

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

IN THE MATTER OF:)	
)	
ALLIED CAPITAL GROUP, INC.,)	
FLOYD J. STUMPF,)	CASE NO. 89-02-04
)	
Respondents.)	

OPINION AND ORDER

On June 26, 1989, the State through Deputy Attorney General Gregg E. Wilson moved to amend the Notice of Intent to Revoke Broker-Dealer and Agent Registrations ("notice of allegations") to conform to the evidence presented at the hearing on June 20-21, 1989. By letter dated June 27, 1989, I solicited objections from opposing counsel. On June 30, 1989, counsel for Allied Capital Group, Inc. ("Allied") filed its own motion for judgment and objections to the State's motion. On July 7, 1989, I received Allied's two memoranda of law in support of its objections and its motion. The State's memorandum of law in opposition to Allied's motion was received on July 10, 1989. Mr. Winderman, on behalf of respondent Floyd Stumpf, did not respond to either motion.

I. The State's Motion to Amend the Charges

Allied's memorandum in support of its objections to the State's motion argues that the State may not take disciplinary action against Allied solely because of violations by Mr. Stumpf. Allied's arguments extend to a license suspension or

revocation under 6 Del. C. §7316(a) and to any fine under 6 Del. C. §7316(g). Allied argues that, under the first clause of §7316(a), agency liability may attach to the corporation only where the offending individual is a partner, officer, director, or controlling person. Mr. Stumpf is none of those, it is said, and therefore he cannot create such liability for Allied by his individual actions.

The State responds that Allied may be liable under traditional agency principles for any violations by its agents. Various cases were cited by the State for the proposition that broker-dealers are held to a high standard of care in their dealings with customers and that therefore the doctrine of respondeat superior applies.

Before ruling on Allied's objections, I should note that this issue of corporate liability under common law agency principles was inherent in the original allegations as well as in the State's proposed amended notice. I myself was unsure of the correct answer at the hearing on June 20-21, when I informed Allied's counsel that I read the original notice as encompassing such liability.

After an opportunity to study the matter, I agree with Allied that it should not suffer disciplinary sanctions solely because of Mr. Stumpf's conduct (assuming that his conduct does not lead to an inference of failure to supervise). After looking at numerous cases, including most of those cited by the State, I resolved this issue by reading the official code comments to the Uniform Securities Act.

The Delaware Securities Act is essentially the same as the Uniform Securities Act with some minor differences. See 1 Blue Sky L. Rep. (CCH) ¶5501 at 1503. Section 7316(a) of the Delaware Act was adopted from §204(a) of the Uniform Act, and the language of both sections is nearly identical. The official comment of the Uniform Act with respect to the language that forms the first clause in §7316(a) is the following:

This clause authorizes the Administrator to proceed against an entire firm merely because an individual partner, officer, director or controlling person is disqualified under one of the specific clauses, but it requires a finding that such action is in the public interest. The disqualification of any other agent, or an employee of an investment adviser, may not automatically be used against the broker-dealer or the investment adviser. But, when the agent's or employee's disqualification is due to lack of reasonable supervision, the Administrator may proceed against the broker-dealer or the investment adviser under Clause (J).

1 Blue Sky L. Rep. (CCH) ¶5524 at 1513-3. Clause (J) of §204(a) provides as a basis for disciplinary action against a broker-dealer or investment adviser the failure of the entity to supervise its agents reasonably. (Oddly, the Delaware version--§7316(a)(10)--dropped the reference to investment advisers).

The above-quoted language suggests that Allied's argument is correct, but the phrase "may not automatically be used against the broker-dealer" (emphasis added) leaves some doubt. The issue was resolved in my mind by reference to the official code comment for Clause (J), which corresponds to §7316(a)(10). The official comment states the following:

This clause represents a codification of the view held by a number of Administrators, as well as the SEC, to the effect that a registrant must be held responsible for violations resulting from inadequate supervision of subordinates. This Act, unlike §15(b) of the Securities Exchange Act 1934, 15 U.S.C. §78o(b), does not authorize the Administrator to proceed against the registration of a broker-dealer merely because one of his agents has violated the statute (unless the agent happens to be a director, officer or partner). But, when an agent's violation is found to be due to a violation of the broker-dealer's duty of reasonable supervision, and when the Administrator finds it is in the public interest to proceed against the broker-dealer's registration, he may do so under Clause (J). This is not to say that proof of a violation by the agent is essential to an order under Clause (J).

1 Blue Sky L. Rep. ¶5524 at 1513-4 (emphasis in original). I think this quoted language is dispositive of the issue.

Without getting into the technical points of Allied's argument as to the Commissioner's power to fine, I do think that the general approach of the Uniform Securities Act--which requires culpability of some sort on the broker-dealer's part--does not favor the view that the Commissioner may impose a fine under §7316(g) against a broker-dealer solely because of an agent's violation and without a finding of a failure to supervise reasonably.

Nevertheless, the State argues that it has produced evidence of culpability by managers at Allied who participated in or at least encouraged Mr. Stumpf's alleged violations. The State points to Mr. Stumpf's statements concerning a Bill Masucci, allegedly the owner of Allied, and an individual named Marti Baren. Although there is testimony that these two were managers at Allied, there is little or nothing in the record to show that Masucci or Baren was or is a partner, director,


officer or controlling person. Although Mr. Stumpf asserted that Masucci was the owner, I would have trouble putting much weight on that assertion in view of the fact that the ownership of Allied should be documented and such documentation is not in the record.

However, it is not my task to weigh the evidence at this time. Because at this stage I should view the evidence in a manner most favorable to the State, I will grant--in its entirety--the State's motion to amend the charges against both respondents. I wish to make it clear, however, that should I finally conclude that Masucci and Baren were not partners, directors, officers or controlling persons, then I will dismiss the charges against Allied except as to the charges of failure to supervise.

II. Allied's Motion for Judgment

For the reasons contained in the State's memorandum of July 10, Allied's motion for judgment is denied. Allied has a statutory duty to supervise its agents, and the conduct of an agent over a period of time may lead to an inference that the duty was not fulfilled. Moreover, State's exhibit 60 constitutes evidence of approval or encouragement of Mr. Stumpf's alleged actions on the part of Allied's management.

SO ORDERED.



Richard W. Hubbard
Securities Commissioner

Date: July 11, 1989

AFFIDAVIT OF MAILING

STATE OF DELAWARE

)

SS:

NEW CASTLE COUNTY

)

Cynthia K. Evans, being first duly sworn, deposes and says that:

1. She is a secretary with the Department of Justice.

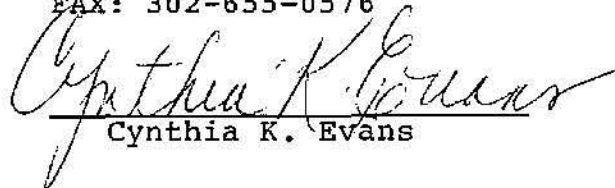
2. That on July 11, 1989 she caused to be placed in the U.S. Mail, First Class and sent by FAX machine, copies of the foregoing document to the below-listed individuals at the following addresses and telephone numbers:

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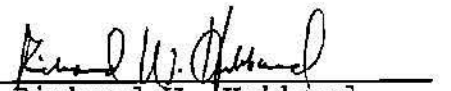
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Cynthia K. Evans

SWORN TO AND SUBSCRIBED before me on this 11th day of July, 1989.


Richard W. Hubbard
Securities Commissioner

Pursuant to 29 Del. C. §2508