

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of :
: INITIAL DECISION
DAXOR CORPORATION : August 31, 2011

APPEARANCES: Richard Primoff and Barry Kamar, for the Division of Enforcement,
Securities and Exchange Commission.

Bruce Schneider, Hannah Yu, and Sandra Rampersaud of Stroock &
Stroock & Lavan LLP, for Respondent Daxor Corporation.

BEFORE: Robert G. Mahony, Administrative Law Judge

I. INTRODUCTION

The Securities and Exchange Commission (Commission) issued its Order Instituting Cease-and-Desist Proceedings (OIP) against Daxor Corporation (Respondent or Daxor) on September 17, 2010, pursuant to Section 9(f) of the Investment Company Act of 1940 (Investment Company Act or Act).

The OIP alleges that Daxor, a public company claiming to be a medical device manufacturing company, is an investment company as defined by Section 3(a)(1)(C) of the Investment Company Act, because it engages in the business of investing and trading in securities and 40% or more of its total assets (other than Government securities and cash items) are “investment securities.”¹ Although its principal product has been available for sale since 1999, Daxor has never realized an operating profit or even significant operating revenue from that product. Instead, Daxor has sustained itself on the considerable income generated by its large portfolio of investment securities, which, as of June 30, 2010, had a reported market value

¹ “Investment Securities” refers to “all securities except (A) government securities, (B) securities issued by employees’ securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which (i) are not investment companies, and (ii) are not relying on the exception of investment company in paragraph (1) or (7) of subsection (c) of this section.” 15 U.S.C. § 80a-3(a)(2).

of approximately \$49 million and constituted 96% of Daxor's assets. Over the last five-and-one-half years, Daxor's investment securities constituted more than 90% of its assets and its net investment income exceeded 750% of its gross operating revenues.

The OIP further alleges that Daxor's securities portfolio is invested entirely in equities and actively traded. Daxor also trades options and maintains short positions of up to 15% of its portfolio value, and it finances its investment activity with margin loans that on occasion have amounted to as much as 18% of the total value of its portfolio. Finally, the OIP alleges that Daxor has never registered with the Commission as an investment company and is not exempt from the requirements of the Investment Company Act; therefore, it is in violation of Section 7(a) of the Investment Company Act.²

A hearing was held in New York, New York, from March 7 to March 9, 2011. The Division of Enforcement (Division) called two witnesses. Respondent called seven witnesses. Numerous exhibits were admitted into evidence. The Division filed a Post-Hearing Memorandum of Law and a Post-Hearing Reply Memorandum of Law. Daxor filed a Post-Trial Brief and a Post-Hearing Reply Brief.³

In its post-hearing brief, Daxor contends that, while it may fit the quantitative definition of an investment company under the Act, its activities and essential character are those of a medical instrument company. (Daxor Br. at 1.) Daxor explains that it has faced significant challenges in successfully selling its principal medical product (the BVA-100, a blood volume analyzer), but it is working to overcome those challenges. Failure to achieve operating profit, Daxor argues, does not alter its essential character and transform it into an investment company. (Daxor Br. at 1.)

II. FINDINGS OF FACT

The findings and conclusions herein are based on the hearing record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91 (1981).

² Section 7(a) provides, in pertinent part: "No investment company . . . unless registered under Section (8), shall directly or indirectly – (1) offer for sale . . . by use of the mails or any means or instrumentality of interstate commerce, any security . . . whether the issuer of such security is such investment company or another person . . . ; (2) purchase . . . any security . . . whether the issuer of such security is such investment company or another person; . . . (4) engage in any business in interstate commerce" 15 U.S.C. § 80a-7(a).

³ Citations to the transcript of the hearing are noted as "(Tr. ____)". Citations to Daxor's answer are noted as "(Answer at ____)". Citations to exhibits offered by the Division and Respondent are noted as "(Div. Ex. ____)" and "(Resp. Ex. ____)," respectively. The Division's post-hearing memorandum is noted as "(Div. Mem. at ____)" and Daxor's post-hearing brief is noted as "(Daxor Br. at ____)". The Division's reply to Respondent's post-hearing brief is noted as "(Div. Reply Mem. at ____)" and Daxor's reply to Division's post-hearing memorandum is noted as "(Daxor Reply Br. at ____)".

All arguments, proposed findings, and conclusions set forth by the parties were considered and only those consistent with this Initial Decision are accepted.

A. Daxor

Daxor is a publicly-traded company, headquartered in New York. (Answer at 2.) Founded in 1970, Daxor initially operated a blood and semen bank.⁴ (Answer at 2; Tr. 170-71.) Daxor raised \$2 million in a 1971 initial public offering and \$7.2 million through a second registered offering in 1985. (Answer at 2-3.) Daxor has approximately forty employees and is managed by Dr. Joseph Feldschuh (Feldschuh),⁵ its president, chief executive officer, chief scientific officer, and chairman of the board. (Answer at 2, 4; Tr. 165, 362; Div. Ex. 118 at 71.) Most of Daxor's stock is closely held by insiders. (Tr. 540-41.) As of February 3, 2011, Feldschuh owned over 72% of Daxor's shares, individual investors owned approximately 15%, and institutional investors owned approximately 9%. (Tr. 541; Div. Ex. 160.)

B. BVA-100

In the late 1970's, Daxor began developing the BVA-100, a product that, for the first time, automatically and accurately measures human blood volume. (Tr. 167.) Accurate knowledge of a patient's blood volume is important in clinical management and several critical settings, including post surgery, blood loss, and in the treatment of heart or kidney failure. (Tr. 155-57, 306.) Despite its clinical importance, directly measuring blood volume (without the BVA-100) is a protracted and complex process and, therefore, blood volume was traditionally measured indirectly, by testing other blood characteristics and deducing the patient's blood volume. (Tr. 154-55, 306-07.) However, although simpler, these tests are inaccurate. (Tr. 155.) The advantage of the BVA-100 is that it measures blood volume directly, accurately, and quickly. (Tr. 167, 184.)

The Food and Drug Administration (FDA) approved the BVA-100 in 1999.⁶ (Tr. 169-70, 176-77; Resp. Ex. 25.) Daxor then began marketing the BVA-100 and offered free BVA-100s

⁴ Daxor continues to offer these services through its wholly-owned subsidiary, Scientific Medical Systems. (Answer at 1.)

⁵ Feldschuh, a practicing physician since 1961, graduated from Columbia College and New York University Medical Center. (Tr. 153.) He was a resident at Montefiore Hospital, where he developed an interest in blood volume measurement, which led to a fellowship with the New York Heart Association at Columbia. (Tr. 153, 158-63.) He is board certified in cardiology and internal medicine and board eligible in endocrinology. (Tr. 153.) Feldschuh taught medicine at New York Medical College and Cornell. (Tr. 154.) He publishes articles, conducts research, and presents the results at conferences. (Tr. 158-66; Resp. Ex. 228, 237, 301, 308, 309, 489, 534.)

⁶ BVA-100 development was delayed because the manufacturer of its required isotope, albumin 131, did not receive FDA approval until 1999. (Tr. 168-70.)

and its isotope testing kits to local hospitals on a trial basis. (Tr. 177.) At the time, Daxor believed the potential market for BVA-100 was \$450 million, assuming it could sell the BVA-100 to 6,000 hospitals for \$75,000 per unit. (Tr. 324-25.) Including the sales of the test kits, this was potentially a billion dollar industry. (Tr. 325.) However, because the BVA-100 and test kits were significantly more expensive than the alternative proxy tests, hospital administrators did not want to purchase them, even if doctors did. (Id.)

C. Sales Effort

By 2002, Feldschuh realized that to be commercially successful, Daxor needed to more aggressively market the BVA-100. (Tr. 180.) Daxor hired John Reyes-Guerra (Reyes-Guerra) to lead a sales team. (Tr. 180-181.) Daxor also hired seven sales representatives with medical equipment sales experience. (Tr. 323-24, 336, 347.) Reyes-Guerra received sales literature, and has attended twenty to thirty trade shows and medical conferences annually. (Tr. 336-42; Resp. Ex. 42, 159, 162, 164, 166.)

Sales representatives contacted laboratory directors, directors of nuclear medicine, physicians who specialize in heart failure, as well as hospitals and diagnostic centers.⁷ (Tr. 324, 335-36.) They educated physicians and others on the benefits of blood volume measurement and the clinical uses of the BVA-100. (Tr. 324, 339.) In order to educate clinicians and advance the sale of the BVA-100, sales representatives were required to visit at least three facilities per day and meet with five people within each facility. (Tr. 346.) Additionally, they called and emailed between 300 to 600 people per month. (Id.) In total, the sales team generated about 1800 points of contact per month. (Tr. 346-47.)

D. Daxor's Challenges

Despite the sales team's efforts, the BVA-100's cost and industry inertia posed significant challenges. (Tr. 183.) Hospitals and diagnostic clinics objected to paying \$75,000 for the BVA-100, plus \$275 for each test kit, when the alternatives were much cheaper, even if less accurate. (Tr. 325-26.) Additionally, many clinicians and doctors were content with the existing method of measuring blood volume. (Tr. 184-85, 325-26.)

Medicare reimbursement also presented obstacles. (Tr. 326.) In 2003, Medicare significantly reduced its reimbursement for the BVA-100 test kits. (Tr. 183, 188, 327; Resp. Exs. 367, 368.) Medicare increased the reimbursement two years later, but not retroactively. (Id.) Then again, in 2007-2008, Medicare reduced its reimbursement formula for BVA-100 testing by 30-35%. (Tr. 189-91, 204, 329-32; Resp. Exs. 371, 374-93.⁸)

⁷ Daxor developed a sales algorithm, which utilized entities, such as nuclear medicine departments, willing to "champion" the BVA-100. (Tr. 337.) The sales representatives would encourage physicians to refer patients to the "champions" for tests. (Tr. 338-39.)

⁸ These exhibits are Reyes-Guerra's presentations to Medicare concerning reimbursement issues.

An additional complication was that the FDA considered the BVA-100 a “complex” diagnostic test, which required a licensed and trained test administrator and a designated area in the facility to administer the test. (Tr. 333.) Daxor inquired into what would be necessary to reduce the classification of the BVA-100, and then implemented those changes. (Tr. 333-34.) Ultimately, during 2003-2004, the classification was reduced to “moderate complexity.” This allowed Daxor to sell the BVA-100 to physicians’ offices and diagnostic imaging centers, in addition to hospitals and laboratories. (Tr. 334-35; Resp. Ex. 567A.)

Daxor has attempted to address the cost issue in several ways. It worked with the Society of Nuclear Medicine to change Medicare reimbursement, although without success. (Tr. 190-91.) More important, in 2007, Daxor began building a facility in Oak Ridge, Tennessee, to manufacture its test kits. (Tr. 64, 192-93, 578-79.) This removed the middleman and cut costs, allowing Daxor to either reduce the price paid by hospitals or to increase its profits. (Tr. 192-93, 578-79.) However, as Ron Cacheiro, a Daxor project manager at the Oak Ridge facility, testified, the process to obtain FDA approval for the Oak Ridge facility is lengthy and arduous. (Tr. 580-81.) Additionally, the Tennessee Health Board and other Tennessee radiation safety authorities impose continuing requirements over the manufacture and distribution of a radiopharmaceutical, which is contained in the BVA-100 test kits. (Tr. 582-83.)

Feldschuh maintains that Daxor continues to improve the BVA-100. (Tr. 206-07.) Daxor is developing a new modular operating platform, the Win BVA 6.0, which will allow Daxor to add new applications to the BVA-100 without significant reprogramming. (Tr. 206-07, 583-85; Resp. Ex. 417.) Daxor is also working on the “wipes” application to detect radioactivity, which would allow hospitals to automate some of their standard operating functions. (Tr. 585.)

Daxor hopes to make the BVA-100 test the standard of care for certain ailments. (Tr. 194-95, 198-200.) A standard of care is the recognized treatment of a particular medical condition. (Tr. 198.) When a treatment becomes a standard of care, it is considered necessary and possibly malpractice if a physician does not use it. (*Id.*) Being a standard of care is also good for business. For example, if the BVA-100 becomes the standard of care for congestive heart failure, from which one million people suffer, its use would vastly expand. (Tr. 199.) The desire to make the BVA-100 a standard of care motivated Daxor to conduct clinical studies. (Tr. 197-98.)

E. Clinical Studies

Starting in 2006, after Daxor’s increased sales efforts bore minimal results, Daxor decided to conduct more extensive clinical trials to persuade hospitals and doctors of the BVA-100’s benefits. (Tr. 530-32.) In 2007, Daxor undertook sophisticated, multi-hospital clinical trials, involving heart failure and renal dialysis. (Tr. 194.) The purpose of the studies was to demonstrate that the BVA-100 more accurately tested blood volume, which allowed doctors to better diagnose patients. (Tr. 200.) This would improve patient mortality and reduce hospital readmissions. (*Id.*) Daxor hoped these studies would make the BVA-100 testing a standard of care. (Tr. 197-98.) Because the BVA-100 was new, the studies produced new findings and generated interest from physicians specializing in heart failure. (Tr. 507.)

Dr. Sandra Gilbert, Daxor's clinical research coordinator generally supervises Daxor's clinical studies.⁹ Typically, Dr. Gilbert and the sales staff find a physician interested in conducting a study. (Tr. 470-71.) Dr. Gilbert then prepares a protocol discussing the study's objectives and criteria. (Tr. 471.) Often, it takes considerable time for the physician to respond to her protocol. (Tr. 472.) Next, the protocol must be approved by that institution's internal review board. (Tr. 473.) Finally, in order to begin the study, the facility must have a BVA-100 on site, or it must be installed, and facility personnel must be trained to use it. (Id.) Enrolling study subjects can also take considerable time, depending on the number of subjects sought and the parameters for inclusion. (Tr. 474.) Studies vary in duration, depending on the subject matter. (Tr. 474-75.) When finally complete, the data are analyzed and the results are later announced at major medical conferences. The announcement may include an oral or poster presentation, which is followed by a publication report for peer review. (Tr. 475-76; Resp. Exs. 303, 304, 556.)

Daxor is currently conducting two major studies, called "Team UF" and "Team HF." (Tr. 142, 146-47, 317-18.) These studies have just begun and will take two to four years to complete. (Tr. 423-25.) If the results favor BVA-100 use, Daxor would offer free BVA-100s and test kits to hospitals. (Tr. 423-25.)

Team UF, lead by Dr. Timothy Manzone, studies how blood volume measurement guides ultrafiltration therapy for heart failure. (Tr. 317-18.) Dr. Manzone is the section chief for nuclear medicine at Christiana Care hospital in Newark, Delaware, and publishes and lectures on behalf of Daxor.¹⁰ He believes that the BVA-100 has the potential to become the standard of care for several conditions, such as heart failure and surgery. (Tr. 320.) However, to be adopted as a standard of care for several areas of treatment, the BVA-100 requires multiple published studies demonstrating improved outcomes in each of those areas. (Tr. 320-21.)

Team HF, led by Dr. Stuart Katz,¹¹ a cardiologist with a sub-specialty in congestive heart failure, studies whether the BVA-100 improves clinical outcomes in discharged heart-failure patients. (Tr. 318, 515-16; Resp. Exs. 291, 312, 313.) The goal is to have 300 patients participate in Team HF. (Tr. 518.) Although the previous initial studies are suggestive, Daxor

⁹ Dr. Gilbert began her employment with Daxor in May 2008. (Tr. 467.) She has a Doctorate in biology from the Massachusetts Institute of Technology, and performed her post-doctoral studies in neuroscience at the University of Chicago. (Tr. 468.)

¹⁰ Dr. Manzone is also employed by Nuclear Medicine Physicians. (Tr. 302-03; Resp. Ex. 530.) Previously an attorney, Dr. Manzone has practiced medicine since 1993. His specialty is nuclear medicine, which involves administering radioactive substances into patients for diagnostic tests. (Tr. 304.)

¹¹ Dr. Katz is a professor of medicine at New York University Langone Medical Center. (Tr. 501.) Previously, Dr. Katz was on the faculty of Albert Einstein College of Medicine, Columbia College of Physicians and Surgeons, and Yale School of Medicine. (Id.) He also holds a masters degree in biostatistics from Columbia School of Public Health, awarded in 2002. (Tr. 502; Resp. Ex. 531.)

has not yet proven that the BVA-100 improves heart-failure patient outcomes, which is what Daxor hopes to achieve through Team HF. (Tr. 524.)

According to Dr. Katz, the BVA-100 offers a variety of medical benefits. For example, the BVA-100 discovered that some patients thought to have anemia, actually suffered from a different ailment. (Tr. 506.) Dr. Katz also believes that the only way to measure blood volume is with a machine such as the BVA-100. (Tr. 507.) Feldschuh believes Daxor is the only company that has an automated blood volume analyzer, and failure to continue developing the BVA-100 would lead to tragic medical consequences. (Tr. 222.)

Despite Daxor's continuing efforts, commercial success has proven elusive. (See Tr. 180, 183-84.) Daxor only sold four units in 2008, one in 2009, and one in the first nine months of 2010. (Div. Exs. 113 at 20, 127 at 26.) Overall, from 2000 to September 2010, Daxor sold twenty-four units, and placed forty-eight on a trial basis. (Resp. Ex. 107.) Unsurprisingly, since 1995, BVA-100 operational revenue has been insufficient to cover the operational cost, and this segment of Daxor has yet to generate a profit. (Tr. 39-40.) As addressed below, and declared in its periodic filings, Daxor's assets are comprised of 90% investment securities, and 90% of its gross income is derived from investment securities, not BVA-100 sales. (Tr. 559-60; Div. Exs. 17-22, 24, 26, 31, 40, 44, 59, 63, 71, 118, 172.)

F. Daxor's Assets

At the hearing, Christopher Mele (Mele), a Certified Public Accountant (CPA) and Division staff accountant, introduced and explained several charts summarizing Daxor's assets and income. (Tr. 23.) The first chart summarized Daxor's condensed consolidated balance sheets from 1995 through September 2010. (Tr. 26-27; Div. Ex. 138.) The chart showed that, from 1995 through 2010, Daxor's investment securities represented over 90% of its total assets. (Tr. 29-30; Div. Ex. 138.) For example, as of September 30, 2010, Daxor had \$81 million in investment securities, which was 94% of Daxor's \$86 million of total assets. (*Id.*) Daxor's available-for-sale securities were 73% of its total assets and 96.5% of its total adjusted¹² assets.¹³ (Tr. 33-35; Div. Ex. 138.) Overall, from 1995 through 2010, Daxor's available-for-sale securities consistently exceeded 90% of its total adjusted assets. (Tr. 35; Div. Ex. 138.)

Mele used the same chart to demonstrate Daxor's substantial and increasing options trading and short positions. (Tr. 29-30; Div. Ex. 138.) As of September 30, 2010, Daxor owned \$5.5 million of put and call options, which was 14.4% of its total \$37.9 million in liabilities. (Tr. 30-31; Div. Ex. 138.) As of the same date, Daxor had \$15.6 million in short positions, which was 41.2% of its total liabilities. (Tr. 31-32; Div. Ex. 138.) Daxor's options and short positions increased over time. (*Id.*) Specifically, Daxor did not own any options until 2003, and it has

¹² Adjusted assets are defined as "total assets less cash, receivable from broker, and securities sold, not received." (Div. Ex. 138.)

¹³ As of September 30, 2010, Daxor's \$74.9 million of available-for-sale securities was 73% of its \$102.5 million of total assets and 96.5% of its \$77.6 million total adjusted assets. (Tr. 34-36.)

since increased its options holdings. (Id.) Daxor's short positions totaled \$72 thousand in 1995, \$10.7 million in 2006, and \$15.6 million in September 2010. (Tr. 32-33; Div. Ex. 138.)

G. Daxor's Income

Daxor earns most of its income from its investment securities. (Tr. 37-38; Div. Ex. 139.) From 1995 through 2010, Daxor reported a net loss from its BVA-100 operations. (Tr. 37-38, 40; Div. Ex. 139.) For that same period (with the exception of 1995), Daxor's income from its investment securities – from dividends, options, and equity sales – was double its income from BVA-100 sales. (Div. Ex. 139.) In fact, since 2007, Daxor reported overall net income only because of its substantial investment securities income.¹⁴ (Tr. 40-42; Div. Ex. 139.)

Daxor's general securities involvement – particularly its securities income – has increased with time. (Tr. 43; Div Ex. 140.) While Daxor's income from options sales never reached \$100,000 from 1995 through 2001, it has increased dramatically over time, reaching \$26 million in 2009.¹⁵ (Tr. 45; Div Ex. 140.) Similarly, Daxor's cash flows from its purchase and sale of equity positions increased since 2004. (Tr. 46; Div Ex. 140.)¹⁶ Daxor's level of borrowing and lending to its securities brokers also substantially increased since 2004. (Tr. 48-49; Div Ex. 140.)

Daxor's securities trading had increased to the point where, by September 2007 and through October 2010, Daxor averaged 424 trades per month, according to calculations done by James Flynn, a securities compliance examiner with the SEC. (Tr. 91-92.) Additionally, while Daxor's dividend income has not fluctuated much since 2005, its realized gains on the sale of securities generally increased over that period. (Tr. 55; Div. Ex. 142.)

H. Daxor's Expenses

Daxor's investment and research expenses are both significant. (Tr. 51-53; Div Exs. 141, 143.) Daxor spent \$3,161,044 on research and development for the year ended on September 30,

¹⁴ For example, for the year ended September 30, 2010, Daxor earned \$1.2 million in revenue from BVA-100 sales, but its costs and operating expenses were \$5.3 million. (Tr. 40-41.) This resulted in an overall \$4.1 million loss from BVA-100 operations. (Id.) In that same period, Daxor earned \$9.2 million from its investments. (Id.) The investment income resulted in an overall net income of \$5 million for that period. (Tr. 40-41; Div Ex. 139.)

¹⁵ Income from options was \$682,000 in 2003, \$6.7 million in 2006, \$18.7 million in 2007, and \$34.4 million in 2008.

¹⁶ Mele testified that, prior to 2003, Daxor only reported the net cash flow from the purchases and sales, instead of reporting the purchases and sales separately. As such, comparison between pre-2003 and post-2003 numbers is difficult. (Tr. 46-47.)

2010.¹⁷ (Tr. 51-53; Div Ex. 141.) Daxor’s investment expense for the same year was \$7,210,312, which was 9.5% of Daxor’s total costs and expenses. (Tr. 59; Div. Ex. 143.)

I. Daxor’s Investment Activity

I. Investing Purpose

According to Feldschuh, the purposes of Daxor’s investments are to preserve its capital and provide income for the development of its products and operations, which continue to incur losses. (Tr. 213, 368-70.) Although Feldschuh wrote, in 2008, that Daxor’s “baseline goal” was to earn 10% on its investment portfolio, he states that he did not have a specific goal, and his focus was primarily on the safety of the investments.¹⁸ (Tr. 370-72, 374-75; Div. Ex. 81.) Daxor’s portfolio consists mostly of utility stocks because Feldschuh considers them to be safe and they earn more than Treasury Bills. (Tr. 214-15, 361.) He also states that the purpose of Daxor’s options trading was to counterbalance movements in its equity holdings. (Tr. 367-68.) However, Daxor’s broker agreements state that its options trading is aggressive and speculative. (Tr. 389-90, 409-13; Div. Exs. 118, 151, 153.) Feldschuh explains those references as merely nominal, required by the broker in order to open an options trading account. (Tr. 411-12.)

Feldschuh further testified that Daxor would be insolvent if its investments were limited to Treasury Bills instead of equities. (Tr. 217-19.) From 1993 to 2002, Daxor’s expenses were \$2.5 to \$3 million annually. (Tr. 220.) In 2002, when Daxor expanded its research and development, its expenses increased to over \$7 million. (Id.) At the same time, Daxor’s revenues from operations increased slightly, but did not match the increase in expenses. (Tr. 220.) Therefore, if Daxor invested in Treasury Bills, assuming 2% interest,¹⁹ it would have been insolvent by 2004-2005. (Tr. 217-18; Resp. Ex. 520A.) Daxor was profitable from 2007 to 2010 only because it invested in equities and options. (Tr. 221.)

¹⁷ Yet, Daxor’s net investment income (net of administrative expenses) for the same period was \$9,845,025, which is over three times the amount it spent on research and development.

¹⁸ In an October 28, 2008, memo to Robert Willens (Willens) – a CPA, Daxor director, and member of its audit committee – Feldschuh raised the possibility of starting a hedge fund that would replicate Daxor’s portfolio strategies. (Tr. 545-47; Div. Ex. 81.) The memo describes other hedge funds’ failings and the uniqueness of Feldschuh’s investment strategy. (Div. Ex. 81.) Feldschuh then asks whether “the Daxor concept [can] be replicated in a hedge fund model?” (Id. at 3.) Willens interpreted this to mean a replication of some of Daxor’s strategies, but not all. (Tr. 547.) Specifically, the new fund would not have the same restrictions as Daxor. (Id.) In the same memo, Feldschuh mentioned that Daxor’s investment strategy yields returns that are “far greater than would normally be seen with standard cash management policies.” (Tr. 375-81; Div. Ex. 81 at 1.) The matter was never raised before the board. (Tr. 547-48.)

¹⁹ Although, according to Feldschuh, Treasury Bills now yield 0% to 0.25%. (Tr. 217-18.)

II. Dividends

Both Feldschuh and Robert Willens (Willens), a Daxor director, testified that, in 2008, one of Daxor's goals was to pay dividends to its shareholders, if Daxor had the money. (Tr. 215, 384; Div. Ex. 127.) Indeed, Daxor paid \$6,452,502 in dividends in 2008 and \$5,739,299 in 2009. (Div. Ex. 118 at 26.) The money for the dividends was generated by Daxor's investment portfolio. (Tr. 539.)

Feldschuh testified that the reason for paying dividends was that Daxor's investments earned more than its operating losses, and Daxor did not immediately need the additional money. Additionally, Daxor wanted to avoid paying a personal holding company tax. (Tr. 215, 538.) For tax purposes, Daxor is a personal holding company and is subject to a penalty tax, if it has undistributed income. (Tr. 216, 538-39.) Therefore, Daxor paid dividends to reduce its undistributed income.²⁰ (Tr. 539.) Willens confirmed that Feldschuh did not want to pay the dividend,²¹ but did so to avoid the tax penalty. (Tr. 541, 551.) Nor did the board want to pay a regular quarterly dividend, because it wanted the funds to finance the development of the BVA-100. (Tr. 541-42.)

III. Portfolio Management and Board Involvement

Feldschuh alone manages Daxor's investment portfolio, and does not consult with Daxor's chief financial officer, David Frankel, before trading.²² (Tr. 380-81, 438.) Feldschuh conducts his own options risk analysis. (Tr. 367.)²³ Feldschuh devotes thirty-three percent of his time to managing Daxor's portfolio. (Tr. 216.) In 2008-2009, he monitored the Daxor portfolio every day, even during vacation. (Tr. 399-403, 548-49; Div. Ex. 76.) In the event of Feldschuh's incapacitation, Daxor would cease trading options, and its only investment income would be from dividends. (Tr. 381, 446-47.) But, dividends alone would be insufficient to cover Daxor's operating losses. (Tr. 381.)

Willens testified that, at Daxor board meetings, Feldschuh would discuss BVA-100 operating concerns and clinical studies. (Tr. 529.) Feldschuh spent little time on Daxor's financial condition. (*Id.*) He never discussed the actual investments, but he would assure the board that the investment returns would enable Daxor to continue pursuing the BVA-100. (Tr.

²⁰ However, in 1997, Daxor incurred a \$145,000 loss before taxes and still paid dividends. (Tr. 557.)

²¹ In the December 17, 2008, board meeting minutes, Feldschuh is quoted as saying he is "optimistic that dividends will be paid in 2009." (Div. Ex. 85.) Feldschuh was optimistic about the underlying circumstances of a dividend, i.e., investment income exceeding the amount of operating losses. (Tr. 554.)

²² David Frankel, however, did receive daily trade confirmations. (Div. Ex. 100.)

²³ Although without formal investment training, Feldschuh bases his trading decisions on financial statements and reports. (Tr. 363-65.)

529, 533-34.) Feldschuh never provided the board or the audit committee with a detailed portfolio review. (Tr. 529, 532-33.) A document written by Feldschuh states that “[m]embers of our audit committee receive monthly updates as to the contents of the portfolio.” (Tr. 558; Div. Ex. 100.) However, Willens disputes that the audit committee received such updates, and he does not agree with Feldschuh’s statement. (Tr. 558-59.)

Willens concedes that, through its investment portfolio, Daxor’s financial welfare is tied to eighty-three separate companies in which it owns stock. (Tr. 565.) He also acknowledges that Daxor is supported by one individual’s, Feldschuh’s, portfolio management. (Tr. 437.) In order to make potential investors aware of this risk, Daxor made the following disclosure: “To the best of the company’s knowledge, of the 6,000 companies reporting to the SEC it is unaware of any company except Daxor where a single individual supports the entire company by cash management, particularly where there are large continuing operation losses.” (Tr. 436-37; Div. Ex. 127 at 37.)

While Daxor is adequately capitalized at present, Feldschuh recognizes it would need additional capital if BVA-100 orders increased. (Tr. 420-22; Div. Ex. 118 at 31-32.) However, he acknowledges that Daxor is not close to being a standard of care or receiving an influx of orders. (Tr. 421, 423-26.) Presently, Daxor has only between ten and twenty BVA-100s in inventory and is not raising capital to increase production. (Tr. 223-24, 426-27.) Finally, Willens acknowledged that Daxor relies on its investment portfolio for its financial survival, and he is not sure when this might change. (Tr. 560.)

III. LEGAL ANALYSIS

A. Investment Company Act

Section 3(a) of the Investment Company Act provides several definitions of an investment company. 15 U.S.C. § 80a-3(a). Subsection (1)(A) defines an investment company as an issuer of securities that engages *primarily* in the business of investing in securities.²⁴ *Id.* Subsection (1)(C) defines an investment company as an issuer of securities that engages (though not primarily) in the business of investing in securities, *and* whose assets are at least 40% investment securities. *Id.* Unlike the definition in Section 3(a)(1)(A), Section 3(a)(1)(C) does

²⁴ “(a) Definitions

- (1) When used in this subchapter, “investment company” means any issuer which--
- (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; [or]
 - (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer’s total assets (exclusive of Government securities and cash items) on an unconsolidated basis.”

not require that the issuer be *primarily* engaged in the business of investing in securities, so long as more than 40% of its assets are investment securities. Id.

Section 3(b) of the Act provides several exemptions from the definition of an investment company. The first, at issue here, exempts an issuer (even one whose investment securities exceed 40% of its assets) that is “primarily engaged . . . in a business . . . other than that of investing . . . in securities.”²⁵ 15 U.S.C. § 80a-3(b).

Thus, for purposes of this analysis, there are three types of issuers: (1) an issuer primarily engaged in the business of investing in securities, which constitutes an investment company, pursuant to Section 3(a)(1)(A); (2) an issuer primarily engaged in a business other than investing in securities, which is not an investment company, pursuant the exemption in Section 3(b)(1); and (3) an issuer that is an investment company under Section 3(a)(1)(C), because more than 40% of its assets are investment securities. The Division’s evidence establishes that Daxor constitutes an investment company under Section 3(a)(1)(C), because Daxor trades and invests in securities and more than 40% of its assets are investment securities. (Div. Exs. 138-143.)

Although Daxor may not intend to be an investment company, the test under Section 3(a)(1)(C) only considers an issuer’s actions and assets, not its intentions. Electric Bond and Share Company, 42 S.E.C. 1053, 1058 (1966) (“[The] test of Section [3(a)(1)(C)] . . . [is] concerned primarily with the existing situation”); 1 TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS § 5.01[A] at 5-10 (2d ed. 2010) (“Intent to be or not to be an investment company is irrelevant.”). Therefore, regardless of Daxor’s intent, it meets the statutory definition of an investment company, and may be required to register as such under Section 8 of the Act. The only issue remaining is whether Daxor is primarily engaged in a business other than investing in securities and, therefore, is exempt under Section 3(b)(1) from being an investment company.

B. Section 3(b)(1) Exemption and Tonopah Factors

The Section 3(b)(1) exemption requires a company to prove it is primarily engaged in a business other than investing in securities.²⁶ Although the statute does not define “primarily

²⁵ “(b) Exemption from provisions. Notwithstanding paragraph (1)(C) of subsection (a) of this section, none of the following persons is an investment company within the meaning of this subchapter:

- (1) Any issuer primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities.”

²⁶ The party seeking an exemption under the Act bears the burden of proof. See, e.g. E.F. Hutton & Co., Investment Company Release No. 15287 (Sept. 5, 1986), 48 S.E.C. 556, 560 (party seeking an exemption under Section 9(c) of the Act bears the burden of proof); SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953) (“[I]mposition of the burden of proof on an issuer who would plead the [registration] exemption seems to us fair and reasonable.”); Zacharias v. SEC, 569 F.3d 458, 464 (D.C. Cir. 2009) (same).

engaged,” see SEC v. National Presto Indus., Inc., 486 F.3d 305, 307 (7th Cir. 2007), the Commission, in Tonopah Mining Co. of Nevada, set out a five-factor, qualitative and quantitative, test to determine an issuer’s primary engagement.²⁷ 26 S.E.C. 426 (1947).

The five Tonopah factors are: (1) the issuer’s history; (2) its public representations of policy; (3) the activities of its officers and directors; (4) the nature of its assets; and (5) the source of its income. Id. at 427. The two quantitative factors, of assets and income, are most important. Id. This is especially true where the quantitative factors lean heavily in one direction. Electric Bond, 42 S.E.C. at 1065. Thus, to determine whether Daxor qualifies for the Section 3(b)(1) exemption, we apply the five Tonopah factors.

I. History

The first of the three qualitative Tonopah factors is the issuer’s history. When reviewing an issuer’s historical development, the Commission considers the issuer’s primary engagement in the past, and whether and how the issuer’s engagement changed over time. Tonopah, 26 S.E.C. at 427. In several cases of “inadvertent investment companies,” the issuer was engaged primarily in an operating enterprise and, with time, its operations dwindled and its investments increased, prompting the question of whether it inadvertently became an investment company. See Electric Bond, 42 S.E.C. at 1054-55; Tonopah, 26 S.E.C. at 427-28; Tobacco Products Export Corp., 12 S.E.C. 743, 744 (1943); National Presto, 486 F.3d at 307; SEC v. Fifth Avenue Coach Lines, Inc., 289 F. Supp. 3, 9-11 (S.D.N.Y. 1968). The Commission also considers whether the issuer has recently increased or decreased its securities holdings. Electric Bond, 42 S.E.C. at 1065.

Daxor’s history demonstrates a persistent, though commercially unsuccessful, attempt at selling its BVA-100. Over the past decade, Daxor has engaged in a variety of approaches aimed at popularizing and selling the BVA-100, ranging from multi-center testing, publishing studies, escalating its sales efforts, and distributing free test products. Yet, despite these efforts, Daxor sold only twenty-four units since 1999. Daxor argues that failure to achieve operational profit does not, by itself, convert an issuer into an investment company. (Daxor Br. at 1.) While this may be true to some degree, continued lack of commercial success in marketing the BVA-100 and failure to ever earn a profit suggests that Daxor is not able to function as a medical device company. However, compared to a typical inadvertent investment company, which has operational success only in its past, Daxor hopes to achieve operational success in the future. Indeed, Daxor’s operational goal is to make BVA-100 testing a standard of care, thereby increasing demand and selling thousands of units nationwide.

Daxor’s actual and increasing involvement in investment securities, however, is more relevant than its hopes for future BVA-100 sales. Specifically, Daxor’s cash flows from its purchase and sale of equities, its options and short positions, and level of borrowing and lending

²⁷ In Tonopah, the Section 3(b)(2) exemption was at issue. However, Tonopah’s five-factor test equally applies to the Section 3(b)(1) exemption, at issue here. See ICOS Corp., 51 S.E.C. 322, 324 (1993); Certain Prima Facia Investment Companies, 18 SEC Docket 948, 954 n.24 (1979). See, also A.V.C. Corp., 44 S.E.C. 134, 135-36 (1969).

to its securities brokers have all increased since 2004. This trend of increasing securities involvement, as opposed to increasing its production capabilities, suggests that Daxor will not need additional capital to increase BVA-100 production in the near future. It further suggests that Daxor has no clear estimate of when, if ever, BVA-100 testing will become a standard of care.

Finally, the Commission also considers the likelihood of a change in the issuer's future investing behavior. See Northeast Capital Corp., 37 S.E.C. 715, 720 (1957); United Stores Corp., 10 S.E.C. 1145, 1151 (1942). Here, Daxor implies that its investment activities will cease or significantly diminish once demand for its BVA-100 increases. (Daxor Reply Br. at 6.) However, Daxor cannot predict when, or if, this will occur. Daxor's history suggests that, at this time, it is not primarily engaged in a business other than that of investing in securities.

II. Public Representations of Policy

In reviewing an issuer's public representations of policy, the Commission considers the issuer's registration statement, reports to stockholders, and periodic filings.²⁸ Tonopah, 26 S.E.C. at 428-30. Under Tonopah, an issuer's representations about the nature of its assets and income are most important, as this informs investors of the issuer's primary activity. 26 S.E.C. at 430 ("More important . . . the nature of the assets and income of the company, disclosed in the annual reports filed with the Commission and in reports sent to stockholders, was such as to lead investors to believe that the principal activity of the company was trading and investing in securities."); Tobacco Products, 12 S.E.C. at 747 ("[T]he mere statement of the assets in the annual reports necessarily induces in investors a major reliance on [the] portfolio as an asset base and earnings producer.").

Daxor's press releases convey a dual message about the nature of Daxor's primary business. The majority of the press releases concern the BVA-100, including announcements of BVA-100 sales, trial placements at hospitals and medical facilities, and updates on Daxor's clinical studies. (See Resp. Exs. 25-37.) However, many of the press releases contain Daxor's earnings and dividend payments, reflecting Daxor's large securities portfolio and income. (Id.)

Daxor's periodic reports also contain this dichotomy. In the narrative sections of its periodic reports, Daxor represents itself as a medical device manufacturer and details its operational efforts. The financial information included in those reports tells a different story. The data demonstrate that Daxor's assets are overwhelmingly investment securities, which generate the majority of its income.²⁹ Given the importance Tonopah attributes to asset and

²⁸ The Seventh Circuit considered the type of investor the issuer's public representations would attract – one looking to invest in an investment pool or one looking to invest in the issuer's operational business. National Presto, 486 F.3d at 315.

²⁹ Additionally, Daxor has described its options trading approach as aggressive and speculative, not only in its broker agreements (required by brokers to open options trading accounts), but also in its 10-K filings for 2009 and 2010. (Tr. 389-90, 409-13; Div. Ex. 118 at 21; 127 at 8; 151; 153.)

income information displayed in periodic reports, this factor weighs against Daxor qualifying for the Section 3(b)(1) exemption.

III. Activities of Officers

The Commission next considers how and where the issuer's employees spend their time and effort. Tonopah, 26 S.E.C. at 430; National Presto, 486 F.3d at 313. Where employees spend considerable time managing the investment securities, there is greater likelihood that the issuer is primarily engaged in the investment business. Id. However, this factor is not dispositive. See Electric Bond, 42 S.E.C. at 1065 (finding issuer was an investment company where assets and income were mostly investment securities, despite employees' operations activities); Tobacco Products, 12 S.E.C. at 745 (same).

Dr. Feldschuh spends about one third of his time managing Daxor's investment portfolio. The majority of Daxor's employees appear to be involved in selling, promoting, upgrading, and studying the BVA-100. (See Tr. 216.) Daxor's sales effort is extensive, employing a team of sales representatives and proactively contacting hundreds of medical personnel and facilities per month. Daxor employees educate physicians on the clinical benefits of the BVA-100. The employees are also engaged in Daxor's multiple clinical studies and the papers it publishes. Finally, Daxor has a facility where it manufactures the test kits and employs engineers to service and upgrade the BVA-100. Clearly, if measured by employee work-hours, this factor weighs in favor of Daxor being primarily engaged as a medical device manufacturer.

IV. Assets

The issuer's asset composition is one of the two most important factors in determining an issuer's primary business.³⁰ Tonopah, 26 S.E.C. at 427, 430; Tobacco Products, 12 S.E.C. at 745. In Tonopah, the Commission specifically considered the issuer's investment assets in comparison to total assets, and whether that ratio changed over time. 26 S.E.C. at 430-31. Daxor's assets are overwhelmingly comprised of investment securities, a great deal of which are used to pay millions of dollars in dividends to the shareholders. From 1995 through 2010, Daxor's investment-related assets represented over 90% of its total assets. Daxor itself does not contest that its assets are overwhelmingly investment securities. (Daxor Br. at 48.) Clearly, from an asset perspective, Daxor is not engaged in a business other than investing in securities.

³⁰ National Presto holds that, under the Tonopah analysis, what matters most is – not asset composition alone, but rather – the belief the issuer is likely to induce in investors; will investors treat the issuer as “an investment vehicle or operating enterprise?” 486 F.3d at 314-15. However, Tonopah considered investors' perception as being created by the issuer's *assets and income*. 26 S.E.C. at 430 (“More important . . . [is whether] *the nature of the assets and income* of the company, disclosed in the annual reports filed with the Commission and in reports sent to stockholders, was such as to lead investors to believe that the principal activity of the company was trading and investing in securities.”) (Emphasis added). Therefore, even from an investor-perception perspective, assets and income are most important.

The Commission's emphasis on the issuer's assets comports with the underlying purpose of the Investment Company Act. The Act addresses a problem stemming from the *nature of investment companies' assets*. The Committee on Banking and Currency, INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT ADVISERS ACT OF 1940, S. Rep. No. 76-1775, at 6 (1940). The assets of investment companies are liquid securities and, therefore, can be more easily misappropriated and diverted by unscrupulous managers. *Id.* The purpose of the Act is to provide safeguards against such occurrence, by imposing substantive rules upon an issuer's governance structure, rather than merely requiring transparency. *Id.* Thus, Tonopah's focus on an issuer's assets when determining its primary business is aligned with the Act's rationale. It is an issuer's assets that create the risk that the Act addresses and, therefore, an issuer's assets are most important when determining whether the protections of the Act should apply.

V. Income

Finally, an issuer's source of income is the second of the two most important indications of its primary engagement. Tonopah, 26 S.E.C. at 427, 431. Tonopah considered both gross and net income, as well as expenditures incurred to produce income. 26 S.E.C. at 431; National Presto, 486 F.3d at 313. Since 2007, an average of 90% of Daxor's gross income and 100% of its net income has been from its investment securities,³¹ because it had a net loss from its operations every year. Because Daxor relies on its investment income for survival, this factor supports the conclusion that Daxor does not qualify for the Section 3(b)(1) exception.

Thus, the Tonopah qualitative³² and especially the quantitative factors support the conclusion that Daxor does not fall within the Section 3(b)(1) exemption and, therefore, is an investment company under Section 3(a)(1)(C).

C. Daxor's Defenses

I. National Presto

Daxor relies on National Presto to support its contention that it qualifies for the Section 3(b)(1) exemption.³³ National Presto qualified for the Section 3(b)(1) exemption because its

³¹ For example, in 2009, Daxor's operational revenue was \$1,689,000, and investment income was \$12,412,000, totaling \$14,101,000. \$12,412,000 is 88% of \$14,101,000.

³² The qualitative factors would be entitled to greater weight if Daxor's assets and income were more closely divided between investments and operations. Electric Bond, 42 S.E.C. at 1065. However, these factors have less significance here, because Daxor's asset composition and source of income are so decidedly one-sided. *Id.* This result is consistent with the Commission's prior holdings. Tonopah, 26 S.E.C. at 430; Electric Bond, 42 S.E.C. at 1065; Tobacco Products, 12 S.E.C. at 745.

³³ Respondent indicates that National Presto provides a new framework for applying Section 3(b)(1). (Daxor Br. at 31.) However, National Presto explicitly applies Tonopah. 486 F.3d at 312.

portfolio and activities would lead reasonable investors to treat it as an operating company rather than an investment fund. National Presto, 486 F.3d at 315. Daxor argues that it qualifies for the Section 3(b)(1) exemption, because “reasonable investors would consider Daxor to be a medical instrument company” (Daxor Br. at 33.)

However, the facts in National Presto are different. National Presto sold consumer goods and munitions, and initially manufactured its products as well. National Presto, 486 F.3d at 307. Eventually, while continuing to design and market its products, National Presto subcontracted most of the manufacturing. Id. at 307, 313. As a result, it had substantial operating income, but not substantial operating assets, as it sold off its manufacturing capabilities. Id. at 307. Specifically, over 90% of National Presto’s gross receipts were from operations, but only 40% of its assets were operations-related. Id. at 314. Additionally, the Tonopah qualitative factors supported a finding that National Presto was an operating enterprise. Id. at 313-14.

Unlike Daxor, National Presto was an operating enterprise, as evidenced by its operational income and the qualitative Tonopah factors. Therefore, National Presto qualified for the Section 3(b)(1) exemption. However, Daxor’s assets are comprised of 90% investment securities, and 90% of its gross income is derived from investment securities. The qualitative Tonopah factors also support a finding that Daxor is an investment company. Therefore, Daxor is not factually analogous to National Presto, nor does it qualify for the same exemption.

Daxor is factually similar to Electric Bond, because most of Electric Bond’s assets and income were investment securities related, but its officers were active in operations and it intended to increase its operations’ holdings. 42 S.E.C. 1054-55. Electric Bond sold many of the public utility companies it owned and invested the proceeds in securities. Id. Seeking the Section 3(b)(2)³⁴ exemption, Electric Bond argued that (1) the activities of its officers and (2) its intent to reacquire utility subsidiaries in the future demonstrate that it is an operating enterprise. Id. at 1064-65. However, the Commission found the exemption did not apply, because 66% of Electric Bond’s assets were investment securities and 60% of its income derived from those securities. Id. The Commission noted that where the assets and income are one-sided, the qualitative factors are less significant. Id.

Like Electric Bond, Daxor’s officers devote the majority of their time to Daxor’s BVA-100 operations. Also like Electric Bond, Daxor intends to increase its operational assets, if the demand for the BVA-100 increases. Yet, like Electric Bond, the vast majority of Daxor’s assets and income are investment securities related. In fact, while Electric Bond’s assets and income were only 66% and 60% securities-related, Daxor’s are both over 90%. Thus, Electric Bond supports a finding that Daxor does not qualify for the Section 3(b)(1) exemption and, therefore, is an investment company under Section 3(a)(1)(C).

³⁴ See supra n.27 that, for purposes of this analysis, Sections 3(b)(2) and 3(b)(1) are the same.

II. Tonopah is Unreasonable

Daxor argues that Tonopah's emphasis on an issuer's assets is an unreasonable interpretation of Section 3(b)(1). (Daxor Br. at 50-55.) According to Daxor, because Section (a)(1)(C) is primarily³⁵ an asset test, Section 3(b)(1), which applies "[n]otwithstanding paragraph [(a)](1)(C)," applies irrespective of the issuer's assets. And, if Tonopah makes Section 3(b)(1) dependent on the nature of the issuer's assets, it is self-contradictory and, therefore, unreasonable.

However, Daxor mischaracterizes Tonopah. Tonopah does not make the application of Section 3(b)(1) exclusively dependant on the issuer's assets. Rather, Tonopah considers asset composition as *one of five* factors. And although Tonopah attributes greater significance to the issuer's assets, it does the same for the issuer's income. Thus, where Section (a)(1)(C) is an asset test, which deems an issuer an investment company, Section 3(b)(1) exempts certain issuers who – after undergoing a more comprehensive five-factor review – are determined to be primarily engaged in an operating enterprise. Therefore, Tonopah reasonably interprets Section 3(b)(1).

III. Plain Language

Daxor also argues that, given the purported unreasonableness of the Commission's interpretation of "primarily engaged" in Tonopah, applying the plain meaning of "primarily engaged" is the correct approach. (Daxor Br. 27.) Daxor argues that this directly leads to the conclusion that Daxor is a medical company. (Id. at 27-28.) This argument fails for several reasons.

The Commission and Federal courts, including the Seventh Circuit in National Presto, upon which Daxor relies, have accepted Tonopah's five-factor test in determining the meaning of "primarily engaged." See Northeast Capital Corp, 37 S.E.C. at 716 n.4; Electric Bond, 42 S.E.C. 1053; National Presto, 486 F.3d at 312. Additionally, Tonopah does not contradict the plain meaning of primarily engaged. "Primarily" offers general, rather than specific guidance. Tonopah filled that gap by providing five factors to help ascertain an issuer's primary engagement. Thus, Tonopah supplements and builds upon the plain language. Furthermore, Daxor's approach demonstrates the necessity of Tonopah's five-factor test; without it, Daxor must resort to providing a broad list of synonyms and dictionary definitions, which do not provide meaningful guidance in determining an issuer's primary engagement. Finally, in its effort to define "primarily engaged," Daxor neglects to define the following words, "in a business." 15 U.S.C. § 80a-3(b). This comes as no surprise, as "business" implies commercial buying and selling, which Daxor has been unable to achieve.

³⁵ Section (a)(1)(C) has two requirements: (1) that the issuer be engaged (although not primarily) in the business of investing in securities; and (2) that more than 40% of the issuer's assets are investment securities.

D. Research and Development Companies

Daxor implies that, given its research and development efforts (R&D), an alternative analysis applies. (Daxor Br. at 47.) The Commission has modified the Tonopah test for R&D companies. ICOS Corp., 51 S.E.C. 322 (1993). R&D companies typically: (1) “require large amounts of capital to fund the development of products that may not produce income for many years”; and (2) use their capital to obtain and produce intellectual capital, which is not capitalized on the balance sheets. Id. at 324.

To address the unique features of R&D companies, ICOS sets out three factors to replace Tonopah’s assets and income factors. 51 S.E.C. at 324. Specifically, the Commission considers the use, rather than just the composition, of the issuer’s income and assets by examining: (1) whether the issuer spends more on R&D than it collects in investment income; (2) whether the issuer’s expenses are substantially R&D-related, and only de minimis investment-related; and (3) whether the issuer’s investments preserve its assets, or it is significantly invested in equity or speculative debt. Id. at 325. If an issuer meets these requirements, then the analysis proceeds to the three qualitative Tonopah factors. If it does not, the issuer – although possibly conducting research and development – is engaged in a “perpetual investment program” and does not qualify for the exemption. Id.

Daxor concedes that it does not pass the ICOS test. (Daxor Br. at 48; Daxor Reply Br. at 2.) First, ICOS requires an issuer’s R&D expenditures to surpass its investment income, but Daxor’s history shows the exact opposite. For example, for the year ended September 30, 2010, Daxor’s net investment income was \$9,845,025 compared to \$3,161,044 of R&D expenses. (Div. Ex. 141.) Second, Daxor’s investment expenses, at 8.7% of total expenses, are not de minimis. (See Div. Ex. 147.) Third, Daxor’s investments are almost entirely equities and options, which do not preserve capital. (Tr. 214-15, 365, 390.) Indeed, instead of preserving its capital, Daxor paid over thirteen million dollars in dividends over the past three years.³⁶ (Div. Ex. 140.) Thus, while Daxor may conduct research and development, it is also engaged in a perpetual investment program and, therefore, does not qualify for the Section 3(b)(1) exemption.³⁷

IV. CONCLUSION

The Division has established that Daxor constitutes an investment company, under Section 3(a)(1)(C) of the Act, because it is in the business of investing and more than 40% of its

³⁶ Feldschuh and Willens both testified that the purpose of the dividend was to avoid paying a personal holding company tax. (Tr. 215, 538, 541, 551.) However, Daxor also paid a dividend in 1997, a year in which it would not have been subject to the penalty tax. (Tr. 557; Div. Ex. 140.)

³⁷ The same is true of Rule 3a-8 – the non-exclusive safe harbor for R&D companies. See 17 C.F.R. § 270.3a-8. Daxor does not qualify for that exemption and admits as much. (Daxor Br. at 48; Daxor Reply Br. at 2.)

assets comprise investment securities. In an effort to qualify for the Section 3(b)(1) exemption, Daxor has produced evidence, including sales efforts and medical studies, supporting its belief that the BVA-100 will achieve greater acceptance in the medical community and, perhaps, become a standard of care. However, this has not yet occurred in any significant way. Sales of the BVA-100 have never generated an operating profit or significant operating revenue. Daxor is completely dependent on its investment activities to remain in business. Accordingly, the quantitative and qualitative factors set out in Tonopah control the outcome here. Daxor is an investment company. It is in violation of Section 7(a) of the Act, and shall be ordered to register under Section 8 of the Act, or otherwise comply with the Act.

V. SANCTIONS

The Division requests a cease-and-desist order be issued against Daxor, pursuant to Section 9(f) of the Act. Section 9(f) of the Act provides that “[i]f the Commission finds . . . that any person is violating . . . any provision of this title . . . the Commission may . . . enter an order requiring such person . . . to cease and desist from committing or causing such violation” 15 U.S.C. § 80a-9 (f)(1). Moreover, the Commission may “require such person to comply . . . with such provision” Id. Because Daxor is an investment company under Section 3(a)(1)(C) and not exempted under Section 3(b)(1), it is in violation of Section 7(a) of the Act. Accordingly, a cease-and-desist order is appropriate.

VI. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission’s Rules of Practice, I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on May 27, 2011, as corrected by Order on Motion on July 7, 2011.

VII. ORDER

IT IS ORDERED THAT Daxor Corporation shall CEASE AND DESIST from violating Section 7(a) of the Investment Company Act of 1940, and it shall register as an investment company under Section 8 of the Act, or otherwise come into compliance with the Act.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission’s Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111(h) of the Commission’s Rules of Practice, 17 C.F.R. § 201.111(h). If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned’s order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to

correct a manifest error of fact, or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Robert G. Mahony
Administrative Law Judge