

ADMINISTRATIVE PROCEEDING
FILE NO. 3-6802

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
RUSSELL ANTHONY PHIPPS :
:

INITIAL DECISION

May 31, 1988
Washington, D.C.

David J. Markun
Administrative Law Judge

I. THE PROCEEDING

This public proceeding was instituted by order of the Commission dated February 26, 1987 ("Order") pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") ^{1/} to determine: (a) whether the Respondent, Russell Anthony Phipps ("Respondent" or "Phipps"), was, as alleged by the Division of Enforcement ("Division") in the Order, found guilty, on August 14, 1986, upon his plea of guilty, of the commission of various federal felonies, namely, mail fraud, interstate transportation of property taken by fraud, and securities fraud, arising out of the conduct of the business of a broker and involving misappropriation of customer funds; (b) whether Phipps' conduct leading to his alleged guilty pleas referred to in paragraph (a) above constituted willful violations by him of the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") (15 U.S.C. §77q(a)) and Section 10(b) of the Exchange Act (15 U.S.C. §78j(b)) and Rule 10b-5 thereunder (17 CFR §240.10b-5); (c) whether Respondent has any defense to the allegations; and (d) the remedial action, if any, that may be appropriate in the public interest under Section 15(b)(6) of the Exchange Act.

1/ 15 U.S.C. §§78o(b), 78s(h).

The evidentiary hearing was held on September 23, 1987, at the Federal Prison Camp at Boron, California. Respondent Phipps appeared pro se.

The parties have filed proposed findings of fact, conclusions of law, and supporting briefs. The findings and conclusions herein are based upon the record. No witnesses were called. The Division relies for its proposed findings upon the entire record, including but not limited to the Order, the transcript of the hearing, and the following certified Division exhibits:

Exhibit 1

Federal grand jury's indictment alleging violations of: 18 U.S.C. §1341, Mail Fraud; 18 U.S.C. §2314, Interstate Transportation of Property Taken by Fraud; 15 U.S.C. §77q(a) and §77x, Securities Fraud; and 18 U.S.C. §2(b), Causing an Act to be Done, Filed on February 11, 1986, U.S. v. Russell Anthony Phipps, CR 86-132-JSL, (C.D. Cal.).

Exhibit 2(a)

Reporter's Transcript of Proceedings, plea of guilty entered on August 14, 1986, U.S. v. Russell A. Phipps, CR 86-132-JSL (C.D. Cal.).

Exhibit 2(b)

Declaration of Kathleen J. Haaland, respecting Exhibit 2(a).

Exhibit 3

Judgment and Probation/Commitment Order of Russell Phipps, CR 86-132-JSL (C.D. Cal.), entered October 17, 1986, finding Phipps has been convicted of: mail fraud in violation of Title 18, United States Code, Section 1341; Interstate

transportation of property taken by fraud and causing an act to be done in violation of Title 18, United States Code, Section 2314 and 2(b) respectively; and securities fraud in violation of Title 15, United States Code, Sections 77q(a) and 77x, and causing an act to be done in violation of Title 18, United States Code, Section 2(b).

The standard of proof applied is that requiring proof by a preponderance of the evidence. ^{2/}

II. FINDINGS OF FACT AND LAW

Respondent Phipps, 45, was a registered representative associated with Newhard, Cook & Company (Newhard") from October 1979 to December 1983, and Smith Barney, Harris Upham & Company ("Smith Barney") from December 1983 to May 1984. Both firms are registered broker-dealers.

The record establishes that on August 14, 1986, in the United States District Court for the Central District of California, Phipps pleaded guilty to, among other things, four counts of securities fraud for knowing and willful violations of Section 17(a) of the Securities Act of 1933, as amended ("Securities Act"), and eight counts of mail fraud for knowing and willful violations of 18 U.S.C. §1341.

As a result of his criminal convictions for knowing and willful violations of Section 17(a) of the Securities

2/ Steadman v. S.E.C., 450 U.S. 91, 101 S.Ct. 999 (1981).

Act and 18 U.S.C. §1341, Phipps is subject to the imposition of remedial sanctions pursuant to Section 15(b)(6) of the Exchange Act. In pertinent part, Section 15(b)(6) empowers the Commission to bar or impose lesser sanctions upon any persons associated with a broker, where such person has been convicted of any offense specified in Section 15(b)(4)(B) or has engaged in conduct described in Section 15(b)(4)(D) of the Exchange Act. Section 15(b)(4)(B) states in part that the Commission can bar or impose lesser sanctions upon an associated person, where such person ". . . has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony * * * meanor which the Commission finds:

- "(ii) arises out of the conduct of the business of a broker [or] . . . ;
- (iii) involves the larceny, theft . . . fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or
- (iv) involves the violation of section 1341 . . . of title 18, United States Code."

Section 15(b)(4)(D) provides that the Commission may bar or impose lesser' sanctions upon an associated person, where such person ". . . has willfully violated any provision of the Securities Act of 1933 [or] . . . [the Exchange Act]. . . ."

As already noted, Phipps was convicted among other things of eight counts of mail fraud under 18 U.S.C. §1341 and four counts of securities fraud in violation of Section 17(a) of the Securities Act, 15 U.S.C. §77q(a). The record discloses that his criminal activities included, among other things, misappropriation of client funds and delivery to clients by use of the mails of fraudulent account statements to conceal the misappropriation. It also shows his misconduct arose out of the conduct of the business of a broker. The Commission is, therefore, empowered to bar Phipps from association with a broker pursuant to Sections 15(b)(4)(B) and 15(b)(4)(D) of the Exchange Act if it finds that to do so would be in the public interest.

A further basis for imposition of sanctions against Respondent lies in the circumstance that certain allegations contained in the indictment to which Phipps pleaded guilty established willful violations, charged in the Order, of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Thus, Phipps admitted certain allegations contained in the indictment, establishing that during the period from approximately December 1980 through January 1984, in connection with the offer or sale of stocks,

bonds, and other investments, by use of the mails or other jurisdictional means, he knowingly and intentionally engaged in fraudulent misconduct, including:

- (a) making false statements concerning the use of customers' funds;
- (b) providing fraudulent account statements to customers; and
- (c) diverting customers' funds for his own personal use.

Phipps acted with scienter, the mental state required by Aaron v. SEC, 446 U.S. 680, 701 (1980) to establish a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As alleged in the federal grand jury's indictment, and as admitted by his guilty plea, Phipps knowingly and intentionally devised a scheme to defraud whereby he swindled clients out of money that he falsely claimed he was placing into various types of securities investments.

As previously noted, Section 15(b)(4)(D) empowers the Commission to impose sanctions upon a person associated with a broker where such person has willfully violated any provision of the Exchange Act. Phipps, while associated successively with the brokers Newhard and Smith Barney, used the jurisdictional means to willfully violate the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

III. THE PUBLIC INTEREST

In determining what sanction, if any, it is appropriate to apply in the public interest, it is necessary for the Commission, among other factors, to ". . . weigh the effect of . . . action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally.^{3/} Besides serving as a general deterrent to dissuade others from the type of misconduct a respondent may be guilty of, a sanction must be designed to protect the public interest by providing reasonable assurance that the particular respondent being sanctioned will not himself commit the same or similar violations in the future.^{4/} In considering the likelihood or probability of future violations by a defendant, in civil injunctive litigation, the courts assess the totality of the circumstances surrounding the defendant and his

3/ Arthur Lipper Corporation, Securities Exchange Act Release No. 11773 (October 24, 1975) 8 SEC DOCKET 273, 281. Although the reviewing Court in Arthur Lipper Corp. v. S.E.C., 547 F.2d 171, 184-5 (2d Cir. 1976) reduced the Commission's sanctions on its view of the facts, it recognized that deterrence of others from violation is a legitimate purpose in the imposition of sanctions.

4/ In the Matter of Lester Kuznetz, Exchange Act Release No. 23525, August 12, 1986 (A.P. 3-6356), 36 SEC DOCKET 466, 470.

violation, looking to factors such as the degree of scienter involved, the isolated or recurrent nature of the violation, defendant's recognition of, or failure to recognize, the wrongful nature of his conduct, the sincerity of his assurances against future violations, and the likelihood, because of the defendant's professional occupation, that future violations might occur.^{5/}

The fraudulent scheme to which Phipps pleaded guilty was indeed an egregious one, as the Division strongly contends.

Beginning in or before December 1980 and continuing until at least January 1984, Phipps knowingly and intentionally devised and carried out a scheme to defraud and to obtain money from his clients by means of false and fraudulent pretenses, representations, and promises. Through his scheme, Phipps swindled his clients who sought his investment services out of money that he falsely claimed he was placing into various types of securities investments.

To accomplish his fraudulent purpose, Phipps engaged in, and caused other persons to engage in various acts, practices, misrepresentations, and deceptions that

^{5/} Cf. S.E.C. v. Murphy, 626 F.2d 633, 655 (9th Cir. 1980), and cases there cited.

were designed to and that enabled Phipps: (a) to induce clients seeking his investment services to pay him at least \$471,000 to invest in stocks, bonds, and various other types of investments; (b) to deceive these clients into believing that the money they had entrusted him with was in fact being invested in the stocks, bonds, and other investments as represented by Phipps; (c) to divert and misappropriate for unauthorized uses approximately \$414,000 or more of the money entrusted to Phipps; and (c) to perpetuate and conceal his fraudulent scheme by making false representations to clients regarding the status of their investments and through the use of other misrepresentations, deceptions, and "lulling" devices.

Before diverting clients' money to unauthorized uses, Phipps generally engaged in various activities to develop a relationship of trust with his clients. For example, in some instances he initially invested his clients' money in legitimate investments and reported to them that their investments were doing well. In one instance, Phipps referred a client to a competitor brokerage house to sell her stock because the competitor would charge a lower commission, then induced this client to entrust a substantial portion of the proceeds with him, purportedly for the purpose of reinvestment.

Phipps also used his association with Newhard to assist him in gaining the trust of his clients. Some clients were sent statements from Newhard confirming that they had an account with that company and that Phipps had invested some of their money as represented.

On occasion Respondent gave fraudulent statements to clients in which he fabricated information about the investment of their money.

After gaining the confidence of his clients, Phipps ultimately failed to invest some or all of their money as represented. Phipps instead diverted substantial portions of the money he collected to uses not authorized or known to his clients, including the conversion of investors' sums to his own personal use.

After inducing clients to entrust him with their money for purposes of investment, Phipps used and engaged in, and caused others to use and engage in, various materially false and deceptive practices and acts in order to lull and deceive clients into a false sense of security and into believing that the money they had entrusted to Phipps was in fact being invested as represented. Such false and deceptive practices and acts were also designed to prevent clients from making complaints and inquiries to governmental agencies and in some cases to induce them to entrust Phipps with

additional money for purported investments. These "lulling" activities were carried out in various ways with particular clients. They included, but were not limited to: (a) the making of false claims to clients that their money had been invested as represented and that the investment was doing well; (b) the payment in some instances of pretended earnings and the return in other instances of some money that had purportedly been invested, (c) the delivery in some instances of account statements reflecting that some money had been legitimately invested; (d) the delivery in other instances of statements reflecting false information regarding the status of clients' investments; and (e) the making of various unfounded excuses regarding problems relating to the payment of earnings and the repayment of money owed to clients.

The record discloses that the guilty plea of the Respondent was accepted after the trial before a jury was fairly well advanced. The U.S. District Court Judge sentenced Respondent Phipps to 12 years imprisonment and ordered him to make restitution of \$432,000 to his former clients. This sentence indicates that the trial Judge considered the scheme perpetrated by the defendant involved very serious violations. The record in this proceeding does not disclose any indication that

Respondent has commenced any restitution nor does it appear that he will at any time soon be in a position to do so.

The fact that Respondent conducted this very serious fraud, one that was carried out with scienter, over a period of about four years indicates, as the Division urges, that this was not an isolated deviation and that future violations would likely occur if the opportunity presented itself to Respondent.

As previously noted, Respondent chose not to testify in this proceeding.

In his brief Respondent does not deny that he pleaded guilty to criminal charges found herein. He makes a number of technical arguments that are without merit. He cites his lack of prior criminal convictions. He contends his difficulties developed because he overestimated his capacities as a businessman and because of his then impending breakup of a 21-year marriage.

Respondent endeavors to argue the "facts" of the case that led to his guilty plea but, since, as previously noted, he chose not to testify or present other evidence, there is no factual basis in the record to support his arguments even if such evidence, had it been offered, could have been received in this proceeding in whole or in part.

What the Commission said in In the Matter of Lester Kuznetz, (cited in footnote 4 above), at 36 SEC DOCKET 470, applies with equal force to Respondent Phipps on the basis of the record in this proceeding:

[Respondent's] misconduct was egregious. * * * he demonstrated a total lack of sensitivity to the obligation of fair dealing borne by those who engage in the securities business. In an industry that presents so many opportunities for abuse and overreaching and depends so heavily on the integrity of its participants, such behavior cannot be countenanced. [Respondent's] actions support his permanent exclusion from the securities business.

We recognize the serious effect of the sanction we are imposing. However, the sanction is designed to protect the public interest by preventing [Respondent] from again engaging in such fraudulent activity. At the same time, it serves the purpose of general deterrence and should act as a warning to any other participant in the securities industry who might be tempted to engage in similar misconduct. [Footnote omitted] In light of the circumstances, we are convinced that the public interest requires [Respondent's] unqualified bar from association with any broker-dealer.

Phipps does not suggest what sanction might be appropriate. His arguments in denial or in mitigation are not supported by evidence (as already noted above, he chose not to testify or offer other evidence), and I do not find them persuasive.

The Division urges strongly that only a permanent bar will adequately protect the public from a recurrence of misconduct on Respondent's part and also deter other potential violators. I concur in the view that a

permanent bar, both for remedial and deterrent purposes, is appropriate and necessary in the public interest.

IV. ORDER

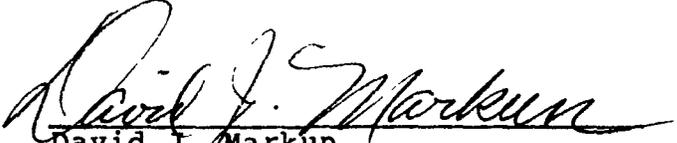
Accordingly, IT IS ORDERED that Respondent Russell Anthony Phipps is hereby barred from association with a broker or dealer. ^{6/}

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR §201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each

^{6/} The Division urges that in addition to being barred from association with a broker or dealer Phipps should also be barred permanently from association with any investment adviser, investment company, or municipal securities dealer. It argues that since the Commission has comparable authority to sanction a person committing a fraud such as found here if the proceeding had been brought under the Investment Advisers Act of 1940, the Investment Company Act of 1940, or under Section 15B(c)(4) of the Exchange Act, dealing with municipal securities dealers, the Commission has authority to bar Phipps under all of those statutory provisions in this proceeding. Unfortunately for the Division's argument, Section 15B(c)(4) of the Exchange Act is restricted to "any person associated, or seeking to become associated with, a municipal securities dealer" and the comparable provisions in the 1940 Acts are comparably restricted. Section 15(b)(6) of the Exchange Act, under which this proceeding was brought, is limited to persons "associated, or seeking to become associated, with a broker or dealer. . . ." Accordingly, the Division's argument in this respect must fail, however desirable and practical the result they seek might be in particular cases.

party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. ^{7/}


David J. Markun
Administrative Law Judge

Washington, D.C.
May 31, 1988

7/ All proposed findings, conclusions and supporting arguments have been considered. To the extent that the proposed findings and conclusions submitted are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues presented.