ADMINISTRATIVE PROCEEDING
FILE NO. 3-3254

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

I. F. D., INC.

(8-12793)

ANDREW WORMSER
MANUEL POSY

INITIAL DECISION
(PRIVATE PROCEEDINGS)

Irving Schiller
Administrative Law Judge

Washington, D. C.
November 8, 1972

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APPEARANCES: Stephen Ostreich and David Greenberg, of the New York Regional Office of the Commission for the then Division of Trading and Markets, now Division of Enforcement *

Wynne B. Stern, Jr., of Fellner & Rovins for I. F. D. Inc., Andrew Wormser and Manuel Posy

BEFORE: Irving Schiller, Administrative Law Judge

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* See Securities Act of 1933 Release No. 5289 (August 14, 1972) which, among other things announced the elimination of the Division of Trading and Markets and the transfer of its enforcement activities to the Division of Enforcement.

These are private proceedings instituted by the Securities and Exchange Commission ("Commission") pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether I.F.D., Inc. ("I.F.D."), Andrew Wormser ("Wormser") and Manuel Posy ("Posy") willfully violated and willfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act"), whether I.F.D. and Wormser failed reasonably to supervise with a view to preventing the violations alleged in the Commission's order for proceedings other persons who were subject to their supervision and who committed such violations and whether any remedial action is appropriate in the public interest pursuant to the above mentioned Sections of the Exchange Act.

The order for proceedings alleges in substance that during the period approximately August 1969 to January 1970, the persons and firm mentioned above willfully violated and willfully aided and abetted violations of the above noted Sections of the Securities Act in that they, directly and indirectly, made use of the means and instrumentalities of transportation and communication in interstate commerce and of the mails to offer to sell, sell and deliver after sale shares of the common stock of Arco [1/] when no registration statement was filed or in effect as to said securities pursuant to the Securities Act. The order further alleges that I.F.D. and Wormser failed reasonably to supervise persons subject to their supervision

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1/ The record discloses that the reference to "Arco" in the order for proceedings were intended to refer to a corporation known as Arco Industries, Inc.

with a view to preventing the violations alleged in the order for proceedings.

After appropriate notice, hearings were held before the undersigned. Proposed findings of fact, conclusions of law and briefs were filed by the then Division of Trading and Markets ("Division") and by the above named respondents.

The following findings and conclusions are based upon a preponderance of the evidence as determined by the record, the documents and exhibits therein and an observation of the various witnesses.

Introduction

I.F.D. has been registered with the Commission as a broker dealer, pursuant to Section 15(b) of the Exchange Act since April 15, 1966.[2/] It is a member of the National Association of Securities Dealers, Inc., ("NASD") a national securities association registered pursuant to Section 15A of the Exchange Act. Wormser was president of I.F.D. from its inception to December 1971 after which he was employed as a registered principal. Posy has been a registered representative at I.F.D. since approximately September 1968.

The record discloses and respondents do not dispute that in August 1969 I.F.D. received a block of 35,000 shares of stock of Arco Industries, Inc. ("Arco") and in November 1969 it received two

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2/ The original registration was under the name of Israel Fund Distribution, Inc., which name was changed in March 1968 to I.F.D., Inc.

blocks of shares of Arco consisting of 50,000 and 100,000 shares respectively all of which shares were sold. The respondents do not dispute and the record establishes that no registration statement was filed or in effect with the Commission as to any securities of Arco pursuant to the Securities Act. The circumstances surrounding the sales of each of the above mentioned blocks of Arco stock is discussed below.

Sale of 35,000 Shares of Arco

The record discloses that in April 1963 one, Linda Meyer ("Meyer") purchased 250,000 shares of stock of a corporation known as Appalachian Resources, Inc. Meyer testified that when she acquired the stock, the said company had no assets, that it was spin off from another company (not identified) and that in addition to her shares there were 150,000 shares outstanding owned by many small stockholders. There is no evidence in the record concerning any operations by the company in the following six years. In April 1969 Appalachian was a shell corporation all of whose directors had either resigned or died. Some time in that month, Meyer met with Franklyn Phillips ("Phillips") and William Clay ("Clay") who told her they had some mining properties which they wanted to put into a company. She told them she had a shell company, Appalachian, in which the properties could be placed. In May 1969 Meyer entered into an agreement with Phillips and Clay in which she turned her Appalachian stock to them and gave them the right to vote her stock for 60 day period. Phillips and Clay sought out one Samuel Gallant ("Gallant"), an attorney they had met in

New York some six months previously, told him that they were getting a shell company and that they had promised Meyer they would put into the shell company various properties which Clay had or could get. They requested Gallant to frame a notice of meeting to stockholders of Appalachian so they could change the name of the company and "do a lot of other things." Gallant prepared the notice and since Appalachian had no officers or directors, requested Meyer who was the only active stockholder of the company to sign the notice which she did, as assistant secretary. Gallant testified that some time during the middle of May he changed the name of Appalachian to Arco, thereafter arranged to pay off back taxes the company owed to the State of Delaware and started negotiation for the acquisition of a company called Silva Ventures, which was eventually merged into Arco. At or about the same time three million shares of Arco stock were issued to Phillips and Clay for services rendered and for properties or mining claims which they put into Arco.

In May 1969 Milford Rockne ("Rockne") and Leonard Porath ("Porath") were president and executive secretary respectively directors and shareholders of Big Nine Mine and Mineral, Inc., ("Big Nine") a company which owned various mining properties, mining claims or leases. Big Nine had been formed in 1965 and originally had nine equal shareholders, some of whom took stock for mining claims and others for services. In 1969 the company was apparently not successful and only Rockne and Porath continued to have any interest in the company. There is no dispute that in June 1969 Big Nine sold some

of its mining properties to Arco in return for 125,000 shares. The shareholders of Big Nine never voted on the above mentioned sale of assets. In August 1969 Rockne and Porath sold some mining equipment to Arco in return for an additional 35,000 shares of Arco stock. After these transactions were effected Rockne and Porath executed stock powers on the 160,000 shares of stock and were told by Phillips and Clay that the stock would be brought to New York where it would be registered and sold. 3/ The stock together with the stock powers and signatures guaranteed by banks in the State of Washington were delivered to Phillips.

Gallant, who had become the attorney for Arco, testified that in August Clay informed him by phone that Rockne and Porath had shares of Arco to sell and asked him to furnish the name of a broker who could sell the stock. In response to questions from Gallant, Clay stated that Arco had taken over the assets of Big Nine, had issued its stock to Rockne and Porath, shareholders of Big Nine, and that their local counsel had indicated to them that they could sell the stock. Gallant told Clay to get a letter from the local attorney to that effect. Gallant thereupon called Posy at I.F.D. and told him that Clay had "a couple of people who want to sell some Arco stock . . . 75,000 shares". When Posy asked where they had gotten the stock Gallant

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3/ The record discloses that some time during the winter of 1969 Clay told Porath that instead of the 160,000 shares of Arco which had been given to Rockne and Porath they would receive an additional 240,000 Arco shares. No reason was given for the promise of the additional shares. However, the additional shares were never delivered.

told him the gist of the Big Nine deal, that there was an opinion from a local attorney "that it was okay" and that the opinion letter was being sent to him. Within two or three days Clay called Gallant and purportedly read the so-called opinion letter to him promising to send him the letter. Gallant testified that on or about August 11, 1969 he either dictated to Clay or had typed in his office, and delivered to Phillips, a letter of instruction to be signed by Rockne and Porath to I.F.D. to sell 75,000 shares of Arco. Three days later Phillips brought Gallant a certificate for the said shares together with the letter of instruction signed by Rockne and Porath addressed to I.F.D. which Gallant delivered to I.F.D.

Both Posy and Gallant testified that at the time the above documents were delivered by Gallant he informed Posy that the shares were exempt from registration under Rule 133. Posy thereupon sold 35,000 of the Arco shares for the account of Rockne and Porath neither of whom signed an account card at I.F.D. Thereafter Posy pursuant to instructions from Gallant, directed that a check payable to Rockne and Porath in the amount of $7,322.25 be given to Gallant who carried it to Spokane, Washington, but instead of giving it to Rockne and Porath turned it over to Clay. Porath testified, and his testimony is unrefuted and credited, that he never received the check, that the signature on the back of the check was not his endorsement, that Rockne's signature on the check was not that of Rockne, and that neither he nor Rockne ever received any money for the sale of the 35,000 share of Arco. The record however does not disclose what

Clay did with the check nor who, in fact, received the funds.

Sale of 50,000 Shares of Arco

The sales of the 35,000 shares mentioned above commenced about August 14 and were completed about September 15, 1969. Shortly thereafter, on or about September 18, 1969 Phillips told Posy that Arco was in need of money and Posy loaned the company $5,000. Gallant, who was present at the time the loan was made, gave Posy stock of Zavala-Riss, Inc. as collateral to assure Posy the loan would be repaid. 4/ On or about October 9, 1969 Gallant informed Posy that Phillips had arranged for a loan to Arco of $25,000 by a Thomas Feely who insisted on a guarantee from a third party. An arrangement was made whereby A. Forman, Inc. (a company owned by Posy) guaranteed the loan and Posy guaranteed performance by his corporation for which he receive a fee of $2,500. The loan was collateralized by 50,000 shares of Arco, 900 shares of Zavala-Riss, Inc., 1,000 shares Intrastate Associates, Inc. and 3,300 shares of Elite Industries, Inc. all of which Gallant held as escrow agent. Posy testified that at the time the loan was made he did not know what the collateral consisted of since the matter was handled by Gallant. On or about October 16, 1969 Posy received two checks from Arco for repayment of his $5,000 loan and his fee of $2,500. Posy testified that he learned about three weeks later that payment

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4/ The record does not disclose the precise number of shares of Zavala-Riss, Inc. which Posy received as collateral.

was stopped on both checks, whereupon he immediately telephoned Gallant, explained what happened with the two checks and requested Gallant to exercise the authority he had as escrow agent to liquidate the collateral since he felt he did not want to be personally "involved in any financial relationship with Arco." Gallant repaid Posy from his personal funds and on November 16, 1969 sent the collateral to I.F.D. ordering it be sold for the account of Gallant as "attorney for Arco". Posy testified that when he received the collateral which included 50,000 shares of Arco he learned for the first time the shares were in the names of Rockne and Porath. The 50,000 shares of Arco were sold on November 17, 1969 and pursuant to Gallant's instructions a check in the amount of $28,691.28 was given to him payable to "Samuel Gallant, attorney for Arco, Inc." The check was dated November 20, 1969. The record amply supports the finding that Posy solicited the customers to whom he sold the Arco stock.

Sale of 100,000 Shares of Arco

As noted earlier Meyer, in May 1969, turned over 250,000 shares of her Arco stock (then known as Appalachian Resources) to Phillips and Clay. The shares were later returned to her. In the latter part of November 1969 Clay met with Meyer, told her that Arco needed money, that his shares were in Washington and that he wanted to use her stock for a period of time until he could get his own

stock after which he would return her stock. On Friday, November 18, 1969 [5/] she met with Phillips and Clay and when they told her they would like to use her stock "just for the purpose of loan", she turned over to them 250,000 shares of her stock. Though Meyer testified that when she gave her stock to Phillips and Clay she had no intention of nor interested in selling her stock, the record reflects that by letter dated November 21, 1969 Meyer authorized Phillips and Clay to sell or assign the stock "currently held in your possession" and to use the proceeds "for the benefit of the corporation". The manner in which 100,000 shares of the said stock was sold is set forth below.

On the week-end of November 22, 1969 Clay telephoned one Marcus James ("James"), whom he had met about a year earlier and who was economic advisor to the Counsel General of Sierra-Leona and advisor to several West African developing countries, and arranged to meet him the following day. They met at Phillips' apartment on Sunday, November 23, 1969 where Clay told James he had a company which had "financial problems", that someone (not identified) "who had shares in the company had made shares available for the use of the company . . ." that the person was not in New York, that Clay

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5/ Meyer was certain she gave her stock to Phillips on the Friday preceding Thanksgiving which was November 21. However, when questioned as to the date she made the following obvious mathematical miscalculation. "If Thanksgiving is on the 27th, on a Thursday, the Monday, the 21st would be Monday wouldn't it? So Friday would have been the 18th."

and Phillips could not sell the stock themselves because they were officers of the company and requested James to act in a nominee capacity in the sale of the shares, "which money would be used to help the company". In response to James' question Clay assured him that the transaction was legal and that counsel for the company "had attested to the legality of the transaction". Clay called Gallant, told him that he had asked James to act as nominee and stated that James wanted to know "whether it was legal". Gallant told James it was legal, that the owner of the stock had it over a certain period and that he had given an opinion as to the legality of the sale. At that time Gallant did not know that it was the Meyer stock which was to be sold nor did he know how many shares were to be sold. The following morning, November 24, 1969, Clay, Phillips and James met and went to the Chemical Bank to have James' signature authenticated on the stock certificates which Clay and Phillips brought with them. From the bank they proceeded to Gallant's office to tell him they were in route to the transfer agent in Jersey City. At the transfer agent's office James was told by the transfer agent that the latter had an opinion of company counsel. The record reflects a letter from Gallant to the transfer agent dated November 19, 1969 advising the latter that the Meyer shares may be re-registered. At no time did James ever have possession of the Arco stock.

The next morning, November 25, 1969, James, Clay and Phillips went to I.F.D.'s office where they met with Gallant, Posy and Wormser.

At that meeting Posy received 100,000 shares of Arco stock in James' name which he turned over to Wormser. Respondents admit that at the time they received the certificates for the 100,000 shares the said shares had already been sold. Though Wormser and Posy observed the shares had been transferred to James one or two days previously they made no effort to inquire from James how he obtained the stock and they made no effort to ascertain in whose name the stock had been registered prior to the transfer to James. Having been told by Posy that company counsel, Gallant, said the shares could be legally sold they were apparently satisfied no further inquiry was necessary. Wormser testified that he called the transfer agent to ask if there were any stops on the stock and whether the transfer agent had any reason for concern as to whether the stock could be sold. The transfer agent assured him everything was in order. James testified he had no knowledge of when the shares were sold or to whom. The record discloses the shares had been sold on November 19, 1969, the date Gallant issued his advisory letter to the transfer agent. Wormser or the cashier gave James a check dated November 25, 1969 for $30,154 telling him it represented the proceeds of the sale of the Arco stock. James handed the check to Clay "because it was his check". James, Clay, and Wormser then went to the Chase Manhattan where Wormser identified James as the payee on the check. Clay produced the check requested that a cashier check be issued to Silva Ventures which he told James was "one of the subsidiary

companies".[6/] Later that day James, Clay, and Phillips went to another branch of the Chase bank and wired the money to Washington. Of the monies realized from the sale of the stock James was paid $1,000 for acting as nominee and Clay and Phillips received $1,000 which James testified was for their expenses. James further testified that several days later he received a confirmation in the mail.

Prior to discussing whether the above detailed sale transactions were violative of the Securities Act it appears essential to chronicle two events which contribute to an understanding of the reasons for and the manner in which Wormser and Posy conducted operations at I.F.D. and to aid in evaluating the testimony of Wormser, Posy and Gallant.

The first of these events is the fact that on August 6, 1969, prior to any sales of Arco stock at I.F.D., Posy received a block of 35,000 shares of Arco stock, "for services to be rendered to Arco". Half of these shares went to a corporation owned by Posy the other half to a corporation owned by Wormser.[7/] The record amply supports the finding that the services rendered by Posy, Wormser and I.F.D. after the gift of the aforesaid stock were primarily the sales of

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6/ The record is not clear as to whether a cashier's check was issued or the Arco check was actually cashed at the Chase bank. It is of minor significance since there appears to be no dispute that funds were wired to Washington that same day as noted in the text.

7/ The record discloses that both corporations signed investment

(CONTINUED)

Arco stock commencing with the receipt of the above noted 75,000 shares of Arco stock on or about August 14, 1969.

The second event concerns the testimony of the three individuals mentioned above relating to the purported receipt of a so-called opinion letter from a local attorney in Spokane, Washington, one Howard Herman ("Herman"), with respect to the Rockne and Porath stock. All three testified they actually saw the Herman opinion letter in the latter part of August or early September and Gallant testified the letter was read to him by Clay even before he saw it. Notwithstanding that the said letter is dated August 16, 1969, Herman testified the letter was dictated by Phillips to him on December 31, 1969 and he typed it that day along with several other documents all of which Phillips requested him to date August 1969. Herman testified he recalled quite vividly that on December 31, 1969, Rockne, Porath and Phillips came to his office in Spokane, Washington where Phillips, whom Herman met for the first time, explained it was very important to get some documents together and "get them back to the company so they would have their bookkeeping in order, so that they could complete this merger or whatever it was that they were doing". Herman testified that he personally typed his so-called opinion letter because it was late afternoon or early evening and

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7 / Continued.
letters prepared by Gallant. In February or March 1970, about the time this matter was under investigation by the staff of the Commission, Posy and Wormser returned the said stock to Gallant for cancellation by Arco.

no secretaries were available on New Years Eve. Moreover, Herman further testified the documents, including his opinion letter could not possibly have been typed in August for three stated reasons. First, he customarily takes his vacationes the first two weeks in August and recalled spending his birthday, August 12, while on vacation at Hayden Lake, Idaho. Second, Herman testified that the opinion letter was typed on an IBM, MT/ST typewriter which was installed in his office September 12, 1969, after which his secretary was required to take a two week course at IBM school to learn how to run the machine and that his wife, who also acts as his secretary, went to the school the following two weeks for the same purpose. Lastly, one of the documents typed on the same occasion the opinion letter was typed, which related to a separate Arco matter not involved in these proceedings, is dated December 31, 1969, which conclusively fixed in Herman's mind the date when the opinion letter and the other documents were prepared. In light of the foregoing and taking into consideration the obvious self interests of Gallant, Posy and Wormser in testifying as they did and the candid admission by Herman that he had no knowledge of the securities laws, had no knowledge of the real purpose he was being asked to prepare and pre-date the documents requested of him by his clients Rockne and Porath and by Phillips, purportedly representing Arco, the conclusion is reached that the opinion letter was not in existence until December 31, 1969 and that Herman's testimony should be credited and the testimony of Posy, Wormser and Gallant that they had the opinion

letter in late August or early September cannot be, and is not, credited.

Violation of Section 5

The Division asserts that at the time the above mentioned sale transactions of Arco stock were made, no registration was filed or in effect under the Securities Act, with respect to Arco stock, that such sales were in violation of Sections 5(a) and (c) of the said Act and that the respondents failed to establish any basis for their claimed exemptions. As noted earlier the record clearly establishes that no registration was ever filed by Arco. The respondents do not dispute they sold the shares of Arco noted above [8/] but assert a jurisdictional defense which they urge requires dismissal of these proceedings and in addition that under specified provisions of the Securities Act and the Rules thereunder, particular exemptions were available.

Prior to discussing the availability of the claimed exemptions consideration is first given to the jurisdictional argument, namely that the record is barren of substantial evidence to support a jurisdictional basis for a Section 5 violation. Generally, Section 5 forbids the use of any means of interstate commerce or of the mails to sell or offer to sell securities unless a registration statement has been filed and is in effect with the Commission. U.S. v. Custer

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8/ Wormser testified he personally did not sell any of the 35,000 shares for the Rockne and Porath account. Such testimony is uncontroverted and it is credited.

Channel Wing Corporation 376 F. 2d 675, 680, cert. denied 389 U.S. 850, 88 S. Ct. 38, 19 L. Ed. 2nd 119. Respondents urge that each of the sales were accomplished without the use of the mails or the use of any means of instruments of transportation or communication in interstate commerce. The record amply demonstrates respondents failed to establish such contention and this argument is rejected. With respect to the 35,000 shares sold by Posy in August 1969, Wormser testified and the documentary evidence supports his testimony that when I.F.D. "sent" a new account card to Rockne and Porath it "was sent to them with the confirmation of the first transaction". (underscoring ours) It is obvious that the word "sent" us used by the witness both in his testimony and as supported by the documentary evidence could only mean the confirmation was mailed. Insofar as the sales of the 100,000 shares in the name of James are concerned, his unrefuted testimony that he received a confirmation in the mails is credited. The Courts have held that the mailing of confirmations from a broker to a selling stockholder reflecting the sale for his account to another party, satisfies the jurisdictional requirements of Section 5. U.S. v. Wolfson 276 F. 2d 779, 784 (2 Cir.) (1968). Moreover, in connection with all the transactions the evidence clearly establishes that checks were issued by I.F.D. to Rockne and Porath, James and Gallant, as escrowee, in payment for the sales of stock which payment consummated the transaction. In Lawrence v. S.E.C. (C.A. 1, No. 7084, July 11, 1968) the Court held that use of interstate facilities to clear a check was enough to establish

federal jurisdiction. See also Cresswell-Keith, Inc. v. Wellingham 264 F. 2d 76 (8th Cir., 1959). With respect to the shares sold by James the record reveals that the securities were carried from New York to the transfer agent in New Jersey through facilities of interstate transportation and that a check was issued by I.F.D. for the proceeds of the sale which were wired to Washington. In light of all of the circumstances it is found that respondents have failed to establish that the record is barren of a jurisdictional basis for a violation of Section 5.

Briefly summarized the other defenses raised by respondents are that respondents did not "willfully" violate Section 5, that the sales by James of the Meyer shares were exempt by Section 4(1) of the Securities Act, that the sales by Rockne and Porath were exempt from registration under Rule 133 and the sales by Gallant as escrowee were, in essence, bona fide sales of pledged securities of approximately 1% of the outstanding shares of Arco. While respondents cite no specific section of the Securities Act or the Rules thereunder pursuant to which the latter Gallant sales were deemed to be exempt, the record reflects that Gallant orally informed Posy that it was his legal opinion that the said shares were also exempt under Rule 133 since the shares sold were in the names of Rockne and Porath and were part of the block of 75,000 shares which had originally been delivered to I.F.D. as to which he had earlier advised an exemption was available. It is well settled that the burden of proving the availability of an exemption

is upon the person claiming such exemption. S.E.C. v. Raleston Purina 346 U.S. 119, 73 S. Ct. 981, 97 L. Ed. 1494 (1953); Gilligan Will & Co. v. S.E.C. 267 F. 2d 461 (2nd Cir.), cert. denied 361 U.S. 896 (1959). Each of these claimed exemptions will be considered below.

With respect to the sale of the 100,000 shares of Arco respondents urge that "The sales through James . . . her nominee by Linda Meyer was a transaction, classic in its exemption under Section 4(1) of the Act". The argument is rejected. The contention that the sales in question were by Meyer through her nominee James is belied by the evidence and the exemption claimed under Section 4(1) is not available. The testimonial and documentary evidence overwhelmingly establishes that Meyer never constituted James as her nominee directly or indirectly to sell her stocks but rather demonstrates that she gave her shares to Clay and Phillips to sell for the benefit of Arco. Meyer, the record establishes, never knew James, had no contact with him and never authorized him to act as her nominee. The arguments by respondents that Meyer held her stock for six years, that she was not an issuer, underwriter or dealer, was not an officer, a director of Arco and was not in control of the said company and their references to the Act and the cases to establish the foregoing are without substance since they have no relevancy to the facts herein. It is clear from the record that Meyer, in fact, gave her stock to Clay and Phillips who were admittedly in control of Arco, for sale by them for the benefit of

the corporation. In other words, the sales in question were effected by Arco's controlling persons Clay and Phillips through a nominee selected by them and to whom they paid a fee for his services. The record makes it evident that Clay and Phillips were well aware that as officers and directors they were unable to sell their securities without complying with the Securities Act and that they conceived a plan of using James as a front to mask their activities. Though respondents assert the sales of the James shares were in essence sales by Meyer, nowhere do they contend nor does the record evidence that she received any of the proceeds of said sales. Respondents do not dispute that such proceeds were received by Arco or its admittedly controlling persons Clay and Phillips. In any event since I.F.D. was a dealer as defined in the Securities Act the exemption in Section 4(1) of the said Act was not available. Quinn and Company, Inc., Securities Act Release No. 9062 (1971); aff'd 452 F. 2d 943 (1971), cert. denied 406 U.S. 957 (1972).

Respondents next urge that the sale of the 35,000 Arco shares by Rockne and Porath were exempt under Rule 133. Respondents' burden of establishing this defense has not been met. The record fails to establish that strict compliance was effected with the provisions of the said Rule in order to make it applicable. Gallant testified that when he gave his opinion to Posy that Rule 133 was available for the sales of the Rockne and Porath stock he had no knowledge of the existence or contents of any agreement between Arco and Big Nine by which assets were presumably transferred by Big Nine to Arco for its

shares, that he did not know the properties or the people involved, that he did not know who was in control of Big Nine, did not know how many shares Big Nine received from Arco, did not know how many shares of Arco were distributed to Rockne and Porath and that he was relying on an opinion of counsel in the State of Washington which he claimed was read to him over the telephone and which he claimed he received late in August or early September. The finding was made earlier that the opinion letter did not come into existence until December 31, 1969. Although Gallant testified concerning the so called opinion letter, in the following manner,

> "I can't imagine any lawyer would write a letter like that. I think they would be more specific, far more specific, in my opinion"

he nevertheless had no hesitancy in giving an opinion to Posy based upon what he claimed was read to him on the telephone and his conversation with Clay who presumably related what occurred. Under the circumstances it is concluded that the record fails to establish that no "sale" was involved in the transaction between Arco and Big Nine within the meaning of Rule 133 and the Rule was not available. In that same connection respondents further urge that the shareholders, Rockne and Porath, who received the Arco stock for the Big Nine assets would not be deemed underwriters under the said Rule where they sold in brokers transactions within the meaning of Section 4(4) of the Act. However, the term "brokers transactions" in Section 4(4) of the Act is defined in paragraph (e) of Rule 133 and specifically

states that one of the conditions which must exist is that "the broker does not solicit . . . orders to buy . . .". Posy testified that he solicited sales of the Arco stock and respondents argument that the sales were not solicited is without foundation and is rejected. Respondents claim of exemption for the Rockne and Porath accounts is not established by the record and such sales are found to be in violation of Section 5 of the Securities Act.

With respect to the sale of the 50,000 shares of Arco stock directed by Gallant, respondents in their brief do not appear to rely upon any specific exemption under the Securities Act which they claim was available, but state that "this sale represented a bona fide sale of pledged securities approximately 1% of the outstanding shares of Arco". It will be recalled that the above mentioned shares had been placed in escrow with Gallant to be used as collateral for a loan of $25,000 to Arco. The documentary evidence discloses that Rockne and Porath authorized the delivery of their Arco shares to Gallant stating "The company is free to use the securities delivered . . . as collateral for loan of $25,000 . . . and, indeed, if necessary for other legitimate expenses of Arco . . .". When Posy became alarmed because two checks he received from Arco had "bounced" he telephoned Gallant to liquidate the collateral. Gallant directed Posy to sell the Arco stock and the proceeds were used to repay the aforesaid loan. It is clear from Gallant's testimony that he gave Posy his opinion that the sale of the escrowed Arco shares, which were in the names of Rockne

and Porath, was exempt under Rule 133 since in his view the shares came from the original block of 75,000 shares of their stock which had been delivered to Posy in August as to which he had previously given an opinion that they were exempt. As found earlier, no exemption was available with respect to the sale of the 35,000 Rockne and Porath shares which were sold from the block of 75,000 shares. Hence, no exemption was available with respect to the remaining 50,000 shares of the same stock. Moreover, the sale of the stock authorized and directed by Gallant, as escrow agent, was a sale for and on behalf of the issuer Arco. Respondents concede that the proceeds of the sale were used to repay Arco's loan and was for Arco's benefit. With respect to respondent's argument that the sale "represented a bona fide sale of pledged securities approximately 1% of the outstanding shares of Arco", respondents appear to be relying on the mathematical formula in Rule 154 under the Securities Act. The Rule as it then existed 9/ defined "brokers transactions" as used in Section 4(4) of the Act. 10/ The Rule defined the term "distribution" as used therein and excluded, among other things, sales by the same person in the counter market in a six months period of approximately 1% of the issuers outstanding stock. However, respondents' reliance on the former Rule is

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9/ Rule 154 was rescinded April 15, 1972. Securities Release No. 5223.

10/ Respondents do not assert that any exemption was available under Section 4(4) of the Securities Act.

completely misplaced for both Sections 4(4) and the Rule are not applicable where the broker solicits orders to buy. As noted earlier Posy solicited orders to buy Arco stock.

Respondents urge that the uncontested evidence in the record forecloses a showing of willfulness on the part of the respondents. Respondents also contend "There is considerable dispute as to the meaning of the term "willfully" and that "To have violated the Act, it must be demonstrated that Respondents knew that the shares had to be registered before sale". The arguments are lacking in merit. It has been uniformly held that "willfully" in the context of the alleged violations means intentionally committing the acts which constitutes the violation. There is no requirement that the actor also be aware that he is violating either the Rules or the Acts. Tager v. S.E.C. 344 F. 2d 5, 8, 2nd Cir. (1965); Hughes v. S.E.C. 174 F. 2d 969, 977 (1949); 2 Loss, Securities Regulation 1310 N 88 and cases cited therein. In the instant case the record unequivocally demonstrates that respondent knew exactly what they were doing and intentionally sold the Arco stock when they knew that no registration had been filed with respect to the said stock. Respondents argue vehemently that in view of the fact that the record discloses that in all of their transactions they relied upon the opinions of their counsel no finding can be made that they willfully violated the Securities Act. The Commission has consistently held that reliance upon the advice of counsel does not preclude a finding of willfulness. Morris J. Reiter 41 S.E.C. 137, 141 (1962).

Moreover, it has been held that respondents as broker-dealers are under an affirmative duty to make reasonable inquiry so as to assure that transactions in which they participate do not violate the federal securities laws. Hanley v. S.E.C. 415 F. 2d 589, 597 (C.A. 2). Early in 1962 the Commission considered the standards of conduct expected of a registered broker-dealer in connection with the distribution to the public of substantial blocks of unregistered securities, particularly those of relatively obscure and unseasoned companies and stated "it is not sufficient for him (the broker-dealer) merely to accept "self serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts". Securities Act Release No. 4445 (February 2, 1962). In the instant case the record overwhelmingly demonstrates that respondents were requested to sell 185,000 shares of a relatively obscure and unseasoned company. Respondents never made any independent effort to make any inquiry concerning the source of the shares they were being asked to sell but merely accepted the self-serving declarations of their counsel when they knew he was also counsel for the issuer. With respect to all of their transactions respondents were well aware they were selling unregistered securities yet at no time did it occur to them they had a responsibility, indeed a duty to satisfy themselves by obtaining facts concerning the issuer and the source of the purported sellers of the stock. While it is true that the degree of independent investigation which must be made by a securities dealer will vary in each

case, a broker-dealer may not abdicate his duties and responsibilities by blindly relying upon an opinion of counsel particularly where such counsel is also counsel for the issuer. Hanley v. S.E.C. supra. Respondents are seeking to establish that in some manner there complete reliance on the advice of their counsel affords them in essence immunity from any finding of a willfull violation. The courts have held that legal advice itself does not constitute complete immunity. Tarvestad v. U.S. 418 F. 2d 1043 (8th Cir., 1969); cert. denied 90 S. Ct. 944 (1970). Respondents also urge that "No further investigation into the facts of this case could have played an equally decisive role in the actions of there respondents than did the outpouring from the "Mount" of the legal gospel by Gallant". There is no merit to the argument for respondents made no effort whatsoever to obtain any facts and were content to accept Gallant's assurances without question. The question of reliance of counsel may however be considered in connection with the imposition of any sanction which may be appropriate in the public interest and such consideration will so be given. Within the ambit of the cited cases, the finding is made that respondents' violations of Section 5 of the Securities were willfull.

Failure to Supervise

The order for proceedings as implemented by the staff's more definite statement, alleges that I.F.D. and Wormser failed reasonably to supervise Posy and all other registered representatives of I.F.D. who sold Arco stock to their customers. Respondents I.F.D. and Wormser

deny the charges and contend they took reasonable steps to supervise persons under their supervision with a view to preventing violations of the Act. In support of their contention, it is urged that Wormser, in the sale of Arco stock, obtained opinions of counsel, made inquiries of the transfer agent and reviewed all sales, in good faith attempt to ensure compliance with the Act. The record fails to support the arguments that adequate supervision was exercised. Admittedly during the period the 185,000 shares of Arco stock were sold at I.F.D., Wormser was president and a director of I.F.D. Though the record does not reflect with precision Wormser's area of responsibility as president of I.F.D., it does reflect that Posy had been sanctioned by the NASD and thereafter as a condition for permission to be employed by I.F.D., a requirement was imposed obligating Wormser to supervise Posy. Wormser testified that to conform with the condition for Posy's employment he adopted a program designed to supervise, which was to examine all of Posy's order tickets and check them, occasionally monitor his phone calls and to hold discussions with him about being "careful not to go into anything that might cause trouble".

The record demonstrates however, that rather than keep a close watch on Posy's activities Wormser permitted Posy to sell the Arco shares when Posy informed him that it was Gallant's opinion the shares could be sold. He never instructed Posy, for example, to obtain information concerning the manner in which Rockne and Porath obtained their shares or their relationship to Arco, never requested Posy to ascertain the manner in which Gallant obtained the shares he was

selling as escrow agent and never instructed Posy to ascertain the circumstances surrounding the manner in which James received his stock. In each of these instances he merely accepted Posy's explanations and never instructed him to obtain any facts which would establish whether the Arco shares could be legally sold. The so-called techniques which Wormser testified he adopted to carry out his added responsibilities upon which Posy's employment was predicated, to supervise Posy, are found to be wholly insufficient in the case at bar. Reasonable supervision, within the meaning of Section 15(b)(5)(E) of the Act, in the instant case where unregistered securities of a relatively obscure and unseasoned company were sought to be sold required Wormser to make certain that facts were obtained by Posy which would assure that an exemption was available and not be content with Posy's self-serving declarations that it was Gallant's opinion the sales were legal. There were factors present throughout the entire course of the sales of Arco stock which should have called for a more searching inquiry and which indicate that effective supervision would have prevented the violations. See e.g., Sutro Bros, Inc. 41 S.E.C. 443 (1963). Some of the factors have been previously discussed and need not be repeated here. It is evident from the record that in the instant it is not a question as to whether Wormser adequately supervised Posy, rather that supervision was entirely lacking since it is mainfest from Wormser's willingness to accept Posy's and Gallant's statements, without making any independent inquiry. Wormser, despite

his increased supervisory functions, never directed or indeed even suggested that Posy make any inquiry. The record is devoid of any evidence that I.F.D. or Wormser supervised any other representative of I.F.D. who sold the Arco stock in question. It is concluded that I.F.D. and Wormser failed reasonably to supervise Posy and other registered representatives in connection with their sales of Arco stock.

Public Interest

Having found that respondents willfully violated the Securities Act, the sole remaining question is whether it is appropriate in the public interest to invoke any sanction. Respondents urge, as they did in their contentions, noted above, that they did not willfully violate the laws and that they, in good faith, relied on their counsel's advice. As stated earlier while reliance upon advice of counsel does not negate a finding of willfullness it may be taken under consideration in connection with determining whether a sanction is appropriate. An analysis of the testimony of Wormser, Posy and Gallant reveals a consistent pattern of conduct undertaken at the behest of Gallant, who time and again recommended I.F.D. and its personnel as capable of selling obscure and unseasoned securities, without any investigation of the facts and circumstances concerning the sales they were requested to make. In one instance Wormser and Posy never met or even talked with the persons on whose behalf they were being requested to sell Arco stock and in another they met the purported seller only after the sales had been accomplished. They

made no inquiry as to how or when such person acquired their shares and demonstrated a willingness to accommodate Gallant who was a friend of both Wormser and Posy, as well as their counsel. The fact that he was also counsel to the company whose securities they were being asked to sell apparently raised no questions in their minds. Nor did the fact that as broker-dealers they had responsibilities which, under the Securities Acts required them to act independently of their counsel, cause them to discharge such responsibilities in an appropriate manner. With respect to the so called sales by Rockne and Porath, Gallant testified he made no independent investigation relying primarily on what was told to him on the telephone or in person by individuals he believed controlled Arco and an opinion which was read to him and which he, Wormser and Posy all testified they received late in August or early September. None of such testimony is credited for, as noted earlier, it is evident from the testimony of the attorney in the state of Washington that he never prepared his so-called opinion until December 31. Herman had not the slightest knowledge of the Securities Act or its ramifications and so admitted. Such fact either Wormser, Posy and certainly Gallant could have easily ascertained. Respondents further urge that it was Gallant who, in the first instance presented respondents with the facts and rendered his opinion thus demonstrating they did not act willfully. The record supports the argument but not the conclusion. Reliance by the respondents upon the advice of their counsel can not and does not absolve them from

their responsibilities to ascertain the facts which their duties as broker-dealers require them to do. The record further reflects that respondents in addition to accepting Gallant's legal advice without knowledge of the facts were also taking instructions from him as to the manner in which the customers account should be handled. Thus the documentary evidence reflects that Rockne and Porath gave written instructions to I.F.D. as to the disposition of the proceeds from the sale of their stock but the firm did not follow such instructions, rather it blindly accepted Gallant's contrary directions without first making any effort to ascertain from the customers whether their previous instructions should be disregarded. Though the instructions from Rockne and Porath included directions to forward the proceeds of sale to them, the check was instead given to Gallant who turned it over to Clay. Porath testified, without refutation that neither he nor Rockne ever received the check or the proceeds of sale and that the endorsements on the back of the check were not their signatures.

Consideration must also be given to the actions of Wormser and Posy in connection with the so-called sales by James. Here again, Gallant recommended I.F.D. as capable of handling the sale of 100,000 shares of Arco stock and Wormser and Posy willingly accepted Gallant's ascertions that the sales were legal and without the slightest hesitation immediately sold the stock. Both Wormser and Posy became aware that the Arco shares had been transferred into James' name three days prior to the sale, and that

he wanted payment prior to settlement date. James told them he wanted to cash the check in order to send the money to Arco and they helped him cash the check. Despite all the obvious danger signals, neither Wormser or Posy made any effort to determine the circumstances surrounding the James transaction. The record further reflects that Wormser and Posy each received 17,500 shares of Arco stock allegedly for services rendered which apparently were returned after the Commission staff commenced an investigation. The entire course of conduct by Wormser and Posy evinces something more than merely acting on advice of counsel.

On April 7, 1971, I.F.D. and Wormser were, upon their consent, without admitting or denying the truth of the charges, suspended by the NASD for seven days having been found to violate the NASD's Rules of Fair Practice and upon the finding that their conduct was inconsistent with high standards of commercial honor and just and equitable principles of trade.[11/] On April 14, 1971 a preliminary injunction was entered in the United States District Court for the Southern District against the respondents enjoining them from further sale of Arco stock unless they comply with the law.[12/] In this latter connection, respondents urge that the Court in its

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11/ NASD Complaint No. NY 1233 - Decision dated April 7, 1971.

12/ 70 Civil Action File No. 2810. Official notice is taken of the entry of a permanent injunction against respondents on May 25, 1971 upon their consent, without their admitting or denying the allegations of the Complaint.

opinion granting the preliminary injunction found an absence of willfullness on the part of respondents which "is res judicata in this proceeding". A perusal of the Court's opinion indicates the Court made no such finding. In quoting the portion of the opinion in which the Court stated it could not agree that "the Commission has clearly established the venality of the defendants' acts", the respondents omit the three lines immediately following the above quoted section in which the Court held "While it is now evident that defendants failed to meet their obligations as brokers and were certainly negligent in their behavior ..." [13/] Moreover, the judgment of the Court in the injunction action was not res judicata on the issue whether it is in the public interest to invoke a sanction under Section 15 of the Exchange Act since that issue was not before the Court in the injunction action. Brown Barton & Engel et al. 40 S.E.C. 1038, 1041 (1962).

After giving consideration to all of the factors noted above, particularly to the fact that they relied on counsel, it is nonetheless evident that respondents do not appear to comprehend fully that their duties as broker-dealers require them to act independently in circumstances such as those presented here and they cannot discharge their responsibilities by the mere assertion that they were acting upon advice of counsel. Respondents' argue that the instant case is distinguishable from other cases where

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13/ 70 Civil Action File No. 2810.

reliance upon counsel's advice is an issue since in those cases the facts are presented to counsel for a ruling whereas here it was Gallant, their attorney who presented them with the facts and his opinion. The argument is specious for it demonstrates that here respondents' actions were not determined on the basis of personal knowledge of the facts which they, as brokers, were required to independently ascertain but rather an abdication of such responsibilities coupled with a wholehearted eagerness to comply with Gallant's bidding. Under all of the circumstances, it is appropriate in the public interest that sanctions be invoked against the respondents. Accordingly,

IT IS ORDERED that the registration as a broker-dealer of I.F.D., Inc. be and the same hereby is suspended for a period of six months and that Andrew Wormser and Manuel Posy be and they hereby are barred from association with a broker dealer, except that after a period of thirty days from the effective date of this order, Andrew Wormser may become associated with a registered broker-dealer upon a satisfactory showing to the staff of the Commission that he will be adequately supervised and that after a period of sixty days from the effective date of this order Manuel Posy may become associated with a registered broker-dealer upon a satisfactory showing to the staff of the Commission that he will be adequately supervised.

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

of Practice.

Pursuant to Rule 17(f) of the aforesaid Rules, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial 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.[14/]

Irving Schiller
Administrative Law Judge

Washington, D. C.
November 8, 1972

14/ To the extent that proposed findings and conclusions submitted by the parties are in accordance with the views set forth herein they are sustained and to the extent they are inconsistent therewith they are expressly overruled.