IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 80-1166

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

EDWARD E. HOLSCHUH,

Defendant-Appellant.

On Appeal from the United States District Court
for the Southern District of Indiana

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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INDEX

	Page
CITATIONS	i-vi
COUNTERSTATEMENT OF THE QUESTIONS PRESENTED	1
COUNTERSTATEMENT OF THE CASE	2
A. Proceedings in the district court	2
B. Counterstatement of facts	4
Mr. Holschuh's involvement in the formation of PCR	4
Mr. Holschuh's arrangement of public financing for the venture	7
Mr. Holschuh's role in the structuring of the offerings	11
Mr. Holschuh's furnishing of false information to the underwriter resulted in misrepresentations in the offering circular	13
Mr. Holschuh's participation in the partnership closings where he "assigned" non-existent lease-hold interests to investors	16
Mr. Holschuh's participation in the knowing and wrongful dissipation of investors' funds	17
Mr. Holschuh's continued deception of investors	20
C. The district court's findings and conclusions	22
STATUTES AND RULES INVOLVED	25
ARGUMENT	26
I. THE DISTRICT COURT DID NOT ERR IN DETERMINING THAT MR. HOLSCHUH VIOLATED THE FEDERAL SECURITIES LAWS	26
A. The findings of fact challenged by Mr. Holschuh are not clearly erroneous	26
B. Mr. Holschuh violated and aided and abetted violations of antifraud provisions of the federal securities laws	30
C. Mr. Holschuh violated and aided and abetted violations of the registration provisions of the Securities Act	37

ARGUMENT (Continued):

	Page
II. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN PERMANENTLY ENJOINING MR. HOLSCHUH FROM FURTHER VIOLATING THE FEDERAL SECURITIES LAWS.....	43
CONCLUSION.....	48

CITATIONS

Cases:

Aaron v. Securities and Exchange Commission, 100 S. Ct. 1945 (1980).....	32
Aunt Mid, Incorporated v. Fjell-Oranje Lines, et al., 458 F.2d 712 (7th Cir.), cert. denied, 409 U.S. 877 (1972).....	26
Brennan v. Midwestern United Life Insurance Co., 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970).....	36
Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir.), cert. denied, 396 U.S. 838 (1969).....	33,36
Chapman v. Dunn, 414 F.2d 153 (6th Cir. 1969).....	39
Commodity Futures Trading Commission v. Hunt, 591 F.2d 1211 (7th Cir. 1979).....	45,46,48
Doran v. Petroleum Management Corp., 545 F.2d 893 (5th Cir. 1977).....	39
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).....	32
Errion v. Connell, 236 F.2d 447 (9th Cir. 1956).....	35
Franke v. Midwestern Oklahoma Development Authority, 428 F. supp. 719.....	37
Hayden Stone, Incorporated v. Brode, 508 F.2d 895 (7th Cir. 1974).....	26
Hecht Co. v. Bowles, 321 U.S. 321 (1944).....	44
Hogland v. Covington County Bank, [1977-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶96,003 (M.D. Ala. 1977).....	33,35
Indiana State Employees Association, Incorporated v. Negley, 501 F.2d 1239 (7th Cir. 1974).....	26

Cases (Continued): Page

Kidwell v. Meikle, 597 F.2d 1273 (9th Cir. 1979)..... 35

Klebanow v. New York Produce Exchange, 344 F.2d 294, (2d Cir. 1965)..... 39

Landy v. Federal Deposit Insurance Corp.,486 F.2d 139 (3d Cir. 1973)..... 36

Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973)..... 42

Linden v. United States, 254 F.2d 540 (4th Cir. 1958)..... 44

McGreghar Land Co. v. Meguiar, 521 F.2d 822 (9th Cir. 1975)..... 39

Mitchell v. Pidcock, 299 F.2d 281 (5th Cir. 1962)..... 46

Otis & Co. v. Securities and Exchange Commission, 106 F.2d 579 (6th Cir. 1939)..... 45

Reube v. Pharmacodynamics, Inc. 348 F. Supp. 900 (1972)..... 31

Sanders v. John Nuveen & Co., Inc., 554 F.2d 790 (7th Cir. 1977)..... 32

Securities and Exchange Commission v. Advance Growth Capital Corp., 470 F.2d 40 (7th Cir. 1972)..... 45,46,47

Securities and Exchange Commission v. American Realty Trust, 586 F.2d 1001 (4th Cir. 1978)..... 45

Securities and Exchange Commission v. Barroco, 438 F.2d 97 (10th Cir. 1971)..... 41

Securities and Exchange Commission v. Blatt, 583 F.2d 1325 (5th Cir. 1978)..... 45

Securities and Exchange Commission v. Bonastia, 614 F.2d 908 (3d Cir. 1979)..... 45

Securities and Exchange Commission v. Cenco, 436 F. Supp. 193 (N.D. Ill. 1977)..... 37,42

Securities and Exchange Commission v. Chinese Consolidated Benevolent Association, 120 F.2d 738, cert. denied, 314 U.S. 618 (1941)..... 41,43

Securities and Exchange Commission v. Coffey, 493 F.2d 1304 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975)..... 36,37

Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc., 574 F.2d 90 (2d Cir. 1978)..... 45

Cases (Continued):

	Page
Securities and Exchange Commission v. Continental Tobacco Co., 463 F.2d 138 (5th Cir. 1972)	37,39
Securities and Exchange Commission v. Coven, 581 F.2d 1020 (2d Cir. 1978), cert. denied, 440 U.S. 950 (1979)	36
Securities and Exchange Commission v. Culpepper, 270 F.2d 241 (2d Cir. 1959)	40,44,46,47
Securities and Exchange Commission v. Falstaff Brewing Corporation, [Current] Fed. Sec. L. Rep. (CCH) ¶97,505 (D.C. Cir. 1980)	37
Securities and Exchange Commission v. First American Bank & Trust Co., 481 F.2d 673 (8th Cir. 1973)	45
Securities and Exchange Commission v. Freeman, Fed. Sec. L. Rep. (CCH) ¶96,361 at 93,244 (N.D. Ill. 1978)	31
Securities and Exchange Commission v. Guild Films Co., 279 F.2d 485 (2d Cir. 1960)	42
Securities and Exchange Commission v. Howey, 328 U.S. 293 (1946)	39
Securities and Exchange Commission v. International Chemical Development Corp., 469 F.2d 20 (10th Cir. 1972)	7,40,42
Securities and Exchange Commission v. Keller Corp., 323 F.2d 397 (7th Cir. 1963)	44
Securities and Exchange Commission v. Koracorp Industries, 575 F.2d 692 (9th Cir. 1978)	45,48
Securities and Exchange Commission v. Lum's Inc., 365 F. Supp. 1046 (S.D.N.Y. 1973)	32
Securities and Exchange Commission v. McDonald Investment Co., 343 F. Supp. 343 (D. Minn. 1972)	39
Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975)	46
Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972)	46,47,48
Securities and Exchange Commission v. Murphy, [Current] Fed. Sec. L. Rep. (CCH) ¶97,588 at 98,116 (9th Cir. 1980)	38,40,42,43
Securities and Exchange Commission v. North American Research and Development Corp., 424 F.2d 63 (2d Cir. 1970)	40,42,43

Cases (Continued): Page

Securities and Exchange Commission v. Radio Hills Mines, [1970] CCH Fed. Sec. L. Rep. ¶92,855 (S.D.N.Y. 1970)..... 7

Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119 (1953)..... 39

Securities and Exchange Commission v. Savoy Industries, 587 F.2d 1149 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979)..... 45

Securities and Exchange Commission v. Southwest Coal & Energy Co., No. 78-1130 (5th Cir. Aug. 28, 1980)..... 37

Securities and Exchange Commission v. Truckee Showboat, 157 F. Supp. 824 (S.D. Cal. 1957)..... 39

Securities and Exchange Commission v. Universal Major Industries, 546 F.2d 1044 (2d Cir. 1976), cert. denied, 434 U.S. 834 (1977)..... 41,47

Securities and Exchange Commission v. World Radio Mission, Inc., 544 F.2d 535 (1st Cir. 1976)..... 45

Sunstrand Corp. v. Sun Chemical, 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 575 (1977)..... 32,37

Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971)..... 34

Tarvestad v. United States, 418 F.2d 1043 (8th Cir. 1969), cert. denied, 397 U.S. 935 (1970)..... 44

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976)..... 24

Tucker v. Janota, et al., [1978-79 Transfer Binder] Fed. Sec. L. Rep. (CCH) (N.D. Ill. 1978)..... 36

United States v. Azadian, 436 F.2d 81 (9th Cir. 1971)..... 43

United States v. Custer Channel Wing Corp., 247 F. Supp. 481 (D. Md. 1965), affirmed, 376 F.2d 675 (4th Cir.), cert. denied, 389 U.S. 850 (1967)..... 44

United States v. DuPont & Co., 366 U.S. 316 (1961)..... 46

United States v. Hill, 298 F. Supp. 1221 (D. Conn. 1969)..... 44

United States v. Musgrave, 483 F.2d 327 (5th Cir.), cert. denied, 414 U.S. 1023 (1973)..... 43

United States v. Naftalin, 441 U.S. 768 (1978)..... 34,40

Cases (Continued): Page

United States v. Riedel, 126 F.2d 81 (7th Cir. 1942)..... 33

United States v. Sampson, 371 U.S. 75 (1962)..... 33

United States v. Standefer, 610 F.2d 1076 (3d Cir. 1979)..... 37,43

United States v. Wolfson, 405 F.2d 779 (2d Cir. 1968), cert. denied, 394 U.S. 946 (1969)..... 43

United States v. W.T. Grant Co., 345 U.S. 629 (1953)..... 47

Upton v. Trinidad Petroleum Corp., 468 F. Supp. 330 (N. D. Ala. 1979)..... 31

Walters v. United States, 256 F.2d 840 (9th Cir. 1958)..... 33

Wright and Beneficial Standard Corp. v. Heizer Corp., 560 F.2d 236 (7th Cir. 1977)..... 32,40

Statutes and Rules:

Securities Act of 1933, 15 U.S.C. 77a, et seq.:

Section 2(1), 15 U.S.C. 77b(1)..... 38
Section 2(4), 15 U.S.C. 77b(4)..... 40
Section 2(11), 15 U.S.C. 77b(11)..... 40
Section 3(a)(11), 15 U.S.C. 77c(a)(11)..... 14,23,38
Section 4(1), 15 U.S.C. 77d(1)..... 25,42
Section 4(2), 15 U.S.C. 77d(2)..... 13,23,38
Section 5(a), 15 U.S.C. 77e(a)..... 2,23,25,37
Section 5(c), 15 U.S.C. 77e(c)..... 2,23,25,37
Section 12, 15 U.S.C. 77e..... 41
Section 17(a), 15 U.S.C. 77q(a)..... 2,passim
Section 20(b), 15 U.S.C. 77t(b)..... 25,45

Rules under the Securities Act of 1933:

Rule 146, 17 CFR 230.146..... 13,39
Rule 147, 17 CFR 230.147..... 39

Securities Exchange Act of 1934, 15 U.S.C. 78a et seq.:

Section 3(a)(10), 15 U.S.C. 78c(a)(10)..... 38
Section 10(b), 15 U.S.C. 78j(b)..... 2, passim
Section 20(a), 15 U.S.C. 78t(a)..... 32
Section 21(d), 15 U.S.C. 78u(d)..... 43
Section 21(e), 15 U.S.C. 78u(e)..... 25

Rules under the Securities Exchange Act of 1934:

Rule 10b-5, 17 CFR 240.10b-5..... 2,23,25,30

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Did the district court err in determining that the defendant had violated and aided and abetted violations of the registration and antifraud provisions of the federal securities laws where substantial evidence in the record established that, in connection with the offer and sale of unregistered securities in the form of limited partnership interests:

-- the defendant was a motivating force behind the public offering of the securities;

-- the defendant provided false and misleading information for the public offering materials;

-- the defendant profited from and otherwise participated in the wrongful dissipation of investor funds; and

-- the defendant continued to deceive investors with false representations after the public offering was completed?

2. Where the district court found that the defendant had exhibited "a lack of candor," and had knowingly engaged in serious securities laws violations and was likely to do so again, did the court abuse its discretion in permanently enjoining him from committing similar violations in the future?

COUNTERSTATEMENT OF THE CASE

This is an appeal from the final judgment and order of permanent injunction entered by the United States District Court for the Southern District of Indiana (Steckler, J.) on December 10, 1979. In that order, defendant-appellant Edward E. Holschuh was permanently enjoined from violating registration 1/ and antifraud 2/ provisions of the federal securities laws.

A. Proceedings in the district court.

On January 16, 1978, the Securities and Exchange Commission filed this enforcement action seeking injunctive and other equitable relief against Mr. Holschuh, Pocahontas Coal Reserves of West Virginia ("PCR"), Pochahontas Coal Processors ("PCP"), the Asset Group, 3/ five directors or principals of one or more of these companies and the attorney for the

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1/ Sections 5(a) and 5(c) of the Securities Act of 1933, 15 U.S.C. 77e(a) and 77e(c).

2/ Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b); and Commission Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5.

3/ The "Asset Group" consists of three entities: Asset Management Corporation, Asset Development Company, and Asset Securities. See note 18, infra.

Asset Group. The Commission alleged that the defendants had violated registration and antifraud provisions of the federal securities laws in the offer and sale of securities in the form of limited partnership interests in a venture undertaken by PCR and PCP and that, unless enjoined, they were likely to commit similar violations in the future. 4/ During the course of the litigation, all of the defendants except Mr. Holschuh consented to final orders of permanent injunction enjoining them from future violations as alleged in the Commission's complaint (Op. 2). 5/

After a five day trial, during which the Commission presented six witnesses, including Mr. Holschuh, 6/ and after he also testified in his own behalf, the district court found that he had violated the registration and antifraud provisions of the federal securities

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4/ The Commission also alleged that other violations had occurred in connection with the offer and sale of promissory notes issued by PCR, but the district court found insufficient evidence to support these alleged violations by Mr. Holschuh. In addition, Mr. Holschuh filed with the district court an accounting which formed the basis for the court's denial of the Commission's request for an order of disgorgement (Op. 23 ¶35). The Commission did not appeal these determinations because Mr. Holschuh no longer had any of the ill-gotten gains.

References to the findings of fact and conclusions of law filed by the district court are cited "Op. ___". References to the transcript of the trial before the district court are cited "Tr. ___". References to appellant's brief are cited "Br. ___".

5/ These defendants consented without admitting or denying the allegations contained in the Commission's complaint. See Securities and Exchange Commission v. Asset Management Corp., et al., Civil Action No. IP 78-34-C (Sept. 17, 1979). Richard D. Hodgin, the attorney for the Asset Group, also consented to a one year suspension from practice before the Commission pursuant to an administrative proceeding instituted in accordance with Rule 2(e) of the Commission's Rules of Practice, 17 CFR 201.2(e). See Securities Exchange Act Release No. 16225 and Securities Act Release No. 6131, September 27, 1979.

6/ The Commission also introduced the deposition testimony of two other witnesses (Tr. 794-795) and seventy-eight exhibits. The defense presented no other witnesses (Tr. 812-874).

laws in the offer and sale of unregistered securities in the form of limited partnership interests (Op. 13-21) by, inter alia, knowingly and recklessly making fraudulent misrepresentations about the use of investor proceeds, leasehold interests, mining permits and mining operations (Op. 19-20 ¶¶24-25; 20 ¶26). The court determined that a permanent injunction against Mr. Holschuh was "appropriate" (Op. 22 ¶31) and, in considering the necessity for such relief, expressly noted his "lack of candor with the Government and the Court" (Op. 21-22 ¶30).

B. Counterstatement of facts. 7/

Mr. Holschuh's involvement in the formation of PCR.

PCR, and its wholly owned subsidiary PCP, were incorporated in West Virginia in October 1976, by Mr. Holschuh, Harold Franklin and Dominick Bartone for the purpose of securing and developing coal leases in that state (Tr. 360-364). 8/ Prior to his involvement with PCR, Mr. Holschuh

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7/ Mr. Holschuh's brief fails to include a statement of facts supported by references to the record as required by Rule 9(c) of this Court; none of the factual allegations in the argument sections of his brief is referenced to the record. Mr. Holschuh attempts to excuse this failure with the baseless assertion (Br. 3) that

> "there are no facts in the entire record to support the trial court's findings and conclusions * * *. Since it is Holschuh's position that none of these facts are present in the record, it is impossible to make reference to the record."

This statement ignores that Mr. Holschuh had the burden to introduce evidence at trial to rebut the Commission's prima facie case of securities law violations by him (see Op. 13 ¶1). He cannot argue on appeal that the record should contain evidence of allegedly exonerating facts that he did not introduce at trial.

Because of Mr. Holschuh's failure to provide a statement of facts, the Commission has set forth at length those facts it believes necessary to an understanding of the case.

8/ See Plaintiff's Exhibit 48, Progress Report to the Board of Directors of PCR, signed by Mr. Holschuh on January 28, 1977.

had worked in the insurance business (Tr. 814-819) and in several securities industry related activities. 9/ In the summer of 1976, Mr. Franklin, who was working for Coal Reserves, a company controlled by Mr. Bartone which allegedly had interests in coal property in several states, including West Virginia (Tr. 323-326), introduced Mr. Bartone to Mr. Holschuh, who was a candidate for a position with Coal Reserves (Tr. 328). 10/ Before introducing them, Mr. Franklin told Mr. Holschuh of his knowledge of "Mr. Bartone's unsavory reputation" (Tr. 328) and, in particular, that Mr. Bartone was a "bad boy" or "shady character" who "had previously been in jail either for gun running or income tax problems" (Tr. 329-330; see also Tr. 772-773).

Mr. Holschuch learned in this initial meeting that Mr. Bartone wanted to raise money to develop Coal Reserves' West Virginia properties but felt that he would have to keep "a low profile" because of his reputation (Tr. 332-333, 335, 364). In subsequent meetings, Messrs. Holschuh, Bartone, and Franklin determined that Coal Reserves should not be used for this venture. 11/ Consequently, through Mr. Holschuh's efforts, a new company, PCR, was incorporated in West

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9/ For example, Mr. Holschuh was instrumental in the formation of the Midwestern Corporation, which sold $18 million in securities of newly formed companies to the public over a two year period (Tr. 814-815; see Plaintiff's Exhibit 26), and of the first Iowa Securities Corporation, which sold limited partnership interests in real estate ventures to the public (Tr. 817; see Tr. 339-340).

10/ At the time, Mr. Holschuh was unemployed or about to become unemployed and needed a position in which he would make money (Tr. 55-56, 332).

11/ In addition to the fact that Mr. Bartone was publicly connected with Coal Reserves, Mr. Franklin testified that "no tax returns had been filed, the books were in a mess, there were no records in terms of what lease payments had been made or had not been made and Mr. Bartone had operated out of his pocket * * *" (Tr. 361).

Virginia on October 12, 1976, to serve as the vehicle for the venture (Tr. 361-364). Mr. Holschuh became the president, a director and a twenty percent stockholder of PCR (Tr. 360-362). 12/ His duties included selecting a board of directors 13/, securing coal leases and the financing to develop them, filing the necessary mining permits and, in general, conducting the field operations of the corporation in West Virginia (Tr. 365-369, 678, 681). 14/

Mr. Bartone owned eighty percent of PCR's stock, yet he did not become either a director or officer of the company (Tr. 370-371) and arranged for his stock to be issued in the name of his "front man," Joseph Russo (Tr. 369-370, 677). 15/ Mr. Holschuh knew that this

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12/ Thereafter, as we explain infra, note 15, he became the sole shareholder of PCP, a position which he held until October 1978.

13/ Mr. Holschuh purportedly secured the three unaffiliated members of the seven member board of directors for PCR. These persons were past acquaintances and business associates of his (Tr. 366). But at least one of them -- Robert Shumaker -- testified that he had never agreed to be a member of PCR's board (Tr. 7). The remaining three members of the board were Mr. Franklin, Shirley Dixon (PCR's secretary and treasurer) and Joseph Russo, a nominee who held the remaining eighty percent of PCR's stock actually owned by Mr. Bartone (Tr. 366-371).

14/ Mr. Franklin became vice-president of PCR and had primarily administrative and accounting duties which he performed in Cleveland, Ohio, where Mr. Bartone's office was located (Tr. 327, 364). Shirley Dixon, a part-time business consultant who had previously worked with Messrs. Franklin and Bartone (Tr. 518, 526), was appointed secretary-treasurer of PCR and also worked in Cleveland as PCR's secretary, bookkeeper and purser (Tr. 365, 498-499, 526).

15/ Mr. Bartone did retain the title of general manager of PCR's wholly owned subsidiary PCP with the attendant duties of overseeing any mining operations when and if they occurred (Tr. 369-370). This permitted him to be "employed by PCP * * * and not show up anywhere in the parent company on any basis" (Tr. 373). However, when a contract miner refused to conduct mining operations for PCP because of Mr. Bartone's relationship to the company, Mr. Holschuh, on July 15, 1977, traded his twenty percent of PCR's stock for one-

(footnote continued)

nominee arrangement was intended to ensure Mr. Bartone's "low profile" (Tr. 371, 677, 687) and to meet his "desire not to have any stock in his name which could be attached by various creditors * * * " (Tr. 371). This facade became increasingly important after the publication in late October of front page headlines, with pictures of Mr. Bartone, in Cleveland newspapers reporting that Mr. Bartone had been indicted in connection with the failure of a Cleveland bank in which he held large investments (Tr. 357-359, 711-712). 16/

Mr. Holschuh's arrangement of public financing for the venture.

Mr. Holschuh and PCR's other principals discussed a variety of possibilities for financing their ventures, including the purchase of a publicly held shell corporation into which PCR would merge and raise money through the sale of stock (Tr. 346-347) 17/ or the formation of

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15/ (footnote continued)

hundred percent of the stock of PCP, thus removing Mr. Bartone from any interest (via PCR) in PCP's ownership (Tr. 746, 783-784). See Exhibit 15 to Plaintiff's Exhibit 77, a letter written by counsel for PCR, James T. Cooper, dated October 6, 1977; Plaintiff's Exhibit 76, Answers of Edward E. Holschuh to Plaintiff's Request for Admissions, Response to Request #1.

16/ Mr. Holschuh and Mr. Franklin discussed the adverse affect this publicity would have if Mr. Bartone were to be identified with the attempt to obtain investor interest in PCR's venture (Tr. 358-359).

Although Mr. Holschuh admitted having knowledge of Mr. Bartone's indictment in October 1976, in investigative testimony before the Commission as well as at trial (Tr. 710-712, 773), he expressly denied any knowledge of the matter in his pre-trial answer to a request for admission (Tr. 710). See note 59, infra.

17/ Illicit financing schemes involving the offer and sale of the stock of publicly held shell corporations are not novel. See, e.g., Securities and Exchange Commission v. International Chemical Development Corp., 469 F.2d 20, 24-29 (10th Cir. 1972); Securities and Exchange Commission v. Radio Hills Mines, [1970] C.C.H. Fed. Sec. L. Rep. ¶92,855 (S.D.N.Y. 1970).

a syndication of investors to whom they would sell limited partnership interests (Tr. 347-348). Because of time constraints arising from pending changes in the tax laws introduced by the Tax Reform Act of 1976, which were to reduce the tax advantages of such investments made after January 1, 1977 (Tr. 348-349), they decided that PCR lacked the capacity to establish a sales force and solicit investors itself. At this point, Mr. Holschuh was introduced to Buddy C. Stanley, the principal of the Asset Group, by a former business associate from whom Mr. Holschuh had sought the names of individuals that might be interested in investing in PCR's venture (Tr. 4-5). After learning that Mr. Stanley's business was "put[ting] limited partnerships together" (Tr. 5), Mr. Holschuh arranged to meet with him and discuss PCR's venture and subsequently determined to solicit investors through Mr. Stanley's companies (Tr. 6, 13-15; see note 3, supra). 18/

At the initial meeting with Mr. Stanley, Mr. Holschuh informed him that he was president of PCR and that the company needed $200,000 to mine "valuable coal leases" held by it in West Virginia (Tr. 18-19). 19/ Mr. Stanley responded that Asset Management might be interested in

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18/ Asset Management, an Indiana corporation, was formed by Mr. Stanley in 1973 to provide investment services for its customers (Tr. 10-11). Asset Management had two wholly owned subsidiaries which also became involved in the PCR solicitation -- Asset Development, formed by Mr. Stanley in 1974 to serve as a general partner and management company for limited partnerships, and Asset Securities, a broker-dealer registered with the Commission and the state of Indiana which, inter alia, solicited and sold limited partnership interests (Tr. 11-13).

19/ Although Mr. Holschuh disagrees (Br. 6) with part of Mr. Stanley's account of this meeting and testified (Tr. 685) that he informed Mr. Stanley that PCR had "options for leases," the district court, which observed the witnesses' demeanor at trial, specifically found that Mr. Holschuh told Mr. Stanley that "PCR had coal leases in West Virginia * * *" (Op. 5, ¶19).

arranging for such financing through the sale of limited partnership interests and that his regular investors were interested primarily in return on their capital and secondarily in advantageous tax treatment of their investments (Tr. 20). Mr. Holschuh was to provide specific information about PCR's coal properties and investment capital requirements in a series of future meetings to be held for the purpose of determining whether the Asset Group should underwrite PCR's venture (Tr. 20, 24, 28-29).

From mid-November until the commencement of investor solicitation on December 21, 1976, Mr. Holschuh met with Mr. Stanley in Indianapolis at least six additional times (Tr. 21). 20/ During these meetings, Messrs. Holschuh and Franklin represented that they owned all of PCR's stock (Tr. 66). Dominick Bartone's name was not disclosed; nor was it mentioned that there was an undisclosed PCR stockholder who held 80 percent of PCR's shares (Tr. 54). 21/

There ensued at the meetings, lengthy discussions concerning coal properties that PCR purportedly had available to assign to the partnerships in return for their investment of working capital (Tr. 26-29, 31-32, 44-45). Messrs. Holschuh and Franklin told Mr. Stanley that PCR had "millions of dollars of coal reserves on its [West Virginia] properties" and that "this was [metallurgical] coal used in primarily the

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20/ Also present at some of these meetings were Mr. Franklin and Richard Hodgin, counsel for the Asset Group (Tr. 22). Ms. Dixon also attended one or more of these meeting in a secretarial capacity (Tr. 22, 538), and Richard Kimball, president and manager of Asset Securities, was occasionally consulted during the discussions (Tr. 22).

21/ Both Messrs. Franklin (Tr. 401) and Holschuh (Tr. 687-688) testified that Mr. Stanley was informed that they "had a principal who wanted to keep a low profile;" but both admitted that neither Mr. Bartone's name nor the extent of his stock ownership in PCR was disclosed (Tr. 401, 687-688). See pp. 16, 29, infra.

steel manufacturing process * * * bringing a premium price in the market place * * * " (Tr. 22-23). They also discussed PCR's interest in several specific pieces of property. At an early meeting, it was represented to Mr. Stanley that PCR held interests in two tracts of coal bearing property referred to as the "Twohig" and "Patterson" properties and that $200,000 was needed to mine them (Tr. 29). However, PCR never obtained any interest in the Twohig property, as it was owned by Mr. Bartone's other company, Coal Reserves. 22/ Mr. Stanley was also advised by Messrs. Holschuh and Stanley that PCR had obtained a lease or option to lease property from the Georgia Pacific Company (Tr. 43-44) for which a West Virginia mining permit already had been granted and could readily be "renewed" (Tr. 52-53, 82-83). Yet an assignable lease on this property was not obtained by PCR until months later, in March 1977, 23/ and the mining permits (which were not filed by PCR until February or March) were not granted until December, 1977 (Tr. 385-386, 859-861, 866).

In others of these pre-solicitation meetings, Messrs. Holschuh and Franklin represented to Mr. Stanley that PCR had available two other West Virginia properties referred to as the "Sun Mine" and "McGrew" pro-

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22/ See Exhibit 3 to Plaintiff's Exhibit 77, cover letter and listing of PCR's property holdings prepared by its attorney. The record does not indicate what the ownership status of the Patterson property was at that time.

The Twohig and Patterson properties were not assigned to investors in the limited partnerships (Tr. 29, 270-271). Core drilling on these properties in mid-December of 1976 indicated that they contained insufficient coal reserves to warrant mining. Thus the parties' negotiations turned to other properties which PCR supposedly had available to assign to the limited partnerships (Tr. 837-840).

23/ See Defendant's Exhibit Y, a letter dated March 28, 1977, from the Georgia Pacific Company to PCR authorizing sublease of the property.

perties (Tr. 31-35, 44-45). They presented an engineering report on the McGrew property indicating that it contained "400,000 tons of minable metallurgical coal" (Tr. 33). In addition, Mr. Holschuh represented to Mr. Stanley that PCR was "pursuing" a lease with respect to the Sun Mine property which he expected to be entered "prior to the closing of their agreement" (Tr. 45). Mr. Stanley testified that Mr. Holschuh stated that PCR would commence mining on one or more of its properties "within sixty days from the closing of the partnerships" (Tr. 64). 24/

Based on these representations of the nature and extent of PCR's property holdings, Mr. Stanley agreed to underwrite the offering through his companies and proposed forming five limited partnerships that would each invest $100,000 in the venture (Tr. 476).

Mr. Holschuh's role in the structuring of the offerings.

Under the terms of the offerings, each of the five partnerships agreed to lease as yet undetermined parcels of the above-described properties from PCR, paying PCR a royalty on each ton of coal mined from the leased parcels. 25/ At the suggestion of Mr. Hodgin (Mr. Stanley's attorney), Mr. Holschuh formed PCP for the purpose of implementing the mining ventures by, for example, securing necessary mining permits and contracting out and overseeing the actual coal mining (Tr. 82, 373). Each partnership agreed to sublease its properties to PCP in return for a royalty payment greater than that to be paid by the partnership to PCR on the minimum of 100,000 tons of coal per year to be mined during the four year duration of the

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24/ At trial, Mr. Holschuh denied making this latter statement (Tr. 857).

25/ See, e.g., Offering Circular for A.M. Coal Partners 1976 A, Plaintiff's Exhibit 1, at 3.

lease/sublease agreements. 26/ In the event that a partnership's properties could not produce the requisite amount of coal, PCR contracted to substitute leases on other properties to fulfill its obligation. 27/ From these operations and the differential between the royalties, each partnership was to earn a projected net profit of approximately $1.00 per ton on the mined coal or $400,000 -- a 400 percent return on their investment over a four year period. 28/

It was also determined at these meetings that, upon formation of all five partnerships, PCR would receive $100,000 in cash and a $200,000 non-recourse promissory note from each partnership (Tr. 95-96). 29/ Messrs. Holschuh and Franklin represented to Mr. Stanley that these $100,000 advance payments were "needed to exploit the coal reserves

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26/ Id. at 3. Several of PCP's obligations, including its subcontracting duties and production requirements, were set forth in a separate guaranty agreement. See Exhibit D to Plaintiff's Exhibit 1, supra.

27/ Id. at 6.

28/ Specifically, the offering circulars and subsequent contracts signed by the parties provided that PCP would pay each partnership the higher of 12.5 percent of the gross selling price of each ton of coal or $5.20. The partnership, in turn, was obligated to pay PCR the greater of 10 percent of the gross selling price or $4.00. The partnership's profits were to consist of the difference between these two figures less any partnership operating expenses. Id. at 3.

29/ Both the $100,000 cash payment and the $200,000 promissory note represented a prepayment of the "annual minimum royalty" PCR was to receive from the partnership for the first year of the venture. This payment was intended to qualify as a partnership tax deduction for 1976. See Exhibit F to Plaintiff's Exhibit 1, supra, a tax opinion by counsel for the Asset Group, Mr. Hodgin.

Mr. Hodgin gave his opinion that the entire $300,000 in advance royalty payments would be tax deductible if made before the pending change in the tax laws on December 31, 1976 (id). The sales price for the total interest in each partnership was set at $120,000. Of this amount, $100,000 represented the cash portion of the advance royalty payment to PCR, $19,200 was an initial management fee to Asset Management (which covered such items as legal fees and brokers fees), and $800 was to be retained as working capital reserve. See, e.g., Plaintiff's Exhibit 1, supra, at 3.

on the leases [PCR] owned" (Tr. 51; see Tr. 688-89) and would be used for that purpose as the corporation did not have the funds to "exploit the leases that they had control of * * * " (Tr. 55).

Mr. Holschuh's furnishing of false information to the underwriter resulted in misrepresentations in the offering circular.

Investors were solicited by telephone and through the mails over a nine day period from December 21 to December 30, 1976 (Tr. 67-71), by representatives of three brokerage firms, including Mr. Stanley (Tr. 67). Offering circulars were distributed to all investors and in many instances meetings were held at which the terms of the investment as set forth in the offering circulars were discussed (Tr. 68). By December 30, all five limited partnerships were formed and fully funded with fifty-nine investors purchasing eighty-three "interests" in one or more of them for a total of $600,000. 30/ Only one of the investors had prior investment experience in the coal mining industry (Tr. 106). 31/

30/ The partnerships were organized as follows (Op. 7 ¶26; Tr. 67, 106, 117-118):

Partnership	Number of Interests Sold	Total Investment
A.M. Coal Partners 1976-A	16	$120,000
A.M. Coal Partners 1976-B	15	120,000
A.M. Coal Partners 1976-C	23	120,000
A.M. Coal Partners 1976-D	13	120,000
A.M. Coal Partners 1976-E	16	120,000
	83	$600,000

31/ As noted above, the offerings were not registered with the Commission, although they were registered with the State of Indiana (Tr. 107). The offering circulars stated that the decision not to register the offerings with the Commission was made in reliance on Section 4(2) of the Securities Act of 1933, 15 U.S.C. 77d(2), which exempts from registration "transactions by an issuer not involving any public offering," and on Commission Rule 146, thereunder. It was further stated that the offerings were being made only to residents of the State of Indiana, presumably an attempt to qualify for the registra-

(footnote continued)

The offering circulars which, except for their titles, were identical for each partnership 32/, were drafted by Mr. Hodgin and reviewed and approved by Mr. Stanley (Tr. 71). Mr. Holschuh did not assist directly in the writing or review, but he was a primary source of information for Mr. Stanley regarding the disclosures in the offering materials (Tr. 79). Key representations in the offering circulars are directly traceable to Mr. Holschuh:

(1) Mr. Holschuh told Mr. Stanley that PCR would assign its West Virginia coal leases to the partnerships (Tr. 45). Consequently, the offering circulars stated, under the heading "Operations," that the partnerships would be formed

> "for the purpose of entering into a lease with [PCR] with respect to mining rights to coal reserves on certain property located in the State of West Virginia and owned, or subject to lease by [PCR] (emphasis supplied)." 33/

Similar statements appear in other sections of the offering circulars, 34/ as well as in the copies of the proposed leases subsequently entered into by the partnerships and PCR and PCP, which were attached to the circulars. 35/ For example, the partnerships' leases with PCR provide:

> "[PCR] does represent, and [each partnership] does rely on the respresentation, that [PCR] has the title to the leased premises and the right to mine the coal therefrom

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31/ (footnote continued)

tion exemption for intrastate offerings, Section 3(a)(11) of the Securities Act of 1933, 15 U.S.C. 77c(a)(11). The district court determined that these offerings did not qualify for either exemption (Op. 16-18).

32/ See Plaintiff's Exhibits 1-5.

33/ See, e.g., Plaintiff's Exhibit A, supra, at 3.

34/ See, e.g., id. at 3 and 8.

35/ See, e.g., Exhibits B and C to Plaintiff's Exhibit 1, supra.

as hereby leased * * * (emphasis supplied)." 36/

(2) The circulars also set forth the terms of the lease/sublease agreements negotiated at the meetings between Messrs. Holschuh and Stanley whereby PCP contracted to mine and sell the coal:

> "[each partnership] will enter into a sublease of such property with [PCP], an affiliate of [PCR], whereby [PCP] will be required to mine and sell at least 100,000 tons of coal from such property each year for a period of at least four years." 37/

(3) And both the circulars and the attached leases and subleases detailed the simultaneously negotiated terms of the royalty agreements with PCR and PCP which provided the basis for the projected 400 percent return on the partnerships' investments. 38/

Although the offering circulars and attached proposed lease agreements represented that PCR held title to West Virginia coal properties, it is uncontroverted that as of December 30, when the last of the limited partnership interests were sold (Tr. 97A, 109), PCR held no such interests.

Additionally, the circulars provided investors with no information on the identity, financial status or planned remuneration of the principals

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36/ See, e.g., Exhibit B to Plaintiff's Exhibit 1, supra.

37/ See, e.g., Plaintiff's Exhibit 1, supra, at 3.

It was further provided in the attached sublease that

> [Each partnership] does represent, and [PCP] does rely on the representation, that [each partnership] has the right to mine the coal hereby leased, * * * pursuant to a lease dated as of December ____, 1976, between [each partnership] and [PCR] * * *.

See, e.g., Exhibit C to Plaintiff's Exhibit 1, supra.

38/ See, e.g., Plaintiff's Exhibit 1, supra, at 3 and Exhibits B and C thereto.

of PCP and PCR. In particular, they failed to disclose Mr. Bartone's criminal record, recent indictment and involvement in the venture, as Mr. Holschuh had concealed this information from Mr. Stanley.

Mr. Holschuh's participation in the partnership closings where he "assigned" non-existent leasehold interests to investors.

On December 28, 1976, Mr. Stanley met with Messrs. Holschuh and Franklin for the closings of two of the limited partnerships. He tendered to them checks totalling $200,000 which represented the advance royalty payments to PCR of the two fully subscribed partnerships (Tr. 119-120, 420, 540). Mr. Holschuh signed leases between PCR and PCP and all five limited partnerships with knowledge that only two of the partnerships were fully funded and that interests were still being sold in the remaining three (Tr. 97A, 109, 419-420, 697-698, 708). 39/ The terms of the lease agreements were identical to those in the agreements attached to the offering circulars and represented that PCR had title to the leaseholds assigned to the partnerships (Tr. 114). Concurrently with the execution of these leases, Messrs. Holschuh and Franklin represented that PCR had secured title to the Georgia Pacific property (Tr. 192-193), an event which had yet to occur (Tr. 725-726). Thus, on December 29 and 30, investors were still being solicited with offering circulars containing false representations of PCR's West Virginia coal holdings.

39/ Under the terms of these agreements, PCR purportedly leased to partnerships A and B an interest in the Georgia Pacific Property, to partnership C an interest in the McGrew Property, and to Partnerships D and E an interest in the Sun Mine Property. See Plaintiff's Exhibits 6-10; Tr. 40-41, 163, 220. But, as noted in the text, PCR had no assignable leasehold interest in the properties when these leases were executed. The investors did not learn what properties had been assigned them until March of 1977, when Mr. Stanley sent each a packet of all partnership papers including maps and property descriptions of the leaseholds (Tr. 123-124).

Specifically, PCR had not acquired title to the leaseholds on the Georgia Pacific, Sun Mine and McGrew properties which it had purported to assign to the partnerships. At the time of these assignments, PCR held only an option to lease the Georgia Pacific property (Tr. 432-433, 722, 725-726); and, even though it obtained a lease on this property shortly thereafter (Tr. 725-726), that lease required approval from Georgia Pacific before PCR could assign the property to the partnerships (Tr. 777). This approval was not obtained until March 1977, well after the assignment was executed by Mr. Holschuh (Tr. 778-780). 40/ Similarly, PCR neither held nor ever secured an assignable interest in the Sun Mine property (Tr. 449, 689). Finally, PCR held only an option to purchase the McGrew property (Tr. 433, 691) which it did not exercise until February 8, 1977 (Tr. 434, 689-691, 741). 41/

Mr. Holschuh's participation in the knowing and wrongful dissipation of investors' funds.

On December 29, 1976, the day after the closing of the first two partnerships, Mr. Holschuh met with Dominick Bartone, Mr. Franklin and Ms. Dixon to divide up the $200,000 in proceeds from the sale of interests in the first two partnerships (Tr. 541). Instead of applying these proceeds for purposes relating to the commencement of mining in accordance with Mr. Holschuh's representations to the Asset Group (Tr. 18, 28-29, 55 (Stanley), 688-689 (Holschuh)), Mr. Bartone "took over the meeting" and it was determined that Mr. Holschuh would receive $25,000 as salary plus $3,000 in expense money; Mr. Franklin and Ms. Dixon would receive $25,000 and $15,000 as salaries, respectively; and Mr. Bartone was to be "reimbursed"

40/ See Defendant's Exhibit Y and n.23, supra.

41/ See Plaintiff's Exhibit 34, the closing statement on the McGrew property signed by Mr. Holschuh on February 8, 1977.

$100,000 for his organizational efforts and for interests in the West Virginia coal properties allegedly assigned by PCR to the partnerships (Tr. 421-423, 542, 781). 42/ Thus, one day after PCR received the initial $200,000 from the partnerships, its principals determined that $168,000 would be spent for purposes unrelated to the mining of coal.

The remaining $300,000 in advance payments was delivered to them upon closing of the other partnerships on December 30 (Tr. 420, 540-541). In the next few months, the payments described above were disbursed and additional payments made, resulting in the dissipation of PCR's assets to the extent that the corporation could not fulfill its obligations to the investors in the limited partnerships. For example, Mr. Bartone received a total of $214,000, of which over $180,000 was spent for non-mining purposes 43/; $51,000 was paid to Mr. Franklin and Ms. Dixon through a consulting firm they operated called Creative Advisory; 44/ and Mr. Holschuh received over $47,000 in salary and expenses. 45/ In fact, almost half of the $500,000 (approximately $223,000) PCR received from the partnerships was spent for purposes wholly unrelated to mining. 46/ These payments

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42/ After statements by Mr. Bartone that he would start writing checks on his $100,000 allotment the following day and that "it was his money and his corporation," Ms. Dixon became angry at the planned depletion of PCR's assets and walked out of the meeting (Tr. 423-424, 542-543).

43/ See Plaintiff's Exhibit 63, PCR and PCP Payments to Dominick E. Bartone, October 6, 1976 to September 16, 1977.

44/ See Plaintiff's Exhibit 61, PCR and PCP Payments to Creative Advisory, October 6, 1976 to September 16, 1977.

45/ See Plaintiff's Exhibit 62, PCR and PCP Payments to Edward E. Holschuh, October 6, 1976 to September 16, 1977.

46/ See Plaintiff's Exhibit 66, listing of PCR and PCP non-coal related expenses (Tr. 629, 634).

resulted in the almost total depletion of PCR's assets by May of 1977; yet no coal was ever mined by PCR (Tr. 369, 621-622, 709).

Mr. Holschuh knew of and participated in this rapid diversion of the $500,000 derived from the investors. Moreover, although he was president of PCR, he did not attempt to prevent the depletion of investors' funds. Even though he spent much of the time from January until May, 1977 in West Virginia, he was in daily telephone contact with the other principals in PCR and PCP and travelled to Cleveland several times a month for meetings with them (Tr. 585-586, 618), many of which related to Mr. Bartone's uncontrollable spending (Tr. 460, 620-621). For example, in early January, Ms. Dixon expressed concern to Mr. Holschuh about five checks totalling $46,000 which Mr. Bartone had directed her to draw on PCR's accounts (Tr. 548-549, 632, 699-700). Several of these checks represented payments to personal acquaintances of Mr. Bartone or to unrelated businesses owned in whole or in part by him (Tr. 454-459). 47/ None of these payments, as Mr. Holschuh knew, was coal-related (Tr. 548-549, 699-700).

Such expenditures were an almost daily topic of discussion between Mr. Holschuh and Mr. Franklin, indeed, they "wondered whether [PCR] would have enough money to hold out until the mining started * * *" (Tr. 460). Of the $240,000 expended by PCR through the end of January, 1977, Mr. Holschuh knew that at least $165,000 represented non-coal related expenditures (Tr. 634). These expenditures included, in addition to the five checks mentioned above, $40,000 for the purchase of a residence for Mr. Bartone at a forclosure

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47/ See Plaintiff's Exhibit 51-D, PCR Check Register, Check Nos. 123-124 and 126-128.

sale (Tr. 561-562, 567) and a $10,000 retainer fee paid to a Denver, Colorado attorney in connection with the proposed acquisition of a publicly held corporation by PCR (Tr. 446-448). 48/ Mr. Holschuh, as president of PCR, signed certain documents necessary to the mortgage application for Mr. Bartone's residence 49/ and co-signed the $10,000 retainer fee check (Tr. 700, 705).

Mr. Holschuh's continued deception of investors.

In the weeks following PCR's receipt of the $500,000 in advance payments from the partnerships, Mr. Stanley made repeated attempts to ascertain from Mr. Holschuh what progress was being made toward the commencement of mining on the partnerships' leaseholds (Tr. 137-138, 143-144, 147). He explained to Mr. Holschuh that he needed from PCR "current financial [information] and information on the progress of mining coal * * * to report to the investors" (Tr. 144). 50/ However, as the district court recounted, instead "[w]hat Stanley and the limited partners received were additional misrepresentations by Holschuh" (Op. 11 ¶39). For example, in early February 1977, Mr. Holschuh advised Mr. Stanley that mining permits had been granted on the Georgia Pacific property and were pending on the Sun Mine and McGrew properties (Tr. 143, 168-170, 198). However, the Georgia Pacific permits were not even filed until late February or early March (Tr.

48/ This acquisition effort was short-lived and counsel received the $10,000 for approximately two hours of work (Tr. 705).

49/ See Plaintiff's Exhibit 72, Request for Verification of Employment Form from Superior Savings and Loan Association of Cleveland, Ohio, signed by Mr. Holschuh as president of PCR on February 18, 1977.

50/ Under the terms of a guaranty agreement with the partnerships which Mr. Holschuh executed as president of PCR, the company was contractually obligated to provide such reports on a bi-monthly basis. (Tr. 129-134, 418). See Exhibit D to Plaintiff's Exhibit 6, supra.

198-199, 708, 861-862) and were not granted until December of that year (Tr. 708-709); and applications for permits were never filed on the Sun Mine and McGrew properties (Tr. 708).

Mr. Stanley also received three handwritten letters from Mr. Holschuh during February and March. 51/ These letters falsely indicated progress by PCR toward the commencement of mining. For example, in a letter received by Mr. Stanley around February 15, Mr. Holschuh stated that he expected to "start moving some coal the latter part of the first week in March." 52/ In a letter dated March 1, Mr. Holschuh reported that he was "almost sure we can get into [the Georgia Pacific] property next week." 53/ Mr. Stanley passed on Mr. Holschuh's representations to the investors in a March 9 letter which stated that Mr. Holschuh expected "to proceed with actual mining activity before the month of April is over." 54/

Mr. Holschuh's statements were obviously false since there was no immediate prospect of commencing mining operations on the leaseholds assigned to the partnerships because PCR had not obtained permits to mine these properties from the state of West Virginia. As noted, PCR's application for a mining permit on the Georgia Pacific property was not filed until late February or early March (Tr. 198-199, 708, 861-862), and the lengthy process of approval was not completed until nine months later (Tr. 708-709). PCR never even filed permit applications on the Sun Mine and McGrew properties (Tr. 708). Further, as Mr. Holschuh had dis-

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51/ See Plaintiff's Exhibits 49, 49A and 49B.

52/ See Plaintiff's Exhibit 49.

53/ See Plaintiff's Exhibit 49B.

54/ See Plaintiff's Exhibit 38.

cussed with Mr. Franklin, the severe depletion of the investors' funds made it uncertain whether there would be "enough money to hold out until the mining started" (Tr. 460).

In late March, Mr. Stanley travelled to West Virginia with David Kimball, his associate in Asset Management, to verify Mr. Holschuh's progress reports (Tr. 157). Mr. Holschuh showed them the Sun Mine and Georgia Pacific properties but still did not disclose either that PCR held no interest in the Sun Mine property or its failure to obtain a mining permit on the Georgia Pacific property (Tr. 163, 165-166). Finally, on July 25 — well after PCR's assets were totally depleted — Mr. Holschuh stated in a "Report on Permits" to Mr. Stanley that

> "all forseeable problems have been resolved and we expect issuance of the permits on August 5, 1977, and the first coal no later than September 1, 1977." 55/

This report was circulated to the investors under cover letter from Mr. Stanley (Tr. 179-180), but, contrary to Mr. Holschuh's representation, no coal was ever mined by PCR (Tr. 369). 56/

C. The district court's findings and conclusions.

The district court determined the Commission had made a prima facie showing that Mr. Holschuh directly violated and aided and abetted violations

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55/ See Plaintiff's Exhibit 40A.

56/ Mr. Holschuh also failed to provide the Asset Group with financial statements as required by the guaranty agreement (see note 50, supra), despite repeated requests (Tr. 136-139, 200-201). When Mr. Stanley examined PCR's records in the fall of 1977, he discovered that PCR had few remaining assets and that much of the investors' money had been spent for purposes unrelated to coal mining. And, although Mr. Holschuh initially resisted because of his fear of Mr. Bartone (Tr. 208), Mr. Stanley insisted that he freeze an escrow account containing PCR funds established to purchase a residence for Mr. Bartone (Tr. 208, 215).

of the registration requirements of Sections 5(a) and 5(c) of the Securities Act of 1933, 15 U.S.C. 77e(a) and (c) (Op. 13-15). The court found Mr. Holschuh primarily liable for these violations (Op. 14 ¶8) because he was an "issuer" of the securities within the meaning of Section 2(4) of the Act, 15 U.S.C. 77b(4). Secondary liability was imposed (Op. 15 ¶9) because Mr. Holschuh aided and abetted violations by the other defendants as the "motivating force behind the entire project." The court further found (Op. 16-18) that Mr. Holschuh failed to rebut this prima facie showing of violations by establishing that an exemption from registration was available. 57/

The district court also held (Op. 18-21) that Mr. Holschuh acted with scienter in violating and aiding and abetting violations of the antifraud provisions of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act, 15 U.S.C., 78j(b), and Commission Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. The court's determination of primary liability for these violations was based upon its findings that prior to, during, and after the offer and sale of the limited partnership interests to investors, Mr. Holschuh knowingly made fraudulent misrepresentations and omitted to disclose material information to the Asset Group concerning the leasehold interests, mining permits, mining operations and use of investor proceeds with full knowledge that public investors would

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57/ Mr. Holschuh argued that the offerings were exempt under Section 4(2) of the Act, 15 U.S.C. 77d(2), as "transactions by an issuer not involving any public offering," and under Section 3(a)(11) of the Act, 15 U.S.C. 77c(a)(11), as securities sold in an intrastate offering (Op. 16-18). The district court rejected these arguments (id.), and Mr. Holschuh has not argued the availability of these exemptions on appeal. See note 77, infra.

be solicited to purchase securities based upon his misrepresentations (Op. 19-20 ¶¶24-25). 58/ The court also found Mr. Holschuh secondarily liable for violating these provisions because he should have known that his "knowingly" made and "materially false and misleading statements" were "'likely to be used in furtherance of illegal activity,'" by the other securities law violators (Op. 20 ¶26).

In light of these violations, the district court granted the Commission's request that a permanent injunction be entered against Mr. Holschuh. It found such an injunction "appropriate" because the Commission made a "proper showing" that there is a reasonable likelihood of future securities law violations by Mr. Holschuh (Op. 22 ¶31). In particular, the court determined that an injunction was warranted because of (1) the serious nature and gravity of Mr. Holschuh's violations, (2) the fact that his occupation or customary business activities involve securities dealings, (3) his failure to recognize his culpability, (4) the recurrent nature of his violations, and (5) the degree of scienter with which he engaged in those violations (Op. 21-22 ¶30). It also emphasized, as we have already noted, Mr. Holschuh's "lack of candor with the Government and the Court" (id.). 59/

58/ The court also deemed Mr. Holschuh's misrepresentations and omissions material because a reasonable investor would have considered them important in determining whether to purchase an interest in the limited partnerships (Op. 20-21 ¶27, citing TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976)).

59/ This finding, which Mr. Holschuh challenges (Br. 27), apparently refers to Mr. Holschuh's conflicting and contradictory testimony under oath before the Commission and the court concerning his representations to Mr. Stanley that the investors' money would be spent for purposes related to mining coal, his knowledge that almost half of this money was instead spent for unrelated purposes, and his knowledge that Mr. Bartone had been indicted in connection with the failure of a Cleveland bank.

(footnote continued)

STATUTES AND RULES INVOLVED

The relevant portions of the following statutes and rules are set forth in the Statutory Appendix, infra: Sections 4(1), 5(a), 5(c), 17(a) and 20(b) of the Securities Act of 1933, 15 U.S.C. 77d(1), 77e(a), 77e(c), 77q(a), 77t(b); Sections 10(b) and 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78u(e) and Rule 10b-5, 17 CFR 240.10b-5, promulgated thereunder.

59/ (footnote continued)

See Post Trial Brief of the Securities and Exchange Commission, filed October 15, 1979, and Tr. 688-689, 700-701, 711-712. In investigative testimony before the Commission on September 20, 1977, Mr. Holschuh stated under oath he had no knowledge that any of the $500,000 PCR received from the investors was spent for purposes unrelated to coal mining. Yet he had engaged in several conversations with Ms. Dixon and Mr. Franklin concerning such expenditures and knew as early as February 1977, that at least $165,000 of the money had been misapplied by PCR -- including $56,000 in payments for which he had executed necessary documents (Tr. 700-701).

There were also conflicts between the answers Mr. Holschuh gave to the Commission's requests for pre-trial admissions and his testimony both before the Commission and the district court. Mr. Holschuh denied Request for Admission #18, which asserted that he had represented to Mr. Stanley that the investors' money would be used to develop coal properties. Yet in his sworn testimony before the Commission he stated he was "sure" he had made such representations to Mr. Stanley, and he later reaffirmed this testimony at trial (Tr. 688-689).

Mr. Holschuh also denied Request for Admission #19, which asserted that he had contemporaneous knowledge of Mr. Bartone's criminal indictment on October 4, 1976. This answer conflicted with his prior sworn testimony before the Commission that he had discussed this matter with Mr. Franklin. When asked about this contradiction at trial (Tr. 711-712), he reaffirmed his original testimony.

ARGUMENT

I. THE DISTRICT COURT DID NOT ERR IN DETERMINING THAT MR. HOLSCHUH VIOLATED THE FEDERAL SECURITIES LAWS.

A. The findings of fact challenged by Mr. Holschuh are not clearly erroneous.

The district court's detailed factual findings demonstrate Mr. Holschuh's active participation in an orchestrated scheme to defraud investors. Mr. Holschuh argues that certain of these findings are clearly erroneous because "there is no evidence in the record to support these findings" (Br. 6-7). 60/ But as the foregoing statement of facts demonstrates and as we show infra, all the factual findings he challenges are supported by substantial evidence, including the testimony of witnesses at trial and the exhibits introduced. While Mr. Holschuh testified in an attempt to refute the evidence that he had violated the federal securities laws, the district court discredited his testimony, observing that he had shown a "lack of candor with the Government and the Court * * * " (Op. 21-22 ¶30). 61/ Mr. Holschuh is plainly in error in denying

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60/ Specifically, he challenges findings of fact 19-24, 27-33, 35, 39-41 and 45 (Br. 4).

61/ "The appellate court must be especially circumspect in reviewing for clear error in the district court's findings when there was conflicting evidence on controverted issues of fact * * * [and] the findings are primarily based upon oral testimony and the trial judge has viewed the demeanor and credibility of witnesses."

Indiana State Employees Association, Incorporated v. Negley, 501 F.2d 1239, 1241-42 (7th Cir. 1974). See also Hayden Stone, Incorporated v. Brode, 508 F.2d 895, 896 (7th Cir. 1974); Aunt Mid, Incorporated v. Fjell-Oranje Lines, et al., 458 F.2d 712 (7th Cir.), cert. denied, 409 U.S. 877 (1972). The direction of the Negley court is particularly apposite here since Mr. Holschuh's statements that certain facts are clearly erroneous are, in general, simply challenges to the district court's determination to discredit his testimony when it conflicted with that of other witnesses.

the existence of record support for the factual findings he contests, arguing that his self-serving testimony is "uncontradicted" (Br. 6-7).

Mr. Holschuh contests the court's findings concerning his false statements in three areas: PCR's interests in the coal leases; the concealment of Dominick Bartone's relationship to PCR and PCP; and the uses that PCR would make of the proceeds from the sale of securities to investors. As we demonstrate below, each of these contentions is without merit.

1. Initially, he contests the court's findings relating to the veracity of his representations to Mr. Stanley concerning the West Virginia coal properties PCR was to assign to the partnerships. 62/ Mr. Holschuh testified at trial (Tr. 685, 689) and again asserts (Br. 6) that he "only stated that PCR had or could get leases in coal properties" (emphasis in original). The district court, however, found that Mr. Holschuh represented without qualification that "PCR had coal leases in West Virginia" (Op. 5-6 ¶¶19, 21). This finding is amply supported by Mr. Stanley's testimony that Mr. Holschuh stated PCR "had valuable coal leases" (Tr. 18-19) on West Virginia properties containing "millions of dollars of coal reserves" (Tr. 22-23).

More significantly, it is uncontroverted that on December 28, 1976, Mr. Holschuh executed leases between PCR and all five partnerships (Tr. 109-111, 418). As noted, 63/ the leases represented that PCR held title to West Virginia coal properties and were identical to blank leases

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62/ See findings of fact 19, 21-23, 28 and 30-32.

63/ See p. 14, supra.

contained in the offering circulars which were being used to solicit investors in three of the limited partnerships. And, concurrent with the execution of these leases, Mr. Holschuh represented to Mr. Stanley that PCR "had title" to the Georgia Pacific property (Tr. 192). Yet, as Mr. Holschuh conceded at trial (Tr. 689, 691, 725-726), on that date PCR did not hold title to leaseholds on the Georgia Pacific, McGrew or Sun Mine properties which he purportedly assigned to the partnerships and, in fact, never acquired any interest in the Sun Mine property. 64/

There is also no merit to Mr. Holschuh's contention (Br. 8) that "he cannot be held responsible for anything contained in or omitted from the [offering circulars]" because he did not review them prior to distribution to the investors. The district court correctly found (Op. 19 ¶24) that Mr. Holschuh "knowingly made * * * false and misleading statements to the Asset Group with full knowledge that public investors would be solicited to purchase securities based upon those statements." This

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64/ Mr. Holschuh baldly asserts (Br. 6), with no discussion, that findings of fact 39-41 and 45, which relate to "additional misrepresentations" (Op. 11 ¶39) made by him after the closing of the limited partnerships, are clearly erroneous. But, as we have shown at pages 20-21, supra, Mr. Holschuh repeatedly misrepresented PCR's progress toward obtaining mining permits and commencing mining operations in a series of written and oral reports to Mr. Stanley. In addition, he failed to disclose to Mr. Stanley and the investors that the proceeds from the sale of partnership interests were being rapidly depleted by PCR for non-mining purposes. Thus, the court was correct in finding that Mr. Holschuh's reports "served only to lull Stanley and the investors into believing their investment was safe and that mining operations were progressing almost as expected" (Op. 11 ¶41) and "clearly demonstrate his lack of candor with Stanley and the investors and his continual misrepresentations to them" (Op. 12 ¶45).

finding is supported by the testimonies of Messrs. Franklin (Tr. 393-399) and Stanley (Tr. 24, 79), evidencing their understanding that a principal purpose of the parties' negotiations was to establish the terms of the offerings to investors as subsequently set forth in the offering circulars.

2. Mr. Holschuh quarrels (Br. 6-7) with the court's findings that he failed to disclose to Mr. Stanley and the investors his knowledge (Tr. 371, 677) that Mr. Bartone was a secret 80 percent stockholder in PCR, thus enabling Mr. Bartone to maintain the "low profile" deemed necessary by the principals in PCR to raise financing for the company's venture. 65/ Although Messrs. Holschuh and Franklin did testify that they "told Stanley * * * they had a principal who wanted to maintain a low profile" (Br. 7) (emphasis in original), Mr. Holschuh misstates the record in asserting that this testimony is "uncontradicted" or that there is "no evidence" to support the court's findings (Br. 6-7). For example, Mr. Stanley testified that Messrs. Franklin and Holschuh represented to him that they owned all of PCR's stock, in addition to being the company's president and vice-president (Tr. 66). Moreover, as Mr. Holschuh conceded (Tr. 687), neither man mentioned Mr. Bartone's name or disclosed that he was the controlling stockholder of PCR.

3. Finally, Mr. Holschuh challenges (Br. 7) the court's finding 66/ that he informed Mr. Stanley that the proceeds from the sale of the limited partnership interests would be used to finance PCR's coal mining operations. Although Mr. Holschuh at one point testified that he did not remember discussing with Mr. Stanley how PCR intended to use these proceeds (Tr. 688), he earlier admitted advising Mr. Stanley "that the

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65/ See findings of fact 20 and 23.

money raised would be used to develop coal properties" (Tr. 688-689). Further, Mr. Stanley testified that Mr. Holschuh initially contacted him for the purpose of raising $200,000 because "PCR did not have the funds to exploit the leases they had control of" (Tr. 18, 28, 55). 67/

B. Mr. Holschuh violated and aided and abetted violations of antifraud provisions of the federal securities laws.

The district court determined that Mr. Holschuh violated Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), and Commission Rule 10b-5 thereunder, 17 CFR 240.10b-5, by knowingly making material misrepresentations and omitting to state material information to Mr. Stanley and the Asset Group prior to, during, and after the offer and sale of securities to the public with full knowledge that these misstatements would be used to solicit investors (Op. 19-20 ¶¶24-25). The court also held that Mr. Holschuh aided and abetted violations of these provisions by his knowing and reckless conduct (Op. 20 ¶26). Mr. Holschuh challenges these determinations on several grounds (Br. 20-26) which, as we will show,

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66/ See findings of fact 23 and 33.

67/ Mr. Holschuh misconstrues the nature of the district court's finding that many of PCR's expenditures of these proceeds were for "non-coal related activities" (Op. 10 ¶35). He states (Br. 7) that his "uncontradicted" testimony establishes that "Mr. Stanley was told that the proceeds were to be used to exercise options, pay lease payments, employ contract miners and develop other properties." But that statement supports the district court's findings concerning Mr. Holschuh's representations as to how the proceeds were to be spent by PCR, as all the activities listed by Mr. Holschuh relate to the production of coal. It is irrelevant to the court's findings that PCR intended to hire a subcontractor to mine the coal or that Mr. Holschuh did not represent that all of the proceeds were to be used to employ the subcontractor (id.). There is no indication in the court's opinion, as Mr. Holschuh implicitly suggests, that it determined PCR's expenditures should have been limited to coal extraction expenses. The court's adverse findings as to Mr. Holschuh were directed toward PCR's purchase of a private residence for Mr. Bartone and other expenditures totally unrelated to coal production. (See Op. 10-11 ¶35-38.)

are meritless.

(i) Mr. Holschuh directly violated the antifraud provisions of the federal securities laws.

Mr. Holschuh argues (Br. 20) that there is "insufficient evidence in the entire record" to support the district court's determination that he engaged in primary violations of the above antifraud provisions, alleging "there was no evidence that [he] at any time had any contact with any of the investors." But, as we demonstrate in our counterstatement of facts and the foregoing argument, there is substantial evidence of record to support the court's findings (Op. 5-6 ¶¶19-21; Op. 10-12 ¶¶34-45) and its conclusions (Op. 19-20 ¶24-25) of antifraud violations based upon Mr. Holschuh's knowing material misstatements and his omission of material facts concerning the management and operations 68/ of PCR and the misuse of investor proceeds. 69/

The Commission was not required to show, as Mr. Holschuh argues (Br. 20), that he directly defrauded investors in personal contacts. It is enough that he actively participated in the formation of the venture, the structuring of the offerings and the issuance of securities through the Asset Group with knowledge that his deceptions were being passed on to the investors. This is precisely the kind of misconduct Congress sought to proscribe in

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68/ See Securities and Exchange Commission v. Freeman, Fed. Sec. L. Rep. (CCH) ¶96,361 at 93,244 (N.D. Ill. 1978), in which the court held that the failure of the defendant to disclose prior proceedings against him was a material omission: "In the context of a small closely held enterprise, it is difficult to conceive of information which would have a greater influence on an investor's decision than a prior history of fraud or other securities-related misconduct on the part of the dominant figure in the enterprise." See also Upton v. Trinidad Petroleum Corp., 468 F. Supp. 330, 337 (N. D. Ala. 1979).

69/ See Reube v. Pharmacodynamics, Inc., 348 F. Supp. 900, 909, 913-915 (1972) (failure to disclose intended use of proceeds from sale of securities to investors, including salaries and alleged "reimbursements," held to be material omission).

making the prohibitions of Sections 10(b) and 17(a) applicable to frauds perpetrated "directly" or "indirectly" upon the investing public. 15 U.S.C. 78j(b) and 77q(a). 70/ As this Court observed in refusing to require privity of securities dealings in a private civil action brought under Section 10(b), "[p]ersonal contact between potential defendant and potential plaintiff in 'today's universe of commerical transactions' is recognized as the

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70/ In any event, Mr. Holschuh is also directly liable for the antifraud violations as a controlling person under Section 20(a) of the Securities Exchange Act, 15 U.S.C. 78t(a), which provides that a controlling person is liable jointly with the entity he controls for any violations of the Act unless he can demonstrate that he "acted in good faith" and did not "induce" the violation. These defenses were not available to Mr. Holschuh. See Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801, 812 (2d Cir. 1975); Securities and Exchange Commission v. Lum's Inc., 365 F. Supp. 1046, 1063-64 (S.D.N.Y. 1973). But see Securities and Exchange Commission v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

Mr. Holschuh contests (Br. 21-22) the district court's dictum observation that the Commission is not required to prove scienter in civil actions brought to enjoin violations of Sections 10(b) and 17(a). But the district court expressly found (Br. 19 ¶23) that Mr. Holschuh acted with scienter within the meaning of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), by "knowingly, recklessly, and negligently [making] materially false and misleading statements in connection with the offer, sale and purchase of securities * * *" (Op. 20 ¶26, emphasis supplied). Subsequent to the district court's decision, the Supreme Court held in Aaron v. Securities and Exchange Commission, 100 S. Ct. 1945 (1980), that the Commission must prove scienter as defined in Hochfelder in actions under Sections 10(b) and 17(a)(1), but that only negligence was required to prove violations of Section 17(a)(2) and (3). That decision has no impact here because the district court found that Mr. Holschuh acted with such scienter. Moreover, the Court in Aaron determined that scienter was satisfied by a showing of knowing conduct, 100 S. Ct. at 1954, and this Court has consistently taken the position that the Hochfelder scienter requirement is satisfied by such findings of knowing or reckless misconduct. See Wright and Beneficial Standard Corp. v. Heizer Corp., 560 F.2d 236, 252 (7th Cir. 1977); Sanders v. John Nuveen & Co., Inc., 554 F.2d 790, 792-793 (7th Cir. 1977); Sundstrand Corp. v. Sun Chemical, 553 F.2d 1033, 1044-1045 (7th Cir.), cert. denied, 434 U.S. 575 (1977).

In any event, although the district court did not specify which sections of 17(a) it determined that Mr. Holschuh had violated, it is clear that his conduct violated both 17(a)(2) (by his obtaining money through false statements and material omissions) and 17(a)(3) (by, e.g., his participation in a course of business involving sales of securities in the form of limited partnership interests in five different partnerships). Thus, even under a negligence standard, Mr. Holschuh would be liable for violation of antifraud provisions of the Securities Act.

exception and not the rule." Sanders v. John Nuveen & Co., Inc., 554 F.2d 790, 793 (7th Cir. 1977). See also Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135, 144 (7th Cir.), cert. denied, 396 U.S. 838 (1969).

Mr. Holschuh also contends (Br. 23) that the district court erred in considering (Op. 19 ¶25), as a part of his violative conduct, his "lulling" of Mr. Stanley and the investors through a series of oral and written reports which falsely represented that PCP was making progress toward obtaining mining permits and commencing mining operations on the partnerships' leaseholds and failed to dislcose the diversion of the investors' money by him and the other principals of PCR. The court was, however, correct in observing that "[t]hese communications constitute part of Defendant Holschuh's illegal scheme to violate the anti-fraud provisions of the federal securities laws. A scheme to defraud may well include later efforts to avoid detection of the fraud" (Op. 20-21 ¶25, citing United States v. Sampson, 371 U.S. 75 (1962); Walters v. United States, 256 F.2d 840 (9th Cir. 1958); United States v. Riedel, 126 F.2d 81 (7th Cir. 1942)). 71/

71/ The Sampson, Walters and Riedel cases applied the lulling doctrine in actions brought by the government under the mail fraud statute, 18 U.S.C. 1341. The district court (Op. 19-20 ¶25) and other courts (see, e.g., Hogland v. Covington County Bank, [1977-78 Transfer Binder] CCH Fed. Sec. L. Rep. (CCH) ¶96,003 (M.D. Ala. 1977), and other decisions cited infra at pp. 34-35) have recognized that the rationale of these cases is equally applicable to civil actions under the antifraud provisions of the federal securities law -- a proposition which Mr. Holschuh challenges (Br. 23) without analysis. But as this Court broadly stated in Riedel:

> "[a] scheme to defraud may well include later efforts to avoid detection of the fraud. A fraudulent scheme would hardly be undertaken, save for profit to the

(footnote continued)

Mr. Holschuh would place an unwarranted restriction on the scope of the antifraud protections of Sections 10(b) and 17(a) by limiting their application to "activity occurring before or during the sale" (Br. 23) of securities. "The short answer is that Congress did not write the statute[s] that way." United States v. Naftalin, 441 U.S. 768, 773 (1978). Section 10(b) is broadly worded to prohibit fraudulent activity "in connection with the purchase or sale of any security * * *" 15 U.S.C. 78j(b) (emphasis supplied). Section 17(a) similarly prohibits such misconduct "in the offer or sale of any securities * * *" 15 U.S.C. 77q(a) (emphasis supplied). The Supreme Court has used the definitional terms "in" and "in connection with" interchangeably, expressly refusing to use this difference in language as a basis for restricting the scope of Section 17(a). See United States v. Naftalin, supra, 441 U.S. at 773 n.4, citing Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 10 (1971). And the Court has stressed that the terms "in" the "offer" and "sale" are "statutory terms, which Congress expressly intended to define broadly [and] are expansive enough to encompass the entire selling process * * *." United States v. Naftalin, supra, 441 U.S. at 773 (citations omitted).

Heeding this language and the broad antifraud purposes of these

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71/ (footnote continued)

> plotters. Avoidance of detection and prevention of recovery of money lost by the victims are within, and often a material part of, the illegal scheme. Further profit from the scheme to defraud, as such, may be over, and yet the scheme itself be not ended."

126 F.2d at 83.

provisions, courts have held that liability may attach for fraud in connection with the sale of securities by lulling the purchasers into a false sense of security after sale. See, e.g., Kidwell v. Meikle, 597 F.2d 1273 (9th Cir. 1979); Hogland v. Covington County Bank, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,003 (M.D. Ala. 1977). The need for disclosure of the facts, even after the receipt of the investors' funds, is especially evident in situations, such as here, 72/ where the violator's lulling activities, if unchecked, result in the depletion of the investors' money, thereby undercutting the utility of equitable remedies such as disgorgement which are available to the government and private litigants under the federal securities laws. Cf. Errion v. Connell, 236 F.2d 447 (9th Cir. 1956) (lulling doctrine applied to toll statute of limitations on private civil remedy available under Section 10(b)). Moreover, even if this Court should decide, as Mr. Holschuh urges (Br. 23), not to rely on the lulling doctrine in order to affirm the district court's determinations of primary violations, Mr. Holschuh is nevertheless liable as the district court expressly found (Op. 19 ¶24) a separate basis for these violations: the fraudulent misrepresentations Mr. Holschuh made to Mr. Stanley and the Asset Group prior to and during the offer and sale of the limited partnership interests to investors. (See e.g., pages 8-11, 13-17, supra.)

72/ Mr. Holschuh's lulling activities prevented the Asset Group from learning of the misapplication of the investors' funds by Mr. Holschuh and the other principals in PCR until the funds were almost totally depleted (see pp. 20-22, supra). Thus, PCR's principals were effectively insulated from the reach of disgorgement orders. For example, the district court denied the Commission's request for an order of disgorgement against Mr. Holschuh because the accounting he filed with the court "indicates there are no funds or other assets remaining in the possession or under the control of Holschuh that are directly or indirectly attributable to the sales of limited partnership interests" (Op. 23 ¶35).

(ii) Mr. Holschuh aided and abetted violations of the antifraud provisions of the federal securities laws.

Mr. Holschuh likewise challenges (Br. 26) the sufficiency of the evidence supporting the district court's determination (Op. 20 ¶26) that he aided and abetted violations of antifraud provisions of the federal securities laws. The court, applying the standard for establishing secondary violations adopted by the Second Circuit in Securities and Exchange Commission v. Coven, 581 F.2d 1020, 1028 (2d Cir. 1978), cert. denied, 440 U.S. 950 (1979), 73/ imposed secondary liability because Mr. Holschuh knew that his fraudulent misrepresentations would be used in furtherance of securities law violations by other participants in the offer and sale of the limited partnership interests and the subsequent scheme to avoid detection of the fraud. There is substantial support for this conclusion in the record. As we have shown 74/, Mr. Holschuh was not only aware of the violative conduct of the other participants in the offering of limited partnership interests but actively participated in those violations through the knowing and reckless publication of oral and written misrepresentations.

Mr. Holschuh argues that the evidence and the district court's findings do not satisfy the test for aiding and abetting liability es-

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73/ The Coven standard is in accordance with this Court's prior pronouncements on aiding and abetting liability under the federal securities laws. See Brennan v. Midwestern United Life Insurance Co., 417 F.2d 147, 151-154 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); Buttrey v. Merrill Lynch, Pierce Fenner & Smith, Inc., supra, 410 F.2d at 144. See also Landy v. Federal Deposit Insurance Corp., 486 F.2d 139, 163 (3d Cir. 1973); Tucker v. Janota, et al., [1978-79 Transfer Binder] Fed. Sec. L. Rep. (CCH) (N.D. Ill. 1978) (restating standard in this Circuit).

74/ See, e.g., pp. 8-11, 13-17, 20-22, supra.

tablished in Securities and Exchange Commission v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975), which requires that the secondary violator have a "general awareness" of his role in the fraudulent scheme and "knowingly and substantially assist" the principal violators in perpetrating the fraud. See also Securities and Exchange Commission v. Cenco, Inc., 436 F. Supp. 193, 200 (N.D. Ill. 1977). We disagree. The evidence and the district court's findings concerning Mr. Holschuh's knowledge and his active participation in the fraudulent scheme clearly satisfy even this test. 75/

75/ Mr. Holschuh is incorrect in arguing that Coffey requires, as a prerequisite to establish secondary liability, that a principal violator have been brought to trial and found civilly or criminally liable for his violations. The principal need only have "committed" a securities law violation (493 F.2d at 1316), and the district court implicitly determined that other participants in the offer and sale of the limited partnership interests, like Mr. Holschuh, committed such violations. See generally United States v. Standefer, 610 F.2d 1076, 1081-1091 (3rd Cir. 1979).

Moreover, although it may be that "mere knowledge of the omitted facts would not suffice as scienter" under the formulation set forth in Franke v. Midwestern Oklahoma Development Authority, 428 F. Supp. 719, 725 (W.D. Okla. 1976), on which Mr. Holschuh relies (Br. 18, 22) (cited in Securities and Exchange Commission v. Southwest Coal & Energy Co., No. 78-1130 (5th Cir. Aug. 28, 1980), slip op. at 8959 n.17), this is not a case of "mere knowledge." "Rather, 'the danger of misleading buyers,'" from Mr. Holschuh's known and repeated misrepresentations and omissions to the underwriter before and during the offer and sale of the limited partnership interests and his continued deception both orally and in writing after the sales which concealed the fraud and lulled the underwriter and the investors, "must have been actually known or so obvious that [Mr. Holschuh] 'must have been aware of it.'" Securities and Exchange Commission v. Southwest Coal & Energy Co., supra, at 8959 n.17, citing Sundstrand Corp. v. Sun Chemical, supra, 553 F.2d at 1045.

And, as the Court of Appeals for the District of Columbia Circuit, in upholding findings of violation of Section 10(b) and Rule 10b-5, recently stated in defining scienter:

> "Knowledge means awareness of the underlying facts, not the labels that the law places on those facts.

(footnote continued)

C. Mr. Holschuh violated and aided and abetted violations of the registration provisions of the Securities Act.

The district court concluded that the Commission had made an unrebutted (Op. 16 ¶12) prima facie showing that Mr. Holschuh violated and aided and abetted violations of Sections 5(a) and (c) of the Securities Act (Op. 13-15 ¶¶11). These sections, in substance, make it unlawful for any person to offer or sell unregistered securities in the absence of an available exemption. 15 U.S.C. 77b(a) and (c).

A prima facie case is established by a showing that (i) no registration statement was in effect as to the securities; (ii) the defendant sold or offered to sell these securities; and (iii) the sale was made through the use of interstate facilities or the mails. Securities and Exchange Commission v. Continental Tobacco Co., 463 F.2d 138, 155 (5th Cir. 1972). On appeal, Mr. Holschuh does not dispute the district court's determinations that the partnership interests were unregistered securities (Op. 13-14 ¶¶3-6) 76/ sold through the instrumentalities

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75/ (footnote continued)

> Except in very rare instances, no area of the law -- not even criminal law — demands that a defendant have thought his actions were illegal. A knowledge of what one is doing and the consequences of those actions suffices."

Securities and Exchange Commission v. Falstaff Brewing Corporation, [Current] Fed. Sec. L. Rep. (CCH) ¶97,505 (D.C. Cir. 1980) (emphasis added).

76/ Limited partnership interests are securities as defined in Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10). See, e.g., Securities and Exchange Commission v. Murphy, [Current] Fed. Sec. L. Rep. (CCH) ¶97,588 at 98,116 (9th Cir. 1980); Goodman v. Epstein, 582 F.2d 388, 408-409 (7th Cir. 1978), cert. denied, 440 U.S. 939 (1979);

(footnote continued)

of interstate commerce (Op. 14-15, ¶¶7, 11), and thus that the Commission had made a prima facie case with respect to two of the three elements. 77/ Rather, Mr. Holschuh contends that the district court erred in determining that he was an "issuer" of securities as he had no direct contact with investors and no control over the partnership entities (Br. 9-13). He further argues that Section 4(1) of the Securities Act exempts him from liability for the conceded registration violations (Br. 9, 11). Finally, he attempts to exonerate himself by claiming reliance on Mr. Stanley and on Mr. Stanley's counsel (Br. 11). All of these arguments are meritless. In view of Mr. Holschuh's activities in furtherance of the offer and sale of the limited partnership interests, the district court correctly concluded that he directly violated and aided and abetted violations of the registration provisions and that

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76/ (footnote continued)

McGreghar Land Co. v. Meguiar, 521 F.2d 822, 824 (9th Cir. 1975); Klebanow v. New York Produce Exchange, 344 F.2d 294, 297 (2d Cir. 1965). The district court concluded that the limited partnership interests in this case constitute securities in the form of an investment contract as defined by the Supreme Court in Securities and Exchange Commission v. Howey, 328 U.S. 293, 301 (1946) (Op. 14 ¶6).

77/ He does not, and cannot, contest (see Br. 9-13) the district court's conclusions that neither the so-called private offering exemption (Op. 16-17 ¶¶13-18) nor the intrastate exemption from registration was available (Op. 17-18 ¶19). See Section 4(2) of the Securities Act, 15 U.S.C. 77d(2), and Rule 146 thereunder, 17 CFR 230.146, which provide an exemption from registration for transactions by an issuer "not involving any public offering;" Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119, 126 (1953); Doran v. Petroleum Management Corp., 545 F.2d 893, 900 (5th Cir. 1977); Securities and Exchange Commission v. Continental Tobacco Co., supra, 463 F.2d at 158. And see Section 3(a)(11) of the Securities Act, 15 U.S.C. 77c(a)(11), which provides an exemption for intrastate offerings; Chapman v. Dunn, 414 F.2d 153, 159 (6th Cir. 1969); Securities and Exchange Commission v. McDonald Investment Co., 343 F. Supp. 343, 346 (D. Minn. 1972); Securities and Exchange Commission v. Truckee Showboat, 157 F. Supp. 824, 825 (S.D. Cal. 1957); Commission Rule 147, 17 CFR 230.147; Securities Act Release Nos. 4434 (December 6, 1961) and 5450 (January 7, 1974).

his activities fall within the scope of the definition of an issuer. 78/

As the record demonstrates, when it was determined by Mr. Holschuh and PCR's other principals that PCR should not sell its own limited partnership interests to finance the coal mining venture, it was Mr. Holschuh who arranged with Mr. Stanley for the requisite financing from public investors; it was Mr. Holschuh who, as president of PCR, negotiated with Asset Group for the offer and sale of the securities; it was Mr. Holschuh -- not the Asset Group, Mr. Stanley, or the limited partnerships -- who was principally responsible for obtaining the leases, mining permits, subcontractors, and other requisites to make a success of the venture for which the securities were sold. Mr. Holschuh and PCR originated and "held the key to success or failure of the partnerships;" they are properly considered the issuer. Securities and Exchange Commission v. Murphy, supra, [Current] Fed. Sec. L. Rep. (CCH) at 98,117-98,119.

Alternatively, the district court's judgment is correct 79/ because Mr.

78/ The district court held that Mr. Holschuh and PCR were issuers of securities as that term is defined by Section 2(4) of the Securities Act. Section 2(4) defines an "issuer" as "every person who issues or proposes to issue any security." 15 U.S.C. 77b(4). As the Supreme Court recently observed, the definitional terms of the securities laws are to be contrued broadly to effectuate the remedial purposes of the statute. United States v. Naftalin, 441 U.S. 768, 773 (1979). See also Securities and Exchange Commission v. North American Research and Development Corp., 424 F.2d 63, 81 (2d Cir. 1970); Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 246-247 (2d Cir. 1959).

79/ Even assuming, arguendo, that Mr. Holschuh is not an "issuer" of the securities, the district court's judgment should be upheld since there are alternative grounds on which to base its determination that Mr. Holschuh violated Section 5. See, e.g., Wright and Beneficial Standard Corp. v. Heizer Corp., supra, 560 F.2d at 246. As we note, the securities laws are broad statutes, and various of its provisions, including the ones at issue in this case, prohibit "any person" from engaging in violative conduct.

(footnote continued)

Holschuh is liable for violations of the registration provisions as an "underwriter" of the securities at issue. Section 2(11) of the Securities Act defines an underwriter as

> "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 * * *" 15 U.S.C. 77b(11) (emphasis supplied).

The record amply demonstrates that Mr. Holshuch actively and directly participated in the transactions that resulted in the distribution of securities in the form of limited partnership interests, and therefore can be classified as an underwriter. See, e.g., Securities and Exchange Commission v. International Chemical Development Corp., 469 F.2d 20, 27-29 (10th Cir. 1972); Securities and Exchange Commission v. Culpepper, supra, 270 F.2d at 247. Thus, Mr. Holschuh's argument that he cannot be liable directly for violations of the registration provisions because he had no direct contact with investors (Br. 12) is without merit.

In any event, Mr. Holschuh's liability does not depend on whether he is denominated an "issuer, underwriter, or dealer." "Still quite apart from the issuer or underwriter basis for liability is liability arising from aiding and abetting or joint participation in the viola-

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79/ (footnote continued)

> Thus, for example, Section 5 is not confined to issuers, but expressly prohibits violative conduct by "any person." See also Sections 12 and 17 of the Act, 15 U.S.C. 77e and 77q. The Tenth Circuit's statement, in discussing the term "aider and abettor," which is not found in the securities laws, is particularly apposite to this case: "[i]t could hardly make any difference in respect to the court's inherent power to deal with contributors what term or designation might be employed in relation to them. Securities and Exchange Commission v. Barraco, 438 F.2d 97, 99 (10th Cir. 1971).

tion of Section 5." Securities and Exchange Commission v. International Chemical Development Corp., supra, 469 F.2d at 28. See Securities and Exchange Commission v. North American Research and Development Corp., supra, 424 F.2d at 82. Clearly, but for Mr. Holschuh's actions, the sales transactions would not have taken place. Thus, Mr. Holschuh's arguments to the contrary notwithstanding (Br. 14-19), he was a "motivating force behind the entire project" (Op. 15 ¶9), and is liable for the registration violations. See, e.g., Securities and Exchange Commission v. Murphy, supra, [Current] Fed. Sec. L. Rep. (CCH) at 98,117-98,119; Securities and Exchange Commission v. International Chemical Development Corp., supra, 469 F.2d at 27-29; Securities and Exchange Commission v. North American Research and Development Corp., supra, 424 F.2d at 82; Securities and Exchange Commission v. Chinese Consolidated Benevolent Association, 120 F.2d 738, 741 (2d Cir. 1941). 80/

Mr. Holschuh attacks the court's conclusion that he aided and abetted violations of Section 5 (Op. 15 ¶9) on the unsupported

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80/ Mr. Holschuh's claim (Br. 17) that the district court applied the wrong standard for determining that he was an aider and abettor of the registration violations is in error. Even though the court found intentional conduct on his part, liability for Section 5 violations can be established by a showing of negligence. See Securities and Exchange Commission v. Universal Major Industries, 546 F.2d 1044, 1046 (2d Cir. 1976), cert. denied, 434 U.S. 834 (1977); Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973); Securities and Exchange Commission v. Guild Films Co., 279 F.2d 485, 490 (2d Cir. 1960). Although Mr. Holschuh asserts, in essence, that scienter is required in this Circuit, he cites no cases to support his argument (Br. 16-17). Securities and Exchange Commission v. Cenco, 436 F. Supp. 193 (N.D. Ill. 1977), which he does cite, is a district court case and has no relevance to his argument. In Cenco, the district court, in considering the standard to be applied in cases of fraud violations -- not registration violations -- held that the definition of scienter included recklessness. 436 F. Supp. at 200.

ground that "[i]t is legally impossible for a person to be both a direct violator of Section 5 and an aider and abettor of a Section 5 violation since for aiding and abetting liability it must just be shown that someone other than the aider and abettor violated the registration laws" (Br. 15). But he concedes (Br. 16) that the Commission proved that Section 5 was violated (Op. 13 ¶1), and cannot seriously deny his primary role in the venture. Moreover, it is not a prerequisite to a determination that Mr. Holschuh aided and abetted violations of the securities laws that there be an adjudication of liability by another defendant where, as in this case, the court has found that the law was violated. Cf. United States v. Standefer, supra, 610 F.2d at 1081-1091; United States v. Musgrave, 483 F.2d 327, 333-334 (5th Cir.), cert. denied, 414 U.S. 1023 (1973); United States v. Azadian, 436 F.2d 81 (9th Cir. 1971).

Mr. Holschuh's attempted reliance on Section 4(1) to absolve himself from liability must also fail (Br. 9, 11). 81/ Mr. Holschuh misconstrues the purpose of the Section 4(1) exemption which "does not in terms or by fair implication protect those," such as he, "who are engaged in steps necessary to the distribution of securities. To give Section 4(1) the construction urged by the defendant would afford a ready method of thwarting the policy of the law and evading its provisions," Securities and Exchange Commission v. Chinese Consolidated Benevolent Association,

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81/ Section 4(1), 15 U.S.C. 77d(1) exempts routine trading transactions with respect to securities already issued and not distributions by issuers or acts of others who engage in such distributions. See Securities and Exchange Commission v. Murphy, supra, [Current] Fed. Sec. L. Rep. (CCH) at 98,122; Securities and Exchange Commission v. North American Research and Development Corp., supra, 424 F.2d at 72; United States v. Wolfson, 405 F.2d 779 (2d Cir. 1968), cert. denied, 394 U.S. 946 (1969).

supra, 120 F.2d at 741, and "open wide an escape hatch from the registration provisions of the [Securities] Act." Securities and Exchange Commission v. Culpepper, supra, 270 F.2d at 247.

Finally, Mr. Holschuh attempts (Br. 11) to rely on securities counsel and Mr. Stanley to insulate himself from liability for his violations of the registration provisions, by arguing in essence, that he relied upon them to sell the securities through a private placement. This attempt must fail. Good faith reliance on counsel, even if proved, is not an absolute defense to violations of Section 5, even in a criminal prosecution. Tarvestad v. United States, 418 F.2d 1043, 1047 (8th Cir. 1969), cert. denied, 397 U.S. 935 (1970); Linden v. United States, 254 F.2d 560, 568 (4th Cir. 1958). And here, such a defense is unavailable to Mr. Holschuh as such a claim requires full disclosure of all relevant information to counsel. United States v. Custer Channel Wing Corp., 247 F. Supp. 481, 502-503 (D. Md. 1965), affirmed, 376 F.2d 675 (4th Cir.), cert. denied, 389 U.S. 850 (1967); United States v. Hill, 298 F. Supp. 1221, 1235 (D. Conn. 1969). Mr. Holschuh does not claim that he relied on his own attorney; and, even with respect to Mr. Stanley's counsel, he failed to provide complete or truthful information to counsel (or Mr. Stanley) during the negotiations with Asset Group.

II. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN PERMANENTLY ENJOINING MR. HOLSCHUH FROM FURTHER VIOLATING THE FEDERAL SECURITIES LAWS.

Based upon its determinations that Mr. Holschuh had violated registration and antifraud provisions of the federal securities laws (Op. 13-21) and that the Commission had made a "proper showing" that an injunction against further violations was "appropriate" (Op. 22 ¶31), the district court entered a final judgment and order of permanent injunc-

tion against Mr. Holschuh (Op. 22 ¶32). Mr. Holschuh, without a single reference to the record, asserts (Br. 27) that the court erred in issuing this injunction because there is no evidence to support its key finding that the Commission made a proper showing that such relief was warranted. As demonstrated by the foregoing analysis, this argument is meritless; the district court did not abuse its discretion.

Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78u(d), under which this action was instituted, provide that in actions brought by the Commission for violations of the securities laws, courts shall grant injunctive relief upon a "proper showing" by the Commission. As this Court and every other Court of Appeals that has considered the question has recognized, in making this showing government agencies

> "need not meet the requirements for an injunction imposed by traditional equity jurisprudence. Once a violation is demonstrated, the moving party need show only that there is some reasonable likelihood of future violations."

Commodity Futures Trading Commission v. Hunt, 591 F.2d 1211, 1220 (7th Cir. 1979), citing Securities and Exchange Commission v. Advance Growth Capital Corp., 470 F.2d 40, 54 (7th Cir. 1972). 82/ See also

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82/ Accord, Securities and Exchange Commission v. World Radio Mission, Inc., 544 F.2d 535, 541 (1st Cir. 1976); Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 99-100 (2d Cir. 1978); Securities and Exchange Commission v. Bonastia, 614 F.2d 908, 912 (3rd Cir. 1979); Securities and Exchange Commission v. American Realty Trust, 586 F.2d 1001, 1007 (4th Cir. 1978); Securities and Exchange Commission v. Blatt, 583 F.2d 1325, 1334 (5th Cir. 1978); Otis & Co. v. Securities and Exchange Commission, 106 F.2d 579, 584 (6th Cir. 1939); Securities and Exchange Commission v. First American Bank & Trust Co., 481 F.2d 673, 682 (8th Cir. 1973); Securities and Exchange Commission v. Koracorp Industries,Inc., 575 F.2d 692, 699 (9th Cir. 1978); Securities and Exchange Commission v. Savoy Industries, 587 F.2d 1149, 1168 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979).

Hecht Co. v. Bowles, 321 U.S. 321, 331 (1944); Securities and Exchange Commission v. Keller Corp., 323 F.2d 397, 402 (7th Cir. 1963).

The district courts are vested with broad equitable discretion in applying this standard to the cases before them, keeping in mind that it is "the public interest enunciated in the legislation which serves as the criterion for the proper exercise of equity powers" and that the

> "courts should be alert to provide appropriate remedies for the effectuation of the declared national policy. Otherwise that policy may be frustrated by judicial inaction."

Securities and Exchange Commission v. Advance Growth Capital Corp., supra, 470 F.2d at 53. Where, as here, the Commission has "successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." United States v. DuPont & Co., 366 U.S. 316, 334 (1961). See also Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801, 809 (2d Cir. 1975); Mitchell v. Pidcock, 299 F.2d 281, 287 (5th Cir. 1962). Thus, the district court's determination to enjoin Mr. Holschuh permanently from engaging in further securities law violations should not be overturned on appeal unless there has been "a clear abuse of discretion," and Mr. Holschuh's burden of establishing such an abuse of discretion is "necessarily a heavy one." Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972). See also Securities and Exchange Commission v. Advance Capital Growth Corp., supra, 470 F.2d at 53.

Contrary to Mr. Holschuh's assertions (Br. 28-29), the evidence established that he committed serious securities law violations "founded on systematic wrongdoing, rather than an isolated occurrence." Commodity Futures Trading Commission v. Hunt, supra, 591 F.2d at 1220. His were not

mere technical or isolated securities law violations, but "continual and extensive violations of provisions which lie at the very heart of a remedial statute." Securities and Exchange Commission v. Advance Growth Capital Corp., supra, 470 F.2d at 53-54. 83/

Significantly, the district court found (Op. 19 ¶23) that Mr. Holschuh violated antifraud provisions of the federal securities laws with scienter by "knowingly, recklessly and negligently [making these] false and misleading statements" (Op. 20 ¶26). As this Court has observed, because these violations "were not inadvertent and harmless * * * [but] were committed with knowledge * * *, 'there exists some cognizable danger of recurrent violation.'" Securities Exchange Commission v. Advance Capital Growth Corp., supra, 470 F.2d at 54, quoting United States v. W.T. Grant Co., 345 U.S. 629 (1953). See also Securities and Exchange Commission v. Universal Major Industries Corp., supra, 546 F.2d at 1048. And, given the serious nature of these violations, it is no defense to an injunction that he may not have been found to have engaged in prior violations or that the instant violations were discontinued prior to the commencement of this court action. See Securities and Exchange Commission v. Advance Capital Growth Corp., supra,

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83/ It is frivolous, in light of this evidence, for Mr. Holschuh to argue (Br. 29) that he voluntarily severed his relationship with PCR "after discovering the defalcations of his associates" and that he made every effort to cooperate with Mr. Stanley in carrying out PCR's contractual obligations to the investors. In addition to fabricating the elaborate coverup of PCR's lack of mining activity and the crippling defalcations of its principals, he actually participated in squandering the investors' money. It is also disingenuous for Mr. Holschuh to imply that he acted with contrition in writing a letter to an Ohio bank at Mr. Stanley's request for the purpose of freezing $40,000 of this money held in an escrow account by PCR since he initially resisted having this account transferred to the Asset Group because of his fear of reprisals from Mr. Bartone. See n. 56, supra.

470 F.2d at 40; Securities and Exchange Commission v. Culpepper, supra, 270 F.2d at 249-50.

Mr. Holschuh further asserts (Br. 28) that an injunction against him is not warranted because he works in the insurance industry and is "not now nor has he ever been engaged in the securities field." The evidence directly controverts this assertion (see page 5 and note 9, supra) and demonstrates that because of Mr. Holschuh's "occupation or customary business activities * * * [he] will be in a position in which future violations could be possible." Commodity Futures Trading Commission v. Hunt, supra, 591 F.2d at 1220. 84/

The district court's exercise of its discretion was plainly correct.

84/ Mr. Holschuh argues that his present retreat to the insurance industry undercuts the need for a permanent injunction against him. But as the Ninth Circuit has noted, "changing jobs * * *, in and of itself, or in combination with the cessation of illegal activities and proclaimed reformation, [does not provide] a complete defense to an injunction suit." Securities and Exchange Commission v. Koracorp Industries, Inc., supra, 575 F.2d at 698.

Also, in view of the seriousness of the violations, the court's order of permanent injunction is not "punitive" as Mr. Holschuh suggests (Br. 30). The court did not abuse its discretion in determining that the need for investor protection outweighed any harmful impact that the injunction might have on Mr. Holschuh's career in the insurance industry. "The public interest when in conflict with private interest is paramount." Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1082.

CONCLUSION

For the foregoing reasons, the district court's judgment and order of permanent injunction should be affirmed.

Respectfully submitted,

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Dated: September 1980

APPENDIX

Section 4(1), Securities Act of 1933, 15 U.S.C. 77d(1):

> SEC. 4. The provisions of section 5 shall not apply to—
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> (1) transactions by any person other than an issuer, underwriter, or dealer.
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> (2) transactions by an issuer not involving any public offering.
>
> (3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except—

Section 5(a), Securities Act of 1933, 15 U.S.C. 77e(a):

> SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise;[2] or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Section 5(c), Securities Act of 1933, 15 U.S.C. 77e(c):

> (c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.[5]

Section 17(a), Securities Act of 1933, 15 U.S.C. 77q(a):

SEC. 17. (a) It shall be unlawful for any person in the offer or[3] sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property 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 were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 20(b), Securities Act of 1933, 15 U.S.C. 77t(b):

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia[3] to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

Section 10(b), Securities Exchange Act of 1934, 15 U.S.C. 78j(b):

> SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 21(e), Securities Exchange Act of 1934, 15 U.S.C. 78u(e):

> (e) Upon application of the Commission the district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this title, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this title, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.[3, 4]

Rule 10b-5, Securities Exchange Act of 1934, 17 CFR 240.10b-5:

17 CFR

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.