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MEMBER

DOCKET NO. 312-99-0789
(SSB NO. 99-029)

IN THE MATTER OF THE REVOCATION §
OF THE SECURITIES AGENT §
REGISTRATION AND THE DENIAL OF §
THE INVESTMENT ADVISER AGENT §
RENEWAL APPLICATION OF §
JAMES NEWTON DARWIN, II §

ORDER NO. REV/DEN/FIN-1381

TO: James Newton Darwin, II Jim Parker Charles S. Neal
CRD # 1779045 Kupperman, Orr, Mouer & Albers State Securities Bd.
400 N. Ronay Dr. 100 Congress Ave., Ste. 1400 208 E. 10th Street
Spicewood, Texas 78669 Austin, Texas 78701 Austin, Texas 78701

ORDER REVOKING REGISTRATION AS A SECURITIES AGENT, DENYING THE INVESTMENT ADVISER AGENT RENEWAL APPLICATION, AND ASSESSING AN ADMINISTRATIVE FINE

The Securities Commissioner, after consideration of the Proposal For Decision ("PFD") issued by the Administrative Law Judge ("ALJ") at the State Office of Administrative Hearings on September 2, 1999, and modified by letters from the ALJ dated October 6, 1999, and October 12, 1999, adopts all of the ALJ's findings of fact and conclusions of law, with the exception of Conclusion of Law No. 10 which is adopted as modified below.

FINDINGS OF FACT

1. A Notice of Hearing and a First Amended Notice of Hearing were filed with the State Office of Administrative Hearings and mailed to James Newton Darwin II ("Respondent") on April 28, 1999, and May 28, 1999, respectively, via certified U.S. mail, return receipt requested. A copy of each was also sent to his attorneys via facsimile and certified U.S. mail, return receipt requested. The Notices stated the time and place of the hearing, the legal authority and jurisdiction under which it was to be held, the particular sections of the statutes and rules involved, and the matters asserted.

2. In lieu of holding a hearing, the staff of the State Securities Board ("Staff") and Respondent agreed to submit Agreed Findings of Fact, to waive the oral presentation of evidence with respect to any matter related to the case, and to ask the Administrative Law Judge ("ALJ") to use the Agreed Findings of Fact as the findings of fact in the Proposal For Decision ("PFD"). The parties also submitted a Stipulation Regarding Additional Evidence in Addition to Parties' Agreed Findings of Fact for the ALJ's consideration preparing the PFD. Some stipulations were subject to objections ruled on by the ALJ.
3. Staff appeared and was represented by its counsel, Charles S. Neal and Sonia M. Mayo of the Board's Enforcement Division. Respondent appeared and was represented by his counsel, Jim Parker.
4. Respondent is an individual with a last known address at 400 N. Ronay Drive, Spicewood, Texas 78669.
5. Respondent was registered with the Securities Commissioner of the State of Texas ("Securities Commissioner") as a securities agent of the following securities dealers:
 - a) Aragon Financial Services, Inc. from April 1, 1994, through December 15, 1995;
 - b) Intersecurities, Inc. ("Intersecurities") from January 29, 1996, through December 4, 1996;
 - c) Washington Square Securities, Inc. ("Washington Securities") from March 18, 1997, through July 16, 1998; and
 - d) ProFutures Financial Group, Inc. ("ProFutures Financial") from October 12, 1998, to the present.
6. Respondent was registered as an investment adviser agent of ProFutures Capital Management, Inc. ("ProFutures Capital"), an investment adviser, from November 6, 1998, until December 31, 1998, when Respondent's registration expired by operation of law. An application for the renewal of Respondent's expired investment adviser agent registration was filed with the Securities Commissioner on or about April 19, 1999, and is currently pending before the Securities Commissioner.
7. Respondent held a Group 1, Life, Accident, Health, and HMO license with the Texas Department of Insurance ("TDI") from approximately February 21, 1992, to approximately April 22, 1998. Respondent also held a Variable Contract Agent's license with TDI from approximately May 31, 1996, to approximately April 22, 1998.

8. While registered with the Securities Commissioner as a securities agent of Intersecurities, Respondent held an appointment as a general insurance agent with Commercial Union Life Insurance Company of America ("CU Life") pursuant to his insurance licenses.
9. During Respondent's appointment with CU Life, the company paid advance commissions to insurance agents who submitted investor applications to purchase tax sheltered annuities.
10. From January 1996 to October 1996, Respondent designed and executed a scheme to defraud CU Life whereby he created, forged, and submitted eighteen (18) fraudulent applications for tax sheltered annuities to CU Life, for the purpose of obtaining advance commissions.
 - a. When preparing the applications, Respondent used the names of fictitious persons and fictitious addresses as purported applicants, and forged the signatures on the applications.
 - b. As the result of his scheme to defraud, Respondent received approximately \$24,500 in advance commissions from CU Life and used the funds for his own benefit.
11. Respondent's fraudulent applications represented that the applicants were employees of various school districts, thereby qualifying them for the type of annuity being offered.
12. In the course of his appointment with CU Life, including during the period of January 1996 to October 1996, Respondent also submitted bona fide applications.
13. CU Life initiated an investigation into Respondent's acts after it failed to receive premium payments from the purported investors on the annuity applications referred to in Finding of Fact Nos. 10 and 11.
 - a. The investigation included sending Respondent two (2) letters dated December 23, 1996, and January 24, 1997, regarding charge backs of advanced commissions to his commission account due to the nonpayment of premiums, and demanded repayment of the advanced commissions.
 - b. Respondent did not respond to the December 23 letter. He did respond to the January 24 letter, but he did not disclose his wrongdoing in that response.
14. In a letter to Respondent dated February 21, 1997, CU Life stated that it had determined that none of the applicants were employed by the school districts indicated, recited again that no premium payments had been received, and demanded Respondent provide an explanation of the circumstances surrounding

the applications in question, which were listed by name of the fictitious investor. CU Life also demanded a repayment of approximately \$24,500 in advanced commissions associated with the applications.

15. On February 24, 1997, CU Life's Internal Audit Department sent questionnaires to the names and addresses reflected on all of Respondent's annuity applications seeking confirmation of their transactions. The envelopes for the eighteen (18) fraudulent applications were returned to CU Life by the post office marked as undeliverable.
16. After issuing the February 21, 1997 letter, a representative of CU Life contacted Respondent by telephone and inquired about the circumstances surrounding the applications. Respondent responded to the letter, stating that he would check into it and get back to the representative.
17. Between February 21, 1997, and March 3, 1997, Respondent admitted to his Managing General Agent, Michael Walling, that he had submitted multiple false tax sheltered annuity applications with forged signatures to CU Life while working as its agent. Mr. Walling encouraged Respondent to confess his wrongdoing to CU Life.
18. On March 3, 1997, in a conference call with several members of CU Life at its Massachusetts headquarters, Respondent admitted his wrongdoing, including stating the names of the eighteen (18) fictitious applicants for whose applications he had received advanced commissions.
19. Respondent offered to repay the advanced commissions to CU Life, and sent a \$5,000 check on March 3, 1997.
 - a. Respondent and CU Life ultimately entered into a restitution agreement dated July 1, 1997, in which Respondent admitted he had submitted fictitious applications and forged signatures on such applications for annuities to CU Life and received commission advances as a result.
 - b. The restitution agreement required Respondent to repay the advanced commissions by March 1, 1998.
 - c. Respondent repaid the advanced commissions prior to November 1, 1997, approximately five months early.
20. Upon CU Life's investigation and discovery of Respondent's fraud, Respondent's appointment with CU Life was terminated for cause by CU Life on or approximately March 7, 1997.

21. On March 7, 1997, CU Life notified TDI of Respondent's termination and, in a response to a subsequent inquiry by TDI, CU Life notified TDI of the surrounding circumstances on June 23, 1997.
22. On approximately February 13, 1998, Respondent applied for renewal of his insurance licenses with TDI.
 - a. The renewals were opposed in writing by TDI's staff on March 20, 1998.
 - b. Respondent surrendered his licenses to TDI on April 21, 1998, and has not been licensed since with that agency.
23. On approximately January 3, 1997, Respondent filed a Form U-4 Application for Securities Industry Registration ("Form U-4") with the Securities Commissioner seeking to become registered as a securities agent of Washington Securities. The application was granted on approximately March 18, 1997.
 - a. Question 22N(1) of the Form U-4 application in effect at that time required applicants to disclose whether they had ever been discharged after allegations were made that accused them of "violating investment-related statutes, regulations, rules or industry standards of conduct."
 - b. The term "investment-related" was defined at the top of page 3 of the Form U-4 as, among other things, pertaining to insurance.
 - c. Respondent answered "no" to Question 22N(1).
 - d. Respondent did not amend his "no" answer to Question 22N(1) on his Form U-4 to disclose his March 7, 1997, termination from CU Life at any time during his registration with Washington Securities.
 - e. Question 22N(2) of the Form U-4 application in effect at the time required applicants to disclose whether they had ever been discharged after allegations were made that accused them of "fraud or the wrongful taking of property."
 - f. Respondent answered "no" to Question 22N(2).
 - g. Respondent did not amend his "no" answer to Question 22N(2) on his Form U-4 to disclose his March 7, 1997, termination from CU Life at any time during his registration with Washington Securities.
24. Respondent terminated his registration with Washington Securities on approximately July 16, 1998.

25. On approximately September 15, 1998, Respondent filed a Form U-4 application with the Securities Commissioner seeking to become registered as a securities agent of ProFutures Financial.
- a. Question 22N(1) of the then and currently effective Form U-4 application required applicants to disclose whether they had ever been discharged after allegations were made that accused them of "violating *investment-related* statutes, regulations, rules, or industry standards of conduct."
 - b. The "explanation of terms" section in the Form U-4 application defined "investment-related" as, among other things, pertaining to insurance.
 - c. Respondent answered "no" to Question 22N(1).
 - d. Question 22N(2) of the then and currently effective Form U-4 application required applicants to disclose whether they had ever been discharged after allegations were made that accused them of "fraud or the wrongful taking of property."
 - e. Respondent answered "no" to Question 22N(2).
26. On approximately September 16, 1998, Respondent filed a Form U-4 application with the Securities Commissioner seeking to become registered as an investment adviser agent of ProFutures Capital.
- a. Question 22N(1) of the then and currently effective Form U-4 application required applicants to disclose whether they have ever been discharged after allegations were made that accused them of "violating *investment-related* statutes, regulations, rules or industry standards of conduct."
 - b. The "explanation of terms" section in the Form U-4 application defined "investment-related" as, among other things, pertaining to insurance.
 - c. Respondent answered "no" to Question 22N(1).
 - d. Question 22N(2) of the then and currently effective Form U-4 application required applicants to disclose whether they have ever been discharged after allegations were made that accused them of "fraud or the wrongful taking of property."
 - e. Respondent answered "no" to Question 22N(2).
27. The Securities Commissioner registered Respondent as a securities agent with ProFutures Financial and as an investment adviser agent with ProFutures Capital based on the Form U-4s he filed in September 1998.

28. Respondent did not disclose the truth on the Form U-4 applications about the wrongdoing at CU Life on the advice of the attorney representing him with regard to the renewal of his licenses with TDI in the spring of 1998.
29. On approximately December 10, 1998, while registered with ProFutures Financial and ProFutures Capital, Respondent filed another application for insurance licenses with TDI.
 - a. On approximately January 7, 1999, TDI's staff indicated its opposition in writing to Respondent's application for licensure.
 - b. Before action could be taken on TDI's staff's opposition, the insurance company sponsoring Respondent's application at TDI (not ProFutures Financial or ProFutures Capital) withdrew its appointment of Respondent, which caused his application file at TDI to be closed automatically.
 - c. Respondent did not become licensed, and is not currently licensed, by TDI.
30. Upon learning of the TDI staff's January 1999 opposition to his insurance license applications, a representative of ProFutures Financial and ProFutures Capital inquired of Respondent as to the reasons for the opposition.
 - a. Respondent then advised the ProFutures Financial and ProFutures Capital representative of his wrongdoing with respect to CU Life.
 - b. Respondent had not previously disclosed his CU Life wrongdoing to a representative of either ProFutures Financial or ProFutures Capital.
 - c. The representative advised Respondent that the information surrounding his CU Life wrongdoing must be disclosed to the Securities Commissioner on Respondent's Form U-4 applications on file at the State Securities Board.
31. On approximately March 10, 1999, Respondent, by and through his counsel, requested a meeting with Staff for Respondent to make a confession about his wrongdoing at CU Life.
 - a. The meeting was held on March 11, 1999, with Respondent and his counsel present, along with counsel for Staff, and the Board's Dealer Registration Division investigators.
 - b. During the meeting, Respondent admitted to the fraudulent conduct with regard to CU Life, and represented to Staff the following:
 - (1) All of the money had been repaid;
 - (2) No investor had been harmed;

- (3) No regulatory, civil, or criminal charges had been brought against him;
 - (4) The Travis County District Attorney's office had declined to prosecute the case because he repaid the funds to CU Life;
 - (5) He (Respondent) would be amending his Form U-4 applications to answer questions 22N(1) and 22N(2) affirmatively; and
 - (6) ProFutures Financial and ProFutures Capital were developing specialized supervision procedures for Respondent.
- c. Staff asked for a copy of the specialized supervision procedures when they were completed.
32. Prior to Respondent's disclosure on March 11, 1999, Staff was unaware of Respondent's conduct at CU Life.
 33. Respondent subsequently submitted additional information requested by Staff detailing the names of the fictitious persons used in the scheme at CU Life, a copy of the restitution agreement between Respondent and CU Life, a letter from Respondent to CU Life admitting his wrongdoing and offering to repay the money, a letter regarding the declination of criminal prosecution due to the repayment of funds, the U-4 amendments, and letters of reference written to TDI by friends and business associates of Respondent with regard to his application for licensure with that agency.
 34. On approximately March 15, 1999, Respondent amended his prior Form U-4 applications for ProFutures Financial and ProFutures Capital to give "yes" answers to Questions 22N(1) and 22N(2), thereby admitting he was discharged by CU Life after allegations were made accusing him of violating investment-related statutes, regulations, rules or industry standards of conduct, and fraud or the wrongful taking of property.
 35. On March 19, 1999, Staff received a copy of the enhanced supervision procedures implemented by ProFutures Financial and ProFutures Capital necessitated by Respondent's conduct at CU Life. The procedures were to be effective for one (1) year.
 36. The enhanced supervision procedures in place at ProFutures Capital and ProFutures Financial prohibit Respondent from handling any customer funds, whether checks or wire transfers, and whether the funds are incoming or outgoing, and he is not permitted to meet with a customer in person without someone from the operations department of the company present.

37. Respondent will be free of the enhanced supervision procedures implemented by ProFutures Financial and ProFutures Capital in approximately March 2000.
38. On approximately March 27, 1999, Staff advised Respondent that it had completed its investigation of Respondent's conduct and determined that his fraudulent business practices and false filings constituted grounds for revocation of his securities agent registration and the assessment of an administrative fine. Respondent's April 19, 1999, investment adviser agent registration renewal application was not on file at the time.
39. Staff offered Respondent the opportunity to withdraw his registration in lieu of seeking revocation, but Respondent declined to withdraw his registration.
40. Respondent regrets the conduct at CU Life and his failures to disclose the conduct.
41. Respondent completed a course in Insurance Regulations and Ethics after he completed his settlement with CU Life.
42. No civil or criminal action has ever been filed against Respondent as a result of his conduct at CU Life.
43. ProFutures Capital and ProFutures Financial support Respondent's efforts to remain licensed as a securities salesman and an investment adviser agent, and they desire to keep him as an employee.
44. After he confessed to Staff about the CU Life incident, Respondent cooperated with Staff and provided it with information it requested.
45. Other than the incident with CU Life, Respondent has no history of previous violations of the Act or the Board's rules.
46. The public must be able to rely upon and place trust in securities dealers and investment advisers and their respective agents because:
 - a. the public uses securities dealers and investment advisers and their respective agents to assist in the investment of money to reach short- and long-term goals, and
 - b. securities dealers and investment advisers are responsible for handling and investing large amounts of money and securities.
47. The Securities Commissioner must have accurate, truthful, and complete information on the Form U-4s, through which persons become registered with the Board as agents of securities dealers and investment advisers, in order to determine whether prospective registrants are worthy of the public trust.

48. The fraudulent scheme Respondent perpetrated at CU Life and his subsequent failure to disclose it to the Securities Commissioner, except upon inquiry of and direction from his employer two (2) years later, was serious.

CONCLUSIONS OF LAW

1. The State Securities Board ("Board") has jurisdiction over this matter pursuant to Sections 14 and 23-1 of the Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 et seq. (Vernon 1964 and Supp. 1999) ("Act").
2. The State Office of Administrative Hearings has jurisdiction over this matter pursuant to TEX. GOV'T CODE ANN. ch. 2003 (Vernon 1999).
3. Service of proper and timely notice of the hearing was effected upon Respondent pursuant to TEX. GOV'T CODE ANN. ch. 2001 (Vernon 1999) and 7 TEX. ADMIN. CODE §105.2.
4. Based on Findings of Fact Nos. 5-11, Respondent engaged in fraudulent business practices, in violation of Section 14.A(3) of the Act.
5. Based on Findings of Fact Nos. 5.c, 20, and 23, Respondent did not violate the version of 7 TEX. ADMIN. CODE §115.1(g)(2)(E) effective from April 9, 1997, through December 2, 1997.
6. Pursuant to Section 18 of the Act and 7 TEX. ADMIN. CODE §§115.2(a) and 133.33(a)(4), the Form U-4 Uniform Application for Securities Industry Registration or Transfer ("Form U-4") is a form required by the Securities Commissioner.
7. Pursuant to 7 TEX. ADMIN. CODE §101.2(c), forms required by the Securities Commissioner have the same force and effect as rules.
8. Based on Findings of Fact Nos. 10, 20, 25.a-e and 26.a-e and 34 and Conclusions of Law Nos. 6 and 7, Respondent violated a rule of the Board, as prohibited by Section 14.A(6) of the Act.
9. Based on Findings of Fact Nos. 10, 20, 25.a-e, 26.a-e, 27, 34, 46, and 47, Respondent made a material misrepresentation to the Securities Commissioner in connection with any information deemed necessary by the Securities Commissioner to determine a dealer's financial responsibility or a dealer's or salesman's business repute or qualifications, in violation of Section 14.A(7) of the Act.
10. Based on Findings of Fact Nos. 5-11, 13-22, 25-27, 29-37, and 40-48, and Conclusions of Law Nos. 4 and 6-9, Respondent is subject to discipline pursuant to Section 14.A of the Act. Based upon Findings of Fact Nos. 5-11, 13-22, 25-27, 29-37, and 40-48, Conclusions of Law Nos. 4 and 6-9, and 7 TEX. ADMIN. CODE

§106.1, there is a basis for the issuance of an order to Respondent, pursuant to Section 23-1 of the Act, assessing an administrative fine.

MODIFICATIONS TO THE PROPOSAL FOR DECISION

Technical changes in the proposed findings of fact and conclusions of law have been made without being detailed below. Such non-substantive modifications include grammatical alterations and conforming citations to the format used by the State Securities Board. A substantive change to a conclusion of law is detailed below, along with a recitation of the specific reason and legal basis for the change.

Conclusion of Law No. 10

As submitted by the ALJ in the PFD, proposed Conclusion of Law No. 10 read as follows:

Based on Findings of Fact Nos. 5-11, 13-22, 25-27, 29-37, and 40-48, Conclusions of Law Nos. 4 and 6-9, and 7 TEX ADMIN. CODE §106.1, Respondent's registration as a securities agent should be revoked; his application for registration as an investment adviser agent should be denied; and a \$15,000 administrative penalty should be imposed against him.

It has been changed to state that based upon the specified findings and conclusions, Respondent is subject to discipline pursuant to Section 14.A of the Act. The conclusion of the ALJ that Respondent should be subject to a sanction of revocation, denial, and an administrative penalty is a "recommendation," not a "conclusion of law." Section 14.A of the Act clearly requires that the Securities Commissioner, rather than an ALJ, may "...deny, revoke, or suspend a registration, place on probation a dealer, agent, or salesman whose registration has been suspended, or reprimand a person registered..." under the Act. While there appears to be no prohibition for the ALJ, as the official who conducted the hearing, to *recommend* a sanction or range of sanctions for violation of the Act, the ALJ is not authorized to make such a *determination*. Such a recommendation, not being a conclusion of law, should not appear in the Conclusion of Law section of the PFD.

It has also been changed to delete the administrative penalty recommended by the ALJ to be imposed on Respondent pursuant to Section 23-1 of the Act. As stated above, an ALJ's recommendation regarding a sanction should be in the form of a recommendation, rather than a conclusion of law. Section 23-1 clearly requires that the Securities Commissioner, rather than the ALJ, may "...issue an order which assesses an administrative fine against any person or company found to have violated any provision of this Act, Board rule, or Board order." The Securities Commissioner has determined the appropriate sanction in this case, as set forth in the Order below.

The legal basis for the change in Conclusion of Law No. 10 is found in Government Code §2001.058(e)(1): the ALJ did not properly apply or interpret the applicable law, being Section 14 of the Act. Final decision authority for actions arising out of the Texas Securities Act rests with the Securities Commissioner, pursuant to Sections 3 and 14 of

the Act. Likewise, regarding the fine, the ALJ did not properly apply or interpret the applicable law, being Section 23-1 of the Act. The authority to assess an administrative fine for violation of the Act or Board rules rests with the Securities Commissioner, pursuant to Sections 3 and 23-1 of the Act.

ORDER

Based on the foregoing findings of fact and conclusions of law, the Securities Commissioner concludes that the Respondent has violated Section 14.A(3), (6), and (7) of the Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 et seq., providing grounds for sanctions under Sections 14 and 23-1 of the Act. An order should be issued revoking the securities agent registration of the Respondent, denying the renewal application of the Respondent as an investment adviser agent, and assessing an administrative fine.

IT IS THEREFORE ORDERED pursuant to TEX. REV. CIV. STAT. ANN. art. 581-14, that the registration of JAMES NEWTON DARWIN II as a securities agent is hereby REVOKED and that the renewal application of JAMES NEWTON DARWIN II as an investment adviser agent is hereby DENIED.

IT IS FURTHER ORDERED pursuant to TEX. REV. CIV. STAT. ANN. art. 581-23-1, that Respondent is assessed an administrative fine of \$15,000. Payment shall be made by delivery of a cashier's check to the Securities Commissioner in the amount of Fifteen Thousand Dollars (\$15,000), payable to the State of Texas, within fifteen (15) days after this order becomes final.

SIGNED and ENTERED BY THE SECURITIES COMMISSIONER this 3rd day of January, 2000.


DENISE VOIGT CRAWFORD
Securities Commissioner