ADMINISTRATIVE PROCEEDING
FILE NO. 3-5258

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	FILED
	:	AUG 08 1979
ALLEN & COMPANY (8-1804)	:	
RICHARD M. CROOKS (WILLIAM H. LANGFIELD, II)	:	SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

August 2, 1979
Washington, D.C.

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: Irving Einhorn and Robert F. Moyer, of the Chicago Regional Office, for the Division of Enforcement of the Securities and Exchange Commission.

David R. Foley and George M. Duff, Jr. (Holtzman, Wise & Shepard), for Allen & Company.

Phillip J. O'Reilly (Delaney & O'Reilly) for Richard M. Crooks.

BEFORE: Jerome K. Soffer, Administrative Law Judge

On July 19, 1977, the Commission issued an order for public proceedings (Order) pursuant to pertinent sections of the Securities Exchange Act of 1934 (Exchange Act), the Investors Advisers Act of 1940 and the Investment Company Act of 1940.[1/] The order named as respondents William H. Langfield II, (Langfield) two investment advisers (Investors Diversified Services, Inc., of Delaware, and Investors Diversified Services, Inc., of Minnesota), 12 registered broker-dealers, and 18 affiliated individuals.[2/]

1/ Sections 15(b), 19(h)(2) and 19(h)(3) of the Exchange Act, Sections 203(e) and 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act.

2/ The broker-dealers are as follows:

Allen & Company
Alliben Corporation (formerly known as M.S. Wien & Co., Inc.)
Blyth, Eastman, Dillon & Co., Inc.
Doyle, O'Connor & Co., Inc.
Drexel Burnham & Co., Inc.
Albert Fried & Company
Heine, Fishbein & Co., Inc.
Loeb, Rhoades & Co.
McDonald & Company
Mitchum, Jones & Templeton, Inc.
Oppenheimer & Co., Inc.
G.A. Saxton & Co., Inc.

The individual respondents are:

Robert D. Antolini
Lee Balter
Richard E. Bolton
John A. Burrello
Anthony Ciulla
Richard M. Crooks
Peter J. DaPuzzo
Dudley A. Eppell
Sanford Fishbein
Lewis S. Goodman
Charles E. Howley
Franklin T. Hurley
John P. McGinty
James A. Murray
Frederick W. Rittereiser
John Sanfilippo
John F. Walsh
William K. Weinstein

The Order is based upon allegations of the Division of Enforcement (Division) that all of the broker-dealer respondents wilfully violated, and the individuals associated with them wilfully aided and abetted violations of, the recordkeeping requirements of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder; that all of the said respondents wilfully violated, and wilfully aided and abetted violations of, the antifraud provisions of the securities laws, specifically Section 17(a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; that respondents Allen & Company (Allen) and Blyth, Eastman Dillon & Co., Inc. (BEDCO), Richard E. Bolton, Richard M. Crooks and Sanford Fishbein wilfully aided and abetted violations of Section 17(e) of the Investment Company Act of 1940 with respect to the dealings with Langfield and registered investment companies; and that all of the broker-dealer respondents failed reasonably to supervise their respective employees with the view towards preventing the violations alleged.

As a result of settlements acceptable to the Commission, the administrative proceedings had been terminated and remedial sanctions imposed by orders entered simultaneously with the issuance of the Order for Proceedings herein, with respect to all of the named respondents except Allen, BEDCO, Antolini, Crooks and Fishbein.[3/] After the commencement of the hearing

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3/ SEA Rel. Nos. 13767 and 13768 dated July 19, 1977.

herein, respondents Antolini and Fishbein tendered offers of settlement which were accepted by the Commission. 4/ After the hearing, an offer of settlement from BEDCO was accepted by the Commission. 5/ Consequently, the only respondents remaining parties to this proceedings are the broker-dealer, Allen, and the individual, Crooks. 6/

The Order directed a public hearing be held before an administrative law judge to determine the truth of the allegations set forth and what, if any, remedial action is appropriate in the public interest for the protection of investors. Public hearings were held on July 17, 18, 19, 20, 21, 24, and 25 of 1978, in New York City. Following their close, respective proposed findings of fact, conclusions of law and supporting briefs were filed by the Division and by respondents (including BEDCO, who was still a party). A reply brief was filed by the Division.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the demeanor of the witnesses. The standard of proof applied with respect to the charges of violations of the anti-fraud provisions of the securities laws is that the allegations with respect thereto be proven by <u>clear and convincing</u>

4/ SEA Release No. 15480, January 8, 1979.

5/ SEA Release No. 16021, July 16, 1979

6/ While this decision may contain references to certain of the former respondents, the findings are binding only on those still remaining in the proceeding, Allen and Crooks.

evidence. The standard of proof regarding the other charges in the order is that the allegations be established by a preponderance of the evidence. 7/

The Parties

From August, 1969 through April, 1974, Investors Diversified Services, Inc. (IDS), a Minnesota corporation was investment adviser 8/ to a number of registered investment companies collectively referred to as the Investors Groups Funds, as well as four other related funds, whereby

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7/ In Collins Securities Corporation v. S.E.C., 562 F.2d 820 (1977), the Court of Appeals for the District of Columbia Circuit held that although the traditional standard of proof in an administrative proceeding is the preponderance of evidence standard, where in such proceeding fraud is charged and which may involve a heavy sanction resulting in the deprivation of respondents livelihood, the "clear and convincing" standard of proof should be applied. In their briefs, respondents urge that this same standard be applied to all of the charges in the order for proceedings herein. However, the rationale of the Collins case was held by the same Court not to extend to an action for a civil injunction, since such a remedy does not result in a literal deprivation of livelihood. Also the Commission has rejected the "clear and convincing" standard of proof with respect to charges of recordkeeping violations Hinkle Northwest, Inc., SEA Release No. 15338 (11/16/78), 16 SEC Docket 173. Respondent Allen urges that the same standard be extended to charges of violations of Section 17(e) because they are based upon the same transactions which underlie the charges of antifraud violations and cites the initial decisions of the administrative law judge in John P. Decker, Administrative Proceeding File No. 3-4976 (Dec. 5, 1977), as reported in 1977-1978 Transfer Binder, CCH Fed. Sec. L. Rep. ¶81,388, holding that the clear and convincing standard should apply because Section 17(e) violations constitute a breach of fiduciary duty, akin to, if not a species of, fraud. However, the Decker decision was later reversed by the Commission. [Investment Advisers Act Release No. 641 (October 16, 1978), 15 SEC Docqet 1342.]

8/ It was registered with the Commission as an investment adviser from December 14, 1971 through April, 1974.

IDS had sole authority and total responsibility to execute all orders for the purchase and sale of these funds' portfolio securities. 9/

The group of mutual funds served by IDS comprise the largest single mutual fund in the world. Among the functions performed for them by IDS as investment adviser would be the execution of orders for the purchase or sale of securities as given by the various fund managers. These instructions were passed on to the IDS traders handling the particular securities.

Respondent Allen, is a partnership located in New York City, and has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since January 1, 1936. 10/ Allen is also a member of the National Association of Securities Dealers (NASD), a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act.

Respondent Crooks was, during the relevant periods herein, employed by Allen as a trader responsible for over-the-counter

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9/ The investment companies include Investor's Mutual, Inc., Investor's Stock Fund, Inc., Investor's Variable Payment Fund, Inc., IDS New Dimensions Funds, Inc., and IDS Progressive Fund, Inc., IDS Variable Annuity Fund A, IDS Life Variable Annuity B, IDS Life Insurance Company and Investors Syndicate of America.

10/ There is also a corporation known as "Allen & Company, Inc." also a registered broker-dealer. During the relevant period herein, the corporation's activities were confined to underwriting, and the partnership engaged in all other activities of an investment banker including trading. Since that time, their operations have been reversed so that the corporation now performs all the functions of an investment banker and the partnership serves merely as an investment vehicle for members of the Allen family. This change of operations has apparently raised a problem for the Division which, in its initial Brief, questions what effect a sanction,

(CONTINUED ON NEXT PAGE)

(OTC) trading in industrial securities, and part of an OTC trading department which included a number of other traders in other categories of securities. 11/

Langfield Background Activities

William H. Langfield II, the principal actor in the transactions and activities embraced within the allegations contained in the Order, was employed in the IDS trading department from August, 1969 through April, 1974 as an over-the-counter (OTC) securities trader. In this capacity, he handled the bulk of the OTC trading for IDS during that period.

In executing the orders from the various IDS funds managers to acquire or sell securities, IDS traders were allowed complete discretion in executing trades. However, unlike the IDS traders in listed securities, who were given prepared lists of dealers among whom they could select to trade, Langfield, as the sole OTC trader, had complete discretion in selecting the party on the other side with whom to trade. He was highly regarded by fund managers for his skill in executing trades favorably for them. During the years he was trading for IDS, Langfield traded

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10/ (CONTINUED)
if any, would have on the named respondent, the partnership, and professes an interest "to pursue the matter further including a possible amendment of the Order and the taking of additional evidence to determine which entity in fact should be sanctioned." (Division's Brief, page 63). However, no such requests have been made as yet.

11/ Crooks was and still is a vice-president of "Allen & Company, Inc.", and now in charge of its OTC trading.

with 50 to 100 brokerage firms and market-makers. The IDS trading desks were quite busy with an average of 300 phone calls daily for each trader.

When Langfield was hired by IDS, at an annual salary of $17,000, he asked for and received permission from IDS to trade for his own account with the market-makers. His salary increased over the years to $25,000 per annum plus occasional bonuses. During his employment, he traded for his own account with the same market-makers (including Allen) for whom he traded with IDS, averaging 2 or 3 trades per day. Other traders at IDS were also permitted to trade for their own account. Market-makers were told by IDS, when they so inquired, that it was permissible for them to trade with Langfield individually.

While trading for his own acount, Langfield was advised of certain "ground rules" that he was expected to observe: that he could not purchase a new issue at its original price, that he would not engage in "front running" (i.e., buy or sell a security knowing that the IDS Funds would buy or sell that security), that he would not short sell IDS held securities, that he would not use "IDS muscle" to promote his personal trading, and that he would not be active in a stock in which the funds had active interest without first clearing with the management.

During the period of his trading, Langfield maintained personal accounts with various brokers at different times who included, as pertinent to the transactions herein, Black & Company, Inc., Andresen & Company, and Heine, Fishbein & Company.

The first item to be noted is that Langfield traded for his personal account directly with the market-makers rather than through his broker, but giving up the name of the broker through whom the transaction was to be recorded. 12/

Thus, there was nothing in the records of his broker or of the market-makers with whom he traded, including Allen, to show that Langfield was in fact trading for his own account, and giving up his broker's name. The records of the brokers did show trades on Langfield's behalf with the market-maker; the records of the market-makers showed only a trade with the broker.

All of his personal transactions were required by IDS to be reported. His brokers sent confirmations daily of each transaction as made and also rendered monthly statements to IDS. The IDS traders, including Langfield, were required

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12/ Langfield was the only IDS trader to trade in this fashion; the others would give their orders to their own brokers for execution rather than trade directly.

to submit quarterly reports showing the name of each security bought or sold, and the time, price and volume of each execution. Thus, IDS knew the details of all trades in which Langfield was involved for his own account with all market-makers including Allen. The confirmation copies from the brokers and the quarterly reports were analyzed by IDS to see that the stated guidelines were being obeyed.

Although Langfield continued to trade both for his own account and for IDS during the same time period, there is nothing to show that he ever traded in the same stock for himself as for his company. And, whether he was trading on his own account or for IDS, he is characterized as a "trader with a very good feel for the market," and a "tough negotiator." IDS never received a complaint that Langfield was using his position with IDS to obtain preferential prices or treatment from any broker-dealer.

Langfield's superior at IDS was James Murray, who was in charge of all trading. Murray was well aware of Langfield's personal trading and at his request, Langfield began trading for the account of Murray's wife on October 3, 1973, when he opened an account for her in her name. Langfield advanced Murray a $10,000 loan to open this account. As a result of Langfield's trading activities and judgment, Murray had earned a profit of over $5,000 in the next 4 or 5 months. Langfield used his same practices of trading directly with the market-maker and giving up the name of the broker where the Murray account was maintained. Neither Andresen or Heine, Fishbein had any other accounts of customers who traded that way.

The total trading volume in all securities by IDS with Allen, and the trading volume handled by Langfield for IDS during the years 1971 through 1973, are reflected in the following table (in millions of dollars):

Year	Langfield with All Traders	Langfield with Allen	IDS with Allen (OTC and listed)
1971	565	22	53
1972	650	4	33
1973	539	3	15

The Langfield trading in OTC stocks for IDS declined from approximately 30 trades per day in 1969 to some 8 or 10 per day in 1973.

When working at IDS, Langfield sat at a console containing direct telephone lines to some 120 traders, market-makers and other funds involved with OTC securities, including Allen, whom he could contact by the mere press of a button. These telephone lines were installed by IDS for his use in trading OTC securities for the IDS funds. The user costs were paid for by the market-makers. The telephone console was available to him not only for IDS transactions but also for his personal trading.

In order to properly carry out his functions as a trader, IDS made available to Langfield additional facilities, including various quotations systems, such as "NASDAQ",[13/] "Autex", "Quotron", "Instanet", "Reuters" and "Dow-Jones", which provided, along with other information, the quotations being made by various market-makers in OTC securities. These facilities were also available in connection with his personal trading.

Background of Respondents' Trading Activities

During the relevant period herein, the OTC trading room at Allen consisted of some 12 to 18 people, including 2 to 5 traders in industrial stocks, one of whom was respondent Crooks.

13/ The NASDAQ quotations system for OTC securities was established by NASD in 1971. The system collects, stores and disseminates quotations in approximately 2,600 OTC securities by market-makers and dealers throughout the United States. Through the use of this system, to which Allen and IDS subscribed during the relevant period, a subscriber may learn the current, representative and median "bid" and "asked" quotations for OTC securities. Since the latter part of 1972, the system also provides the names of market-makers in those securities and their current quotations and changes therein, information that is shown on a display terminal on the trader's desk.

Under NASDAQ, the number of market makers in a given security averages 6 or 7, although they may vary from as few as 2 to as many as 30. Under the current NASDAQ system, a market-maker is obligated to make a purchase or sale of 100 shares at his last quotation and to continue making such trades until such time as his quotation is changed, which he may do in a matter of seconds as often as he wishes.

In any given transactions, the market-maker may depart from his quoted price in order to compete with another market-maker giving a better quotation at the time. Also, any trade larger than the 100-share obligatory one may be at a negotiated price depending upon the many factors influencing a trader's decision. Thus, trades could be executed between different parties at or about the same time at different prices in OTC transactions since, unlike those occuring on the floor of exchanges, the individual transactions are not reported on the quotation services utilized.

Others in the room were assistant traders and lesser employees. The industrial OTC traders would handle from 250 to 400 trades per day. Crooks handled on an average of 150 to 200 trades, although on some days he would execute as few as 30 or as many as 400 trades. Each trader handled his own list of OTC securities; Crooks acted as a market-maker for the firm for an average of 30 to 35 stocks. He was aided in his work by an assistant.

Allen had some 150 direct telephone lines, the great majority to broker-dealers and a small number to institutions including IDS, which were on a console before each trader and enabled instant communication between Allen and its customers upon the press of a button. These lines were used to negotiate trades, exchange quotations, and to give and receive information and opinions concerning OTC securities. Mr. Crooks estimates that he initiated less than 20 percent of the trades in which he engaged. Ninety percent of Allen's trades were with broker-dealers, about half of whom were competing market-makers, and less than ten percent with institutions such as IDS.

Allen participated in the NASDAQ system [14/] with respect to most of the securities in which it made a market, and had the capability of entering and changing its quotations for

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14/ Prior to the establishing of this system, Allen entered its quotations in the "pink sheets".

these stocks.

OTC transactions between IDS and Allen usually involved Langfield for IDS and Crooks and other individuals for Allen. During the earlier periods, Crooks would call IDS prior to the 10:00 A.M. opening of trading on virtually every business day in order to discuss bases for possible trades. On some days, there would be no other contact, but on others there might be as many as 20 calls during the day.

When approached by Langfield in November 1970 to trade for his own account, Crooks satisfied himself that IDS did not object, and proceeded to trade with him openly.

About once a week, Langfield would call Allen to discuss general market conditions, and to seek information from Crooks including price and volume information about specific securities. Crooks responded thereto under the belief that the inquiries were for IDS, although it would often turn out that Langfield was concerned with his personal trading. Crooks considered Langfield when negotiating for his own account like any other trader. Although Langfield was the only one who gave up the name of a clearing broker when he agreed to a trade, Crooks did not deem this practice unusual. Crooks considered Langfield, both in his personal trading as well as for IDS, to be one of the best traders, having a great sense of timing, and being a good observer of market trends and a "tough" negotiator.

Langfield's personal trading activities were profitable both for himself and for Murray. Out of 902 complete purchase and sale transactions between September 30, 1970 and April 4, 1974, 81 percent were profitable, 16 percent showed a loss, and 3 percent involved neither a profit nor a loss. Included in this total were 75 purchases from or sales to Allen, which produced a profit to Langfield 84 percent of the time.

On a dollar-basis, an analysis by the Division of Langfield's accounts at his respective brokers shows that during the above period his over-all profits from his trading totaled $345,672.56. Similar calculations made for trading with respondent Allen show that for transactions in which Allen was involved as a buyer or seller he profited to the extent of $22,312.50, gross.

The Division also analyzed the time patterns involved in the 902 transactions by Langfield for his own (and Murray's) account and found that a complete buy and sell of the securities involved was accomplished, in almost half the cases, within a one-day time period, with an even greater proportion of the Allen trades in this category. The time periods developed are reflected in the following table:

	All Trades		Allen Trades	
Time Periods	No.	P.C.	No.	P.C.
Same day	187	21%	19	25%
One day	251	28%	31	41%
Two days	113	13%	7	10%
Three days	73	8%	3	4%
4-10 days	182	20%	12	16%
11 days and over	96	10%	3	4%
	902	100%	75	100%

"Stop" Orders

One of the relevant aspects pertaining to Langfield's trading activities is the uncontradicted fact that he frequently made use of a device known as a "stop". A "stop" in connection with OTC trading, according to the testimony of many witnesses in this proceeding, is a pricing mechanism whereby a market-maker would guarantee another trader that he would execute an order at the bid or asked price then quoted, but would provide protection against a move in the market and give the trader the benefit of such move in his favor. 15/ "Stops" were commonly used in OTC transactions among traders in order to assure that a purchase or sale would be effected and to meet price competition of other market makers.

The terms of the "stop" transaction would be agreed upon but execution would wait until later depending upon which way the market progressed. At some later time in the day, the market-maker would determine, as he observed the trend of the market, to execute the transaction either at the price agreed when the stop was made (if the market became unfavorable to his customer) or at a somewhat (fractionally) better price if the market had progressed more favorably to the other-side trader.

15/ These stops are unlike the typical "stop order" or "limit order" used in trading on the floor of exchanges.

Langfield used "stop" transactions in perhaps 30 to 50 percent of his trading, much more frequently when he was buying than when he was selling.

The procedures for recording transactions with Langfield and others as maintained by Allen are significant in an evaluation of the charges in the Order.

At Allen, a typical OTC trade would begin with a call via the direct telephone lines, indicated by the flashing of a light on the console, which would be picked up by any one of the approximately fifteen traders in the trading room. The caller would inquire as to a security in which Allen was a market-maker, offering either to buy or sell. The Allen trader answering the call, usually not being the one handling that security, would yell the bid or offering to the trader who did. The latter would shout back or indicate his response as to whether to buy or sell, the terms and quantity of the order, etc.

After the trade was agreed upon, Allen's trader handling the security had the obligation to write up a 3-part order ticket containing the terms of the transaction and he would then mechanically time stamp the ticket. However, there frequently would be occasions when this procedure would be delayed. When trading was very active, only a memorandum would be made of the terms of a transaction which would be written up and time stamped later. Sometimes a trader would merely forget to stamp the ticket until later.

The time stamp machines were occasionally inaccurate due to mechanical breakdown or becoming unplugged overnight. They would thus record inaccurate times or dates, some of which are patently improbable, and unnoticed at the time. The record shows examples of tickets being stamped on "Jan. 33", "Jan. 34", "Sept. 31", and "May 32" and at such times as "3:10 A.M.", "9:33 P.M.", "9:49 P.M.", "11:22 P.M.", and "12:39 A.M.", among others.

In accordance with his usual procedures, Langfield after negotiating his trades, would call his clearing brokers, usually at the end of the day, and report the details of his trades including an approximate time when each sale was executed. The personnel at these brokers would record and time stamp the transaction on an order ticket, turning back the time clock manually to reflect the time that Langfield had given. At times when Langfield would call during the day to report a trade the order ticket would then be stamped as the time he called. Langfield's brokers did not confirm trades with the market-makers, although from time to time the latter would call to confirm a particular trade by Langfield. They had no knowledge of the actual time of these trades. On a few occasions Langfield would report the fact that he would be "stopped" in a stock. He paid a commission to his clearing broker with respect to his personal trades cleared through his account.

Where a trade involved the use of a "stop", as described hereinbefore, Allen's records did not reflect that fact. Under its procedures, when the terms of a "stop" order had been agreed upon, they would be noted on the outside margin of the 3-part order ticket. When the stop order was executed later in the day, the contra-broker or trader would be notified (at times after some delay), the order ticket written at the stopped price (or better), and the ticket mechanically time stamped. It would then be separated at the margin for entry on the firm's books, and the margin with its notation that a "stop" was involved would be thrown away. Since this was the only record, there remained no written record, that a particular trade resulted from a "stop". 16/ Morever, the time stamp on the ticket would not reflect when the actual trade was first agreed to.

16/ From the record herein, it would appear that this procedure for handling "stops" was followed by other market-makers.

<u>The Record-Keeping Violations</u>

The Order charges that Allen (and all the other market-maker respondents) wilfully violated, and that Crooks (and all other individual respondent-traders) wilfully aided and abetted violations of, Section 17(a) of the Exchange Act and Rule 17a-3 promulgated by the Commission thereunder.

The pertinent allegations in the Order state that the books and records maintained by Allen did not disclose the fact that Langfield was its customer trading directly with them for his personal account, and inaccurately reflected "Heine or another registered broker-dealer where Langfield maintained his personal account" as its customer instead of Langfield.

Section 17a-3 of the Exchange Act requires every broker or dealer to make and keep for prescribed periods such records "*** as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purpose of this title." The record prescribed by the Commission are those contained in Rule 17a-3, and, as pertinent hereto, in the provisions of Subsections (a)(1) and (7) thereof. 17/ The Order

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17/ Rule 17a-3 (a)(1) directs brokers and dealers to maintain:

> "Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursement of cash and all other debits and credits. <u>Such records shall show the account for</u>

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also contains reference to other subsectious of the Rule, specifically those designated (3), (6), (8) and (9).

The Division argues that the trading activities of Langfield with Allen made him its customer and his name should have been recorded on its books and records as such, and that it was inaccurate and inappropriate to show that respondent was dealing with Langfield's current clearing broker as its customer. Respondent, on the other hand, contends that it was proper to show that the account was with Langfield's broker both under New York Stock Exchange Rule and under general trade custom, especially since there never was an attempt to conceal Langfield's role in the transactions. It was well known to IDS to whom all details were disclosed.

Since it is the intent of Section 17(a) and Rule 17a-3 thereunder that the records of registered broker-dealers disclose the name of the customer for which each transaction is effected [see In re Black & Company, Inc., Fed. Sec. L. Rep. CCH (1974-1975) Transfer Binder ¶79,921, at page 84.376], the

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17/ (CONTINUED)
which each such transaction was effected, the name and amount of, securities, the unit and aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered."

Rule 17a-3 (a)(7) also provides that broker-dealers prepare and maintain:

"A memorandum of each purchase and sale for the account of such member, broker, or dealer showing the price and, to the extent feasible, the time of execution; and, in addition, where such purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt, the terms and conditions of the order, and the account in which it was entered."

(Underlining added)

issue becomes one of whether Langfield was actually the customer of Allen to the extent that an account should have been carried in his name or at least reflect that his was the beneficial interest involved.

It is clear from the facts in this record that Langfield and not his clearing broker negotiated the terms of all of his trades directly with the market-makers; that frequently his decision to buy or sell a particular security was based upon information he gleaned from his daily contacts with the market-makers; that the sole reason for clearing the transactions through a broker was to serve the convenience of Langfield in keeping track of his trades; and that the broker played no part whatsoever in the trades except for having their names "given up" by Langfield, and charging him a commission. From all that appears, the conclusion is inescapable that Langfield was in every aspect the actual customer of Allen, and that its books and records did not so reflect.

Despite the respondent's contention that there was nothing unusual about the record-keeping arrangements, Langfield was the only individual who was permitted to trade in this way. In fact, Mr. Crooks tells us that Langfield received better treatment than would have been accorded his broker, Heine, Fishbein, if that firm had attempted to trade for him.

Allen's contention that the clearing broker was its actual customer because moneys and securities were passed through the broker merely promotes form over substance.

Respondent's reliance on New York Stock Exchange Rule 411 18/ concerning the manner of handling "give-ups" is misplaced. That Rule merely requires that when a customer of a broker gives up its name to another in connection with a transaction, the latter must confirm to the former the facts relating to the transaciton. In no way does it relieve the second broker of his statutory obligations to maintain accurate records reflecting that its actual customer in this instance was Langfield. Rule 411 merely imposes a separate, not a substitute, obligation than that which subsists under the statute and Commission rule. 19/

18/ This Rule reads:

> .60 Give-ups on wire business; method of handling —
> When a member or member organization receives an order from a customer of another member or organization, with instructions to give up that other member or organization, the member or organization originally receiving the order in New York shall on the same day send a written confirmation of the order as received to the office of the other member or organization.
>
> The member or organization executing such an order shall confirm the execution thereof on the same day in writing to the office of the New York member or organization for whose account it was executed.

19/ There is also a question of whether New York Stock Exchange Rule 411 applies to OTC trading off the floor, but this question need not be resolved for the purposes of this proceeding.

Allen further argues [20/] that Allen received no commissions from trading with Langfield, that others such as Mr. Murray and traders on the floor of the Stock Exchange have from time-to-time traded with individuals giving up the names of their brokers, that Langfield found it more convenient to give up his current broker's name rather than maintain individual accounts with each of the numerous market-makers with whom he traded, and that there was no attempt at concealing Langfield's personal trading activities. None of these contentions has any bearing on the obligation to maintain accurate books.

Section 17(a)(1) expresses an intent that the Commission rules promulgated thereunder not only be for the protection of investors, but for the advancement of the public interest and the furtherance of the purposes of the Act as well. And the purposes of the Act would not be served by mere *pro forma* compliance with the Rules. Unless the required records are maintained to reflect actuality, they become meaningless and constitute no compliance at all.

Respondents stress that there was no intent to deceive anyone and that Langfield's activities were made known to all interested parties, thereby distinguishing the situation from

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20/ Respondent Crooks has joined in all of the arguments advanced by his employer, Allen.

that found to have existed in the Black case, supra. However, the Commission has repeatedly stressed the importance in the regulatory scheme that books and records be kept current and in proper form. Pennaluna & Company, Inc., 43 SEC 298, 312-313 (1967); Olds & Company, 37 SEC 23, 26 (1956). The requirement that records be kept constitutes "an unqualified statutory mandate" [Billings Associates, Inc., 43 SEC 641, 649 (1967)], and embodies the requirement that such records be true and correct. Lowell Neibhur & Co., Inc., 18 SEC 471, 475 (1945).

Accordingly, it is found that Allen violated, and respondent Crooks aided and abetted in such violations of, the hereinbefore cited provisions of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. It is further found that such violations were "willful" as that term is understood in proceedings under the securities laws. 21/

There remain other matters raised in the briefs of the parties involving the claimed inaccurate recording on the part of trading personnel and by the time clocks of the precise time when trades were executed, and the admitted failure by respondents to record the fact that transactions with Langfield were stopped.

21/ It is well established that a finding of willfulness does not require an intent to violate the law; it is sufficient that the one charged with the duty consciously performs the acts constituting the violation. See Billings Associates, Inc., supra, and Hughes v. S.E.C., 174 F.2d 969, 977 (C.A.D.C., 1949).

The Division contends that if this were so, then these failures constitute further evidence of record-keeping violations. Respondents counter by arguing that they cannot be found to have so committed violations, since these specifications were not raised in the Order for Proceedings, nor charged prior to the Division's brief.

There is no question that the Rule 17a-3(a)(7) requires that a record be made and preserved of the times at which transactions are executed. Respondents were aware of this. In fact, Mr. Crooks testified that periodically the "back office" personnel would admonish the traders for not taking more care in recording the times of execution of transactions. Moreover, the same Rule requires that the records show the terms and conditions of the order. Clearly, the terms of a "stop" in trading practices should be recorded under this mandate.

Although neither at the pre-hearing conference, nor at various times during the hearing when giving statements of position did the Division advance these additional grounds for alleging a record-keeping violation by these respondents, respondents do not appear to be in a position to claim "surprise" since the relevant facts surround the timing of orders and the stop transactions were developed at length by them in their proof. These facts are conceded, the only question remaining is whether they constitute a violation of the record-keeping requirements. They do.

Receipt of preferential treatment by Langfield

The basis for the charges that respondents violated Section 17(e)(1) [22/] by wilfully aiding and abetting Langfield and Murray, affiliated persons of IDS, in turn in affiliated "person" of registered investment companies (IDS Funds), to accept "compensation" for the purchase or sale of property to or for such registered companies, is substantially the same as those supporting the allegation of violations of the antifraud provisions of the securities laws, [23/] i.e., that respondents gave Langfield "preferential treatment" in his personal trading with a view towards obtaining business from IDS.

22/ Section 17(e) of the Investment Company Act of 1940 provides, as follows:

It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person --

(1) acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker.

23/ Section 17(a) of the Securities Act makes it unlawful for any person "in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce, or by the use of the mails, directly or indirectly - to do any of the following:

"(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

(CONTINUED ON NEXT PAGE)

The "preferential treatment" allegedly consisted of giving Langfield, when trading for his own account, advantages not given to other non-institutional customers, including: (1) prices more favorable than "prevailing market prices", (2) "institutional" price and volume quotations: and (3) "direct access" to the market-makers' trading personnel.

(a) More Favorable Prices

The core of the Division's case against respondents herein is found in the evidence it has adduced to support the charge that respondents gave Langfield, in his individual trading, prices demonstrably and patently more favorable "than prevailing market prices" both when they sold him securities and when they bought securities from him.

This evidence consists of a series of exhibits constructed by one, Thomas Lynch, a securities compliance examiner of the Commission, from records and data assembled from various sources, including IDS, brokers, respondents, and NASD. This study extended to the fifty to seventy-five market-makers with whom Langfield dealt for his personal account during the relevant period.

23/ (CONTINUED)

Section 10(b) of the Exchange Act makes it unlawful, in connection with the purchase or sale of any security to use or employ, "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 promulgated thereunder, extends, in effect and with a few language changes, the provisions of 17(a) relating to the sales of securities to both the purchase or sale thereof.

The records used included: the quarterly report (Form 204) that Langfield filed with IDS, the monthly statements of transactions together with the supporting order tickets or other trading records of his clearing brokers, the records of the market-makers or other-side brokers including their order tickets and position sheets relating to their trades in the same security for the same day, and NASDAQ quotations printouts. The information obtained from these records were compared and tabulated with respect to each of the market-makers with whom Langfield traded for his own account.

The purpose of this record-gathering was an attempt to establish on a time-sequence basis the relation of the Langfield trades with other trades and market quotations in the same security as made by the respective market-makers in a contemporaneous period. Times of the transactions used were those appearing on the order tickets (sometimes handwritten, sometimes machine stamped and sometimes both), on teletype machines, on "wire" stamps, and on position sheets. 24/

NASDAQ computer printouts were not used in all cases either because there were none, or, if available, were not requested.

24/ The market-makers' position sheets were a daily tabulation maintained by an individual trader for each security he handled showing opening position and price, purchases and sales with the times thereof and resulting position, the closing position and price and the net profit or loss from the day's trading.

From his compilation of all of the foregoing records, Lynch prepared under the direction of Commission counsel a series of exhibits with respect to particular Langfield trades with respondents intended to show on a sequential basis the two previous and two subsequent transactions by the market-maker in that security. 25/

In preparing the exhibits the compliance examiner, Lynch, did not use his own discretion as to the data to be used or as to which transaction was to be shown, nor was he called upon during his testimony to express any judgment or opinion whatsoever as to any interpretation to be placed upon the exhibits and the information therein.

Mr. Lynch also computed the purported profit or loss derived by Langfield from his transactions by determining a completed transaction represented by a buy and sell of the same security on a "first in and first out" basis. This computation resulted in the Langfield profit figures heretofore recited. It is conceded that in some cases, the prices shown in these records did not take into account the commissions paid to the clearing broker, and hence overstated to this extent the profit derived.

In summary, out of a total of 75 Langfield transactions with Allen during the relevant period, a series of exhibits have been introduced in this record with respect to only 20 of them.

25/ Where there was only one or no trades prior or subsequent only the lesser number was listed.

These 20 transactions form the nucleus of the Division's charges that respondents gave Langfield prices on OTC securities purchased or sold for his personal account which were "inconsistent with and more advantageous than the prevailing market prices" as represented by Allen's quotations in NASDAQ or by other purchases and sales contemporaneously executed by Allen and Crooks.

The inference intended to be drawn is that these exhibits by themselves inevitably point to a conscious and deliberate effort by respondents to reward Langfield for giving them IDS "business". The Division has conceded that it makes no claim of price discrimination with respect to the other 55 Allen trades it caused to be examined.

It would be helpful in evaluating the interpretations and conclusions to be drawn from the 20 selected transactions to consider the factors, as disclosed by several witnesses without contradiction in this record, motivating any market-maker in negotiating a trade that is offered to him and in setting quotations with respect to his trading activities.

A market-maker's trader would first consider his position, whether long or short and the size thereof, in the security involved, and decide what he wanted his position to be. This, in turn, would depend upon such considerations as his belief as to what the market was going to do both generally and with respect to the particular security. He would also consider his own contemporary quote in NASDAQ as well as the contemporaneous quotations of other market-makers in that security, including the number and standing of these market-makers, the so-called "best" or "inside" quotation, the "representative" or average quotation, and the spreads that prevail. He would then decide whether he desired to compete or not to compete with the best prevailing market price at that moment, taking into consideration whether it would be easy or difficult to dispose of or acquire shares in that security, and the "fundamentals" of the corporation whose security is involved. Moreover, he would have to take into account his positions and holding in other stocks because of limitations in his own and his company's capital trading account. Frequently, the trader must make a snap decision in the face or pressures resulting from his flow of business and the number of securities in which he individually is trading. 26/

The prominent factor in the Division's exhibits is the time sequence in which Langfield trades appeared to have occurred. Here, the evidence is uncontradicted that in many instances the recorded time did not accurately reflect the time of execution. Thus, during very busy periods, trades

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26/ Often, at the opening of trading at 10:00 A.M., a large number of direct lines that each trader had at his disposal would "light-up" at once. The trading room would become quite an active place with the traders answering the lines and calling back and forth to each other since the trader handling a particular security frequently would not be the one answering the call. This atmosphere, therefore, would exert pressures on a trader in making up his mind as to the price he wanted to quote in NASDAQ and the price at which he would execute a buy or sell transaction. Although changes in the NASDAQ quotations could be accomplished in a matter of seconds, in a very busy market quotations might have to be updated by an individual market-maker in as many as 10 to 20 securities at one time. In the more volatile and active markets, the NASDAQ system loses its value and is not referred to as much as it might be in a more quiet market.

were not regularly timed when made, but done so later when the pace had slackened. As heretofore stated, mechanical time clocks were frequently inaccurate for various reasons, such as being accidently unplugged or breaking down. Sometimes, different clocks being used would record different times.

Finally, the extensive use of stop transactions also affected the time recorded on the documents, since they were not timed when the transactions was first agreed upon, but rather they show a later time when execution was accomplished.

With respect to the selected transactions between Langfield personally and Allen represented by Crooks and its other traders, an example of the type of exhibits prepared by Mr. Lynch for the Division can be seen in Exhibit 41, concerning a purchase from Langfield of 500 shares of "Decisions Data" on September 5, 1972. The pertinent part of the Exhibit reads as follows:

	ALLEN			ALLEN - NASDAQ		
Time	Buy	Sell	Price	Time	Bid	Ask
11:36		100	38.50			
11:41	200		38.00			
* 11:49	500		39.50	11:44:28	37.50	39.00
3:23	300		37.50	15:24:39	27.00	38.50
3:27	500		37.50			

* - Langfield trade.

The Division argues that the only conclusion to be drawn from this Exhibit is that Crooks bought 500 shares from Langfield at a price $1.50 higher than a contemporaneous purchase, which it characterizes as a "substantial premium". (Division's Brief, page 32).

Crooks, testifying from memory, 27/ recalled that this transaction involved a "stop" at the opening of trading which was executed later.

Examination of the NASDAQ quotations with respect to this security shows that Allen's closing bid the trading day before was 39 1/2 and it continued until 10:09 A.M. on the day in question when the market-maker dropped the bid to 39, dropped it to 38 at 11:10 and down another point at 11:32. By contrast, the day before Allen kept raising its bid from 35 prior to opening to 39 1/2 by 3:06 P.M. Further, the NASDAQ printout shows that other market-makers were bidding 39 1/2 prior to opening, that the price then went down during the day.

27/ At the hearing, Crooks testified as to the details of some of the trades based upon his recollection, and he stated that his remembrance of them was better than when he gave prior testimony during investigation in 1974 because he had an opportunity to review the pertinent records in the interim. His professed recall of the facts surrounding these transactions was tested on cross-examination, and, based upon his entire testimony and the observance of his demeanor as a witness, the Administrative Law Judge finds his recollection as to those trades to be credible.

The conclusion, then, is that the credible recall testimony of Crooks that the transaction was stopped at 39 1/2 is in keeping with the trading pattern in a highly volatile security, as shown by the total information found in the quotations over a reasonable period rather than the conclusion suggested by the Division based upon a limited analysis.

Although the parties have gone into the details of each of the 20 Allen transactions to support their respective contentions, the Administrative Law Judge deems it unnecessary to do so in order to arrive at a conclusion as to whether there was a pattern of <u>conscious</u> preferential price treatment by these respondents in their trading with Allen.

Of the other Allen transactions, the following are explained in fashion substantially similar to "Decisions Data", above, as being consistent with a stop transactions, incorrect time recording, etc., but generally in line with price range for that security for that day: "U.S. Financial", "Levengston Ship Building" (2 trades), "Frigitronics" (on August 31, 1971), "American Micro-Systems", "Decisions Data" on September 1 and 13, 1972. "Compusamp", "Self-Service Restaurants", "Rival Manufacturing", "Jerrico", "Bally Manufacturing 28/ and the

28/ The circumstances surrounding the "Bally" trading price show a sale by Allen to Langfield of 200 shares at 11:05 A.M. at 31 3/4, although there were two prior sales to others at 33 and 33 1/2, respectively, and two subsequent sales at 33 1/2 and 34, respectively, all occurring (CONTINUED ON NEXT PAGE)

sale of 100 shares of "Anheuser-Busch" to Langfield.

Contrary, there were a lesser number of trades that Allen and Crooks have not satisfactorily explained, but which by use of the Division's Exhibits would appear to show a price preference (although generally of not more than 1/8 or 1/4 point). These trades are: "Smith, Miller and Patch", "Frigitronics" (on September 27, 1971), "Electronic Data Systems", "Computer Technology, "Centronics Data", and the purchase from Langfield of 100 shares of "Anheuser-Busch". It should be observed that the first four of these trades were at a time when there were no NASDAQ printouts to be had and were not within the personal knowledge of Crooks.

In summary, the Division has attempted to sustain its burden to prove that respondents gave Langfield, in his personal trading with the, better prices than the prevailing

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28/ (CONTINUED)
within a period of less than one hour. Crooks testifying from memory recalled that he had entered into a transaction in the morning to sell Langfield the 200 shares at 32 1/4 on a "clean-up basis" (in effect, a stopped price), that Langfield later in the day accused Crooks of an unfair practice and wanted to cancel the trade, and that, in order to settle the matter Crooks took a half a point off the agreed price at a cost of $100 to Allen rather than to cancel the deal since, as the result of a sharply falling market, the total value of the 200 shares was off as much as $600 or $700. While this believable recollection would refute conclusion of deliberate price preference, it does have a bearing on the discussion hereinafter concerning "direct access".

market price in that security, 29/ or which they were giving to their other customers and quoting in NASDAQ, by extracting from the total number of transactions they had with Langfield some 27% of the Allen trades for price analysis as outlined above. It makes no claim that the remaining trades which constitute the great majority, show price preference to Langfield. 30/

It becomes apparent that the Division has attempted to weave a pattern showing preferential price treatment in the circumstantial manner which has been developed in proceedings designed to show the existence of stock manipulation. In the usual manipulations case, a series of transactions are organized in sequential fashion which, when taken together, leads inexorably to a conclusion that the price progression in a given security could only have come about by means of manipulative practices, rather than by the operation of normal

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29/ Respondents in their briefs charge that there was a fatal defect in the Division's proof in the failure to adduce such evidence of "prevailing market price" as NASDAQ quotations or other evidence of what other market-makers were pricing the involved securities. However, the prices that these respondents actually bought and sold in a competitive market is a reliable indicator of the prevailing market price. See Charles Michael West, SEA Release No. 15454, January 2, 1979, 16 SEC Docket 592.

30/ Crooks pointed out a number of these remaining trades in which Allen profited in its dealings with Langfield, appeared to give others prices better than those given Langfield, and where the use of stops redounded to the benefit of Allen rather than Langfield alone.

market forces. Such methodology has frequently been upheld in that type of case. See Collins Securities Corp. v. S.E.C, 562 F.2d 820, 822 (D.C. Cir. 1977). However, such an approach does not have the same effect in this case.

The differences between the Langfield transactions presented and the typical manipulations transactions are myriad. For one thing, the Langfield trades were unrelated to each other and the small number analyzed out of the total trades with the respondents negates the inference of a recognizable pattern. Then, the picture of the trading practices as developed by the respondents, particularly in the absense of contradictory proof from the Division, further reduces the number of questionable transactions to but a handful, and hardly sufficient to demonstrate a "pattern" of deliberately giving of better prices in return for IDS "business".

These trading practices include Langfield's extensive use of "stop" transactions and the procedures for recording their time of execution, the haphazard and incorrect recording of the time of other trades, and the many factors other than price influencing a market-maker's judgment in deciding whether to conclude a transaction. Under all of the circumstances, it must be concluded that the Division has failed, in the manner attempted, to meet its ultimate burden of proof with respect to its charge involving "commercial bribery" against these respondents. 31/

However, these transactions will be further considered hereinafter in the discussion as to whether "direct access" was a form of preferred treatment of Langfield.

(b) Institutional price and volume quotations

As part of the preferential treatment allegedly accorded Langfield, the Order charges that respondents gave him " *** the use of price and volume quotations when trading for his account *** that would only be given in some instances to preferred institutional customers *** " (par. AA).

The Division supports this charge on the basis of the calls that Crooks and other Allen traders regularly made to Langfield to acquaint him for the benefit of IDS with their positions and quotations in order to invite trades with IDS. On some of these occasions, Langfield might reject the trade for his employer 32/ but undertake to make a personal one in a much smaller quantity than usually traded by IDS, at the

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31/ Although BEDCO has settled with the Commission recently, the evidence adduced at the hearing with respect to its trading with Langfield for his personal account would have served to reinforce these conclusions with respect to Allen's and Crook's trading with him.

32/ It must be remembered that Langfield had no discretion as to which security to trade. He merely carried out the orders of the various IDS Funds managers in this respect.

same price as offered to IDS. The Division would have it concluded that the respondents were thus giving Langfield "institutional price and volume quotations".

However, a careful search of the Division's proof discloses no evidence that there is such a thing as an "institutional" price as opposed or different from some other kind of price; or that market-makers had the same or different quotations for one type of institution over another, 33/ or with respect to other dealers in the security, and, if so, whether the prices were the same or different as between large and small dealers, those which were or were not competing market-makers, those who were regular traders and those who traded occasionally, etc. The Division only assumes that respondents must have been offering IDS a better deal than it would offer others; unfortunately for this assumption, there is nothing in the record to substantiate it.

In its arguments to support its proposed findings, the Division falls back on its series of Exhibits offered to prove the giving of better prices, as discussed above, but these Exhibits do not establish that there are such things as "institutional" prices. Nevertheless, the entire manner of respondents'

33/ Institutions, after all, comprise many different types: mutual funds, pension funds, banks, insurance companies, etc.

dealing with Langfield as a trader for IDS, as reflected in these personal transactions, quite properly belongs under the discussion of "direct access" which immediately follows, and its effect upon the claimed violations of the securities laws.

(c) Direct Access

There still remains the question of whether respondents gave Langfield "preferential treatment" in his personal trading for himself and Mr. Murray's wife by giving him, as charged in the Order, direct access to their trading personnel, an advantage not given to their non-institutional customers. To put it differently, did the direct access between Langfield and the respondents and the resulting trading procedures available to him give to Langfield a preference and an advantage which, if established, would be a form of compensation under the pertinent Investment Company Act provisions and the stated anti-fraud sections of the securities laws.

From the record herein, it is clear that Langfield's position vis-à-vis respondents was unique and that it operated to his personal advantage. Langfield's relationship was unique because Allen had no other customer who traded for his personal account and gave up the name of a clearing broker, or had any other individual accounts absent exceptional circumstances.

On his side, Langfield was unique because he was the only IDS trader who, in taking advantage of the right given all IDS traders to transact personally under specified guidelines, engaged in his own dealing directly with the market-makers rather than through the facilities of a broker.

The availability to Langfield of instantaneous direct access to Allen's traders, by virtue of his position with IDS, was distinctly advantageous to him. 34/ Given the importance of timing as an element of successful trading, Langfield's professional skill as a trader, his technique of trading on a short-term basis (over 70 percent of his trades were completed within 48 hours or less), and the various factors influencing a market-maker's judgment, he was able to engage in his personal transactions in a manner not readily available to an individual investor who was not himself a dealer or market-maker. He was able to wheel and deal, to obtain information about positions and market trends, to observe and compare prices and trends, to know when to use stops, how far to press or withdraw in his negotiations, and to otherwise use his admittedly superlative talents as a trader in a way which might

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34/ The parties attempt to attach importance to the question of who was paying for the direct-line service. Installation costs were paid by IDS; operating charges by the market-makers. For the purposes of the issue involved, this question is secondary. It is sufficient that these facilities were available to and used by Langfield in his personal trading.

not otherwise have been feasible did he not have available the direct access to respondents granted him by virtue of his position with IDS.

For example, the Allen sale to Langfield on September 13, 1972 of 200 shares of "Decision Data" at a price of 32.00 (Exhibit 40) occurred four minutes after a purchase by Allen of 30,000 shares at 31 1/2 which it then offered to IDS through Langfield at 32, and, since IDS was not interested in the security, enabled Langfield to put in a stop at the offered price. 35/ As recognized in the Brief submitted by respondent Crooks (at page 18) in discussing this trade: "The record demonstrates and it is undisputed that Langfield was in a most advantageous position as far as having information available to him ***."

A similar situation occurred in the same security on September 1, 1972 wherein Langfield was able to negotiate a stop for his personal trade based upon timing and his having direct access to Allen's trader. As stated in Crook's Brief with respect to this transation (at page 21): "Langfield was a talented negotiator ***. His employment by IDS, and the

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35/ This form of preferential treatment is not the same as the grounds urged by the Division, i.e., that it demonstrated deliberate giving of a "better" price almost as a bribe, or the giving of a so-called "institutional" price which is not defined in this record. Rather it is a preference inherent in the relationship that was permitted by respondents to exist and continue.

security industry information necessary to his employment, provided by IDS, were the implements which enabled Langfield to trade successfully".

With respect to at least one of Langfield's clearing brokers, Heine, Fishbein, Crooks agrees that Langfield probably got better price and treatment, including the use of stops, than he could have if his broker had handled the trades for him. 36/

Another good example of how having direct access to respondents' trading room and personnel was of definite advantage to Langfield was seen heretofore (footnote 28) in the "Bally" transaction wherein he was able to obtain an adjustment of a disputed claim with Crooks. It is difficult to see how any individual buyer dealing through his broker could have done as well.

Respondents, in denying that Langfield was given any preferential treatment, assert that he was considered by them, because of his relationship to IDS, to be a "trader" and that they treated him in the same way as just another trader. Herein, of course, lies the very heart of the matter. Langfield, when he undertook to buy and sell for his own account, was acting

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36/ This was not necessarily true with respect to Langfield's other clearing brokers.

like a retail customer. He should have had his deals handled through a broker, or through an account maintained with the retail department, if it had any, at Allen. He should not have been accorded the privileges of the professional trader. In fact, were it not for his position as trader for IDS, he no doubt would have been denied direct access to Allen's trading room, where no such accounts were maintained except in extraordinary circumstances and as a special favor to some important member of the firm.

Langfield, himself, recognized the unusual position he occupied and the opportunities for benefits it provided him. In his investigatory testimony, Exhibit "TT" in evidence, Page 30, he was asked why he continued to remain at IDS when he was able to trade for himself and earn many times more than his salary, rather than to stay home and to trade full time on his own behalf. After stating a personality reason, he went on the state:

> Number two, at I.D.S. I had the Electronic equipment that if I went home or if I went into business for myself, I would have to buy it. *** I had direct wires to brokers. If I were home, I would not have direct wires at home.

At another point in this same testimony it is learned that Langfield used the daily contact his position gave him with street traders as a means of helping him to select the securities for his personal trades, and the quotation facilities available to him in order to place his order with the market-maker giving the best quotation.

Under all of the circumstances, it is clear that when Langfield was permitted to trade for his own account directly with market-makers generally, and respondents specifically, he was receiving a distinct preference which he would not otherwise have received were he not also a trader for IDS. 37/

Investment Company Act Violations

Having found that Langfield did receive during the period charge preferential treatment of the kind described, one of the questions to be resolved is whether he thereby received "compensation" prohibited by Section 17(e)(1), and, if so, whether Allen and Crooks aided and abetted in such violation.

It is not disputed that Langfield is within the class of persons covered by the Act, i.e., that IDS was an affiliated person of registered investment companies (Investors Group Funds)

37/ This type of trading advantage provided to Langfield was well summarized in the testimony of Mr. Crooks (Transcript, Pages 956-6):

BY MR. EINHORN:

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Q. Mr. Crooks, wasn't Langfield's ability to obtain direct access to you and contact you in a moment over your direct line, a distinct trading advantage to him?

A. I would say so.

Q. It enabled him to respond more quickly to market information and price movements in stocks than he would have been able to if he didn't have that direct wire?

A. That's correct.

That's true.

and that Langfield was, in his role as employee of IDS, an affiliated person of such affiliated person.

However, respondents dispute that any "preferential treatment" given Langfield constituted "compensation" or that it had any connection with his allocation of IDS business to Allen. In support of the first conection, they argue that a showing must be made that the "compensation" was given and accepted in appreciation of past, or anticipation of future conduct, citing U.S. v. Brashier, 548 F.2d 1315, 1318 (9th Cir. 1976, cert. den. 429 U.S. 1111 (1977), and U.S. v. Deutsch, 451 F.2d 98, 112-113 (2d Cir. 1971), cert. den., 404 U.S. 1019 (1972). In support of their second contention, they urge that as Langfield became more active in his personal trading, he became less active in his trading for IDS Funds. Thus, from 1971 to 1973, Langfield's personal trades with Allen virtually doubled, whereas IDS dollar-volume trading with Allen in all securities declined from $53,177,160 to $15,211,379 annually and in OTC securities (through Langfield) the annual decline was from $22,144,573 to $3,025,318. Crooks additionally argues that there is no evidence or reason to believe that Langfield's personal transactions in any way caused the Funds to be damaged or their trades made at unfavorable prices, and that there is no indication that Langfield's performance for IDS was not entirely satisfactory.

The Deutsch decision, cited both by the Division and respondents in support of their respective positions, is apparently a case of first impression which presents a careful analysis and review of the meaning and intent of Section 17(e)(1). It points out that the Act was designed primarily to correct self-dealing, and has an objective to prevent affiliated persons from having their judgment and fidelity impaired by conflicts of interest. Hence, it is not necessary that the recipient of compensation take any action as a result thereof. As stated at Pages 112-113 of 451 F.2d.:

> The language of Section 17(e)(1) makes no mention of intent to influence; the subsection is cast in the familiar "for" terminology of the gratuity statutes *** where the only intent required is that the payment be given and accepted in appreciation of past, or in anticipation of future, conduct. ***
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> *** We do not believe that Congress intended that intent to influence should be read into Section 17(e)(1) of the Act. The paying of compensation is an evil in itself, even though the payor does not corruptly intend to influence the affiliated person's acts, for it tends to bring about preferential treatment in favor of the payor which can easily injure the beneficiaries of investment companies. Congress recognized that affiliated persons had manifold opportunities for self-dealing and designed a statute to remove the potential for conflicts of interest by prohibiting the receipt of compensation "for the purchase or sale of any property ***." *** We hold that to read into Section 17(e)(1) a requirement of intent to influence would frustrate this statutory purpose. (Underlining added)

It is quite clear that the preferential treatment afforded to Langfield was "compensation". His direct access to Allen's trading room and personnel contributed immeasurably to the profits he was able to earn in his personal trading for himself and Murray (even if we concede, as contended by Allen, that the amount of such profits might have somewhat overstated by the Division). While the Division has been unable to establish any specific price advantage flowing from respondents to Langfield in their trades, there was a definite trading advantage flowing, and this is "compensation". Deutsch, supra. defines compensation under the Act as meaning "something of value", such as an option to buy a security. Even a legitimate loan has been held to constitute "compensation" under Section 17(e)(1). See United States v. Blitz, 533 F.2d 1329, 1345 (2d Cir. 1976), and Brashier, supra, at Page 1328. The trading advantage accorded Langfield falls within these concepts.

Moreover, the furnishing of this benefit did not have to be accompanied by an intent on the part of the donor and/or recipient to take any action with respect thereto. Deutsch also makes it clear that in his employment by IDS, Langfield was "acting as agent" and that the compensation was "for" the purchase and sale of property to or for the investment companies. Thus, the arguments based upon the volume of business Langfield did or did not do with respondents in the relevant period or the intent or lack of intent to influence Langfield by respondents are not germane to the issues involved. The potential for conflicts of interest were created by the receipt of the compensation, and, hence, a violation of the statute on his part occurred.

The position taken by respondents that Langfield was a "professional trader", and that it was perfectly proper to open its trading room and personnel to him on this basis cannot be sustained. Whether he was a "professional trader" or merely a "public" customer is not the relevant issue. The important factor is that Langfield was within the class of affiliated persons whose activities of a self-dealing nature are proscribed by the Investment Company Act. He is not just any other customer or trader, and when respondents accorded him the preferential treatment detailed above, they became involved with the special status created in the Act.

Neither is there a need, as respondents assert, for a special Commission rule forbidding trading with an affiliated person of an investment company, nor is there any help to be found for respondents in proposed Rule 17j-1, [38/] which would merely allow the Commission to draw up rules or regulations concerning the trading by affiliated persons for their own account.

38/ 4 CCH Fed. Sec. Law. Rep., para. 48,445 and para. 48,451 (1978).

That respondents "aided and abetted" such violation is also manifest. Respondent Allen argues that to be held responsible as an aider and abetter, it must be shown that it had a "general awareness that its role was part of an overall activity that is improper and knowingly and substantially assisted such violation" [citing SEC v. National Student Marketing Corp., 457 F. Supp. 682, 712 (D.D.C. 1978)]. In this context respondent emphasises that "awareness" and "knowing assistance" must be shown on its part. In effect, respondent is attempting to invoke some sort of "scienter" standard as a prerequisite to being held as an aider and abetter.

No such standard is involved in violations of Section 17(e)(1) on the part of the principal wrongdoer, Langfield, and hence, no such standard is required to charge an aider and abetter. Compare SEC v. Coven, 581 F.2d, 1020, 1026-1028 (CA- 2, 1978). In that case, the Court of Appeals, citing SEC v. Management Dynamics, Inc., 515 F.2d, 801. (CA-2, 1975), lays down the standard that is to be applied, as follows (p. 1028):

> *** The test is whether an alleged aider and abetter "should have been able to conclude that his act was likely to have been used in furtherance of illegal activity", in light of all of the circumstances, 515 F.2d at 811, including the nature of the defendant's assistance to the primary wrongdoer, his participation in the challenged conduct, his awareness of the illegal scheme, and any duties to investigate or supervise that may be applicable.

It having been found that Langfield's dealings with respondents were a violation of the Section, and they having participated in the preferential treatment heretofore outlined in every step of the way, they cannot avoid being deemed aiders and abetters of such proscribed conduct merely because they did not believe Langfield's conduct to have been illegal. And their acts were "willful" as that term is used under the securities laws. (See footnote 21, supra). 39/

Violation of Anti-Fraud Provisions

The Order for Proceedings charges respondents with wilfully violating and wilfully aiding and abetting the violation of the antifraud provisions of the securities laws (see footnote 23 above) in two respects: for failing or causing others (unnamed) to fail to provide the IDS Funds with "independent judgment in the selection of executing market-makers"; and for failing to disclose to the IDS Funds that Langfield and Murray were receiving and accepting preferential treatment with a view towards obtaining business from the IDS Funds.

39/ The reliance of respondents on the Initial Decision in the Decker case, supra, to establish that a "clear and convincing" standard of proof should be requried to prove a violation of Section 17(e)(1) is misplaced, since that Decision was not followed by the Commission (see footnote 7 hereinabove). However, so as to resolve any doubts on this score, the conclusions herein that respondents aided and abetted Langfield to violate Section 17(e)(1) are sustainable even under a "clear and convincing" evidence standard.

With respect to the first specification, there is nothing in the record to support any conclusion that Langfield (or "others") failed to provide IDS Funds with the best execution possible. The record contains several references to the fact that he traded well and with a great deal of skill both for IDS and for himself, but nothing to the contrary. Moreover, the Division has stipulated that it does not contend that in any specific or individual security transaction between respondents and IDS any such transactions was made at a price or on terms other than the best execution possible under the circumstances. In fact, it concedes in its reply brief that "it is simply not possible to determine whether or not Langfield got best price and execution for the funds" (page 32). The burden of proof is on the Division; it has not been sustained.

As to the second specification, here again there has been a failure of proof to establish that respondents did not disclose to the Funds that they were giving preferential treatment to Langfield in order to get more of his business.

In the first place, the only type of "preferential treatment" found to have been provided Langfield was the giving of direct access, the very access which was provided him by IDS and respondents jointly. It is difficult to assume that IDS or the Funds did not know that Langfield in his personal trading was taking advantage of this access thus provided, especially in the total absence of any proof to the contrary. They also knew, or should have known, that it was his earnings from trading, not his IDS salary, that retained his services for them.

One of the most serious defects in the Division's case is the <u>total absence of any proof</u> that the IDS Funds were not told of Langfield's personal trading practices and the extent to which they might have involved preferential treatment. While it is true, as argued by the Division, that the knowledge of Langfield's superiors at IDS is no proof that the Funds' managers or officials had knowledge, this is not a substitute for the burden primarily on the Division to establish in the first instance that the necessary representations were never made to those being defrauded, i.e., the IDS Funds.

In any event, apart from the furnishing of direct access to Langfield, all other proof of record seems to point to the conclusion that others in responsible positions at IDS and its Funds knew of his personal trading. There is no question that his superior, Mr. Murray, at IDS knew. And Mr. Murray's <u>uncontradicted</u> testimony (Transcript, pages 156-7 and 199-200) was that other IDS trading personnel, ten fund managers, and the investment department in general also knew. Moreover, Langfield had maintained so-called "white sheets" (Exhibit B) on which he recorded the details of his various trades for IDS, and, on a separate portion of these sheets, the details of his personal transactions. These sheets were kept on his desk where they could have been - and were - seen by anyone. Langfield's uncontradicted testimony (pages 46-7 of Exhibit TT) was that the various portfolio managers perused these sheets in checking his trades for them. He also named a number of other IDS personnel who had indicated one way or another that they knew of his personal trading.

In view of the regular and periodic reporting to IDS by Langfield and his clearing brokers, the open manner in which he traded for himself, the relationship that existed between IDS and its various Funds, and the fact that the direct access available to Langfield was provided by IDS, that total lack of any proof by the Division to show that respondents did not advise the Funds of the "preferential treatment" given Langfield demonstrates a complete failure to sustain its ultimate burden of proof, whether by the "clear and convincing" standard 40/ or the "preponderance of evidence" standard. Hence, it is concluded that no violation of the anti-fraud provisions has been established.

Failure to supervise

The final violation asserted is that respondent Allen failed reasonably to supervise its employees with a view towards preventing the other violations charged.

40/ The application of the "clear and convincing" standard of proof in administrative proceedings charging violation of the anti-fraud sections has recently been reaffirmed in Whitney v. SEC, No. 78-1326, D.C. Cir., June 28, 1979.

The difficulty in finding a violation in this instance is that, given the open manner in which Allen and its employees and officers traded with Langfield, and in view of the respondents' belief that their procedures in trading with Langfield were lawful, sanctioned by IDS and engaged in by some 50 to 75 other market-makers, there is no way that any additional or different supervision by respondents would have prevented the violations heretofore found to have occurred.

Public Interest

The violations which have been found herein to have been committed by respondents are quite serious ones. The importance to the regulatory scheme of keeping books and records in proper form has previously been pointed out. In like fashion, the pertinent provisions of Section 17 of the Investment Company Act, sometimes referred to as the "self-dealing" section 41/, which are designed to prevent affiliated persons from injuring the interests of stockholders of registered investment companies, 42/ must be upheld, even where the injury is merely potential rather than actual. To this end, the imposition of appropriate sanctions is warranted.

41/ Transit Investment Corp., 28 SEC 10, 16.

42/ S.E.C. v. Talley Industries, Inc., (CA-2), 399 F.2d 396, 405.

Due regard must be given to the facts and circumstances of each particular case, since sanctions are not intended to punish respondents but to protect the public interest from future harm. See Berko v. S.E.C., 316 F.2d 137, 141 (CA-2, 1963), and Leo Glassman, SEA Release No. 11929 (December 26, 1975), 8 SEC Docket 735, 737. Sanctions should also serve as a deterrent to others. See Richard C. Spangler, Inc., SEA Release No. 12104 (February 12, 1976, note 67).

There are a number of mitigating factors in respondents' favor to be balanced against the seriousness of the violations found. First, both Allen and Crooks point to unblemished records during their respective years in the securities business. The record contains nothing to the contrary, nor does the Division dispute these averments.

Secondly, the one element that stands out is the fact that the practices which constitute respondent's violative conduct were so widespread. There were at least 50, and perhaps many more, market-makers (the majority of whom were not proceeded against because of the small number of questioned transactions they had with Langfield) who traded with Langfield individually during the relevant period under similar circumstances as respondents. Other than the failure of respondents herein and, presumably, all the others to record properly on their books and records that Langfield was, in fact, their customer, there appears to have been no attempt to conceal their trading activities with him. Allen and Crooks satisfied themselves that Langfield had permission for IDS to trade for his own account. Thus, a pattern emerges of extensive and unconcealed activities involving numerous OTC market-makers which deserves consideration in assessing a sanction against Allen and Crooks.

Additionally, it would appear from this record that the unique situation involving Langfield and these respondents will not be repeated by them. During the relevant periods, he was the only trader employed by a mutual fund specifically assigned to the OTC market. Moreover, the ethical requirements at IDS have, since early 1974, been changed so as to forbid any of its employees from dealing directly with market-makers while giving up a clearing broker's name, and, further, forbidding the use of "stops" in OTC trading.

However, there always is the possibility that at some future time, others might contemplate conduct comparable to that observed to be violative herein.

Accordingly, and in light of the purpose to be served in the public interest by the imposition of sanctions, it is concluded that a suspension of Allen from all market-making activities in over-the-counter securities for a period of five days, and a suspension of Crooks from association with any broker-dealer for a like period is warranted. 44/

ORDER

Under all of the circumstances herein, IT IS ORDERED:

1. That respondent Allen & Company be suspended from effecting transactions in over-the-counter securities for a period of five business days following the effective date of this Order.

2. That respondent Richard M. Crooks be suspended from association with a broker-dealer for a period of five business days following the effective date of this Order.

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 Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review this initial

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44/ In their briefs and arguments, the parties have requested that Administrative Law Judge to make findings of fact and have advanced arguments in support of their respective positions other than those heretofore set forth. All such arguments and expressions of position not specifically discussed herein have been fully considered and the Judge concludes that they are without merit, or that further discussion is unnecessary in view of the findings herein.

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.

Jerome K. Soffer

Jerome K. Soffer
Administrative Law Judge

August 2, 1979
Washington, D.C.