ADMINISTRATIVE PROCEEDING
FILE NO. 3-5860

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

RONALD L. BROWNLOW :
(Oppenheimer & Co., Inc., et al.)

INITIAL DECISION

Washington, D.C.
August 18, 1980

Edward B. Wagner
Administrative Law Judge

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APPEARANCES:

David M. Matteson and James L. Sanders of the Chicago Regional Office for the Division of Enforcement, Securities and Exchange Commission, 219 S. Dearborn Street, Room 1204, Chicago, Illinois 60604.

Ronald L. Brownlow, pro se, 749 West Franklin St., Jackson, Michigan 49022

BEFORE: Edward B. Wagner, Administrative Law Judge

The Proceeding

This public proceeding was instituted by the Commission on January 8, 1980 pursuant to provisions of the Securities Exchange Act of 1934 (Exchange Act) against Ronald L. Brownlow (Brownlow) and six other respondents. All respondents except Brownlow settled. 1/

Brownlow was charged in the order with wilful violation of antifraud provisions of both the Securities Act of 1933 (Securities Act) and of the Exchange Act 2/ during the period from September, 1976 through December 1977 while an employee of Oppenheimer & Co., Inc. (Oppenheimer). The charges against Brownlow relate to his activity in connection with a program he developed referred to as the Special Option Program (SOP) and involve alleged:

(1) Misrepresentations and omissions concerning the SOP;

(2) Inducement to trade in unsuitable securities, namely options pursuant to the SOP;

(3) Churning; and

(4) Misrepresentations to customers of the status of their accounts.

1/ Sanctions were imposed pursuant to these settlements upon Oppenheimer & Co., Inc., a broker-dealer registered with the Commission, Daniel J. Piet, Warren K. Hayes, Charles W. Wright, and Robert Hunzik, registered representatives at Oppenheimer's Chicago office, and Thomas J. O'Donnell, the manager of Oppenheimer's Chicago office. SEA Rel. No. 16474 (1-8-80).

2/ Section 17(a) of the former and Section 10(b) and Rule 10b-5 thereunder of the latter.

A hearing was held in April, 1980 in Chicago. Thereafter, the Division and Brownlow filed proposed findings [3/] and the Division filed a reply brief.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of witnesses. The "clear and convincing" standard of proof was applied to the fraud charges in accordance with Collins Securities Corp. v. SEC, 562 F.2d 820 (D.C. Cir. 1977).

As indicated, Brownlow dealt in options and the following definitions are necessary to an understanding of his activities.

Definitions

1. A call option is a contract which gives the buyer the right to purchase a specific amount of the underlying stock at a specific price (designated as the strike price) until the specified expiration date. A short hand method of describing, for example, a Honeywell Corp. option with a $90 strike price and a January expiration is "HON JAN 90".

2. The buyer of the call has the right to acquire the underlying stock (one hundred shares for each option contract) until the expiration date at the strike price from the seller. The seller, on the other hand, for

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3/ Brownlow originally requested that his filing be kept confidential. In a letter dated July 16, 1980 he stated that this request was "inadvertent" and made his materials public.

In his July 16 letter Brownlow complains about the unfairness of a procedure, Commission Rules of Practice [17 CFC 201.16(e)], which contemplates a Division reply to his materials as the final filing and requests an explanation. It is noted that this is the usual arrangement where there are successive filings and a moving party, such as the Division. The Division's position in this respect is equivalent to that of an appellant in an appeal.

having received a premium from the sale, is bound for the life of the contract to deliver the stock at the strike price if the option is exercised.

3. Strike price is the price at which the buyer, pursuant to the option contract, can acquire the stock.

4. The premium is the market price or cost to the buyer of the option.

5. A covered option is the writing or the selling of an option by a customer who has the corresponding amount of the underlying stock in his account.

6. An uncovered option is the writing or the selling of an option by a customer who does not own the underlying stock. An uncovered option is also called a naked option.

7. A spread is a combination of both long and short options. Spreads involve options of the same class, that is, having the same underlying security, but with different striking prices or expiration dates.

8. A bear spread involves the sale of a call with a lower strike price and the purchase of a call with a higher strike price. A bear spread results in a credit in the customer account because the call with the lower strike price that is sold will have a higher premium (and thus a larger credit) than the cost of the long call. The theory of a bear spread is that the stock will go down to the point that in unwinding or closing the spread, the net cost will be less than the initial credit upon the opening.

9. An exercise is the action that the holder of the option can take pursuant to the option contract to require the seller of the option to deliver the underlying stock at the strike price.

10. An assignment is the effect of an exercise. Through the brokerage firm and the Option Clearing Corporation, specific accounts with short option positions are randomly designated to deliver the underlying stock at the strike price.

11. A call option is in-the-money if it has some intrinsic value, that is, if the market price of the underlying stock is higher than the strike price of the option. A call option is out-of-the-money if the strike price is higher than the market price.

Respondent and His Customers

Brownlow, a graduate of Michigan State University, is presently 32 years of age and was 29 during the events in issue. He has been a registered representative in the securities business since 1972. He was employed at Shearson, Hayden & Stone, Inc., from December, 1972 until September, 1973 and then at Bache, Halsey, Stuart, Inc., until November, 1974 at which time he joined the sales force at Merrill Lynch. Brownlow worked there until August, 1976. He then went to Oppenheimer, where he stayed until December 1, 1977. Brownlow was employed by Cowen & Co., another registered broker-dealer, from October, 1978 until February 1, 1980.

Brownlow was asked to resign both at Oppenheimer and Cowen.

Brownlow's income as a registered representative rose progressively from $15,000 in 1974, to $23,000 in 1975, to $45,000 in 1976, and to $97,000 in 1977. Around 60% of his income in 1976 and 1977 was option-related.

In January 1976, while at Merrill Lynch, Brownlow prepared a report entitled "Presentation of Special Option Program (SOP) Utilizing Option and Margin Techniques" (SOP Report). This report described Brownlow's version of the bond option program. The SOP Report stated that the program was developed to yield a 20% rate of return for customers, that its primary goal was preservation of capital and that it was appropriate for conservative investors. The bond option program essentially involved the selling by the customer of naked options. The option premiums received in the accounts were to be aggregated and used to purchase additional securities. The original equity of the customer, usually in the form of bonds, was used to collateralize the uncovered options, which were to be at least 20% out-of-the-money and have at least a two point premium.

Brownlow was prohibited by management both at Merrill Lynch and at Oppenheimer from using his SOP Report as a selling tool. Nevertheless, in late 1976 he gave the SOP Report to bond option customers, including Dr. Eugene Kennedy (Dr. Kennedy) and Thomas Costello (Costello).

As a result of the speculative option strategies utilized by Brownlow, 10 selected bond option accounts, handled by Brownlow at Oppenheimer over periods ranging from 7 weeks to 14 months, suffered aggregate losses of over $216,000, [4/] including commissions of over $169,000. Four of such customers including Dr. Kennedy and Costello, are described below.

Marilyn Braun Vinik (Vinik), 43, opened an account with Brownlow in 1975, shortly after her husband died. At that time her annual income was about $20,000 and her net worth, including her home and the proceeds of her husband's life insurance, was approximately $200,000. Vinik had no prior investment experience and did not understand even the most basic elements of options.

Nonetheless, in 1976 Brownlow induced Vinik to trade in options, stating that he was "very, very good at it," and had made profits on seventy-five consecutive trades. He also said that her option account would be subject to very little risk. At Brownlow's urging, Vinik participated in the bond option program at Merrill Lynch and then at Oppenheimer from September, 1976 to December, 1977, when Brownlow was discharged. All trading decisions in Vinik's account were made pursuant to discretionary authority. As a

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[4/] These losses were based on the liquidating value of each account, either when it was terminated, or on November 30, 1977, the day before Brownlow was discharged, as compared to the original equity.

result of such trading at Oppenheimer, in thirteen months Vinik lost over $35,000 or 36% of her original investment.

Robert Firth (Firth), 69, is a retired tool and process engineer from Dayton, Ohio. Firth was referred to Brownlow by Vinik, Firth's daughter. Firth had an annual income of $15,000 in 1976 and 1977. The only investment experience Firth had prior to opening an account with Brownlow at Merrill Lynch was in dividend-yielding utility stocks. Firth had never traded options before and did not understand any of the trading strategies or terms.

At Brownlow's request, Firth participated in the bond option program at Merrill Lynch and then at Oppenheimer from September, 1976 to December, 1977. All of the trading decisions in Firth's account were made pursuant to discretionary authority. As a result of Brownlow's trading, in fourteen months Firth lost over $17,000, or 20% of his original equity.

Dr. Kennedy, 51, is an author and a professor of psychology. Brownlow represented to him that the objective of his program was preservation of capital. Brownlow further stated that existing accounts were successful in generating a consistent yield. At Brownlow's urging, Dr. Kennedy opened an option account at Oppenheimer in February, 1977, and participated in the bond option program until November, 1977. All trading was done pursuant to discretionary trading authority. As a result of such trading at Oppenheimer, Dr. Kennedy lost over $6,000 or 25% of his original investment.

Costello was a Brownlow customer who participated in the bond option account at Merrill Lynch and at Oppenheimer from late 1976 to December, 1977. Brownlow told Costello that the program's objective was preservation of capital while obtaining consistent returns. All of the trading decisions in Costello's account were made pursuant to discretionary authority. As a result of such trading at Oppenheimer, Costello lost over $5,000 in fourteen months.

(1) Misrepresentations and Omissions Relating to Bond Option Program

The SOP was represented as giving "an above average return with relative safety of principal" and as "a realistic investment alternative for conservative investors" (Div. Ex. 2, pp. 1, 2) developed "to attain an annual net taxable yield of twenty percent (20%)" (Id., p.7). It was, in fact, an extremely risky program. Naked options involve unlimited exposure. Such a program would appear to be an appropriate vehicle for conservative investors only if a stable or "down" market were assured, or if a periodic "up" market can be sufficiently anticipated. Obviously, there can be no such assurance nor predictability.

Risk was consistently downplayed. Thus, in the concluding paragraph in the Preface to the Report U.S. Treasury Bills are mentioned in the same breath with the SOP:

> "... It is imperative that the investor understand that any investment contains a level of risk. Government issues such as Treasury Bills are without assurances of risklessness. Therefore, a program such as the SOP has 'risk'...." (Id., p. 2).

The SOP Report purported to show, as a basis for its prediction of a 20% annual profit, results from certain of Brownlow's customers in the program for a six month period from June through December, 1975. The Report stated that these customer accounts showed an "average net equity increase" of 14.6%, or 35.4% on an annualized basis (Id., p. 60). The Report further stated that the performance range on an annual basis was from 20% to 46%. These figures were false and misleading since they did not take into consideration the open positions in the accounts. All but one of the open positions in the accounts in question showed substantial losses. 5/ By not taking into account unrealized losses, the Report substantially overstated the profitability of the accounts.

Moreover, even if unrealized losses had been properly reflected, it is, as the Division suggests, doubtful that a six month period would be sufficiently representative.

Brownlow employed a race track analogy in presenting his program. He stated that the party on the other side of the transactions was speculating on a 20-1 shot. By implication, Brownlow's customers had 19 chances to 20 of profiting on the individual transactions. The analogy has no basis in fact and is misleading.

5/ The only exception showed a small profit.

Brownlow made unfounded predictions of almost assured profits and failed fully to disclose the extent of the risks involved. As the Division contends, in his representations *concerning the SOP Brownlow wilfully defrauded and deceived* his customers as charged in the order for proceedings. 6/

(2) Inducement to Trade in Unsuitable Securities

The precise charge in the order is that Brownlow:

> "purchased and sold or induced such customers to purchase and sell listed options notwithstanding that such transactions as effected by [him]... were not suited to the financial situations, investment sophistication and investment objectives of certain of these customers". (Underlining added).

The Division argues that Brownlow's option trading program, considered generically, was unsuitable for Vinik, Firth, Dr. Kennedy and Costello in terms of the three criteria underlined above.

In terms of investment objectives and investment sophistication the program was not suitable for any of the four accounts. While naked options involve theoretically unlimited risk, the investment objective of Vinik, Firth, Dr. Kennedy and Costello was to receive income while preserving their principal. None of them wished to speculate nor to expose their assets to large losses. The four customers were inexperienced and unsophisticated. Vinik's and Firth's only

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6/ Scienter is found with respect to this and other Brownlow violations. It is discussed as to all his violations in a later section of this Initial Decision (pp. 23-4).

previous investments were in income stocks. Both told Brownlow that they did not understand his program or even the elementary concepts of option trading. Costello and Dr. Kennedy, who had little prior option experience, also told Brownlow that they did not understand his program.

The financial situations of Firth and Vinik made the program unsuitable for them on that score as well. It would be difficult to imagine a program more unsuitable for Firth.

As part of opening the Oppenheimer account in the Fall of 1976, Brownlow sent Firth a blank Oppenheimer form (the Option Checklist) and asked him to sign it. The form was used by Oppenheimer to determine whether to approve the customer account. It contained blanks for customer information such as age, income, net worth, and occupation. Firth called Brownlow about the blank form and Brownlow stated that he would fill it out, if Firth and his wife signed it first. After the form was signed and returned to Brownlow, false information was typed on the form. Firth was stated to be 50 years old (instead of 68). The form further stated that he was still employed as an engineer at NCR Corp. (rather than retired from that company), that he had an income of $30,000 (instead of $15,000, which was derived from Social Security, pension benefits and interest income) 7/ and that he had a bank account at the First National

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7/ Firth was supporting his wife and 90 year old invalid mother.

Bank of Dayton. Firth has never had an account at that bank. Firth did not give Brownlow any such information. Brownlow stipulated that he prepared or caused to be prepared Firth's Option Checklist containing the false information.

Although Brownlow suggested in his cross examination of Firth that the latter had given Brownlow's secretary the bank information, Firth denied it and his testimony is credited (Tr. 173-4). Brownlow apparently seeks to explain this matter in his post-hearing filing stating at p. 15 as to Firth: "errors at OPCO caused by new office environment and new secretarial assistant." Such an explanation would probably be difficult to accept even if there were testimony or other evidence to back it up. There is none.

It is concluded that Brownlow fabricated the information on Firth's form. The clear inference is that, if the truth had been told, Oppenheimer would not have approved Firth for the Special Option Program. Firth's account was relatively small, $85,592, and his loss in 14 months totalled $17,510 with some $22,609 paid in commissions.

Vinik is a closer case with respect to adequacy of financial resources. Vinik, a widow at the time she was brought into Oppenheimer by Brownlow from Merrill Lynch, had a net worth of $200,000 in 1976 which consisted of the proceeds from her former husband's life insurance, which she invested in Brownlow's program, and the equity in her residence. Her annual income during this period was only $20,000. Having two small children to support, Vinik clearly did not have the

financial capability to withstand large losses to her capital. In fact, in just over one year in Brownlow's option program at Oppenheimer, she lost over $35,000.

Brownlow claims in his filing that her second husband's income of $45,000 per year should have been taken into account by the Division. However, at the time she was put into the Special Option Program at Oppenheimer by Brownlow she was still a widow. Moreover, her second husband's annual income at the time of their marriage in November, 1976 was not $45,000 but $30,000 (Tr. 227).

It is concluded that Vinik was not a suitable candidate for the SOP from the standpoint of her financial situation.

Brownlow clearly placed these four customers in a program that was unsuitable for them. The more difficult question is whether such conduct constitutes a violation of the antifraud provisions. The Division cites Shearson, Hammill & Co., 42 S.E.C. 811, 834 (1965), and Richard N. Cea, 44 S.E.C. 8 (1969), for the proposition that recommendations of unsuitable investments to unsophisticated and inexperienced customers have been found to be part of fraudulent schemes. Both opinions contain language which tends to support that conclusion. It is, however, noted that neither opinion is recent and that in a later decision, Haight & Company, Inc., 44 S.E.C. 481, 498 (1971), affirmed without opinion C.A.D.C. (1971), the Commission casts some doubt upon suitability as

a fraud concept, stating:

> "Finally, respondents contend that the hearing examiner applied improper standards in determining that their securities recommendations to clients were unsuitable. This contention reflects a misapprehension of the examiner's decision. Neither of the examiner's conclusions, nor our own, as is evident from the foregoing discussion rest on a determination that the securities recommended and sold were 'unsuitable'."

While the Commission has adopted "suitability" rules for SECO (Registered with the SEC only) brokers [8/] and for certain limited types of transactions, [9/] it has not adopted such a rule for NASD (National Association of Securities Dealers) members.

This type of conduct has thus been before the Commission on other occasions. It is not, however, sufficiently clear that it has been regarded as violative of the antifraud provisions to warrant a conclusion that Brownlow committed a violation in this respect. [10/] In fact, it makes little difference. Other jurisdictional bases for sanctioning Brownlow clearly appear. His conduct in regard to suitability is relevant to the public interest question involved in assessing an appropriate sanction and will be taken into

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8/ Rule 15b10-3.

9/ Sale of mutual fund shares and life insurance policies in combination "equity funding" packages. Rule 15c2-5(a)(2).

10/ It is noted that Brownlow as a pro se respondent is not in a position to argue legal subtleties.

account in that respect.

(3) Churning

As the Division points out, churning has been defined as the "practice of engaging in excessive trading for the purpose of producing commissions rather than acting on behalf of one's client...." Lorenz v. Watson, 258 F.Supp. 724, 733 (E.D. Pa. 1966). It basically involves a broker's deriving profits (commissions) for himself with little regard for the interests of his customer. Stevens v. Abbott, Proctor & Paine, 288 F.Supp. at 836, 845 (E.D. Va. 1968); Russell L. Irish, 42 S.E.C. 735 (1965), aff'd 367 F.2d 637 (9th Cir. 1966), cert denied 386 U.S. 911 (1967).

There is no question that one of the two essential elements of churning has been made out— control by Brownlow over the bond option accounts. Hecht v. Harris, Upham & Co., 283 F.Supp. 417 (N.D. Cal. 1968). Brownlow had discretionary authority, and his customers made none of their own trading decisions.

In determining whether the second element, excessive trading, has been established, courts have looked to whether the broker's predominant purpose was to advance his own interests rather than his customer's. Marshak v. Blyth, Eastman, Dillon & Co., 413 F.Supp. 377 (N.D. Okla. 1975). The record shows that on a number of occasions Brownlow executed transactions which had no economic benefit or profit potential for the customer but which did result in commissions for him. These uneconomic transactions were

mainly spreads with locked-in losses. Other such transactions involved selling naked deep-in-the-money call options and improper exercise of options.

Spreads with Locked-In Losses

This occurred when Brownlow had sold naked options for a customer at the premium and then paid more than that premium for call options purchased for the same customer's account on the same stock at the same striking price but with a shorter expiration period. In these situations Brownlow could not close out both sides of the spread simultaneously at anything but a loss, regardless of the direction of the market. He had, however, assured himself of commissions both on the sale and on the purchase and on such transactions as might be necessary to trade the customer out of the position.

This is illustrated by the following transactions in the Firth account.

In late 1976, and in 1977, Brownlow traded RCA Corporation (RCA) common stock and options in Firth's bond option account. The first RCA trades in Firth's account were purchases of the common stock in September and October, 1976, totalling over $15,000. In December, six covered RCA JUL 25's were sold against the stock held long in the account. Two weeks later, the common stock was sold at a loss, leaving the calls uncovered and exposed to theoretically unlimited risk. On January 5, 1977, the following day, this position was

spread, with the purchase of six RCA APR 25's. The spread was put on so that it could not have been simultaneously closed out at anything other than a loss. Brownlow had caused Firth to pay more for the near term option than he received for the corresponding option with the later expiration date. The RCA spread thus had no profit potential for Firth.

The long position was sold on January 26, 1977 at a loss equal to the commission costs of $146 and the short side was also closed out at a loss of over $650. Similar transactions involving RCA securities occurred in four other Brownlow bond option accounts.

Similarly uneconomic trades occurred in Dr. Kennedy's account in Texas instruments (TXN) options. Brownlow-Piet's [11/] first such transaction was the short sale of five TXN JAN 90's in Dr. Kennedy's account on April 25, 1977. Brownlow-Piet then spread this position on June 7, 1977 by buying five JUL 90's. Three days later the long position was sold. Four days thereafter it was purchased again, re-establishing the same spread as before. As put on by the partnership, the above TXN spread could not have been simultaneously closed out at anything

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[11/] From sometime in March through July, 1977 Daniel J. Piet, another Oppenheimer registered representative who accepted an offer of settlement in this proceeding, worked with Brownlow on Brownlow's bond option accounts in a partnership in which they shared the commissions on a 50-50 basis. Brownlow is just as responsible for the Brownlow-Piet transactions described here as for those he handled separately. Those which may have been initiated by Piet were reviewed daily by Brownlow. The partnership transactions have been stipulated to bear a "466" production number rather than Brownlow's "480" number in the Oppenheimer records.

other than a loss. Dr. Kennedy paid more for the shorter term option (JUL 90) than he received for the sale of the longer term option (JAN 90). The JUL 90's were closed at a loss of $1,552, or over 90% of the original investment, and the JAN 90's were closed later at a $685 loss. Similar transactions occurred in five other Brownlow bond option accounts.

Conceivably, these transactions could have been effected to restrict losses to fixed levels in anticipation of or in response to price changes in the underlying stock (See Div. Ex. 2, p. 47). 12/ It was suggested to Brownlow on four occasions that, if he had explanations for these and other transactions, he should give them in his testimony (Tr. 110,397,547,547). He made no attempt to justify them.

Selling Deep In-The-Money Call Options

On March 3, 1977, Brownlow exposed Vinik's account to theoretically unlimited risk by effecting a sale of four in-the-money uncovered HON MAY 40 calls with only a short time until expiration. This transaction increased the number of short HON MAY 40 calls to eight. Because of the proximity of the expiration date of the call and the fact that they were in-the-money, there was a strong likelihood that the short calls would be assigned. On March 9, 1977, the calls were, in fact, assigned. Vinik's account was required to deliver 800 shares of Honeywell for which it was paid $40 per

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12/ Such an explanation would appear to be untenable in Firth's RCA transactions since the covering stock was sold only one day before the spread was put on.

share. Because Vinik's account did not own the underlying stock, on March 25, 1977, it had to go into open market and buy the stock. In doing so Brownlow effected a transaction for Vinik in which 800 shares of Honeywell at $48 per share were purchased — eight dollars per share more than she received in the sale of stock.

The assignment and subsequent covering purchase resulted in a loss of over $1,500 to Vinik, including $800 in commissions.

Brownlow-Piet caused Dr. Kennedy to sell four uncovered TXN JUL 80's on June 16 and 22, 1977. These were in-the-money calls with only one month to expiration and therefore subject to significant risks of assignment. This position was closed out soon thereafter at a loss.

Improper Exercise of Options

On November 19, 1976, Brownlow effected a transaction in the account of Vinik in which Brownlow exercised six expiring HON NOV 45 calls previously held long in the account. On the day of exercise, Honeywell common stock, the equity underlying the calls, traded between $43-5/8 and $45-1/4. At a market price of $45 or less for Honeywell common stock there was no economic justification for exercising the HON NOV 45 calls because the stock would have been cheaper to purchase in the open market. At a price of $45-1/8 or even $45-1/4 for the underlying stock the exercise of the HON NOV 45's would be of no real economic benefit to the customer, because the commissions involved put the account in a loss position from the moment of exercise.

On December 27, 1976, the HON stock was sold at a loss of $653. The loss resulted even though the sale price was higher than the purchase price because the cost of the options as well as the commissions are part of the acquisition cost. The commissions on these stock transactions alone totalled over $1,200. In view of the very substantial commissions involved in an exercise, the appropriate transaction, unless a substantial increase in the price of the stock had been expected, would have been a closing sale of the long call option (Tr. 406).

Results in Brownlow's accounts were disastrous for his customers but profitable for him.

During the thirteen month period from October, 1976 to December, 1977 of Vinik's account with Brownlow, there were 261 trades executed in Vinik's account, virtually all of which were option related, which generated over $24,000 in commissions, almost one-fourth of her original investment.

Over the fourteen month life of his account at Oppenheimer, commissions in Firth's account were $22,609, representing over one-fourth of his original investment. These commissions even exceeded the total income that Firth received from all sources during that same period.

Almost 60% of losses in Dr. Kennedy's account stemmed from commissions.

During the fourteen month period while Costello's bond option account at Oppenheimer was managed by Brownlow, 272 trades were executed, virtually all of which were option-

related and which generated almost $24,000 in commissions in an account with an opening balance of around $205,000.

As indicated above, Brownlow offered no evidence to explain or justify any of the transactions delineated. Such transactions, which have no economic justification as far as the customer is concerned but which clearly benefit the salesman, are a fortiori excessive (See. Tr. 414).

On the basis of the foregoing I conclude that Brownlow wilfully violated the antifraud provisions as charged by churning his accounts.

(4) Misrepresentations to Customers of the Status of Their Account

The Division's evidence showed that on several occasions during 1976 and 1977, Brownlow misrepresented the status of their accounts to customers.

In 1976 and 1977, Brownlow led Firth to believe he was making money. Brownlow kept telling him that "we were in good shape" in the account (Tr. 167). When Firth complained about not receiving any income from the account (which he needed on a regular basis), Brownlow began sending him $2,000 a month and told Firth not to worry about the money. Firth had advised Brownlow that a principal objective was to receive income. The payments were, however, far from income realized by the Firth account. Without telling Firth Brownlow obtained these funds by increasing Firth's margin debt through borrowing $2,000 every month from Oppenheimer.

Brownlow deceived Firth, who did not have the investment sophistication to know otherwise, into believing the account was performing successfully. [13] In fact, Firth's account declined in value in 1976 and throughout 1977.

Brownlow also misrepresented the profit status of her account to Vinik. He told her that her account had realized profits during the first quarter of 1977. In fact, Vinik's account had dropped in value by from 3 to 4 thousand dollars.

On two occasions Brownlow deceived Dr. Kennedy into believing that his account was profitable. [14] On June 21, 1977, Brownlow prepared a four-page status report on the Kennedy account. He gave that report to Dr. Kennedy's attorney two days later. That report stated that Dr. Kennedy had profits of $2,663 (also expressed as 11%). It also showed an annualized profit figure of 45%. Brownlow did not disclose the unprofitable status of the open positions. Dr. Kennedy relied on Brownlow's figures and believed that his account had profited by $2,663.

In fact, as of the date of Brownlow's report, Dr. Kennedy's account had realized profits of only $896 and had declined in value by over $5,400, or almost 20% of the original investment.

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[13] As Firth testified:

"Q. During the trading at Oppenheimer, did you think you were making money in your account?

A. Yes. He always informed me that we were in good shape except the one time he said -- the only statement I received from him was -- I don't remember the exact date, but where we had lost over $7,000 in the account. And he says he hoped to do better the next time.

Soon after that he disappeared." (Tr. 167).

[14] Kennedy's initial investment was $25,000.

On August 22, 1977, Brownlow told Dr. Kennedy that his account had $1,500 in profits and was worth $26,500. In fact, the account had lost money and was worth less than $20,000.

In October, 1977, Brownlow told Dr. Kennedy that there was $10,000 cash in his account. Since he believed that Brownlow had violated his (Kennedy's) instructions as to trades, Dr. Kennedy asked Brownlow to send this cash to him. He then received a check for only $7,000. Dr. Kennedy reasonably believed that the $7,000 he received had represented cash money in the account. Much later, he discovered that there were no such moneys in the account at the time and that Brownlow had increased Dr. Kennedy's margin debt by $7,000 to obtain the money.

Brownlow had the expertise to value the accounts and must have known their status. As the Division contends, it is clear that rather than risk losing a customer, Brownlow covered up the unprofitable trades through patently false status reports and checks designed to placate his customers. Through these activities Brownlow wilfully violated the antifraud provisions as charged.

Scienter

The United States Supreme Court in Aaron v. SEC, No. 79-66 (June 2, 1980), has recently held that a finding of scienter is required in connection with Section 10(b) and Section 17(a)(1) violations.

I find scienter in the sense of "a mental state embracing intent to deceive, manipulate, or defraud" (Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, fn. 12) present here. As the Division contends:

> "Clearly this case does not sound in negligence; rather it is a continuing course of conduct, a grand scheme. It started with Brownlow's utilization of the SOP Report which contained inflated trading results and then proceeded to his representations to unknowing customers that naked options involved little risk. When losses occurred, Brownlow knowingly prepared false profit reports and even attempted to literally 'buy' time with the checks from the non-existent profits. These were the acts of a broker who intended to deceive, manipulate and defraud." (Div. Br., p. 25).

It should be added that a broker of Brownlow's sophistication could not have entered into the transactions which had no economic utility described in the "churning" section of this initial decisions without consciously making his interests predominate over those of his customers.

In any event, even if scienter were not found, Brownlow's conduct clearly violates Section 17(a)(2) and 17(a)(3) of the Securities Act as to which no finding of scienter is necessary.

Brownlow's Defenses

Brownlow's defenses are without merit. He first attempts to discredit the customer witnesses who testified against him, charging a "serious omission" on the part of the Staff in not disclosing the way in which the Oppenheimer settlement

fund was distributed. [15/] He specifically states that Firth "'stretched' the truth for the benefit of the SEC Staff ...." (Resp. Br., p. 16).

He further states;

> "In fact, I am accusing the SEC Staff of withholding this information. If these clients received or will receive payments from OPCO regarding this matter....., then tell me that I received a fair and unbiased hearing." (Resp. Br., p. 16).

Brownlow cross-examined every Staff witness at length and had the opportunity to bring out any possible bias or interest based upon reimbursement of losses. He did not do so.

There is every reason to suppose that these customers did receive payments from Oppenheimer in the settlement. There is no evidence that they entered into any agreement with the Commission Staff or with Oppenheimer to testify against Brownlow in return for reimbursement of their losses. There is no reason to discredit their testimony, and I have not done so.

Brownlow appears to charge more specifically that perjury occurred in the testimony of Division witnesses. He states at pp. 7-8 of his filing:

> "In the testimony of Mr. Boodell, Attorney for Dr. Kennedy, four direct questions regarding Dr. Kennedy's demands for repayments from my personal funds to cover his $6000 loss and threats to drive me from the securities business were asked and answered 'No, he did not'. Well, twenty minutes later, the same questions directed

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[15/] The settlement provided for the return by Oppenheimer of $175,000 to customers who suffered losses, SEA Rel. No. 16474 (1-8-80).

> to Dr. Kennedy were answered with a 'Yes, I did'..... not once, but four times. Again, I'm no lawyer but I do understand conflicting testimony and 'possible perjury'."

In fact, Boodell said he recalled no such demand (Tr. 285-6) nor did Dr. Kennedy (Tr. 364-5). There is no basis in the record for Brownlow's quoted statements.

Brownlow attempts to shift the blame for his problems to his partner at Oppenheimer, Daniel J. Piet. He argues that during a two-week vacation in 1977 (March 26 through April 10, inclusive) his partner Piet did all the damage in some 306 transactions, most of which were allegedly inappropriate naked options and bear spreads entered into at the low ebb of the market (Resp. Br. pp. 4,5).[16/] However, on March 22, 1977 before Brownlow left on vacation, substantial naked options were sold in National Semiconductor and in Digital Equipment stock in 6 of his accounts (Div. Ex's. 19,20,21,22,26,27). In further refutation, the Division points "as an example" to the Vinik account where the same number of sales of naked option contracts occurred in the two-week plus two-day period after Brownlow returned as in the two-week vacation period. (Div. Ex. 19).

A Division study showed that four of Brownlow's accounts were in an unrealized loss position even before he left on his first vacation, and Brownlow's own conduct is inconsistent

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16/ He complains that "the same situation to a lesser extent" occurred during a second vacation from June 25 to July 5, 1977.

with the theory that Piet had made trades of which Brownlow disapproved. Despite Piet's supposedly disastrous trades, Brownlow can recall no concerted program to rectify them when he, Brownlow, returned to work after his March 26 to April 10 vacation. Brownlow's so-called "vacation" defense does not stand analysis.

It is noted that Piet, Brownlow's partner from March through July, 1977, had nothing to do with Brownlow's misrepresentations concerning the SOP, his placing customers in an unsuitable program, nor his deception of his customers.

None of the transactions described in detail in the "churning" section of this decision occurred during Brownlow vacations.

Brownlow argues that unrealized losses are "academic" (Resp. Br., p.9), pointing out that the Internal Revenue Service looks only at realized gains and losses. As the Division notes, the reason for this is that there is no tax liability until the security position is closed. As clearly illustrated by the facts in this case, unrealized positions are an essential element in accurately determining the status of an account.

Public Interest

The Division asks that Brownlow be barred from association with any broker or dealer [17/] provided he may apply to

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17/ Brownlow became registered with the Commission as an investment adviser on March 21, 1978. Although the Division also requests that he be barred from association with any investment adviser, investment company of affiliate, I have no authority pursuant to the Securities Exchange Act (under which this proceeding was brought) to impose such sanctions.

become re-associated after 2 years. It submits that Brownlow's fraudulent conduct was intentional and egregious, and that he was fired from Cowen & Co. early this year after further questionable trading in options. 18/

Brownlow asks that the case against him be dismissed. As he states:

> "My goal/objective to achieve a 'zero base decision'. I do not deserve any form of suspension." (Resp. Br., p. 18).

He seems to view his problems as merely a matter of his customers' not liking to lose money (Resp. Br., pp. 15,16). If that were all that were involved, there would, of course, be no case against him. What happened here in addition, however, is that Brownlow cheated and deceived his customers.

Brownlow is far from contrite. He expresses condescension and contempt for the Staff investigator who testified against him (Resp. Br., p. 14), and whom I found to be an articulate and reliable witness. As previously noted, he accuses one of his former customers and the attorney of another of false testimony (Resp. Br., pp. 16, 7-8). He contends that the Staff has been sold "'a bill of soiled goods'" by his former supervisor at Oppenheimer (Resp. Br., p. 4). He blames his former partner, Piet, for his difficulties. Brownlow's charges and innuendoes have no basis in the record.

18/ Brownlow suggests that Cowen fired him as an accomodation to certain unnamed Oppenheimer partners (Resp. Br. p. 12). There is no evidence of this in the record.

A severe sanction is called for to impress upon Brownlow and others that this type of conduct cannot be tolerated. See Arthur Lipper Corporation v. SEC, 547 F.2d 171, 184 (2d Cir. 1976) cert. denied, 343 U.S. 1009 (1978); Lamb Brothers, Inc., 13 SEC Docket 265, 274 fn. 49 (1977). The bar requested by the Division is fully warranted. Further, any association after the 2 year period has expired should be under supervision and in a non-proprietary capacity.

Accordingly, IT IS ORDERED that Brownlow is barred from association with any broker or dealer, except that after two years from the effective date of this order he may become associated with a broker-dealer in a non-supervisory, non-proprietary capacity upon a satisfactory showing to the Commission that he will be adequately supervised.

This order shall become effective in accordance with and subject to 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 (15) 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 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. 19/

Edward B. Wagner
Administrative Law Judge

August 18, 1980
Washington, D.C.

19/ 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.