ADMINISTRATIVE PROCEEDING
FILE NO. 3-4506

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
MITCHUM, JONES & TEMPLETON, INC.	:
(Laidlaw & Co., Inc.)	:
	:

INITIAL DECISION

Washington, D.C.
May 28, 1976

Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: James G. Mann and Thomas D. Hamill, for the Commission's Division of Enforcement.

Jay H. Mintz, Frank M. Kaplan and Charles T. Rose, of Schwartz, Alschuler & Grossman, for Mitchum, Jones & Templeton, Inc.

BEFORE: Max O. Regensteiner, Administrative Law Judge

In these public proceedings under the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940, which originally involved more than 20 respondents, the only issues remaining for determination are whether Mitchum, Jones & Templeton, Inc. ("registrant"), a registered broker-dealer and investment adviser, engaged in misconduct as alleged by the Division of Enforcement and, if so, what if any remedial action is appropriate in the public interest.[1/]

The allegations pertaining to registrant relate to its role in a proposed public offering of 200,000 shares of common stock of SaCom at $6 per share. According to SaCom's registration statement, which became effective on October 31, 1972, as well as the final prospectus used in the offering and certain exhibits filed as part of the registration statement, registrant was a member of the underwriting group with a firm commitment to purchase 12,000 shares. The basic allegation is that, inconsistently with those representations, registrant had an undisclosed understanding with Laidlaw & Co., Inc. (a former respondent), the managing underwriter, whereby registrant would not be required to (and in fact did not) purchase any SaCom stock. The representatives of the two firms who assertedly entered into this understanding were Rollin F. Perry (also a former respondent), at the time head of Laidlaw's corporate finance department, and John B. Callery, Jr., who was then manager of

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1/ Except for registrant and Leo E. Bromberg, all respondents submitted settlement offers which the Commission accepted. By recent order of the Commission, the proceedings with respect to Bromberg were discontinued.

Although the findings herein of necessity make reference to some of the former respondents as well as to certain non-respondents, they are binding only on registrant.

registrant's syndicate department and a first vice-president. The Division alleges that by failing to disclose the asserted understanding, registrant willfully violated and willfully aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and willfully aided and abetted violations of Sections 5(b), 7 and 10 of the Securities Act.[2/] Registrant is also charged with a failure to provide reasonable supervision in connection with the alleged antifraud violations.

Following extended hearings, the parties filed proposed findings and conclusions and supporting briefs, and the Division filed a reply brief.

The findings and conclusions herein are based on the record and on observation of the witnesses' demeanor. Preponderance of the evidence is the standard of proof applied.

Registrant

Registrant, which was founded in 1920, has its main office in Los Angeles. It is a member of the New York Stock Exchange and other exchanges and of the National Association of Securities Dealers. During 1972, when the events in question occurred, it engaged in a wide range of securities activities, including the operation of a retail

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2/ Section 5(b) requires, among other things, that a proper prospectus be delivered in connection with the delivery of securities. Sections 7 and 10 specify the information which must be included in a registration statement and prospectus, respectively, filed with the Commission. Where a prospectus contains materially misleading statements, its filing violates Sections 7 and 10 and its delivery violates Section 5(b). See Eugene M. Rosenson, 40 S.E.C. 948, 952 (1961) and S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1098 (C.A. 2, 1972).

business and the origination of and participation in underwriting syndicates. As of October 1972, it conducted retail activities through about 20 offices, most of them in California, had approximately 20,000 customer accounts and employed about 300 salesmen.

Callery entered registrant's employ in 1953 as a retail salesman. In 1960 he became a partner of the firm (then a partnership), and in 1964 or 1965 he was appointed manager of its syndicate department. Throughout 1972 Callery had general responsibility for the operations of that department, including the authority to enter into agreements committing registrant to participate as an underwriter in syndicates managed by others. Callery left registrant in 1973. He was not named as a respondent in these proceedings.

The SaCom Offering

SaCom had been incorporated in California in 1968. In 1972 it was engaged in the design, development, manufacture and sale of specialized communications and microwave systems and equipment, and it had about 180 employees. Its facilities were located in the vicinity of Los Angeles. A registration statement for the SaCom offering was originally filed with the Commission in June 1972 and, as noted, became effective (in amended form) on October 31, 1972. The registration statement and prospectus stated that Laidlaw was the representative of the underwriters (the technical term for managing underwriter) and listed 21 other broker-dealers, including registrant, as participating underwriters. Together with one other broker-dealer, registrant was listed in the 12,000 share bracket, which

was the top bracket below Laidlaw, the manager. Laidlaw's listed underwriting commitment was 74,000 shares.

Laidlaw, a New York firm founded in 1842, did not enter the field of corporate securities underwriting until sometime after November 1968 when it disposed of its private commercial banking business. Through its corporate finance department, which Perry headed from mid-1970 through 1972, it had been manager of one other underwriting syndicate for a stock offering prior to the SaCom offering. Until the SaCom offering, Laidlaw enjoyed an excellent reputation in the securities industry.

As will be discussed in more detail below, the SaCom offering proved to be disastrous. Only 69,630 shares of the 200,000-share offering were sold to public investors, none by registrant. Within a few hours after the registration statement became effective, Laidlaw, through Perry, terminated the underwriting syndicate and accepted or purchased for its own account the 130,370 shares then unsold, including the 12,000 shares for which registrant was committed. At the closing which took place several days later, SaCom was paid the full amount to which it was entitled under the underwriting agreement. Registrant paid Laidlaw for the 12,000 shares and was repaid by Laidlaw in the same amount. A statement of account from Laidlaw to registrant, dated November 8, 1972, showed a credit to registrant of $1,800 for underwriting compensation (representing 15¢ per share for 12,000 shares), debits of $1,918 for expenses and $300 for transfer tax on "shares sold for your [registrant's] account to dealers," and a net

balance due Laidlaw of $418. Presumably this amount was paid to Laidlaw, although the record contains no evidence on the point. Laidlaw's ownership of the unsold SaCom stock, together with other SaCom shares which it had purchased in the open market, caused it to be in violation of the New York Stock Exchange's net capital rule and led to the demise of the firm as an independent entity.

The Alleged Understanding

The Division's contention, in essence, is that at some time prior to the effective date of the SaCom offering, Perry and Callery reached an understanding, undisclosed to the other underwriters, prospective underwriters, or investors, that registrant would not have to bear the risk normally assumed by an underwriter in a firm commitment underwriting that in the event of an unsuccessful offering it may have to accept for its investment account that portion of its underwriting commitment which remains unsold. For proof of the existence of the alleged understanding, the Division relies in the first instance on testimony given by Callery during its investigation of the SaCom offering. It claims that in the course of that testimony, pertinent portions of which were received in evidence during the public hearings, Callery repeatedly admitted the existence of such an understanding. However, in view of the fact that in an affidavit later submitted by Callery, he had sought to "clarify" that testimony so as to negate any such admissions (in the Division's view, the affidavit amounted to a recantation rather than a clarification), and that at the public hearings both Callery and Perry denied the existence of any such understanding, the Division also relies on evidence

demonstrating, in its view, that absent such understanding, (1) registrant would not have participated in the syndicate and (2) registrant would have been required to accept for its investment account the 12,000 shares, which had not been sold to the public or to other underwriters or dealers.

Registrant, on the other hand, asserts that the "so-called 'arrangement'" between Perry and Callery was simply a communication, customary in the syndicate business, that registrant would be obliged to offer for sale to the public only those securities for which it had indications of interest -- which proved to be none. It urges that that communication did not abrogate or modify its obligation to pay SaCom for the 12,000 shares, which was in fact met, or its obligation to accept for its investment account any shares not "retained" by it which were not sold or purchased by other underwriters or selected dealers. It was Laidlaw's decision to buy those shares for its own account, a decision which was within its discretion as manager to make, that relieved registrant of the latter obligation (so the argument goes).

In my opinion, a preponderance of the evidence supports the conclusion that Callery and Perry had an understanding substantially as urged by the Division. That determination rests both on the statements made by Callery in his investigative testimony and on the circumstances surrounding the SaCom offering. To put these matters, the parties' contentions and my findings into their proper context, it may be helpful to begin the discussion with a reference to pertinent provisions of

the contracts entered into by the SaCom underwriters and to certain terminology commonly employed in the syndicate or underwriting business. Under the terms of the underwriting agreement, which was executed on October 31, 1972, SaCom agreed to sell to the underwriters, and each underwriter agreed to purchase from SaCom, a specified number of shares at a price of $5.49 per share, representing the public offering price of $6 per share minus the "gross spread." The division of the gross spread was provided for in the other basic contract, the agreement among underwriters, executed on the same date. Under its terms, Laidlaw was entitled to 10¢ per share for originating and managing the offering; the underwriters' compensation, for risking their capital, was fixed at 15¢ per share; and the balance represented the selling concession of 26¢ per share. That concession would be earned by underwriters and members of the selling group on shares sold to public investors.

As is normally the case, the agreement among underwriters established the manager as the party chiefly responsible for effecting the distribution of the securities being offered. By its terms, each underwriter authorized Laidlaw to reserve out of that underwriter's commitment whatever amount it chose for sale to institutional and individual retail purchasers either directly or through a selling group of dealers selected by it. The remaining portion of each underwriter's commitment represented its "retention." Every underwriter obligated itself to offer to the public the number of shares comprising that retention. The agreement further provided that in the course of the offering the number of shares in the reserved and retained portions, respectively, could be adjusted in the manager's discretion.

There were two ways in which an underwriter could end up with unsold shares if the offering proved unsuccessful. One was if it was unable to sell its retained shares. In registrant's case, it was assigned "zero retention" on the effective date. An underwriter could also be saddled with unsold shares if it had less than 100 percent retention, and the reserved shares, referred to colloquially and collectively as "the pot," were not fully sold. Under those circumstances, any such underwriter could be subject to "pot liability" on a pro rata basis. As noted, it is the Division's contention that the understanding between Callery and Perry precluded Laidlaw from imposing on registrant its proportionate share of such liability and as a practical matter precluded it from imposing such liability on other underwriters as well.

Returning now to the circumstances surrounding registrant's participation in the SaCom underwriting syndicate, the record shows that Perry had some difficulty in putting the syndicate together, with the result that the target date for the offering was postponed several times. Efforts to obtain interim financing for SaCom during 1972 were substantially unsuccessful. There is no evidence, however, that Callery was aware of these matters.

Perry anticipated that a substantial part of the offering would be sold in the Los Angeles area because that was where SaCom was located. Indeed, in the summer of 1972, Laidlaw hired a corporate finance representative for the West Coast with an office in Los Angeles whose major activity initially was to "help syndicate the [SaCom] deal," i.e., line up underwriters and possibly selling group members. Registrant was one of the most substantial and highly regarded firms

in the Los Angeles area and it had a large underwriting business. In 1972 alone, it participated as underwriter in about 400 offerings; in another 180-200 offerings it was a selling group participant. 3/ And, as noted, it had a very substantial retailing capacity.

Perry's first communication with Callery regarding the SaCom offering occurred at a meeting in Callery's office in the late summer of 1972. The meeting was held on Perry's initiative for the purpose of soliciting registrant's participation as an underwriter in the SaCom offering. At some point thereafter registrant agreed in principle to join the underwriting group. 4/ Registrant subsequently obtained an indication or indications of interest totalling 600 shares. 5/ However, those indications were cancelled before the effective date of the offering, and registrant so advised Laidlaw. As noted, on the effective date registrant was assigned zero retention by Laidlaw.

3/ According to Callery, during the 1960's registrant was manager or co-manager of securities offerings totalling about $1 billion, making it somewhere between 30th and 35th largest underwriter in the United States.

4/ Legally, it was not bound until the underwriting agreement was signed on October 31, 1972, the effective date.

5/ Callery did not know or could not recall whether one or more customers accounted for the 600-share indication(s).

Callery's Admissions

In the course of the public hearings, portions of investigative testimony given by Callery in September 1973 were received as substantive evidence.[6/] As noted, the Division takes the position that in that testimony Callery repeatedly admitted the existence of the asserted understanding with Perry. Registrant, on the other hand, urges that the questions asked were not clear, with a consequent failure of communication between questioner and witness. What Callery intended to convey, it claims, was merely that Perry assured him that registrant would not be assigned a retention in excess of indications of interest obtained by it, and that, without affecting registrant's contractual obligations, Laidlaw would be in a position to and would "take back" as reserved shares and reallocate to other underwriters and the selling group shares not retained by registrant. That explanation of Callery's investigative testimony essentially comports with his testimony at the public hearings and with the "clarifying" affidavit.

The portion of Callery's investigative testimony received in evidence which is set out below fairly conveys the substance and flavor of that testimony:

> "Q Did Mr. Perry indicate to you that you were not required to take any part of the 12,000 shares you were underwriting?
>
> A Yes, he did.

6/ They were admitted as prior statements inconsistent with Callery's testimony and as admissions by registrant. Cf. Rule 801(d) of the Federal Rules of Evidence.

Q Did Mr. Perry ever say anything as regards the possibility that the offering would not be successful?

A I can't recall if he did or not. He seemed very assured that the offering would come, that they would tailor it to the size that could be offered successfully, and I assumed from him that if we couldn't do our job that Laidlaw would do it.

Q Did he say Laidlaw would do it, or the syndicate would do it?

A Well, that Laidlaw would. I was under the assumption that the stock we couldn't sell, they could sell.

Q Did your understanding with Mr. Perry encompass the possibility that Laidlaw would reallocate the stock, that is, unsold stock, to the hands of the syndicate members to the underwriters pursuant to the underwriting agreement?

A My understanding with him was that if we couldn't sell our stock that he would take our stock back. What he did with it then is the concern of the managing underwriter, the manager of the account. My assumption was they would redistribute the stock to other underwriters or to the selling group. Their own sales force would place the stock that we didn't place.

Q Was it your understanding that in no event to allocate would your firm be required to take any of the SACOM stock? 7/

A Yes, that is correct.

Q. Now, you provided Laidlaw with the power of attorney to sign the underwriter's agreement?

A Yes.

* * *

Q Now the underwriting agreement provided, did it not, that your firm could be required to accept SACOM stock?

A Yes.

7/ Callery testified at the public hearings that he could not recall the actual question, which was apparently garbled in the transcription.

Q Was that contrary to your understanding with Perry?

A Well, under the terminology of an agreement among underwriters, that would be in conflict with his verbal assurance that if we were not able to place the stock that Laidlaw would take the stock back.

MR. MINTZ [Counsel for Callery and registrant]: I think for clarification purposes, are we not talking about the agreement among underwriters as opposed to the underwriting agreement?

THE WITNESS: It should be "agreement among".

By Mr. Mann:

Q Why did you provide him with this power of attorney then?

A That was necessary to be a part of the underwriting group.

Q Why didn't you insert some provision in the agreement to the effect that your firm could not be required to take stock?

A Well, we had the verbal assurance that we would not have to take stock from Mr. Perry, and I could see no reason -- whenever I have given stock back, I have never tampered with an underwriting agreement or an agreement among underwriters.

Q Was it your understanding that the agreement with Perry, verbal agreement, would supersede the other agreement?

A Absolutely. That is the nature of the syndicate business.

Q What is the nature of the syndicate business?

A That agreements between the managing underwriter and his underwriters -- you make verbal agreements all the time as to how much stock you are taking down; if you are taking down additional stock; if you are giving back stock, you make a verbal agreement with the manager, the syndicate manager.

Q Is it fair to state that your firm was not an underwriter of 12,000 shares?

MR. MINTZ: Let me think about that one for a minute.

MR. MANN: Let me withdraw it.

MR. MINTZ: Let me go on the record and object to that question and suggest that instead of asking Mr. Callery for what amounts to almost a legal determination of what an underwriter is, suggest that maybe the question be rephrased to basically ask the facts surrounding Mitchum, Jones & Templeton's obligation.

MR. MANN: I will withdraw the question.

Q Mr. Callery, did you consider in your own mind that Mitchum, Jones was an underwriter in the SACOM offering?

A I considered us to be an underwriter, yes, a part of the underwriting group.

Q Did you consider that your group had an underwriting obligation, or any underwriting obligation with regard to the SACOM deal?

A Yes. Because that is assumed when you sign the documents that you are assuming a liability.

Q What obligation did you assume?

A We -- in effect, when he took back all of the stock, we had no obligation for placing any of the stock.

Q Well, is it fair to state that on the effective date your firm had no obligation whatsoever with regard to taking stock?

A That's correct.

MR. MINTZ: Let me interject this thought: The answer to that question involves, I think, a legal determination as to whether or not the verbal understanding between Mitchum, Jones & Templeton to Laidlaw was an enforceable obligation in light of the executed agreement among underwriters.

By Mr. Mann:

Q Well, Mr. Callery, was it your understanding, pursuant to your verbal understandings and agreements with Perry, that your firm had no obligation whatsoever to take SACOM stock?

A That's correct, that is it.

Q So pursuant and in accordance with your understanding and agreements with Mr. Perry, you had no underwriting obligation; is that correct, in SACOM?

Q Yes.

MR. MINTZ: Let me again interject this: I think it's appropriate if you ask Mr. Callery his conversations with Mr. Perry concerning whether or not Mitchum, Jones & Templeton could turn back 12,000 shares of stock to Laidlaw; however, I am not sure it's appropriate to ask Mr. Callery what Mitchum, Jones & Templeton's obligation was.

These would be the agreements among underwriters with the verbal understanding between Mr. Callery and Mr. Perry.

MR. MANN: I am not referring to the legal effect, if any, of the formal written agreement.

My question refers to the agreement with Mr. Perry:

In accordance with those verbal agreements, is it correct to state that you didn't consider you had an underwriting obligation with regard to SACOM?

THE WITNESS: Yes." (Div. Exh. 2, pp. 29-34)

It is evident that the above testimony did not have as clear a focus as would have been desirable. And it appears likely that at least in some degree there may have been a failure of communication between Division counsel and Callery. For example, as Callery testified at the public hearings, he may have understood references to registrant's not being required to "take" stock, which appear in several of the questions and answers, as pertaining merely to the retention of stock for retail sale and not -- as the Division apparently interpreted them -- to absolution from the risks normally assumed by an underwriter.

On the other hand, at the time he was being interrogated, Callery knew that Laidlaw had absorbed all of registrant's 12,000-share commitment, or at least that registrant had sold no stock and had not been required to accept any unsold stock despite the failure of the offering. Thus, it must have been apparent to him that the Division was concerned with that aspect of the offering. Questions asked in a variety of forms gave him the obvious opportunity and opening to state that his understanding with Perry pertained only to registrant's selling obligation and not its obligation with respect to any unsold stock. Yet Callery, who impressed me as a sophisticated and articulate individual and who had had vast experience in the underwriting business, failed to so state in testifying, among other things, that it was Laidlaw's concern what it did with unsold stock taken back from registrant and that he did not deem registrant to have an underwriting obligation. My assessment of the over-all import of Callery's investigative testimony in the context indicated leads me to the conclusion that it does reflect an admission that he and Perry had an understanding that registrant would not have to accept any unsold SaCom stock.

Other Evidence

As previously indicated, the circumstances surrounding the offering are also most reasonably consistent with the existence of an understanding between Perry and Callery substantially as alleged by the Division. Most telling, in this connection, are the absence of any effort by registrant to sell

SaCom shares to its customers[8] and Perry's actions on the effective date of the offering.

Registrant argues that no "real evidence" was introduced that it made no effort to obtain indications of interest. In fact, there is considerable evidence that registrant and Callery did not follow their normal procedures in the SaCom offering. For example, Callery testified that it was standard practice for the syndicate department, upon acceptance of an underwriting position, to include the offering in question on the so-called syndicate calendar which was distributed to the branch offices on a weekly basis. The parties have stipulated that the syndicate calendar for the week preceding the effective date of the SaCom offering (when sales efforts would normally be expected to reach their peak)[9] did not include the SaCom offering.[10] Further, Callery testified that it was standard

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8/ The Division also relies on certain other evidence, such as that pertaining to the small size of the issuer, the speculative nature of the offering, and registrant's declination of prior invitations to join the underwriting syndicate for its argument that Callery (and registrant) had no interest in the offering on its merits and would not have participated in the syndicate absent the understanding. While I do not find such evidence persuasive, the record makes clear that, for whatever reason, registrant did not wish to place the stock with its customers.

9/ The parenthetical phrase represents my observation and is not a part of the stipulation.

10/ Callery testified that he did not know whether previous syndicate calendars included the SaCom offering. When asked by Division counsel whether anyone had indicated to him that SaCom never appeared on any syndicate calendar, he responded that he had discussed the matter with his counsel (the same attorney who represented registrant at the hearings), and he refused to answer the question on the basis of the attorney-client privilege.

procedure for him or his associates in the syndicate department to discuss a securities issue with divisional sales managers or branch managers after he had accepted an underwriting position for registrant. Here the managers were not contacted, either initially or later. Moreover, Callery's testimony indicates that no preliminary prospectuses were sent to customers.[11/] In light of registrant's normal practice in 1972 of sending a preliminary prospectus to a customer if requested by the customer or if a salesman tried to get an indication of interest, this strongly suggests the absence of any effort to obtain such indications.[12/]

Moreover, common sense indicates that in 1972, a year characterized by knowledgeable witnesses as one of very high underwriting activity, registrant with its large retail distribution facilities could have sold a substantial number of SaCom shares had it so desired. It must be noted in this connection that Callery testified that it was his impression that SaCom, though smaller than issuers for which registrant would normally be an underwriter, had a good growth record and good prospects. And it was located in registrant's home territory. I also deem significant the testimony of a principal of another underwriter in the SaCom offering who until 1970 had been manager of registrant's Phoenix, Arizona branch office.[13/] He testified that SaCom was not a difficult issue to sell and that in October 1972 new issues were "the thing that

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11/ In addition, records of the printer which printed the prospectuses show that only 50 were ordered for registrant, and that they were all delivered to one office in Los Angeles, which could have been the main office. The printer's records do not show the source of the order.

12/ The record does not show whether the indications(s) of interest for 600 shares which registrant had at one time were solicited or unsolicited.

13/ His firm sold its full commitment of 3,000 shares of SaCom stock.

was doing . . . the best." (Tr. 374) And he expressed the opinion that for registrant, as a multi-office, retail oriented firm, 12,000 shares would have been a relatively insignificant amount of stock to retail.

It seems highly unlikely that registrant would have joined, or remained in, the underwriting syndicate and made no effort to sell shares unless it had the assurance that itsassigned retention would not exceed indications of interest and that it would not be liable for unsold shares in the syndicate pot. Registrant suggests that it is not necessarily customary for broker-dealers who have agreed to participate in an offering as underwriters to obtain indications of interest, since a broker-dealer may participate merely in a "banking" and not in a distribution capacity. While this observation may be sound as an abstract proposition, as applied to the facts here it suffers, among other deficiencies, from the absence of any evidence that registrant's participation was solicited for "banking" purposes. On the contrary, Callery's testimony is to the effect that it was implicit in Perry's invitation to registrant to join the syndicate that Perry wanted registrant to use its best efforts to sell its commitment, and that Callery expected registrant to be able to sell SaCom stock, hopefully all 12,000 shares. And Perry testified, among other things, that he expected registrant to do a "terrific [selling] job" (Tr. 1095) and was "shocked" and "amazed" that registrant had not obtained any indications of interest.

The record suggests one other possible interpretation of registrant's lack of sales effort which would be consistent with the non-existence

of the claimed understanding. But I find it unpersuasive. As previously indicated, Callery testified that in their meeting Perry indicated that there would be considerable demand for the SaCom stock and that Laidlaw would be able, itself and/or through others, to place any stock which registrant was unable to sell. Perry testified to the same effect. Callery further testified that when he called Perry shortly before the effective date to tell him the 600-share indication of interest had been cancelled and to ask him whether Laidlaw would "take back" that amount, Perry indicated there would be no problem and he would give registrant zero retention, because "the account was in good condition, that he had places to go with our stock." (Tr. 326) In view of that response, Callery testified, he expected the offering to be successful and he did not expect on the effective date that registrant would have any pot liability. Registrant further argues that Callery assumed that if interest in the offering declined before the effective date, Laidlaw would postpone the offering, reduce its size or take some other action to avoid the possibility of pot liability.

It seems incredible to me, however, particularly in the context of a very speculative offering such as SaCom's was, that if Callery thought registrant might be subject to pot liability, he would have blithely relied on Perry's assurance that there was ample demand for the SaCom stock, or on an assumption that Laidlaw, with which he had not previously been associated in an underwriting, would not proceed with the offering if demand and supply were not in balance. The only conversation with Perry that Callery could recall, other than their meeting, was the

telephone conversation shortly before the effective date in which, according to Callery, Perry indicated no concern about cancellation of even the 600-share indication of interest. In light of the fact that on the day preceding the effective date Perry anticipated that 60,000 shares would be unsold as of the following day, I simply cannot credit Callery's account of that conversation.

Thus, I am left with the inference that registrant's actions or rather inaction in connection with the distribution of SaCom stock was attributable to an understanding between Callery and Perry that registrant would not be exposed to the risk of its commitment being unsold. 14/

That inference becomes even more compelling in light of the evidence concerning Perry's actions on October 31, 1972, the effective date of the offering, as viewed in the context in which such actions occurred. As has been noted, it quickly became apparent to Perry that there was little buying interest in the SaCom stock being offered and

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14/ The question of why, even with this understanding, Callery agreed for registrant to join the syndicate is somewhat puzzling. The most obvious possible motive, and the one suggested by the Division, is that by reason of the understanding Callery expected that registrant would receive an underwriting fee in a substantially riskless transaction. The Division points out that even though the net result for registrant was a loss of over $400, Callery could not anticipate the amount of the expenses that would be charged to registrant. And Perry was "out of the picture" by the time expenses were assessed. As testified by one of registrant's expert witnesses, an underwriter would normally expect to make a profit on its underwriting compensation. On the other hand, the amount of registrant's potential profit from underwriting compensation was small at best and was insignificant in terms of registrant's total underwriting business.

that the offering was a "disaster." 15/ Late in the morning of October 31, Perry decided to and did terminate the underwriting syndicate, relieve the underwriters of their obligations except for what they had retained, and accept or purchase all unsold stock in the syndicate, totalling 130,370 shares, for Laidlaw's own account.

The crucial question, for purposes of this proceeding, relates to the reasons for Perry's actions. Registrant urges that, as Perry testified, his decision to buy the unsold stock was based on his belief that Laidlaw's reputation would suffer irreparable damage and the firm would in effect be out of the underwriting business if it required the syndicate members to take back their portions of the unsold stock. The Division, on the other hand, contends that the only reasonable explanation for Perry's actions on the effective date is that by reason of the understanding with registrant and a comparable understanding with at least one other underwriter, Perry could not require them to assume pot liability. By way of explanation for the fact that Perry did not allocate pot liability to other underwriters, the Division points to the fact, established by expert testimony presented at the hearings, that it would not have been feasible to discriminate among underwriters. In light of the surrounding circumstances, I find the Division's explanation of Perry's actions by far the more persuasive.

15/ Perry testified that on the effective date, buying interest vanished and was replaced by selling interest. He further testified that the sell orders came from holders of large blocks who had obtained their stock in the "initiation" of SaCom or in connection with acquisitions by SaCom.

First, information in Perry's possession regarding Laidlaw's net capital position put him on clear notice that the actions he took on October 31 would endanger Laidlaw's very existence. Under the circumstances, I cannot accept his testimony that he was motivated by concern for the firm's reputation in the underwriting business. William E. Dugan, Laidlaw's chairman and chief executive officer during the period under consideration, testified that at a meeting with Perry and Laidlaw's controller shortly before the effective date of the SaCom offering, he advised Perry of Laidlaw's net capital position in relation to various standards applied by the New York Stock Exchange in the enforcement of its net capital rule. Thus, he informed Perry that Laidlaw had excess capital of about $10,000 over a 10:1 ratio between aggregate indebtedness and net capital (above which the Exchange exercised special surveillance); about $275,000 over a 12:1 ratio (above which business contraction was required); and about $550,000 above a 15:1 ratio (above which a member was required to cease doing business). As Dugan further testified, he told Perry that the firm's capital was sufficient to support the contemplated underwriting commitment of 74,000 shares, 16/ provided the offering was successful. He further advised Perry that on October 18 he had signed a 30-day letter of intent, on behalf of Laidlaw, to merge with another firm, and he stressed the importance of Laidlaw's maintaining a good capital position during that period. Perry testified

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16/ Dugan testified that such a commitment would result in a "capital hit" of slightly above $130,000 and that the Exchange was not concerned about a firm exceeding the 10:1 ratio because of an underwriting commitment, as long as it stayed below a 12:1 ratio, provided the distribution was completed within three weeks.

that he could not recall any discussion with Dugan about a merger in relation to capital requirements for the SaCom offering, that it was his impression, based on what Dugan told him, that Laidlaw had about $650,000 — $700,000 of capital available to support the underwriting, and that he thought this was adequate to support the unsold syndicate shares acquired by Laidlaw. Dugan impressed me as a forthright witness and as having a clear recollection of the discussions with Perry concerning net capital. I credit his version of those discussions.

Further support for the Division's position concerning the reasons for Perry's actions on the effective date is found in evidence that Perry had an understanding with another firm listed as underwriter that it would not be required to take unsold shares. That firm, Sterling Grace & Co., which according to the SaCom registration statement had a commitment to purchase 8,500 shares, had a retention of zero on the effective date and sold no stock in the offering.

Melvin Marks, an official of Sterling Grace who acted as an intermediary between Perry and his own superior, testified that the latter had originally declined Perry's invitation for Sterling Grace to participate as an underwriter, but had accepted a subsequent offer to participate with zero retention. When Marks' testimony was taken during the SaCom investigation,[17/] he made certain statements to the effect that he understood from his conversation with Perry that

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17/ Portions of the investigative transcript were received in evidence (Div. Exh. 7).

Sterling Grace would not be required to take stock under any circumstances even if the offering was not all sold, and that he did not consider his firm to be an underwriter, since it was "buying nothing and selling nothing." (Div. Exh. 7, p. 53) In his testimony at the public hearings, Marks stated that Perry clearly indicated to him that the offering was all sold or at least that there were sufficient indications of interest so that there would be no problem, and that the question of what would happen if the offering were not all sold never entered his mind. Accepting that testimony -- and despite certain inconsistencies there is some support for it in the investigative testimony -- the insistence of Sterling Grace on zero retention as a prerequisite to joining the syndicate makes it clear that it anticipated, as Perry must have realized, that it did not expect to be required to accept SaCom stock under any circumstances.

The Division further asserts that shortly after the effective date, Perry, in substance, admitted to Dugan that Laidlaw could not require the members of the underwriting syndicate to accept and pay for unsold stock. Registrant urges that Dugan's testimony, on which the Division's argument is predicated, does not in fact support the argument. As I read that testimony, the substance of his conversation with Perry was that the latter, in response to Dugan's question as to why Laidlaw had to pay for all the unsold stock, said that this was so because he had given the underwriters varying degrees of retention all the way down to zero. Registrant suggests -- with some support in Dugan's testimony -- that Dugan merely made an assumption, based on Perry's answer, that Laidlaw was obliged to keep the stock. But the assumption

was justified. Perry's response makes sense only as an acknowledgement that he could not require other members of the syndicate to take unsold stock. 18/

Materiality of the Perry-Callery Understanding

Registrant contends that even if there was an understanding as alleged, this was not material information requiring disclosure. It urges that such an understanding could not have affected the issuer's right to receive the full proceeds of the offering, which is the key feature of a firm commitment underwriting, and was therefore of no concern to prospective investors. While sound as far as it goes, 19/

18/ During cross-examination by the Division, Perry invoked his privilege against self-incrimination in response to a number of questions pertaining to allegations which had been made against him, but not against registrant, in the order for proceedings. The questions were asked for the purpose of attacking his credibility. The Division moved on the record to strike Perry's direct testimony on the ground that it had been deprived of an adequate opportunity for cross-examination. I reserved decision on the motion pending presentation of argument in the proposed findings and briefs. I now deny the motion for the following reasons:

1. The Division had adequate opportunity to cross-examine Perry regarding the matters covered in his direct examination. Under the authorities cited by registrant (and other authorities), the preclusion of inquiry into collateral matters bearing only on credibility does not warrant striking the direct testimony. See also the last sentence of Rule 608 of the Federal Rules of Evidence which by implication seems to support that proposition.
2. The Division did not present written argument in support of the motion until its reply brief, thus depriving registrant (which argued the question in its brief) of an opportunity to respond to the Division's arguments.
3. Since I have not credited Perry's denial of the alleged understanding, denial of the motion is not prejudicial to the Division.

19/ Cases cited by the Division where registration statements were held deficient because it was implied that there was a firm commitment underwriting when in fact only a best-efforts underwriting was involved are not pertinent. Here each underwriter had a firm commitment to SaCom under the terms of the underwriting agreement. The understanding between Laidlaw and registrant pertained to the ultimate allocation of risks as between the two firms.

the argument does not dispose of the question of materiality. The representation in the registration statement and the related documents that registrant was an underwriter with a specified commitment carried with it the implication that registrant had assumed the risks normally assumed by a firm commitment underwriter. That, as I have found, was not the case here. And to the extent it was not, the degree of registrant's interest in and endorsement of the SaCom offering were vastly diminished. Particularly in light of the fact that registrant was a well-known firm and was listed in the top underwriting bracket, these were circumstances which "a reasonable investor might have considered... important in the making of . . . [an investment] decision," [20/] and as such they were material information. The understanding was also material to prospective underwriters who were informed that registrant would be a member of the underwriting syndicate.

Accordingly, I find that the failure to disclose the understanding rendered the representations concerning registrant in the registration statement and related documents and otherwise materially misleading. Registrant, as a party to the understanding, must share in the responsibility for that consequence.

Conclusions as to Violations

In view of the findings made above, and the fact that under long-established concepts [21/] registrant must be held responsible for the

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20/ Affiliated Ute Citizens v. U.S., 406 U.S. 128, 154 (1972).

21/ See, e.g., Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961).

misconduct of Callery, its agent and employee, it follows that registrant willfully aided and abetted violations of Sections 5(b), 7, 10 and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 under the latter Act.

Alleged Failure to Provide Reasonable Supervision[22/]

The Division's contention that registrant failed reasonably to supervise rests largely on the fact that registrant's operating procedures manual contained nothing pertaining to decisions by the syndicate department manager to enter underwriting syndicates or the terms of underwriting arrangements governing such syndicates. The Division urges that the absence of standards prohibiting Callery from entering into an understanding such as he had with Perry, or into similar understandings, in conflict with contractual arrangements and with representations made in filings with the Commission establishes a failure of reasonable supervision. I cannot accept the argument. Obviously, there must be internal procedures commenting upon and prohibiting the more common types of misconduct. But the impropriety here involved cannot be so classified. And it would be both unrealistic and counterproductive to require a broker-dealer's compliance procedures to attempt to enumerate the infinite variety of improper practices that must be avoided. The alternative

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22/ The Commission has recently stated that where findings of substantive violations are made against a firm, it is unnecessary to find the firm responsible for a failure of supervision with respect to the same misconduct. Management Financial, Inc., Securities Exchange Act Release No. 12098 (February 11, 1976), 8 SEC Docket 1248, 1252, n. 20. That holding does not, however, appear to preclude consideration of a supervision allegation in a case such as the instant one where the misconduct was the essentially isolated act of a single employee and the determination of appropriate remedial action hinges largely on the issue of supervisory failure.

(in terms of this case) of having a general proscription against undisclosed and improper understandings would have been meaningless.

Further, the record is too skimpy to warrant a finding that the supervision which was actually exercised over Callery was not reasonable under all the circumstances. Callery's immediate superior who had responsibility over both the syndicate and corporate finance departments was not called as a witness. And there is nothing in the record pertaining to the extent of review of the firm's records relating to its participation in underwritings. The misconduct found here was not of a nature which itself bespeaks inadequate supervision. Consideration must be given in this connection to the fact that Callery was a highly-placed employee who as far as the record shows had earned the confidence and trust of his superiors through his many years of service.[23/] His misconduct here was of an isolated nature and not something which could reasonbbly be anticipated. And although it appears in retrospect that close and perceptive review of the records pertaining to each of the offerings in which registrant was an underwriter might have led to detection of the impropriety, in my judgment it would be tantamount to making registrant an insurer to hold under all the circumstances here that it failed reasonably to supervise.

Public Interest

The Division urges that the public interest requires the suspension of registrant's broker-dealer and investment adviser registrations for

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23/ This is not to suggest that an employee in that category need not be supervised. But the experience and reliability of the particular employee obviously have a bearing on the degree of supervision which is reasonably necessary.

90 days. In support of these rather stringent sanctions, it points to the serious nature of the violations as well as to additional factors, such as registrant's assertedly deficient supervisory standards and procedures and sanctions previously imposed on it by certain self-regulatory organizations.

There can be no doubt that the violations were indeed of a serious nature. On the other hand, they represented an isolated occurrence. Callery, the responsible individual, has not been associated with registrant for several years. And I have found the record insufficient to sustain the charge of supervisory deficiencies. Moreover, the record indicates that registrant, which has drastically curtailed the scope of its operations since 1972, is no longer in the underwriting business. The prior disciplinary actions to which the Division alludes -- consisting of censures imposed in two instances by the National Association of Securities Dealers and two fines imposed by the Pacific Stock Exchange -- were relatively minor in nature [24/] and were based on misconduct different from that involved here. They do not in my judgment militate toward imposition of a sanction in this proceeding. Under all the circumstances, I cannot find that it is either necessary or appropriate in the public interest to impose a sanction on registrant. [25/]

24/ That the Division itself considered them insignificant is indicated by the fact that they only came to light during the direct testimony of registrant's chief executive officer which was part of registrant's case.

25/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision they are accepted.

Accordingly, IT IS ORDERED that these proceedings with respect to Mitchum, Jones & Templeton, Inc. are hereby discontinued.

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

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

Max O. Regenstein

Max O. Regenstein
Administrative Law Judge

Washington, D.C.
May 28, 1976