release No. 33-4744, effective December 11, 1964, 29 F. R. 16982; amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

#### [¶ 2370]

#### Consent to Service of Process

**Reg. § 230.262.** (a) If the issuer, any of its directors or officers, any person for whose account any of the securities are to be offered, or any underwriter of the securities to be offered, is not a resident of the United States, each such non-resident person shall, at the time of filing the offering statement required by § 230.255, furnish to the Commission in a form prescribed by or acceptable to it, a written irrevocable consent and power of attorney which—[Amended in Release No. 33-6340 (¶ 83,015), effective September 17, 1981, 46 F. R. 41766.]

(1) designates the Securities and Exchange Commission as an agent upon whom may be served any process, pleadings, or other papers in any civil suit or action brought against the person executing the consent and power of attorney or to which he has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of the United States, where the cause of action (i) accrues on or after the effective date of this rule, and (ii) arises out of any offering made or purported to be made under §§ 230.251 to 230.262 or any purchase or sale of any security in connection therewith; and

#### ¶ 2370 Reg. § 230.262