ADMINISTRATIVE PROCEEDING
FILE NO. 3-6255

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
FRANK W. HUMPHERYS	:
	:

INITIAL DECISION

Washington, D.C.
March 22, 1984

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: John J. Kelly, Jr., and Michael F. Brown, attorneys, Denver Regional Office, for the Division of Enforcement.

R. Michael Sentel for Frank W. Humpherys.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

On June 13, 1983 the Securities and Exchange Commission issued an Order (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) instituting a public proceeding to determine whether respondent Frank W. Humpherys (Humpherys), and two other individual respondents, committed various violations of the Exchange Act and regulations thereunder, as alleged by the Division of Enforcement (Division), and the remedial action, if any, that might be appropriate in the public interest.

The two other respondents have submitted offers of settlement and did not appear at the hearing.[1/] Therefore, this initial decision is applicable only to Humpherys, although, in view of the nature of the charges and factual circumstances, it may be necessary to make findings concerning the other respondents.

The Order, as applicable to Humpherys, alleges that he willfully aided and abetted a broker-dealer in violating Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

The evidentiary hearing was held in Denver, Colorado, on September 26 and 27, 1983. At the conclusion of the

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1/ The other two respondents, Vaughan H. Shaw and James J. Keegan, have submitted offers of settlement which the Division will recommend be accepted by the Commission.

hearing, both parties having rested, respondent moved to dismiss the proceeding against him and his motion was granted. The Division then filed a petition for review of the "initial decision" with the request that it be certified to the Commission. That request was granted, and on October 27, 1983 the Commission issued an order deferring review and directing further proceedings. The Commission directed that the parties be accorded the opportunity to file proposed findings and conclusions together with supporting briefs, and that thereupon an initial decision be prepared and filed. Accordingly, by order of October 31, 1983, a briefing schedule was set, with which the parties have now complied.

Humpherys has been represented by counsel throughout the proceeding; and proposed findings of fact, conclusions of law, and supporting briefs have been filed by Humpherys and the Division.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

Respondent

Humpherys was born July 28, 1945 in Blackfoot, Idaho. He attended Hunter City College, New York, N.Y.

from September 1967 until January 1977, the date he received a B.A. degree. He was employed by the brokerage firm of Bache, Halsey, Stuart, Shields (Bache) in New York from September 1967 until January 1977 as a margin department manager reviewing customers' and cash margin accounts for Regulation T compliance. In February 1977 he transferred to the Denver office of Bache as a branch operations manager. On July 1, 1980, he was hired by J. Daniel Bell & Co. (Bell & Co.), the registrant herein, as director of customer relations. He remained with Bell & Co. until its dissolution in August 1982; he then joined the brokerage firm of Kidder, Peabody in Denver as assistant operations manager in its new branch office. In April 1983 he was employed by another brokerage firm, E.J. Pittock, as operations manager.

Recordkeeping Violations

The Order charges that during the period from on or about October 1, 1979 through March 10, 1982 Humpherys and James J. Keegan (Keegan) willfully aided and abetted a broker-dealer, J. Daniel Bell & Co. in violating Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Humpherys and Keegan caused

the broker-dealer to fail to make and keep current its books and records.[2/]

Bell & Co. has been registered with the Commission since December 8, 1973, and it has a history of securities violations beginning in 1978 or 1979. In September 1979 Bell & Co. hired James Fox to supervise back office operations. In January 1980 Keegan was appointed an ex officio member of the board of directors and designated acting secretary and treasurer; his final appointments to such positions were to be contingent upon obtaining a broker's license and passing the NASD principal's examination. In May 1980 the board of directors named

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2/ Section 17(a)(1) of the Exchange Act, as applicable here, requires registered brokers and dealers to keep such books and records as the Commission by rule or regulation may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records that must be maintained and kept current. Rule 17a-3(a)(5) requires a securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by such member, broker, or dealer for his account or for the account of his customers or partners and showing the location of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried.

Keegan as a consultant, stating that as soon as a financial principal, a director of operations, and a head cashier were hired, Keegan would assume compliance responsibilities in his capacity as administrative vice president.

On May 29, 1980, the U.S. District Court for the District of Colorado at Denver entered a permanent injunction against Bell & Co. The court found, among numerous violations, that Bell & Co. had violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. The court ordered Bell & Co. to do certain things, among which were the appointment and retention of (1) a financial principal and (2) an operations manager, both to be qualified and competent by industry standards.

Accordingly, on July 1, 1980, Humpherys was employed for the position of operations manager in compliance with the court order. Humpherys testified that he was interviewed and hired by Keegan to be director of customer operations responsible for the customer cashiering, transfer, and trade input areas; and that Fox remained in charge of the broker operations of the back office. He also testified that near the end of November 1980, after Thanksgiving, he assumed responsibility for the broker side as well so that at that time he was in charge of the entire back office operation. However, the minutes of a

board of directors meeting, dated October 27, 1980, show that Fox was relieved of his responsibilities in operations and that Humpherys was promoted to director of operations from director of customer operations and placed in charge of the entire back office under the supervision of Keegan.

Ms. B, an NASD examiner, testified that because of Bell & Co.'s extreme problems with books and records, which had impelled the injunction, she made inspection visits to the firm almost daily during 1980 to determine what was being done to resolve the problems of bringing the firm into compliance with NASD and SEC regulations. Beginning in July 1980, after Humpherys was hired, she had almost daily discussions with him concerning the back office operations. Bell & Co. had engaged an outside accounting firm to handle past problems, and Humpherys appeared to be handling the current problems.

B started her annual examination in October 1980. She wished to do a one hundred percent verification of stock positions and made arrangements for herself and two other examiners to come in on November 18, 1980. According to B, Humpherys was director of back office operations. The physical stock count was made on November 19, 1980 for the preceding day, November 18, 1980. Part of

Humpherys' duties appeared to be to keep information concerning the location of all securities. Bell & Co. cleared its transactions through Pacific Coast Clearing Corp. (PCC), a corporation in the business of clearing daily transactions. The Eagle System (Eagle), a computerized recordkeeping system, was used for keeping the firm's books and records. B explained that PCC is part of the stock record in that outside records received from PCC are used by the NASD examiners to verify a firm's securities position record.

B performed a one hundred percent short side securities verification. This verifies each and every certificate located on the securities position record: where it actually is (in the firm's box, at transfer, at PCC, failed to receive) or whatever the stock record indicates. This verification examination disclosed a considerable number of differences between the PCC clearing sheets and the firm's records. The firm prepared a daily cash reconciliation, but it did not appear to be reconciling for the stock positions. The cash reconciliation disclosed a number of uncompared trades, dating back to December 1979, which did not appear to have been corrected. B discussed these uncompared trades with Humpherys who told her that when he was hired Fox was responsible for those and he had left it for Fox to correct. However, since at the time

of the examination Fox was no longer there, B asked Humpherys what he was doing about it, to which Humpherys replied that he was aware of the problem but that he had not taken any action on it.

B testified that normally she would review only one day's complete stock record, but because of the circumstances discovered in her examination of November 18, she returned on November 21 to review the stock record for November 20, 1980. B, who had conducted the examination in March 1980 which had led to the injunction on May 29, 1980, testified that in March 1980 Bell & Co. had experienced operational problems, such as sending out duplicate checks to customers, paying customer credit balances without having on hand the securities they had sold to obtain those credit balances, and mailing stock certificates to customers who still owed the firm money. B reviewed the customer statements to verify whether these types of problems had been corrected. She found approximately 25 accounts in which these problems seemed to be recurring. B and Humpherys then began a review of the accounts on the computer terminal. B found a customer with a debit balance and no securities position on the account. The account reflected a delivery to that customer,

which would cause the firm to have an unsecured balance. Moreover, there would be no incentive for the customer to pay the firm the money owed.

Normally, a broker will not send out stock until it has been paid for. Humpherys said, "That's okay, I still have the stock." B said, "Fine, show me that you have the stock and I won't count it as unsecured." B went through several more customer statements and Humpherys made the same response each time. Finally, B said, "I need to see the stock, I can't take your word for it." Thereupon, Humpherys proceeded to open a file drawer and produced several folders of stock certificates. B reviewed these certificates and found that the customers' statements did not reflect the fact that the customers' stock was still long their account, that it was still on their account record. B asked Humpherys if these stocks were reflected on the securities position record or stock record of the firm, and he indicated that they were not. B then asked Humpherys if he had a list of these stocks, that is, could he tell her what was in the drawer. He did not have a list of those securities at that time. Thereupon, B prepared a list of the stocks and requested Humpherys to book them into the securities position record. There were 282 certificates representing

about 1,800,000 shares of stock. B compared a representative sampling of the certificates in each of the folders produced by Humpherys with the securities position record of the firm and those customers were not listed as being long stock; in other words, their names were not on the stock record, nor were those shares on any record as being located in the firm. No records showed the location of those certificates.

November 21, 1980 was a Friday, and the booking of the certificates began immediately under Humpherys' direction. When B returned on Monday, November 24, 1980, she began to verify the booking. However, there were numerous problems and it took several days, but eventually the certificates were all booked.

Humphery's supervisor appeared to be Keegan, but Keegan was not an NASD registered financial principal although Humpherys and others thought he was. The only registered principal at the firm was Mr. J. Daniel Bell who, under the NASD rules, would be the one responsible for the firm's books and records. Mr. Bell was not in the office that day, November 24, 1980, so B went to Keegan and suggested that the firm should consider sending telegraphic notice under SEC Rule 17a-11 of the failure to maintain accurate books and records. B testified that

Keegan seemed somewhat surprised that some of the certificates held in the firm's possssion were not on the books.

B testified further that when Bell & Co. originally became a NASD member it was what is known as a "K2A" firm, that is, a firm exempt from the SEC's customer protection rule by reason of operating pursuant to the exemption provided in subsection (k)(2)(A) of Rule 15c3-3. 3/ However, because of the examination conducted in 1979, and the net capital and bookkeeping violations found in early 1980, it was determined that Bell & Co. should become fully subject to the customer protection rule, SEC Rule 15c3-3. However, since its operational problems had not been eliminated, the firm entered into an agreement with the NASD that it would not

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3/ Rule 15c3-3 provides for the custody of customer securities by a broker and for the establishment of special reserve bank accounts for the benefit of customers. Subsection (k)(2)(A) states: The provisions of this rule (15c3-3) shall not be applicable to a broker or dealer who carries no margin accounts, promptly transmits all customer funds and delivers all securities received in connection with his activities as a broker or dealer, does not otherwise hold funds or securities for, or owe money or securities to, his customers and effectuates all financial transactions between the broker or dealer and his customers through one or more bank accounts, each to be designated as "Special Account for the Exclusive Benefit of Customers of (name of the broker or dealer)."

safekeep customers' securities until the NASD had made a determination concerning whether Bell & Co. was in compliance with all SEC regulations. Humpherys was aware of that agreement.

Following her preparation of the list of unbooked stock certificates, B had a meeting with Humpherys and Keegan. On November 24 or 25, 1980, Keegan visited the NASD office in Denver to discuss whether the firm should have sent telegraphic notice of the 17a-3 violations. Keegan did not think the violations were sufficient to warrant sending a telegram. In addition, he requested that B be removed from the examination of Bell & Co. because she had become too familiar with its books and records and he wanted someone to come in with a fresh look. This request was denied.

B testified that while Humpherys did not tell her that he knew that the procedure he had been following was a violation of 17a-3, he did say that it was his understanding that the firm was not supposed to be safekeeping securities because of the agreement with the NASD.

Humpherys testified that he was hired by Keegan, whom he thought to be the financial principal for Bell & Co. It was not until this proceeding that he learned that

Mr. Bell was the financial principal and that Keegan had never passed the NASD's financial principal examination. Keegan was Humpherys' supervisor, and he discussed all back office problems with him. Humpherys stated that he was not hired to work on the books and records but as a director of customer operations. During his first few weeks at Bell & Co. Humpherys was researching customer related problems and found that Bell & Co.'s procedures for handling securities were sloppy and he tried to correct them.

Humpherys testified that when he was hired he read the injunction and learned of the existing violations; that he was told that Bell & Co. was a K2A firm; that he was not familiar with K2A and that Keegan explained this designation meant they could not hold customers' securities; and that the firm had an agreement with the NASD regarding the safekeeping of securities. He testified that the 282 certificates shown to B were not on the stock records; that he voluntarily showed them to B; and that he did not know that such procedure was a violation of Rule 17a-3.

Humpherys testified that it was his understanding that as a K2A firm they could receive in and

book only those securities that had been sold and were negotiable; that if the stock had not been sold and it was negotiable, they could not receive such securities into the customers' accounts. Humpherys felt that such securities should be kept in a secure location, which was the same vault where they kept all of their securities but segregated so that they could follow up and take appropriate action. Some of the certificates may have been return mail items. Humpherys said that he developed an over-riding entry, DEL-17, which was a code showing that the securities were being held in operations. He continued to use this procedure even after B began her examination, and did not discontinue it until she told him that it was incorrect and that the securities in question should be booked into an SK-1 account, a safekeeping account, on the Eagle Computer System.

Respondent does not deny the testimony of B concerning her examination and the discovery of the books and records violations. In fact, he agrees with most of it. In his brief, he states that he was employed for the position of operations manager in compliance with the U.S. District Court order; that Keegan was ostensibly in charge of the overall operation of the back office and the books and records; that on July 1, 1980 when he joined the firm, it had extreme books and

records problems; that securities were kept in numerous locations; that he instituted the procedure of using the DEL-17 code to handle customers' stock certificates and that Keegan approved it; that records he created or used reflect the requirements of Rule 17a-3(a)(5) (such as: incoming and outgoing mail logs, transfer units, customers' statements, journal entries, and stock records); that until approximately November 21, 1980, the firm did not have a securities record as is alleged to be required by Rule 17a-3(a)(5); that he merely tightened the controls on the system he inherited when he began work at Bell & Co.; that he was not aware of, nor did he have reason to know, the requirements of Rule 17a-3; and that he did not intentionally violate the rule or willfully aid and abet others in a violation, if any, of that rule.

Respondent contends that Keegan and Mr. Bell were responsible for the creation and accuracy of the firm's books and records and that his only responsibility as a nonlicensed employee was to maintain accurate records. Humpherys asserts that he merely enhanced the recordkeeping of the firm and was not responsible for implementing or creating records that comply with the Exchange Act.

As can be seen from the foregoing summary of respondent's position, he relies principally on shifting responsibility to others; that there were records which

reflected the securities; and that he had no knowledge of Rule 17a-3.

In its brief the Division points out that prior to September 1980, Humpherys was aware that the NASD and the firm, because of operational problems, had agreed that it would not safekeep customers' cash or securities and that it would operate as a K2A firm; that Humpherys was aware of the May 1980 injunction which enjoined Bell & Co. from, among other things, bookkeeping violations; and that he designed a plan for keeping securities in safekeeping which would not be recorded on Bell & Co.'s securities position record.

In granting respondent's motion to dismiss on September 27, 1983, the following statement was made by the administrative law judge:

> The charges, getting down to Mr. Humpherys, that he aided and abetted the violation, lead us to determine the aiding and abetting requirements. In an opinion issued by the Commission on February 28, 1981, Security Act Release No. 17597, in the matter of William R. Carter and Charles J. Johnson, Jr., which is in 22 S.E.C. Docket, Page 292, beginning on Page 314, the Commission goes into a considerable discussion of aiding and abetting:
>
> > In context of the federal securities laws, these principles hold generally that one may be found to have aided and abetted a violation when the following three elements are present:
> >
> > 1. There exists an independent securities law violation committed by some other party;

2. The aider and abettor knowingly and substantially assisted the conduct that constitutes the violation;

3. The aider and abettor was aware or knew that his role was part of an activity that was improper or illegal.

The citations cited by the Commission from which this conclusion concerning aider and abettor are Rochez Brothers, Inc. v. Rhoades, 3d Circuit, 527 F.2d 880, 889 (1975): SEC v. Coffee, 493 F.2d 1304, 1317, 6th Circuit (1975), cert. denied 420 U.S. 908; Woodward v. Metro Bank of Dallas, 522 F.2d 84, 97, 5th Circuit (1975).

In Rochez Brothers, Inc. v. Rhoades, the court said, quote:

> Courts have been unwilling to extend vicarious liability where the secondary defendant's activity is merely inaction. Inaction may be a form of assistance, but only where the plaintiff is able to show that the silence of the aider and abettor was consciously intended to aid the securities law violation.

In view of the foregoing discussion, I am unable to conclude that it has been demonstrated by sufficient evidence that Mr. Humpherys willfully aided and abetted a violation of securities laws in connection with Section 17a of the Exchange Act and Rule 17a-3 and 17a-3(a)(5) particularly concerning the securities which he voluntarily disclosed to the NASD examiner.

Accordingly, I conclude that there is no showing that Humpherys knew of the violations or intentionally assisted and that there may have been a continuing violation to which Humpherys did not contribute or in which he did not participate.

It appears, after a careful review of the record and consideration of the respective briefs, that the foregoing conclusion was rendered improvidently. Humpherys admitted

knowledge of the violations at the time he was hired and the fact that he was hired in compliance with the court order stemming from those violations. His formulation of code DEL-17, which was designed for keeping customers' securities without recording them on the firm's securities position record, and his awareness that the firm was not to be safekeeping securities, and that its records should not reflect that it was, in fact, safekeeping securities, all add up to conduct which brings him within the requirements for an aider and abettor.

Although Humpherys asserts that he voluntarily disclosed the 282 certificates in question to the NASD examiner, this is not entirely true. As B testified, it was only after several demands to be shown the stock that Humpherys finally produced it (supra p. 9). Also, the fact that the data required in the position record might have been derived from other records maintained by Bell & Co. did not satisfy the requirements of Rule 17a-3.[4/] As the Commission has said: "The efficacy of Rule 17a-3 would be materially diminished if persons in charge of the records could take it upon themselves to decide . . .

4/ Collins Securities Corporation, et al., 46 S.E.C. 20, 37 (1975); Whitney & Company, 41 S.E.C. 699, 703 (1963); Eugene N. Owens, 42 S.E.C. 149, 151 (1964).

that compliance with some of those requirements is not necessary." 5/

The record fully supports a finding that Humpherys willfully aided and abetted Bell & Co. in violating Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. 6/

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the violation which Humpherys is found to have aided and abetted. The Division urges that Humpherys be suspended from association with a broker-dealer for a period of 60 days and be suspended from acting in other than a supervised nonsupervisory capacity for a period of six months. Respondent requests that the charges against him be dismissed.

The respondent argues that he did not cause Bell & Co. to stop making a stock record or ledger of customers'

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5 / Associated Securities Corporation, 40 S.E.C. 10, 18 (1960), aff'd 293 F.2d 738 (10th Cir. 1961). See also, Olds & Company, 37 S.E.C. 23, 26 (1956).

6/ In this context it is well established that a finding of willfulness does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing. Billings Associates, Inc., 43 S.E.C. 641, 649 (1967); Tager v. S.E.C., 344 F.2d 5, 8 (1965); Hughes v. S.E.C., 175 F.2d 969, 977 (1949); Capital Funds, Inc. v. S.E.C., 348 F.2d 582, 588 (8th Cir. 1965).

stocks; that there had not been such a record since before he was employed; and that he did not knowingly assist in perpetuating the alleged violation. He asserts that, if anything, his activities brought the firm closer to being in compliance with Rule 17a3(a)(5) than it had been before his employment. He maintains that he was unaware of the requirements of Rule 17a3(a)(5) and certainly did not "consciously intend" to aid the violation of a rule of which he had no knowledge; that his intent was to help Bell & Co. stay in compliance with its consent decree; and finally, that the cases relied on by the Division to support a finding of willfullness do not accurately reflect the current case law. (See note 6 and cases cited).

Humpherys' contention that he was unaware of NASD and SEC recordkeeping requirements is unacceptable. He was employed pursuant to the court's order to appoint a competent and qualified operations manager. In view of his 13 years experience as a back office man with Bache he presumably met the court's standards. The Commission and the courts have held that it is the duty of brokerage firm employees to inform themselves concerning the pertinent requirements of the securities laws. In a recent case where the respondents contended that they were unaware of certain NASD requirements,

the court, in affirming a Commission decision, said: [7/]

> As employees, Carter and Ribiero are assumed as a matter of law to have read and have knowledge of these rules and requirements.

There is little doubt that Humpherys was confronted with a difficult situation when he took over the back office at Bell & Co. As he testified, he found boxes of securities in various locations and a shortage of experienced personnel. He and his back office people were required to work seven days a week, ten to fourteen hours a day, in an effort to correct the problems. Although the NASD referred Bell & Co. to SIPC, it was not necessary for SIPC to do anything because the firm was able to liquidate without any harm to investors.

Upon consideration of all of the circumstances, the mitigating factors involved, and Humpherys' previously unblemished record, it is concluded that, in this instance, the public interest does not require more than a censure.

ORDER

Accordingly, IT IS ORDERED that the respondent Frank W. Humpherys be, and hereby is, censured.

7/ Carter v. S.E.C., CCH Fed. Sec. L. Rep., 97,754 (1984); (9th Cir. 12-1-83); see, also, Sirianni v. S.E.C., 677 F.2d 1284, 1288 (9th Cir. 1982); Willard G. Berge, 46 S.E.C. 690, 693, aff'd sub nom. Feeney v. S.E.C., 564 F.2d 260 (8th Cir. 1977), cert. denied, 435 U.S. 969 (1978).

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review 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. 8/

Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.
March 22, 1984

8/ All proposed findings, conclusions, and contentions have been considered. They are accepted to the extent that they are consistent with this decision.