ADMINISTRATIVE PROCEEDING
FILE NO. 3-6183

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	;
RAYMOND L. DIRKS	:
JOHN D. SULLIVAN	:

INITIAL DECISION

Washington, D.C.
December 19, 1983

Irving Schiller
Administrative Law Judge

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APPEARANCES:

Edwin H. Nordlinger and Venrice R. Palmer for the Division of Enforcement.

Stanley S. Arkin and Marc Bogatin of Arkin & Arisohn; Richard B. Lind of Gersten, Savage & Kapalowitz and James Sargent of Whitman and Ransom for respondent Raymond L. Dirks.

James S. Siffert of Lanker and Siffert for respondent John D. Sullivan

BEFORE:

Irving Schiller
Administrative Law Judge

This public proceeding was instituted by an Order of the Securities and Exchange Commission (Commission) dated September 23, 1981 (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934[1/] (Exchange Act) and Section 14(b) of the Securities Investor Protection Act of 1970 (SIPA) to determine whether Raymond L. Dirks (Dirks) and John D. Sullivan (Sullivan) willfully aided and abetted the violation by John Muir & Company (Muir) of the provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 promulgated thereunder (hereinafter referred to as the net capital provisions) and to determine further what, if any, remedial sanctions in the public interest should be imposed on respondents Dirks and Sullivan.

The Order, in essence, charges that during the period from on or about July 31, 1981 to August 14, 1981, respondents Dirks and Sullivan possessed, directly or indirectly, the power to direct, and cause the direction of, the management and policies of Muir, and that during the relevant period the respondents willfully aided and abetted Muir's violation of the net capital provisions of the Exchange Act. The Order further alleges that on August 17, 1981, upon Muir's consent, a trustee was appointed for it by the United States District Court for the Southern District of New York under the Securities Investor Protection Act of 1970[2/] (SIPA).

1/ 15 U.S.C. § 78 o(b); 15 U.S.C. § 78s (h).

2/ SIPA v. Muir, 81 Civil 70001 [(S.D.N.Y.) (Bankruptcy Ct.)]

After appropriate notice, hearings were held in New York City, New York. Proposed findings of fact and conclusions of law and supporting briefs were filed by the Division of Enforcement (Division), and respondents Dirks and Sullivan. The findings and conclusions are based upon the record and upon observation of the witnesses. Preponderance of the evidence is the standard of proof applied.

The Respondents

Dirks became a general partner of Muir April 1, 1981. For approximately six months prior thereto he was a limited partner of the firm. He had the largest financial interest in the firm. The record indicates that effective April 1, 1981 Dirks was entitled to 54% of the net profits and would share a similar percentage of the losses of the firm. The record also reflects that Dirks shared with Sullivan and another general partner Robert W. Smith, "the responsibility for Muir's management and planning and for supervision of Muir's employees and operation."

Sullivan became a general partner of Muir in July 1972 and Managing General Partner in 1976. He was a registered representative of the firm from April 1959 to June 1972. As noted above, Sullivan shared with Dirks and another general partner responsibility for Muir's management and planning and for the supervision of Muir's employees and operation.

Muir

Muir is a limited partnership. It has been registered as a broker-dealer with the Commission since December 26, 1935 and is a member of the New York Stock Exchange (NYSE). On August 17, 1981, upon its consent, a trustee was appointed for Muir by the United States District Court for the Southern District of New York, under SIPA.[3/] The record discloses that as of that date Muir had over 40,000 customer accounts of which about 18,500 to 19,000 were active accounts. At the time of the liquidation, Muir held about $200,000,000 in customer securities and several million dollars of cash belonging to customers. From March 1980 to August 1981 Muir's operations expanded to 15 nationwide offices and it had acted as underwriter for more than 40 security issues. By September 30, 1981, the trustee was able to transfer only approximately 10,000 accounts to other broker-dealers, using the bulk transfer of accounts procedure provided under SIPA.[4/] As of December 31, 1981, about 13,000 accounts had been transferred out and as of June 1, 1982 approximately 16,960 customer accounts (about 80% of Muir's active accounts) had been transferred.[5/]

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3 / SIPA v. Muir, supra n.2

4/ 15 U.S.C. 78 fff-2(f)

5/ The record reflects that in April 1983 counsel for the trustee advised the Bankruptcy Judge that although "there are few remaining customer claims yet to be resolved" the trustee will be involved in litigation of certain claims and continue his investigation into the reasons for and circumstances surrounding Muir's demise and to determine whether he has claims against third persons. The trustee was unable to predict the time he will need to complete the Muir liquidation.

On or about August 17, 1981 SIPC advanced $18,000,000 from the SIPC Fund to the trustee which was used by him to secure the release of Muir's customers' securities from bank loans. The record discloses that as of April 1983 the trustee repaid SIPC approximately $5,600,000 of the aformentioned advance.

Allegations Relating to Muir's willfull net capital Violations.

As noted earlier, Dirks and Sullivan are charged with willfully aiding and abetting Muir's net capital violations during the period July 31, 1981 to August 14, 1981. To determine whether the respondents willfully aided and abetted Muir's net capital violation requires a finding first that Muir itself willfully violated.

The record reflects that Donald Katz (Katz), Muir's comptroller and manager of its accounting department, prepared a computation of Muir's net capital position as of July 31, 1981, utilizing the books and records maintained by Muir. Katz testified he completed the computation during the second week in August 1981. The computation reflects that as of July 31, 1981 Muir had a "negative net capital" of $100,000, namely, Muir's total assets minus total liabilities (net worth), minus the illiquid assets, which the net capital rule requires to be deducted when

determining net capital, amounted to a figure less than zero by $100,000. Katz testified that, in fact, Muir had no net capital whatsover. Katz further testified that, although his computation did not reflect the exact amount needed to bring Muir within the minimum net capital requirements, he estimated that, from the figures on his computation and the balance sheet attached to it, such amount was approximately $1,600,000. Thus, Katz testified, that Muir's net capital deficiency or the amount required to comply with the net capital requirements at July 31, 1981 was approximately $1,700,000 ($100,000 negative net capital plus $1,600,000 in liquid assets). Dirks and Sullivan do not dispute the foregoing computation. Thus, the record supports the finding that from on or about July 31, 1981 to August 14, 1981 Muir willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.[6/]

6/ In addition the record reveals that on August 16, 1981, SIPC filed a complaint in the United States District Court in the Southern District Court of New York, under Sections 5(a)(3) and 5(b)(2) of SIPA (15 U.S.C.A. § 78 eee(a)(3)(b)(2), seeking a decree adjudicating that customers of Muir are in need of protection provided by the said Act and requesting the appointment of a trustee. The complaint alleged, among other things, that Muir was not in compliance with the net capital requirements of the Exchange Act and the Rule thereunder (Rule 15c3-1) and was unable to meet its obligations as they mature. Muir did not deny the allegations and consented to the appointment of a trustee by the Court. Muir's failure to deny the net capital allegation coupled with its consent to the appointment of a trustee constitute an admission by Muir that it violated the net capital Rule as alleged in the aforesaid complaint.

Allegations Relating to Respondents' Willfull Aiding and Abetting Muir's Net Capital Violations

Although the respondents concede Muir's net capital violation during the relevant period, they vigorously assert that the Division failed to prove that either of them knew or was aware, until at least about August 14 or 15, 1981, that Muir failed to comply with the requirements of the net capital Rule at July 31, 1981 and that the Division failed to establish that either of them willfully aided and abetted Muir's violation.[7/] The awareness and knowledge of Dirks and Sullivan of the factors bearing upon the deteriorating financial condition of Muir and the current of events preceeding July 31, 1981 as they impacted on Muir's net capital position at that date will be analyzed below.

The record discloses that Jessie Dirks,[8/] a certified public accountant was employed by Muir to make financial analysis and prepare budgets. Katz testified that in December 1980 or January 1981 she prepared a projection of Muir's future capital needs which reflected that if

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7/ Respondents also urge that there is no basis for sanctions against them under Section 14(b) of SIPA, that any such claim violates due process and that the Division is barred from instituting these proceedings because of an alleged agreement not to charge net capital violations if Muir voluntarily filed for SIPC violation. These contentions will be considered infra.

8/ Jessie Dirks is the wife of respondent Dirks. She was, at all relevant times herein an employee of Muir.

the firm's level of business continued to rise, the firm would require additional capital of up to $10 million. Katz agreed with what ultimately became a prophetic projection. He testified that Muir's business grew steadily and during the period January to April 1981 Muir's trading account constantly increased. During this same period Muir prepared weekly computations as required by Rule 15c3-3 under the Exchange Act[9/] to ascertain whether weekly deposits were required to be made in its special reserve bank account for the exclusive use of its customers. These weekly computations, commencing in January to about April 1981 indicated Muir was not required to make deposits in its reserve account. In May 1981 Muir's available cash started to become insufficient to pay for securities being purchased by the firm's trading account.

About the third week in April 1981 Katz became alarmed that the weekly computations reflected that Muir would have to make deposits in its reserve account under Rule 15c3-3. In the period April-May 1981 Muir began to have liquidity problems. Not having sufficient cash to pay for all of the securities it purchased for its trading account Muir began to borrow money to pay for its

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9/ 17 C.F.R 240.15c3-3.

purchases, collateralized by customer securities. This borrowing caused Muir to start making deposits in its reserve account. In April its weekly deposits were about $1,000,000. In the third week of April 1981 Katz advised Sullivan of the deposit requirement and suggested to him that the firm's trading position be liquidated to ease the liquidity problem rather than continue borrowing and making reserve deposits. Sullivan told Katz that corrective action would be taken. Neither Sullivan nor Dirks made any attempt to eliminate or at least reduce the firm's trading position. The trading account continued to increase as did the reserve deposits which near, the end of May, the deposit requirement approximated $5,000,000. When Katz realized that about 75% of Muir's capital was tied up as a reserve deposit and unavailable for use in the general business of the firm he again contacted Sullivan advising him to call a meeting of Muir's officials to resolve the liquidity problem.

Toward the end of May a meeting was held in Dirks' office attended by Dirks, Sullivan, Katz, Robert Smith (Muir's third general partner), John Faulkner (operations manager), Jim Langer (cashier) and Peter Farkus (senior vice-

president of operations). Katz testified[10/] that at the meeting "[T]here were two primary areas of discussions . . . [O]ne was the growth of the trading account; and the second was additional capital." Katz informed those present that he believed Muir needed $5,000,000 in new capital. During the meeting "a commitment was made to try to reduce the trading account" and Dirks stated he would contact a client of his, and discuss "a loan on the under-five dollar securities that were a principal position of the firm's trading account." The record discloses that Dirks contacted Carl Lindner, (Lindner), who originally loaned $5,000,000 to Muir, and in July loaned an additional $1,900,000 to the firm. During the period May through July 1981 Muir's trading account continued to increase. The record supports the finding that during the same period neither Sullivan or Dirks made any attempt to decrease the firm's trading account. Katz further testified that, in June and July 1981, when he saw that Muir was continuing to make deposits in the reserve account he would bring that fact to Sullivan's attention, "[A]lmost on a weekly basis." Sullivan must have talked

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10/ Neither Sullivan, Dirks nor the other persons attending the meeting (other than Katz) testified at the hearing. Katz's testimony as to what transpired at the meeting is unrefuted and is credited.

to Dirks during the June-July 1981 period concerning the necessity for the firm to continue to make deposits in the reserve account and the need to raise additional capital for, as noted above, it was Dirks' client who, in July, made a second loan to the firm of $1,900,000. At any rate, there is no evidence in the record that anyone other than Dirks communicated with Dirks' client Lindner regarding the loans to the firm which Dirks apparently believed would ease Muir's financial problems.

Sullivan's awareness and knowledge of Muir's deteriorating financial condition and the possible impact of such condition on the firm's net capital position is further demonstrated in the record by two events in June and July 1981. The first relates to the May-June 1981 Focus Reports. Katz testified that, in June 1981, he reviewed Muir's profit and loss figures preparatory to preparing a report required under the Commission's Rules under the Exchange Act and became aware of an operating loss for the month of May of about $950,000. He told Sullivan and another general partner of such loss and asked Sullivan what he should do. After discussing the matter Sullivan asked Katz " what could we, you know, do about this loan. We can't report it." Katz indicated what could be done and Sullivan gave his approval.

Katz then prepared the Focus report for May showing a loss of only about $30,000.

Katz explained in his testimony the manner in which he calculated the reported loss. Muir's accounting practice was to carry profits in certain of the firm's trading accounts as liabilities to serve as a reserve against possible future losses in those trading accounts. Muir's practice was to carry as liabilities cash deposits from issuers for whom Muir acted as underwriter, as expense allowance for future underwritings. With Sullivan's consent, Katz calculated the $30,000 loss figure he reported in the Focus report by taking the loss figure of only one of Muir's operating divisions and adding in the unrealized profits carried as reserves for the trading accounts and amounts carried as expenses for future underwritings. Similarly, in July 1981, Katz became aware that for the quarter ending July 1981 Muir had an operating loss. Katz again told Sullivan and another general partner of Muir about the loss and Sullivan told Katz "to do what was done before." By using the same type of calculation he did the prior month, Katz prepared a Focus report for the quarter showing a small profit. Both Focus reports were reviewed and signed by Sullivan. Sullivan urges he never "instructed" Katz as to how the item should be handled in the May Focus report nor to "falsify"

any information on any of Muir's books and records, but that it was Katz who suggested the method of covering up the $950,000 loss. Sullivan argues that all Katz's testimony reveals is that Sullivan relied on "Katz's advice on the treatment of three items in the May Focus report". The argument is without substance and rejected. It is immaterial who suggested the treatment of the items. What is significant is that first, there is no evidence that Sullivan told Katz that the $950,000 loss was wrong or even incorrectly calculated and second, since there is no evidence from Sullivan, or the other general partner present when Sullivan made the foregoing statements, Katz's testimony regarding his conversation with Sullivan's is unrefuted and credited.

The second event relating to Sullivan's awareness and knowledge of Muir's financial condition is illustrated by the information he was given of the firm's policy of not accruing all liabilities. The record reveals that prior to the time Sullivan became a general partner of Muir the firm's policy, as explained by Katz, was that "the bills payable was not an item that was taken into consideration on the balance sheet.' When Sullivan became a general managing partner Katz asked him whether there was to be any change in the policy and was told

to continue the same policy. The Focus Report, which Muir was required to file, contains instructions to accrue all liabilities in such report. Katz, when asked whether Muir complied with the instructions replied that the firm did not accrue bills payable. The record discloses that shortly prior to May 1981 Muir stopped paying its bills and invoices, apparently because of insufficient cash flow and that, at approximately June 3, 1981, Muir had unpaid bills of at least $109,712.[11/] Katz testified that although he had responsibility for the payment of bills and that Sullivan's instructions were to pay bills promptly, Katz was assigned other duties and was unable to carry out his bill paying responsibilities. Katz also testified that Sullivan and Dirks knew that Katz, in the latter part of June and July, was preoccupied with other matters. The record lacks evidence from either Sullivan or Dirks or anyone else, that they made any attempt to ascertain whether Muir was, in fact, paying its bills and invoices in the May thru July 1981 period

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11/ Between August 10 and 14, 1981 a New York Stock Exchange examiner on Muir's premises found that approximately $1,200,000 of unpaid bills and invoices were not reflected on the firms books. After the SIPC trustee took charge of Muir's records his accountants calculated such unpaid bills, which they found lying in a file cabinet. They determined that the overdue bills, as of August 1981, amounted to $2,399,379.

or whether the failure to pay such bills affected or at least could have had any effect upon Muir's financial position.

Sullivan asserts he had no reason to know that bills were not being paid upon receipt. The argument is not supported by the record and is not acceptable. The significance of the assertion is that in the May-July 1981 period, notwithstanding Sullivan's knowledge that beginning in April 1981 the firm's weekly deposits in the reserve account was $1,000,000, he did not concern himself with the firm's financial condition nor did he determine whether it had available cash to pay its bills. As one of Muir's general partners, Sullivan had, at the very least, a duty and responsibility to keep himself informed of the firm's financial condition and to take steps necessary to insure that the firm was complying with the Commission rules including whether the liabilities were being properly accrued in the Focus Report. Sullivan's failure to fulfill his responsibilities is inexcusable and he is found to have failed to know what should have been known and failed to do what should have been done. Aldrich, Scott & Co., Inc., 40 SEC 775,778 (1961).

The Commission and the Courts have consistently held that under the federal securities laws brokers and dealers are "charged" with the responsibility of insuring that

the firm's books and records are kept in compliance with the requirements of the Exchange Act. SEC v. Reich-Cassin & Co., 362 F Supp 946,949 (S.D.N.Y. 1973); Armstrong v. McAlpin, 699 F 2d 79,91 (2d Cir. 1983); Jerome H. Shapiro, 46 SEC 472, 475, 476(1976). The Commission has also held that principals of a brokerage firm are under a duty to keep informed of the firm's financial condition. Herman M. Solomon, et al., 44 SEC 910, 912 (1972). Lack of knowledge by principals of the true financial condition of their brokerage firm or claimed reliance on others to inform them of the accurate financial situation of the firm does not absolve them from their duty and responsibility for knowing the firm's net capital position at all times. John T. Pollard, 38 SEC 592, 598 (1958); Aldrich, Scott & Co., Inc., supra. The Commission cogently pointed out the danger of relieving operating principals of the type of responsibility noted above. It said:

> "To acquit [a chief executive] of responsibility . . . . would encourage ethical irresponsibility by those who hold themselves out as active heads and who in the very nature of the corporate setup should be primarily responsible." Merrit, Vickers, Inc., 42 SEC 274, 280 (1964)

Dirks and Sullivan were operating principals of Muir and active heads of the firm. They are, thus,

chargeable with and primarily responsible for knowing the financial condition of Muir at all times. The record supports the finding that during the period, at least January to April 1981, Dirks and Sullivan were heedless of the fact that the firm's level of business was continuing to rise and that additional capital would be needed to avoid the developing liquidity problem. In April, Sullivan was told that Muir was having a cash flow problem and that the firm had started to make weekly deposits of $1,000,000 in its reserve bank account. In May, when such deposits had risen to $5,000,000, Dirks, Sullivan and other partners met in Dirks' office in an effort to resolve the financial problems. Other than borrowing $6,900,000 from a client of Dirks, which neither increased or decreased the firm's net capital,[12/] neither of them made any attempt to ascertain the exact net capital position of the firm nor did they do anything concrete to relieve the firm's liquidity problem. To continue the "business as usual" approach by permitting the trading position to increase during the June-July 1981 period, which, by August, necessitated the appointment of a SIPC trustee, evinces an abdication of the responsibility Dirks and Sullivan had toward customers and constitute reckless conduct.

12/ See Higgs Inc., 2 SEC Docket 197 (1973)

Sullivan contends that no witness testified that he knew or was aware of the fact that Muir was in violation of the net capital rules and Dirks also claims he had no knowledge of the firm's net capital violation. The arguments of both respondents are contrary to the record and rejected. The record demonstrates that Sullivan was told by Katz, in April 1981, that the continued trading in the firm's account required substantial deposits in the reserve account and Dirks, certainly in May, knew the same facts, as demonstrated by his securing, enormous loans from his client. They knew perfectly well that the continued trading and deposits could impact on the firm's net capital position, and if no corrective action was taken the firm would face a net capital deficiency. Of utmost importance is that during the entire three month period to the end of July no instructions were issued by Dirks or Sullivan to Katz or anyone else to prepare an accurate net capital computation so that a determination could be made concerning the firm's net capital position. This too constitutes reckless behavior for which both respondents must be held accountable.

Dirks and Sullivan deny they willfully aided and abetted Muir's net capital violation. It is well settled that to demonstrate willfull aiding and abetting proof is required of, (1) the existence of a violation of the securities laws by a

a principal violator, (2) the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation and (3) the aider and abettor was aware, or knew, that his role was part of an activity that was improper or illegal. Carter and Johnson, 22 SEC Docket 292,315-16 (1981); SEC v. Falstaff Brewing Corp., 629 F.2d 62,72 (D.C. Cir.), cert. denied, sub nom, Kulmanowitz v. SEC, 449 U.S. 1012; Investors Research Corp. v. SEC, 628 F.2d 168, 177 (D.C. Cir.) cert. denied, 49 SEC U.S. 101 S. Ct. 317 (1980).

Proof of the first element is clearly established in the record and the finding has been made earlier herein that during the period July 31 to August 14, 1981 Muir willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.[13/]

A finding that the second component for determining an aiding and abetting finding namely, that Dirks and Sullivan knowingly and substantially assisted in the conduct that constitutes the violation is amply supported by the record. Dirks contends he did not knowingly and

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13/ The record discloses that during the relevant period Muir continued to effect transactions in securities using the facilities of interstate commerce. Neither Dirks or Sullivan contend otherwise.

substantially assist in such violation. To buttress his contention he cites Katz's testimony that he (Katz) prepared daily computations of Muir's net capital showing the firm in net capital compliance, copies of which Dirks received. However, Katz also testified the daily computations he prepared were "estimated" approximations of Muir's net capital position based upon whatever net capital figures were in the last FOCUS report and were 30-45 days old. Katz further testified these estimates were inaccurate and erroneous and that when he was instructed in August to prepare a net capital computation from Muir's books and records as of July 31, 1981 it showed Muir to be in net capital violation. Other evidence in the record demonstrates Dirks' knowledge and the manner in which he substantially assisted in conduct constituting the violation. At the May 1981 meeting of the general partners Dirks was present when Katz explained the financial problems facing Muir, of the huge deposits required to be made in the firm's reserve account and the pressing need for additional capital.[14/] It would be naive indeed to believe that Dirks, with his experience in the securities industry, was insensitive to the firm's net capital situation, particularly since

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14/ Dirks did not testify or give his version of the meeting. Katz testimony is thus unrefuted and credited.

he knew that the firm's trading account was steadily increasing and that, absent a decrease in such account or other steps taken, the continued increase in the account would impact upon the firm's net capital requirements. What is significant is that there is no evidence in the record that Dirks, during the period May to July 1981, took any corrective action to ease Muir's financial problems or ever instructed or even requested Katz to give him an accurate net capital computation. All of these factors are probative that Dirks "knowingly and substantially" assisting in conduct constituting Muir's violation.

Sullivan, like Dirks, pleads that he did not knowingly and substantially assist in conduct that constituted the violation. His arguments, too, are not supported by the record and are rejected. As noted earlier, Sullivan, in April 1981, was told by Katz that Muir's trading was causing severe liquidity problems requiring the firm to make reserve deposits. Sullivan told Katz that corrective action would be taken. Like Dirks, he did nothing to alleviate the matter. Sullivan's argument that Katz's conversations with him from April 1981 to July about reducing the trading positions is "too remote to satify the requisite burden of proving substantial assistance" lacks merit. To alert a general partner over a four month period immediately prior to

a violation, the last two months of which were on a weekly basis, that continuous increases in the firm's trading position was causing a liquidity drain on the firm and the failure of the partner to take any action to remedy the matter, forms a well founded basis for concluding that the partner substantially assisted in conduct ultimately resulting in the violation. In addition, the evidence also reflects that Sullivan knew the daily net capital computations he received were based on a computation 30-45 days old and that the figures were based on Muir's last FOCUS Report. Moreover, it was Sullivan who told Katz that Muir could not show a loss of $950,000 in the May FOCUS report, and Katz, after discussing it with Sullivan, obediently reflected a loss of only $30,000. Sullivan was also present at the May 1981 meeting when Katz explained the financial problems Muir faced. Sullivan, like Dirks, knew that without some positive action to relieve the liquidity problem, increases in the trading account would impact on the firm's net capital position.[15/] Upon the basis of the foregoing factors it is concluded that Sullivan knowingly and substantially assisted in conduct which ultimately resulted in Muir's net capital violation.

15/ Sullivan did not testify. Katz's testimony regarding the May 1981 meeting and his testimony concerning the loss reported on the May FOCUS report, which Katz also testified was signed by Sullivan, remains unrefuted and is credited.

A finding that the third component for aiding and abetting to wit, that Dirks and Sullivan were aware or knew that their respective roles were part of an activity that was improper or illegal is supported by the record. The findings made above relating to the knowledge acquired by Dirks and Sullivan concerning the declining financial condition of Muir need not be repeated hereunder. Suffice it to say that the record amply supports the finding that those same factors demonstrate that both respondents were manifestly aware that the role each played was clearly part of the activity which resulted in a violation and certainly was improper.

Sullivan argues that under Carter, Johnson, supra, the Commission held that "the proper scienter standard require[s] (sic) a showing that respondents were aware or knew that their role was part of an activity that was improper or illegal" and that this requires proof that Sullivan actually knew of Muir's net capital violation and that he intended those violations occur before he can be held to be an aider and abettor. Dirks also argues that under Carter, Johnson there must be proof that he knew of Muir's violation and intended the violation to occur. Their reliance on Carter, Johnson is misplaced. In Carter, Johnson the charges included allegations that those respondents willfully aided and abetted violations of the anti-fraud provisions of the Exchange Act. The instant case is not a fraud case nor are there

any allegations of violations of the anti- fraud sections of the said Act. The violations alleged relate to Muir's failure to comply with the net capital requirements and to willfull aiding and abetting such violation by Dirks and Sullivan. Neither the allegations of violations of net capital nor allegations of aiding and abetting such violations require proof under any "scienter standard" or proof that respondents intended the violations to occur. Sullivan's reliance on SEC v. Falstaff Brewing Corp., supra, is also misplaced. That case too involved allegations of violations of the anti-fraud sections of the Exchange in which the Court held that proof of "scienter, i.e. intent to deceive, manipulate or defraud" was required. With respect to "knowledge" of a violation even where scienter is required the Court stated:

> "Knowledge means awarness of the underlying facts, not the labels that the law places on these facts. Except in very rare instances, no area of law-not even the criminal law-demands that a defendant have thought his actions were illegal. A knowledge of what one is doing and the consequences of those actions suffices" (627 F.2d at 77)

In the instant case it is not necessary to prove that respondents intended that Muir violates the net

capital provisions. The record supports the finding that Sullivan and Dirks knew what they were doing and under any circumstances were assuredly aware of the nature and consequences of their actions. Awareness of the consequences of their actions would subsist by virtue of any inaction or a failure to take corrective action to prevent the net capital violation. In ITT v. Cornfeld, 619 F2d 909, 927 (2d Cir. 1980) the Court held that even in a fraud case a failure to act can create an aiding and abetting liability where the party charged was required to act:

> ". . . . inaction can create aider and abettor liability only when there is a conscious or reckless violation of an independent duty to act."

It would be incredulous to believe that with all the "red flag" warnings Dirks and Sullivan had, as detailed above, concerning the deteriorating financial condition of the firm, the deposits made in the firm's reserve account, and the increasing trading positions which caused a liquidity problem in the firm, that they had no duty to take affirmative action. Their inaction can be characterized as reckless violation of their duty.

Dirks also argues he can not be charged with a willfull aiding and abetting Muir's net capital violation since the responsibility for assuring compliance with the net capital rules had been delegated to Katz. The argument

is unpersuasive. With the knowledge Dirks had concerning the financial condition of Muir, as detailed above, he was under a duty to take action to correct such problem so he could be assured of the firm compliance with the net capital rule. The Commission in Carrol P. Teig, 10 SEC Docket 510,511 (1976) held

> Teig cannot find shelter in the assertion that primary responsibility for compliance with the net capital rule rested with other persons. We think that his knowledge of the nature of the problem required him to take or demand steps to assure that it would promptly be corrected. At the very least, Teig should have encouraged Chica, president of the firm, to provide [the executive vice-president] the support necessary to enable him to assure the firm's compliance with net capital requirements. Teig did not respond in this fashion, however. Instead, with clear knowledge of the likelihood that continuation of the firm's trading practices would cause violations of the net capital rule, he did nothing. Under these circumstances, we think that he can fairly be held to have willfully aided and abetted the violations that ensued."

See also Jerome H. Shapiro, supra at 11,12. Responsibility for compliance with net capital requirements of Muir was lodged with its general partners and reliance upon Katz was unwarranted. John H. Degolyer, 9 SEC Docket 380,381 (1976).

Dirks and Sullivan are found to have willfully aided and abetted Muir's violation. Willfullness in the context of the Exchange Act and Rules thereunder requires proof

only that the person charged acted intentionally in the sense that he was aware of what he is doing. Tager v. SEC, 344 F.2d 5,8, (1965). See also Arthur Lipper Corporation v. SEC, supra. Willfullness does not require proof of evil motive, or intent to violate the law, or knowledge that the law was being violated. Lamb Brothers, Inc., 13 SEC Docket 265,270, n.25 (1977). Two salient facts are considered in concluding that Dirks' and Sullivan's conduct was willfull. Both general partners were present at the May meeting referred to earlier, at which there was a general understanding that something would be done. However the record shows that, other than borrowing some $7,000,000 from a client of Dirks, no positive action was taken to reduce trading or any other steps planned to reduce the trading position in an effort to solve the liquidity problem. Second, and even more important, they never told Katz to prepare an accurate net capital computation during the three months prior to July 31, 1981, so that a determination could be made concerning the firm's net capital position. Instead, Dirks and Sullivan permitted the firm to continue doing business. Such conduct demonstrates that respondents were recklessly indifferent to the deteriorating financial position of Muir. Whether they intended to violate the law, or as they claim, had no knowledge of the firm's net capital position does not exculpate them from liability for wilfully aiding and abetting Muir's net capital violation.

Responsibility of Dirks and Sullivan, as general partners of Muir for Causing the Appointment of a Trustee for Muir Under SIPA

The Order alleges that, upon its consent, a trustee was appointed for Muir on August 17, 1981, by the United States District Court for the Southern District of New York under SIPA. The Division asserts that under Section 14(b) of SIPA The Commission is empowered to bar or suspend persons specified therein, including general partners, owners of 10 per centum or more of the securities, or controlling persons of any broker or dealer for whom a trustee has been appointed pursuant to that Act, from being or becoming associated with a broker or dealer if, after apropriate notice and opportunity for hearing, the Commission determines such bar or suspension is in the public interest.[16/] Dirks contends that he never received notice . . . "neither in the Order for Public Proceedings nor at trial . . ." that sanctions would be sought against him under Section 14(b) of SIPA, that he was constitutionally entitled to adequate notice of charges against him, and that the Division is barred from raising such purported basis for liability. Sullivan also contends he was never

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16 / Section 14(b) of SIPA provides in pertinent part that "The Commission may by order bar or suspend for any period any . . . . general partner, owner of 10 percent or more of the voting securities, or controlling person of any broker dealer for whom a trustee has been appointed pursuant to this Act . . . from being or becoming associated with a a broker or dealer, if after appropriate notice and opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest. 15 U.S.C. § 78 jjj (b).

notified that sanctions could be imposed if there was no violation of the Exchange Act and no disclosure was made of the precise nature of the charges against him.[17/] Their contentions lack merit. Respondents' assertion that the Order did not give them notice that sanctions would be sought under Section 14(b) of the SIPA is not supported by the record. The order, as noted, above sets forth in paragraph II (c) the allegation that a trustee was appointed under SIPA. Paragraph III of the Order states succinctly that "In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors, that public administrative proceedings be instituted pursuant

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17/ In an attempt to bolster his argument that no disclosure was made to him Sullivan points to an order issued by the undersigned on a motion he made for a more definite statement in which it was stated that the order for proceedings alleges, in substance, that respondents wilfully aided and abetted Muir's violation of the net capital provision of the Exchange Act and Rule thereunder. The order referred to by Sullivan states with precision that his motion was "for a more definite statement with respect to the allegations that the aforesaid respondent wilfully aided and abetted John Muir & Company (Muir) to do business at a time Muir failed to maintain the required minimum of net capital." The order further states Sullivan requested information relating to specific items relating solely to net capital because they were deemed "essential to permit him to understand the charges given the complexity of the net capital rule." It is clearfrom the motion filed by Sullivan that he made no request for any information relating to the Section 14(b) allegation and since there was no necessity to consider any matter other than the net capital charges, no mention was made in the order of Section 14(b).

to Sections 15(b) and 19(h) of the Exchange Act and pursuant to Section 14(b) of the SIPA to determine what, if any, remedial sanctions in the public interest should be imposed on respondents Dirks and Sullivan." (emphasis supplied) The Commission considered similar arguments of lack of notice of a Section 14(b) allegation and stated:

> "We do not consider it necessary to require that the order for proceedings contain a precise statement of the basis on which the public interest determination is to be made. The essential requirement is simply that adequate notice be provided at a meaningful time in order to permit the party proceeded against the opportunity to submit a defense. In resolving this broader issue, we must examine the entire proceeding to determine whether the party charged was adequately apprised of the basis on which the "public interest" determination would be reached and whether he was afforded a full opportunity to contest those facts and seek to justify his conduct." (Carrol P. Teig, supra at 513)

Respondents were afforded adequate notice, at the outset of the proceeding, by the Order which stated that a trustee was appointed for Muir and that a determination would be made whether any remedial sanction should be imposed on them. Examination has also been made of the entire proceeding to

ascertain whether Dirks and Sullivan were adequately apprised of the basis on which the "public interest" determination would be reached and whether they were afforded a full opportunity to contest the facts and seek to justify their conduct. The record reveals that respondents were furnished with a list of witnesses intended to be called by the Division against them on the public interest together with copies of documents proposed to be offered in evidence concerning the public interest issue. The documents were furnished to respondents several months before to the hearing, and other public interest documents were given to them at the hearing. When the hearing commenced counsel for the Division made an opening statement in which he stated, among other things, that he would not only prove that respondents aided and abetted Muir's violation but that proof would be adduced that Muir "is now in SIPA liquidation", that "respondents are partners of a firm that is in SIPC liquidation and that "we will prove that in both these sections that it is in the public interest to impose sanctions on both of these respondents." (emphasis supplied) During the course of the hearing, counsel for the Division offered a document in evidence to be considered in the "public interest." Counsel stated on the record:

> "I think it's useful for your Honor, particularly in light of the 14B count, the public interest under that section to see exactly . . . ."

Prior to the closing of the record the undersigned again considered whether certain other documents offered in the public interest should be received in evidence and gave counsel for both respondents ample opportunity to present reasons why such documents should be excluded. The record further reveals that, in fact, objections by respondents to the receipt in evidence of some of such documents were sustained and they were excluded from the record. In addition, Sullivan was given a postponement of a month in order to allow his newly retained counsel adequate opportunity to prepare his case. At the request of Sullivan, witnesses originally produced by the Division, were recalled to permit him to cross-examine them. It is concluded that respondents had ample notice of the Section 14(b) allegations and adequate opportunity to prepare their respective defenses and a full opportunity to contest the facts relating to the public interest issue and to seek to justify their conduct.

Respondents further contend that the Division is seeking to impose a theory of strict or absolute liability under Section 14(b) and that the Division's position is contrary to the statute and violates due process. Respondents argue that since Section 2 of SIPA[18/] states that SIPA is to be read as an amendment to the

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18/ Section 2 of the SIPA states "Except as provided in this Act, the provisions of the Securities Exchange Act of 1934 (14 U.S.C. see 78a and fol.; . . .) apply as if this Act constituted an amendment to, and was included as a section of, such Act.

Exchange Act and that since Section 15(f) of the SIPA[19/] provides that liability of controlling persons under Section 20(a) of the Exchange Act do not apply to any liability under or in connection with SIPA, no sanction may be imposed upon them under Section 14(b) inasmuch as they are control persons.

A perusal of Section 14(b) of the SIPA makes it evident that to impose sanctions upon any general partner or controlling person of any broker or dealer for which a trustee has been appointed, a determination must be made that the sanctions are in the public interest. Thus, sanctions may not be imposed on any concept of strict or absolute liability premised solely upon the fact that a person has a title, or occupies a position, such as officer, director, or general partner, or that the status of such person is one of a controlling person of a broker or dealer. Rather, the perception under Section 14(b) is that persons who are sought to be sanctioned should be those who, by their acts or conduct, caused or were primarily responsible for causing the trustee to be appointed. The approach therefore is to deteremine whether the functions or activities of persons are such that they must be held to be accountable for the factors which necessitated the appointment of a trustee. Neither Section 2 or Section 15(f)

19/ Section 15(f) of the SIPA states "The provisions of subsection (a) of Section 20 of the 1934 Act shall not apply to any liability under or in connection with this Act.

of the SIPA, relied upon by respondents, inhibit the imposition of sanctions under Section 14(b) of that Act upon persons who bear the responsibility for the appointment of a trustee for a broker or dealer.

Applying these principles to the instant case it is determined that Dirks and Sullivan are persons who must be held responsible for primarily causing a trustee to be appointed for Muir. They were general partners of the firm who, as alleged in the Order, possessed directly and indirectly, the power to direct and cause the direction of, the management and policies of Muir. As controlling partners of the firm they had the responsibility to be informed at all times of the financial condition and to make certain the firm was in compliance with the net capital position of the firm. The record reveals that neither Dirks or Sullivan carried out their responsibilities. As noted earlier herein, respondents were told, in May 1981, of Muir's financial difficulties to decrease the firm's trading account and the need for additional capital to lessen the liquidity problem. Clearly, corrective action was called for to avoid the financial collapse that led to the appointment of a trustee. The record shows not only that no such action was taken (other than borrowing money) but equally important in determining responsibility under Section 14(b) is the fact that respondents never instructed

anyone in the firm to prepare an accurate net capital computation so that they could ascertain whether Muir was in compliance with the net capital rule. It is just this kind of irresponsibility which ultimately led to the trusteeship. In Carrol P. Teig, supra, the Commission held that persons who were in the position to prevent the financial failure of a broker-dealer firm must be considered responsible when the firm fails. It wrote:

> "We consider it significant that the category of persons subject to potential sanction all share one common trait--each could reasonably be expected to be aware of the broker-dealer's practices and financial condition and to take or demand action to avoid the financial collapse that leads to SIPC trusteeship. This fact, coupled with the fact that the fiscal irresponsibility and the resulting collapse of some broker dealers during the sixties was the major motivating factor for passage of the Act, persuades us that failure to act in such a responsible manner can form the basis for a bar or suspension from association with a broker or dealer. Thus, simple neglect or nonfeasance can provide an adequate basis for sanction under Section 10(b), even in cases in which the conduct might not give rise to a finding of aiding and abetting a specific violation of the securities laws or support a charge of failure to supervise, provided adequate notice of the charge is given and an opportunity to defend against it is afforded. It follows, of course, that substantive violations of the federal securities laws or other laws can likewise form a basis for sanctions under Section 10(b) of the SIPA. (emphasis supplied)(10 SEC Docket at 513)(Section 10(b) of SIPA was redesignated Section 14(b), May 21, 1978, P.L. 95-283 §9, 92 Stat. 260.)

So too, in the instant case the role which each respondent played in the events which led to the SIPC trusteeship has been spelled out above and need not be repeated hereunder. The record supports the finding that Dirks and Sullivan were derelict in their duty to act in a responsible manner. Their neglect or nonfeasance in failing to do what duty required them to do, namely, to take or demand action to avoid the financial collapse that led to the SIPC trusteeship sufficiently forms a basis to consider whether the imposition of a sanction under Section 14(b) is in the public interest.[20/]

Alleged Agreement Not to Bring Net Capital Charges Against Respondents if Muir Voluntarily Filed for SIPC Liquidation.

Respondents claim that at a meeting held on August 16, 1981, (the day prior to the appointment of SIPC trustee) at the offices of a New York law firm, at which the respondents and certain executives

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20/ Respondents urge the SIPA is without guidance as to the meaning of "public interest" and it therefore violates their due process rights to notice of the charges against them. The argument is specious. The Commission and the Courts have imposed sanctions in numerous cases under Section 15(b) of the Exchange Act and consistently spelled out the public interest factors considered under that Act which, like the SIPA, does not define public interest. Moreover, Sullivan, in his brief, argues that "Even if this tribunal finds a violation, the public interests clearly demand that Sullivan not be sanctioned." He then recites the various public interest factors which he believes do not mandate a sanction. He received notice of the charges against him, has had a hearing on such charges at which he was afforded an opportunity to present his defense, including the right to offer matters to be considered in the public interest which he believed do not warrant the imposition of a sanction. The record amply demontrates his due process rights have not been violated.

and employees of the New York Stock Exchange (NYSE) were present, an agreement was made by Donald N. Malawsky, (Malawsky) the New York Regional Administrator of the Commission, not to file any net capital violation charges if Muir voluntarily agreed to a SIPC liquidation. The Division denies any such agreement was made. Mr. Robert Bishop (Bishop) a senior vice-president of the NYSE testified that he, with help from his staff, prepared a document entitled "A debriefing memo of the Stock Exchange" dated August 18, 1981 that reflected Bishop's account of a discussion which took place at that meeting. Although Dirks and Sullivan were present at the meeting neither of them testified concerning any agreement by Malawsky. Nor did they produce any of the other persons present at the meeting to support their claim. Thus, the only evidence in the record which Dirks and Sullivan rely upon to establish their claim of an agreement was furnished by the Division's witness, Bishop in his "debriefing memo" which states:

> "When they came into the meeting their lawyer said in very strong language that the partners were very willing to consent to a SIPC liquidation, but they were not willing to consent to an SEC complaint of rule violations. There were four charges in the SEC complaint for net capital violation, books and record violations, danger of not meeting the 15c3 [15c3-3] re-deposit, and a fourth one that I cannot remember at the moment. I told them immediately that the books and records charge was unjustified and Don Malawsky soon thereafter agreed to take it out. The Muir lawyer was very strong in telling them if they were going along that route of going into court with a suit against them, they were going to reopen the

> negotiations for the three milion dollars for their inventory and their warrants and thereby cure the capital violation, and get the money to make the deposit even though they might have to go down a couple of days later and spoil the . . . " Those " . . ." are in the memo itself.21/ "both the losses and those assets and the lease business and that was that. There was an adjournment and during that adjournment the SEC decided they would not press their complaint. The law did not require it and Floyd Brandow had pointed out to me a few minutes before the meeting--he spoke along the same lines as the firm's lawyer said in the meeting I was just talking about, where there's consent there isn't any need for an SEC action. That's the way it went forward."

An analysis of Bishop's memo makes it evident that no agreement was made by Malawsky not to file net capital charges. The memo states the Commission had prepared a complaint it intended to file in court charging Muir with "four rule violations" including net capital. Muir's lawyer stated that Dirks and Sullivan were willing to consent to a SIPC liquidation but was not willing to consent to an SEC complaint of rule violations. The memo then states "there was an adjourment and during that adjournment the SEC decided they would not press their complaint" (emphasis implied). It is most significant that Bishop did not state that an agreement had been reached not to pursue the net capital charge. In that connection, it is observed that in the earlier part of the memo, Bishop states that when he told the SEC that a books and records charge, also included in the complaint, was unjustified, Malawsky "agreed to take it out" (emphasis supplied). This makes clear that if Bishop

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21/ Bishop testified that the reference to the dots indicates that words were omitted due to the fact that the memo was a transcript of a tape and the person who transcribed the tape was unable to understand the words omitted.

believed that Malawsky had made an agreement never to pursue the net capital charge it is reasonable to believe that Bishop would have stated it as carefully as he stated that Malawsky agreed to drop the books and records charge. Bishop's memo reflects that Malawsky's decision was a unilateral determination not to proceed in court with the SEC complaint for rule violations since as the memo states Muir was willing to consent to a SIPC liquidation. In light of such consent there was no need for a separate action by the SEC. Bishop points out that the reason for the procedure adopted to effectuate the SIPC liquidation without the need of an SEC complaint charging net capital violation, was that "the law did not require it". . . . where there's consent there isn't any need for an SEC action" (emphasis supplied). The memo expresses the thought that it was the consensus of opinion of the persons at the meeting that "the law" (SIPA[22/]) did not require Commission action where the broker-dealer firm consents to the liquidation by SIPC. Bishop then states "That's the way it went forward." This is a far cry from establishing proof that Malawsky agreed never to file charges that Muir was in violation of the net capital rule because Muire consented to a SIPC liquidation. It is concluded that the record does not support respondents' argument that the Division agreed not to charge net capital violations if Muir voluntarily filed for SIPC liquidation There is no evidence of such agreement and the Commission is not barred from instituting this proceeding.

22/ See Section 5(a)(4) of the SIPA

Public Interest

The remaining issue is whether, in the light of the foregoing findings, remedial action is appropriate in the public interest. In the instant case, the appropriateness of any remedial sanction will be considered upon the basis of the findings that Dirks and Sullivan willfully aided and abetted Muir's net capital violation and the findings that they bear the responsibility for the manner in which the operations of Muir were conducted, particularly with respect to their reckless conduct in failing to adopt measures essential for a solution of Muir's deteriorating financial condition, which ultimately made it necessary for SIPC to request that a trustee be apointed pursuant to SIPA.

The findings made earlier herein analyzed the rationale for holding respondents willfully aided and abetted Muir's net capital violation. They need not be restated here. The contentions of Dirks and Sullivan that they had no awareness or knowledge of Muir's failure to comply with the net capital requirements have been fully discussed and rejected. It is not necessary to repeat them. To determine whether a sanction should be imposed for aiding and abetting Muir's net capital violation several factors stand out which weigh heavily in favor of a sanction. Briefly stated, the record discloses that Dirks and Sullivan were aware of the financial problems facing Muir beginning in January 1981, and certainly during the April-July 1981 period, and other than Dirks'

arrangement to have a client of his loan the firm approximately $7 million, they made no attempt to adopt necessary corrective action to solve the firm's declining financial condition. Most important in that connection is their failure to obtain an accurate net capital computation, until August 1981, which would have alerted them as to the firm's ability to comply with the net capital requirements. The picture which emerges is one of marked indifference to and an abdication of the responsibility which the law imposes on persons who are general partners, and in Dirks' case also a majority owner, of a brokerage firm to be aware of their responsibility to secure compliance with the net capital requirements at all times. Dalen Investments & Funds Inc., 45 SEC 65 at 67-8 (1972). It is concluded that the imposition of an appropriate sanction in the public interest for willfully aiding and abetting Muir's net capital violation is warranted by the record.

Consideration is now given to whether a sanction is warranted under Section 14(b) of the SIPA. The findings that Dirks and Sullivan are responsible for the significant roles they played in the events which precipitated the appointment of a SIPC trustee have been detailed above and reference is made here to such findings. Sullivan contends no sanctions are called for and argues that the imposition of any sanction in this case will have a "chilling effect" on any broker who in the future may wish voluntarily

to seek SIPC protection. Quite the contrary is true. The imposition of a sanction in this case will serve notice upon a broker that, even though he may voluntarily consent to a SIPC liquidation, a sanction may nevertheless be imposed, under the conditions set forth in Section 14(b) of the SIPA[23/], where such sanction is determined to be in the public interest and his conduct is found to be similar to that demonstrated in the instant record. Under such circumstances, such broker is more apt to do everything in his power to prevent a SIPC liquidation rather than remain indifferent to the financial position of his firm, particularly when such conduct could lead to the appointment of a SIPC trustee.

Sullivan also argues that no sanctions against him are warranted because he made a good faith effort on August 9, 1981 to have the NYSE agree that Muir could close its doors the next day because he believed Muir was "approaching or near a net deficit"; that he cooperated with the NYSE in its attempt to obtain an accurate picture of Muir's financial condition and that a week later he consented to a SIPC liquidation. The arguments are unpersuasive. They do nothing more than reaffirm that Sullivan, despite all the warnings he had received concerning Muir's financial condition, took no corrective action even in August 1981. The arguments also reveal that Sullivan only believed Muir to be "near" a net deficit when, in fact, it already failed to comply with the net capital requirements as of July 31, 1983. The law

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23/ See fn. 16 supra

required him to know the firm's net capital position. Had he informed the NYSE that Muir was unable to meet the net capital requirements on August 9 or 10, 1981, the NYSE would not have insisted he must abide by its rules requiring firms remain open when the firm is in compliance. Such conduct manifests reckless conduct toward customers, not as claimed by Sullivan that he "cooperated in every respect with the NYSE in its attempt to obtain an accurate picture of Muir's financial condition" and that he "manifested an interest in protecting the public, Muir's customers and other brokers . . ." If he were truly interested in protecting his customers and the public he could have done something more positive during the May-July period rather than wait until August to obtain an accurate picture of Muir's financial condition.

The record demonstrates that as a result of the reckless conduct of Dirks and Sullivan with respect to the firm's financial condition, as set forth earlier herein, Muir's customers were in danger of losing their investments and money. Muir had about 40,000 customer accounts of which about 19,000 were active accounts. The customers with active accounts were grievously damaged by their inability to obtain access to their securities and monies and for some time deprived of sources of income. The record further reveals that at the time of the liquidation Muir held about $200,000,000 in customers securities and millions of dollars in cash belonging to customers. The securities markets

were in a general decline and customers, particularly those who had invested in speculative securities, were helpless to avoid losses by selling. About ten months after the trustee took over Muir, the accounts of nearly 17,000 customers had been transferred to other brokerage firms leaving about 2,000 customers still waiting for their securities and funds. These factors are given weight in concluding that sanctions against Dirks and Sullivan are appropriate in the public interest under SIPA.

The Division urges that with respect to "public interest" consideration be given to the opinion of the federal court in June 1983, finding that Dirks violated the anti-fraud provisions of the securities acts[24/] while at Muir and that a sanction was imposed on him in January 1967 by the NYSE. The Commission has held that it is proper to consider a prior sanction imposed by a regulatory body in determining what sanctions are in the public interest. Lamb Brothers, Inc., et al, supra; Peter J. Kirsch, et al, 25 SEC Docket 1533, 1542 (1982); See also Goffe-Carkener-Blackford Securities Corporation, et al, 45 SEC 975,980-1 (1975)

24/ The Court held that Dirks violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. SEC v. Michael C. Scott a/k/a Michael C. Cole and Raymond L. Dirks, 82 Civ 1166 (WCC) (1983). Dirks argues that since an appeal is pending in the Second Circuit no consideration should be given to this case. The argument is rejected. The Commission and the Courts have held that a finding of violation by a court of competent jurisdiction remains authorative even though it is being appealed. Lamb Brothers, Inc. et al, supra; Paul M. Kaufman, 44 SEC 374 (1970); Berman v. United States, 302 U.S. 211,213 (1937).

where consideration was given to sanctions imposed by the Midwest Stock Exchange and the Department of Agriculture. Dirks' argument that a 1967 sanction is old and totally unrelated to and has no bearing on the issues in this case relates to the weight to be given to such sanction not to the propriety of considering it in the public interest. Accordingly, consideration will be given in the public interest to both matters.

The Division also urges that public interest consideration be given to sanctions imposed upon Sullivan by the NYSE and the American Stock Exchange (AMEX). The record reveals that in June 1981 the NYSE prepared a report of an examination it conducted of the financial, operational and supervisory standards/sales practice procedures established at Muir and found that, while Sullivan was Managing General Partner, the firm had violated the anti-fraud provisions of the Exchange Act, the Securities Act and the Investment Advisers Act of 1940. The report cited instances of failure to comply with Regulation T of the Federal Reserve Board and stated that as a result of specified deficiencies it appeared that "a breakdown in the systems of the credit department led to an inability to effectively exercise supervisory responsibility in compliance with Exchange Rule 342(b)(1)(2) (Supervision and Control) and 342(e)." On June 11, 1981 the NYSE, in a letter to Muir, "Attention Mr. John D. Sullivan, Managing Partner", admonished Muir and stated the firm's violations of SEC Rule 15c3-3(d)(1) could not be condoned and that such violation "could well have exposed customers to potential loss."

In March 1979 the AMEX issued a decision, after a hearing, in a case against Muir and Sullivan, finding that Muir and Sullivan violated AMEX rules and imposed a censure and a $21,000 fine against Muir and a censure and a $500 fine against Sullivan.[25/] Sullivan contends that the NYSE admonition of Muir has no bearing on the public interest in this case, that the June 11, 1981 letter from the NYSE "was not directed at Sullivan's conduct, although it was mailed to his attention" and that the Division's reliance on prior disciplinary actions is remote. None of the foregoing arguments militate against giving public interest consideration to the sanctions, the admonition, or the report of the NYSE. The argument that prior disciplinary action is "remote" merely relates to the weight to be given to the matter. In that connection, it is noted that Sullivan requests that consideration be given to a letter from the NYSE to him dated January 9, 1979 complimenting his efforts for the "significant growth achieved by the firm over the recent past." Apparently Sullivan does not consider this too "remote," nor does he mention that the same letter also notes that the AMEX Inspector found "deficiencies" and that since Sullivan and a Mr. Hausen took corrective action no further

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25/ In the Matter of John Muir & Co., and John D. Sullivan, Decision 78-5-7. (March 29, 1979).

comment was warranted. It is concluded that consideration will be given in the public interest to the foregoing matter relating to Sullivan as requested by the Division and by Sullivan.

Having concluded that a sanction against Dirks and Sullivan is warranted by the record and in the public interest, the nature of such sanction must also be determined. The Commission and the Courts have held that administrative proceedings under the Exchange Act are not brought for the purpose of punishing a respondent but are remedial in nature. If they are to be remedial any sanction imposed must have a deterrent effect not only on the respondents in this case but on others in the securities business who may otherwise be tempted to engage in the type of conduct which not only constituted wilfull aiding and abetting a net capital violation but additionally was found to be the cause for the appointment of a SIPC trustee.[26/] The callous disregard manifested by Dirks and Sullivan for the requirements of the net capital rule, and their equally callous disregard of the effect their conduct had upon the financial condition of Muir, which placed Muir's customers in a dangerous position and ultimately led to the appointment of a SIPC trustee, mandate that they be prohibited from serving in a supervisory,

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26/ See Arthur Lipper Corporation, supra; Thomas A. Sartain Sr., 19 SEC Docket 562,567-8 (1980).

managerial, financial, principal or proprietary capacity in any broker or dealer firm.

IT IS ORDERED that Raymond L. Dirks and John D. Sullivan be, and they hereby are, barred from association with any broker or dealer in a supervisory, managerial, financial, principal or proprietory capacity.

This ORDER shall become effective in accordance with and subject to Rule 17(f) of the Comission's Rules of Practice, 17 CFR 201,17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Comimssion as to each party that 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.[27/]

Irving Schiller
Administrative Law Judge

Washington, D.C.
December 19, 1983

27/ All proposed findings, conclusions and supporting arguments of the parties have been considered. To the extent that the proposed findings, conclusions are in accordance with the findings, conclusions and views stated herein, they have been accepted and to the extent they are inconsistent therewith, they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues pesented. To the extent that the testimony of various witnesses is not in accord with the findings herein, it is not credited.