MEMORANDUM

June 24, 1992

TO: The File [redacted]

FROM: former New York Enforcement Staff Attorney
Broker-Dealer Enforcement #1

SUBJECT: In the Matter of King Arthur (MNY-1490)

As a result of obtaining written and verbal information from two customers, Earl McClain and Sandra Bozarth, who invested money through Avellino & Bines ("A&B"), it is my opinion that A&B have been selling unregistered securities and may be acting as an unregistered investment company or broker-dealer. I am basing my opinion on the fact that Ms. Bozarth and Mr. McClain were told that they were investing money so that A&B could use the money to purchase securities.

The transactions went as follows: An investor would send money to A&B. In turn, A&B would invest the money in the securities market - primarily in "arbitrage." The transactions were set up to give an appearance of a demand note. Once an investor gave A&B money, A&B sent back a letter indicating that the investor gave them X amount of money and that A&B was giving them between 13.5% - 18% interest. Both Mr. McClain and Ms. Bozarth invested money with A&B. In turn, A&B gave Ms. Bozarth and Mr. McClain a notice stating that they would be getting a stated interest compounded quarterly. The interest rate that A&B was paying on this money was 13.1% - 14%.

Based on the information supplied by these two customers, Allen Meyer, John Gentile and I contacted Frank Avellino of Avellino & Bienes. During the conversation, Mr. Avellino told us that he borrows money from friends, relatives, referrals and past clients of his CPA firm. In turn, he gives these people "demand notes." WHen asked what he does with the money borrowed, Avellino stated that he invests the money in real estate and "some securities." Mr. Avellino said that he does not solicit people and only borrows money from people that he knows.

Based on this information it appears that Mr. Avellino and Mr. Bines and the firm A&B have been engaged in selling securities to the public, which are unregistered, in violation of Section 5(a) of the Securities Act of 1933. My opinion is based upon research, in particular the United States Supreme Court case of Reves v. Young, 110 S. Ct. 945 (1990). In Reves, the Supreme Court noted that Congress "enacted a definition of security sufficiently broad to encompass virtually any instrument that might be sold as an investment." Specifically, in Reves, the Supreme Court adopted the Second circuit's "family resemblance" approach to determine whether a note is a security. The family resemblance approach begins with the presumption that every note is a security. This presumption is rebuttable only if it is shown that the note bears a strong resemblance, in terms of four specified factors, to

any instrument on a list of instruments which have previously been deem not to be securities. The Reves decision lists the following as notes that have been held to be securities: the note delivered in consumer financing; the note secured by a mortgage on a home; the short term note secure by a lien on a small business or some of its assets; the note evidencing a character loan to a bank customers; short term notes secured by an assignment of accounts receivable; a note which simply formalizes an open-account debt incurred in the ordinary course of business; and notes evidencing loans by commercial banks for current operations. According to Reves even if the note does not resemble any of the above notes, they may nevertheless be deemed not to be securities based on an examination of four factors: 1) the motivations of a reasonable buyer and seller (if the sellers purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested in primarily in the profit produced (i.e. interest) the instrument is likely to be a security); 2) the plan of distribution, 3) the reasonable expectations of the investing public, and 4) the existence of an alternative regulatory scheme.

Applying Reves to the facts and evidence gathered, indicates that although Avellino and Bienes attempt to disguise the investment as a "demand note," the investment/demand note is still a security and should have been registered.

STRATEGY

In order to assist me in recommending to the Commission that the staff seek an injunction, I have assembled a group of examiners to help accumulate documents and obtain necessary evidence. This group consists of: Steve Weinstein (Law Clerk), John Gentile (Branch Chief, Broker-Dealer Examinations and Interpretations), Pat Iossa (Examiner), Robert DeLeonardis (Examiner) and John Nee (Examiner). I have brief them on the case, and will be monitoring the evidence gathered. The group will be calling customers and obtaining declarations from them. We will have a meeting this afternoon to discuss exactly what should be said in obtaining these declarations from customers. I will be extremely clear on what the group can say with respect to the informal inquiry (*i.e.*, fact finding inquiry only).

Because I have been notified by Avellino & Bienes' counsel - Ira Sorkin, that they will voluntarily cooperate, and because Andrew Copperman's counsel - John Murphy, also said that Copperman will voluntarily cooperate, there is not need to seek a formal order of investigation. However, if needed, I'm sure that we would be able to get a formal order based on the information provided by the two clients mentioned above, and based on the information provided by Frank Avellino.

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