BEFORE THE SECURITIES COMMISSIONER

OF THE STATE OF DELAWARE

IN THE MATTER OF:	)	
	)	
POWER SECURITIES CORPORATION,	)	
RICHARD T. MARCHESE, DARIN	)	Case No. 89-03-02
PAUL POPOLI, and JOSEPH M.	)	/89-05-04
MCMAHON,	)	(Consolidated)
	)	
Respondents.	)	
	)	

W. Michael Tupman, Esquire, Deputy Attorney General, Department of Justice, Wilmington, Delaware, attorney for the State of Delaware.

No appearance by respondents.

OPINION AND ORDER

Date: January 7, 1992
Wilmington, Delaware

Charges were issued by the Delaware Securities Division (hereinafter "Securities Division") on January 18, 1990, against respondent Joseph M. McMahon ("McMahon"), and on January 26, 1990, against respondents Power Securities Corporation ("Power"), Richard T. Marchese ("Marchese"), and Darin Paul Popoli ("Popoli"). Power was a registered broker-dealer in Delaware at the time of the alleged violations of the Delaware Securities Act (6 Del. C. Ch. 73), and McMahon, Marchese, and Popoli were registered broker-dealer agents of Power. The following violations were alleged:

(1) willful misrepresentations and omissions of material fact in violation of 6 Del. C. section 7303(2) and section 7316(a)(2);

(2) dishonest and unethical conduct in violation of section 7316(a)(7);

(3) with respect to Power and Marchese only, failure to supervise reasonably the conduct of Power's agents; and

(4) with respect to Power and Marchese only, violations of the laws or rules of other jurisdictions resulting in adverse orders in those jurisdictions--which orders constitute a violation of 6 Del. C. section 7316(a)(6).

Marchese, unlike the other agents, was alleged to be a principal and majority shareholder of Power. The State subsequently withdrew all charges of dishonest and unethical conduct based on 6 Del. C. section 7316(a)(7).

None of the respondents appeared at the hearing on August 6, 1991. Each was aware of the existence of the proceeding, however, as each had received notice of the charges and had initially requested a hearing through counsel. Respondents Power, Marchese, and Popoli subsequently terminated their representation by counsel and did not communicate further with the Securities Division. Respondent McMahon requested a postponement of the hearing, and a postponement until August 14, 1991, was granted as to his portion of the proceeding. On the morning of August 14, 1991, Mr. McMahon requested (by facsimile transmission) a second postponement, which was denied.

At the hearing on August 6, 1991, the State presented the testimony of three witnesses: Denise Herron, , and . Ms. Herron was a securities investigator who testified that the respondents were registered to sell securities in Delaware during the relevant time period, and she authenticated various documents that were placed into evidence. and testified that they were Delaware residents who purchased securities from the respondents. testified that he made two separate purchases from Power through its agent Mr. Popoli. The first purchase was on August 11, 1988 (trade date), when he paid $1620 for shares in a company named "The AST Group, Inc." (hereinafter "AST"). (Actually, the August 11, 1988 purchase of AST shares was in two trades rather than one, but for convenience I will treat these trades as one transaction). One week later, on August 18, 1988,

sold his shares of AST for $1920, a profit of $300. Mr. did not receive his profits in cash, however. Rather, he reinvested the proceeds of the AST sale along with an additional $800 to purchase shares in a company named "Daine Industries, Inc." (hereinafter "Daine"), for $2720. Mr. testified that the last bid quotation he heard for his 30,000 shares of Daine was $.005 per share (making his shares worth $150) and that he believed the shares were worthless.

Mr. testified that Popoli initiated the contact with a "high pressure" telephone call, urging to invest $10,000 in AST. Popoli recommended AST to , saying that he "could easily get me in and out at a profit." Popoli said nothing about risk and did not discuss any financial information about the company. Similarly, Popoli highly recommended Daine to Mr. and disclosed nothing about its risks or financial situation.

Mr. testified that he purchased securities from Power through its agent Joseph McMahon when McMahon called at his office. On September 12, 1988 (settlement date), purchased 100,000 shares of a company named "Chromalux Corporation" (hereinafter "Chromalux") for $2,270. On October 17, 1988, purchased 50,000 shares of a company named "Immune Response, Inc." (hereinafter "Immune Response") for $2,645. On October 28, 1988 (settlement date), purchased 100,000 shares of a company names "Genexus International, Inc." (hereinafter "Genexus") for $3,020.

purchased an additional 500,000 shares of Genexus on November 10, 1988 (settlement date), for $15,020.

On October 13, 1989 (settlement date), Mr. sold his shares of Chromalux for a net total of $60. Also on October 13, 1989 (settlement date), Mr. sold his shares of Immune Response for a net total of $440. Mr. subsequently received an account statement dated June 28, 1991 from RAF Financial Corporation ("RAF"), which had been the clearing broker for Power. The statement indicated that 600,000 shares of Genexus had been reduced to 86 shares in a reverse split. The statement indicated that RAF was charging Mr. $50, presumably for holding his shares of Genexus. However, the statement did not reflect any amount for Mr. Genexus shares, stating only "value not transmitted." A separate part of the account statement called "Financial Summary" showed zero next to the words "EST. MARKET VALUE." Mr. testified that he believed his Genexus shares were worthless.

Mr. testified that at the time McMahon sold him the shares of Chromalux, McMahon did state that penny stocks carry higher risks than other stocks. However, McMahon also said that he could get a "20 to 30 percent gain in less than three months." recommended the Chromalux purchase, explaining that the company was "into high density TVs." McMahon did not disclose any facts regarding Chromalux's financial situation. testified that "everything was positive from Mr.

McMahon." For the Immune Response recommendation, McMahon again said that he could get a 25 to 30 percent profit within three months. McMahon said that Immune Response had a new vaccine, an anti-tumor drug that could make a lot of money. Mr. McMahon did not discuss any risks. When recommending Genexus, McMahon said the company was affiliated with the University of Utah and that it was a good long term investment. said that McMahon seemed "in a rush" when he recommended the 500,000 shares purchase of Genexus in November 1988.

Both Mr. and Mr. testified that each purchase and sale in 1988 was at the recommendation of the Power salesmen, Popoli and McMahon. Both investors seemed to rely totally on what they were told.

The State offered various documents pertaining to the securities at issue: AST, Daine, Chromalux, Immune Response, and Genexus. Generally, these exhibits were registration statements that were generated in the same year (1988) as that of the sales to the two Delaware investors.

The AST Group, Inc., a Delaware corporation, was formed on December 11, 1987, as part of a reorganization to change the domicile of its predecessor corporation, Zodiac Resources Inc. ("Zodiac"). Zodiac was formed as a Utah corporation on January 26, 1984. In 1985 Zodiac sold 1.5 million shares of common stock in a public offering at one cent per share. Zodiac had no significant revenues or expenses, and its principal asset as of June 1988 was cash in the amount of $6000. On June 20, 1988,

Zodiac acquired all the common stock of AST Vending, Inc. ("AST Vending"), whereby AST Vending became a subsidiary of Zodiac, whose name was changed to AST Group, Inc. The shareholders of AST Vending received 600 million shares of common stock of Zodiac in exchange for their AST Vending shares.

AST Vending was organized on May 9, 1988, only one month prior to the acquisition by Zodiac. The three largest shareholders of AST Vending were Edward Bevilacqua, II, Melvin Wyman, and Walter Goodwin. At the time of the Zodiac-AST Vending share exchange, Mr. Bevilacqua, II, received 467,400,400 shares of Zodiac (which became AST Group, Inc.), while Wyman received 80,000,000 shares and Goodwin received 45,000,000 shares.

AST Vending had apparently been little more than a shell corporation at the time of its formation on May 9, 1988. On May 20, 1988, it entered into a lease/buy agreement with San Diego Valley Vending, Inc. ("Valley Vending"), a California corporation that owned approximately 800 vending machines in 300 locations. The purchase price was $928,793, paid by cash of $160,000, debt obligations totaling $618,793 and the assumption of $150,000 in payables to vendors. A second, smaller purchase from Valley Vending, Inc. was accomplished through the issuance of $187,882 in additional debt obligations.

Valley Vending itself had substantial business operations but was not very profitable. Although it had gross sales of several million dollars annually, for the fiscal year ended September 30, 1986, its net income was only $52,814. In the next

fiscal year, ending September 30, 1987, its net income dropped to $7540. For the six months ending March 31, 1988, its net income was $3908. This was the business operation acquired by AST Vending and Zodiac, which became The AST Group, Inc., and it was the only business operation of AST.

Despite the meager earnings, AST had one billion shares issued and outstanding as of August 31, 1988, and it was then issuing 320 million warrants for 320 million additional shares. Despite the huge number of shares, its net tangible book value was only $41,903, approximately $.00004 per share. Six hundred million shares were in the hands of promoters who had paid an aggregate consideration of $54,517. The company's debt was in excess of one million dollars.

This was the company that Popoli recommended to as "a winner." Popoli said that he could easily get in and out of the stock at a profit. Of course, since the stock price was grossly inflated Mr. Popoli had no way of knowing that he could obtain a profit for Mr. unless Popoli knew the market was being manipulated.[1] (I make no findings on that point).

The second security Mr. purchased was 30,000 shares of common stock of Daine Industries, Inc. Daine was a "blind pool"

---

[1] I say the stock price was grossly inflated because Redacted purchased it at $.016 per share. At this price, the one billion shares outstanding would have had an aggregate value of $16,000,000. That price seems excessive for a company with a net tangible book value of $41,903 and a net income of $11,448 in the prior 18 months.

incorporated on September 24, 1987. It had no business operations or operating history, and its investors were utterly dependent on management's discretion as to the use of investment capital. A public offering was undertaken in February 1988, whereby 50 million units (each unit consisting of one common stock share and two warrants) were offered at one penny per unit. Prior to the offering, the company had 150,000,000 shares of common stock outstanding with a net tangible book value of $15,750, or $.000105 per share.

The principal shareholders of Daine were the Seidenfeld family--Arthur and his parents, Anne and Samuel--who together owned 143,000,000 of the 150,000,000 shares outstanding prior to the public offering. The Seidenfelds also controlled several other corporations including Modern Technology Corporation ("Modern Technology") and Davin Enterprises, Inc. ("Davin"). Upon the completion of the public offering, Daine was committed to pay Modern Technology a monthly fee between one thousand and two thousand dollars for the services of its officers--the Seidenfeld family.

Daine had no employees other than its officers, the Seidenfelds. Even the Seidenfelds were not full-time employees. The prospectus stated that" [a]ll officers are engaged in other businesses which they may regard as their full-time occupation." (S-16 at 19). The February 1, 1988 prospectus also stated that "it should be anticipated that the officers and directors may grant priority to their full-time positions rather than to the

Company." (S-16 at 7). Arthur Seidenfeld, the president and principal promoter of Daine, was expected to spend 15% of his time on the day-to-day affairs of the company. (S-16 at 18).

Since Arthur Seidenfeld also controlled Davin Enterprises, Inc., another blind pool, it was anticipated that conflicts of interest might arise should a business opportunity emerge. The prospectus frankly addressed this issue:

> If a particular business opportunity is presented to management who is also involved in another blind pool, such management will decide which company will receive that opportunity. Such decision may be made because of the person's greater financial state in one blind pool versus another, or for any other reason.

(S-16 at 7).

Since Daine had no operations and had only an intention to look for an investment opportunity sometime in the indefinite future, investors in Daine were obviously dependent on the experience and expertise of the promoter, Arthur Seidenfeld. Again the prospectus was candid: "Notwithstanding such dependence, management of the Company has only limited previous experience in seeking, investigating and acquiring or entering into business opportunities." (S-16 at 6). At the time of the February 1988 offering, Daine's management was not even investigating any business opportunities. (S-16 at 9). The prospectus suggested that Daine might use the proceeds of its public offering to make an unsecured loan to another company. (S-16 at 13).

In its Form 10-K annual report filed with the Securities and Exchange Commission ("SEC") on September 23, 1988, Daine reported

that it had 230,992,600 shares of common stock outstanding. As of June 30, 1988, the end of its fiscal year, Daine owned no property and had generated a net loss of $9,666 attributable to general and administrative expenses. Since it had sold 50,000,000 units in its public offering and had raised further capital through the exercise of warrants, Daine had current assets of slightly more than one million dollars. It still had not identified a business opportunity or engaged in any business operations. Strangely, the company reported that on August 22, 1988, the bid price for its common stock was $.04 per share, giving the company an aggregate market value of $9,239,704. As with the bid price of AST stock, Daine was grossly overvalued.

On August 18, 1988 (trade date), Mr. bought 30,000 shares of Daine at $.09 per share. (S-13A). At this price, the market value of the company was valued in excess of twenty million dollars. This value, and the price paid by Mr. , bore no relationship to the earnings or net tangible book value of the company. It is difficult to understand why any honest, competent stockbroker or brokerage firm would recommend this security at that price.

The three securities that Mr. purchased at Mr. McMahon's recommendation were Chromalux, Immune Response, and Genexus. According to a Form 10-k annual report for its fiscal year ended December 31, 1987, Chromalux fabricates and markets large screen video/computer display projectors. Its predecessor company was First Equity Investments, a blind pool that sold

1,845,167 shares of common stock in a public offering and then acquired the assets of Display International, Inc., a company with actual business operations. Approximately 100 units of the display projector had been built. Twenty one units were sold in fiscal year 1987. The company had 8,488,000 shares of stock outstanding as of March 30, 1988. The president of Chromalux was Arthur Tucker, who along with his wife owned 56% of the common stock. On December 31, 1987, the company had $4320 in net working capital, $476,156 in total debt, and $98,422 in total shareholders' equity. From its inception (July 15, 1985) to March 31, 1986, the company suffered a net loss of $158,484, and for the year April 1, 1986 to March 31, 1987, it suffered an additional loss of $72,077.

Mr. purchased 30,000 shares of Chromalux on the basis of McMahon's recommendation and assertion that would obtain a 20 to 30 percent profit within three months. Such a representation by a broker trying to make a sale is improper even with respect to a so-called "blue chip" corporation, but with respect to a company that has never made a profit such conduct is egregious.

Immune Response was a company seeking to develop and market products for the treatment of the human immunodeficiency virus ("HIV"), which may lead to the acquired immunodeficiency syndrome ("AIDS"). Despite a partnership with a subsidiary of Rorer Group, Inc., and the presence of certain well respected scientists on its Scientific Advisory Board, the company had no

patented products and had substantial losses every year since its inception. For the year ended December 31, 1987, it lost $993,127.

Mr. testified that McMahon recommended the purchase of Immune Response, telling that he could make a lot of money, 25 to 30 percent in three months. No risks were disclosed, and it was not mentioned that no products were ready for sale or that Food and Drug Administration approval had not been obtained as to the sale of any products.

Genexus International, Inc., was established as a business hoping to nurture new businesses at something called a "Genexus Innovation Center." Genexus planned to create a number of "Innovation Centers." The predecessor of Genexus was originally incorporated in 1985 under the name of "Leibra, Inc." In 1986 the company changed its name to "Leitech, Inc." and changed its domicile from Utah to Nevada. In 1987 there was a share exchange and the company became "Genexus International, Inc., the parent of "Genexus Inc." and several other subsidiaries. Unfortunately, the corporate reorganizations and name changes did not help the company make a profit, as it suffered a net loss of $251,501 for the period from its inception on December 8, 1986 through December 31, 1987. Total revenues for that period were $123,409. The operations of the subsidiaries were not profitable either, as Biological International, Inc., for example, with little or no operations suffered a net loss of $3609 for the year ended December 31, 1987. In its audit report, Arthur Young & Company

found the continued existence of Genexus contingent upon: (a) obtaining sufficient financing to fund future operations, (b) achieving profitable operations, (c) successful development and marketing by unconsolidated subsidiaries of their technologies and products.

Mr. testified that McMahon recommended Genexus as a "good long term investment." As with the other recommendations, no risks were disclosed.

As a result of their investments, Mr. lost $2270 and Mr. lost $22,455. They lost virtually all their money on every investment, each of which was highly recommended.

The brokerage firm, Power Securities Corporation, has been the subject of denial or revocation orders in the following jurisdictions: Massachusetts (S-2), New Jersey (S-3), Oklahoma (S-4), Nevada (S-5), New Mexico (S-6), and Pennsylvania (S-7). These orders show that Power has committed many registration violations, has been the subject of a securities-related injunction, and has submitted incomplete or misleading registration application filings. These grounds constitute the basis for a license suspension or revocation under 6 Del. C. Section 7316(a)(6).

I accept the testimony of the two investors, who seemed sincere and credible. I do not believe Mr. McMahon's assertions in his affidavit (submitted before the hearing) that he did not mislead his client, . The other respondents failed

to appear at the hearing and provided no evidence to rebut the investors' testimony.

My conclusions are the following:

1. Respondent Darin Paul Popoli has committed two willful violations of the 6 Del. C. Section 7303(2). He willfully misrepresented the prospects for a profit on the securities that he sold to . Popoli's statement in connection with the sale of AST that he could easily get Mr. in and out of the security at a profit constituted a material misrepresentation of fact in connection with the sale of a security. Optimistic forecasts of financial success are deemed to be statements of fact.

Popoli also willfully omitted to state material facts that should have been disclosed in order to make his other statements not misleading. Although he did not have to read the prospectus to Mr. , Popoli was required to give a balanced presentation of the investment's characteristics. At a minimum, he should have disclosed with respect to AST the limited public market (which meant that might have been unable to find a buyer for the security), the risk that might lose his entire investment principal, and that the company had a tiny book value and limited earnings with respect to the huge number of shares outstanding.

Popoli also failed to disclose any risks in connection with the sale of Daine. As with AST, Popoli was required to disclose the limited public market for the security and the

risk that could lose his entire investment. Additionally, Popoli should have disclosed that Daine had no business operations and had never earned any positive income.

Thus, both the sale of shares of AST and the sale of shares of Daine were fraudulent.

2. Respondent Joseph M. McMahon has committed four willful violations of 6 Del. C. section 7303(2). McMahon willfully misrepresented the prospects for a profit on purchases of Chromalux and Immune Response securities. McMahon told that he could obtain a 20 to 30 percent profit within three months. As noted above, this sort of optimistic forecast may be deemed a material fact.

Additionally, McMahon willfully omitted material facts that should been disclosed to make his other statements not misleading. These willful omissions occurred with respect to all four sales: Chromalux, Immune Response, and Genexus (two trades). In each case, the underlying companies lacked a history of profitable operations, there was a limited market for the securities, and the investor risked losing his entire principal. McMahon's recommendation of each security without mentioning these important facts was thus misleading.

3. Respondent Power Securities Corporation has committed nine willful violations of the Delaware Securities Act: six violations of 6 Del. C. section 7303(2) through its agents

Popoli and McMahon, two violations of 6 Del. C. section 7316(a)(10) for failing to supervise reasonably its agents Popoli and McMahon, and one violation of 6 Del. C. 7316(a)(6) for its denial and revocation orders in other jurisdictions, which orders will be aggregated as one violation here for convenience.

Although a broker-dealer is not strictly liable for its agent's conduct, where multiple violations show a pattern of conduct by the agents that pattern may be attributed to a company's management. The sale of penny stocks, often involving worthless or nearly worthless securities, requires particular vigilance by management to ensure that the sales practices are scrupulous. Power did not meet its obligations in any of its transactions with the two Delaware investors.

4. Respondent Richard T. Marchese was the controlling shareholder of Power as well as being a registered broker-dealer agent of Power in this State. As a controlling person of the firm he bears responsibility for its conduct and is liable for its violations. Additionally, Marchese was denied agent registration in the Commonwealth of Massachusetts (S-2), a violation of 6 Del. C. section 7316(a)(6).

I find that it is in the public interest that the registrations of respondents Darin Paul Popoli, Joseph M. McMahon, Richard T. Marchese, and Power Securities

Corporation be revoked. These sanctions shall become effective on the 61st day after the date of this Opinion and Order unless stayed by an order of the Delaware Court of Chancery.

SO ORDERED.

Richard W. Hubbard
Securities Commissioner

Date: January 7, 1992