ADMINISTRATIVE PROCEEDING
FILE NO. 3-2156

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
ARTHUR LIPPER CORPORATION ARTHUR LIPPER III	INITIAL DECISION
(8-13182)	

APPEARANCES: Kevin Thomas Duffy, Stanley Sporkin, Marvin E. Jacob, Robert M. Laprade, Joanne Leveque, and Robert L. Anthony, for the Division of Trading and Markets of the Commission.

John A. Dudley, of Sullivan & Worcester, and Howard S. Klotz, for Arthur Lipper Corporation and Arthur Lipper III.

BEFORE: Warren E. Blair, Chief Hearing Examiner

These proceedings were instituted by an order of the Commission dated September 18, 1969 ("Order") pursuant to Sections 15(b), 15A, and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Arthur Lipper Corporation ("registrant"), a broker-dealer registered under the Exchange Act, and Arthur Lipper III ("Lipper") wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as alleged by the Division of Trading and Markets ("Division") and whether remedial action under the Exchange Act is necessary.

In substance, the Division's allegations are that during the period from about July 10, 1967 to on or about August 5, 1968, respondents committed the alleged violations by entering into fraudulent arrangements with the management of certain investment companies controlled by IOS, Ltd. (S.A.) ("IOS"), [1/] and that respondents' activities pursuant to those arrangements had the effect of benefiting an IOS

1/ By order of the Commission dated July 7, 1970 these proceedings were consolidated with those instituted against IOS, Ltd. (S.A.), et al., A.P. File No. 3-2157 (September 18, 1969). Hearings in the consolidated proceedings were held, but because offers of settlement by the IOS respondents were to be submitted for Commission consideration after the close of the hearings, post-hearing procedures with respect to IOS respondents have been held in abeyance. In March, 1971 the Commission issued its Findings and Order imposing remedial sanctions against Bernard Cornfeld, Edward M. Cowett, Raymond Grant, and Robert F. Sutner, four of six IOS respondents. Securities Exchange Act Release No. 9094 (March 1, 1971). On March 18, 1971 the hearing was reopened as to the remaining two IOS respondents, IOS, Ltd. (S.A.) and Investors Planning Corporation. Findings herein are made only as to Arthur Lipper Corporation and Arthur Lipper III and are not binding on the respondents named in IOS, Ltd. (S.A.), et al., supra.

controlled broker-dealer to the detriment and disadvantage of the affected IOS controlled investment companies. Allegedly, FOF Proprietary Funds, Ltd. ("FOF Prop."), IIT, a foreign investment trust ("IIT"), and Regent Fund, Ltd., a Canadian investment fund, were investment companies whose managers were owned or controlled by IOS. Investors Planning Corporation ("IPC"), a broker-dealer registered under the Exchange Act, was also under IOS control during the period in question. Under the alleged arrangements with managers of the mentioned investment companies, provision was made for the payment of monies to IPC out of charges and commissions earned by respondents on over-the-counter transactions executed by them for the accounts of the investment companies.

The answer filed by respondents denied the alleged violations, and admitted that give-ups [2/] were paid by registrant to IPC out of commissions earned by registrant on over-the-counter transactions executed for the accounts of the named investment companies but denied any duty to disclose those give-ups to shareholders of those investment companies. Registrant and Lipper appeared and were represented by counsel throughout the hearing.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by parties to these proceedings.

2/ A "give-up" is in effect a splitting of the commission received by the executing broker with another broker designated by the customer to receive a certain portion of that commission.

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

Respondents

Registrant, located in New York City, has been registered as a broker-dealer under the Exchange Act since March 31, 1967, and is a member of the National Association of Securities Dealers, Inc., ("NASD") and of the New York Stock Exchange ("NYSE"), American Stock Exchange, and other national securities exchanges registered under the Exchange Act. Lipper has been president, a director, and a controlling stockholder of registrant since its formation.

IOS, Ltd. (S.A.)

IOS, a Panama corporation having its principal office in Geneva, Switzerland, is a holding company which controlled numerous subsidiaries during the period in question. Among those subsidiaries were IPC; FOF Prop.; IIT Management Co. (S.A.) which managed IIT; Regent Fund Advisers (1963) Ltd., and Canadian Fund Management Company, Limited, which then managed Regent Fund; and Fund of Funds, Ltd. ("FOF"), a Canadian open-end investment company which as of December 31, 1967 owned all of the outstanding shares of and had over $375,000,000 invested in FOF Prop. Bernard Cornfeld ("Cornfeld") was president and Edward Cowett ("Cowett") executive vice-president of IOS during the period in question; each also was an IOS director and

held various management positions in IOS subsidiaries.

From June, 1960 until June, 1967, IOS was registered as a broker-dealer under the Exchange Act. Its registration was terminated by a withdrawal thereof pursuant to an offer of settlement accepted by the Commission in connection with proceedings instituted against IOS and other respondents in 1966 (hereafter referred to as "the 1966 Proceedings").[3/]

In 1965 IOS acquired the assets of a large established broker-dealer in the United States and placed those assets in IPC, intending that IPC be the IOS subsidiary which would sell securities in the United States market. IPC became registered as a broker-dealer in June, 1965 and became a member of NASD. However, as part of the settlement of the 1966 Proceedings, IOS was required to dispose of its entire interest in IPC.

Initially IOS assumed that IPC would operate at a loss for two or three years, but when IOS became aware in December, 1966 that a settlement of the 1966 Proceedings would entail divestment of its IPC interest, IOS took immediate steps to improve the profitability of IPC's operations in order to present a potential buyer of IPC with a picture of a sound business. IOS actions to that end included changes in IPC's management personnel and generation of income for IPC by means of IOS directed give-ups paid to IPC by broker-dealers executing portfolio transactions for IOS controlled investment companies.

Early in 1967, Cowett gave his attention to a further problem that the contemplated settlement of the 1966 Proceedings created for IOS.

3/ IOS, Ltd. (S.A.) d/b/a Investors Overseas Services, Securities Exchange Act Release No. 8083 (May 23, 1967).

Under the terms of the offered settlement, portfolio transactions for IOS and its affiliated funds would be permitted in the United States if their orders were placed with an independent non-affiliated entity outside of the United States, but neither IOS nor any of its affiliated funds would be allowed to place orders directly with securities brokers located in the United States. Cowett therefore approached Lipper, then a partner in the brokerage firm of Zuckerman, Smith & Co., and asked whether his firm would be interested in opening offices in London, England and Geneva, Switzerland for the purpose of being the central coordinating agent for handling the flow of IOS brokerage transactions. Other partners of Zuckerman, Smith & Co. declined the proposal but were willing to let the firm act as clearing agent for Lipper if he formed his own company. Lipper reported these facts to Cowett and at the same time indicated his willingness to undertake to create the system that IOS required. The upshot of these conversations was that Lipper formed registrant and opened offices in London and Geneva upon Cowett's assurance that IOS sources would generate sufficient business "to cover the kind of investment that was being entailed."

Commencing in April, 1967 an elaborate communications network linking registrant's New York office with its foreign offices was utilized for the transmission of orders and information relating to IOS fund portfolio transactions and for the exchange of other information of interest between IOS and registrant. Additionally, registrant's facilities were used during market trading hours by IOS

personnel in Geneva to obtain quotes, research information, and other securities information from sources in the securities business in the United States.

Violations by Respondents

As indicated, Lipper expected that from registrant's inception it would be favored with IOS fund-related business as compensation for the risk he assumed in launching the firm. And Lipper clearly realized that about 50% of the commissions registrant generated from IOS business would have to be paid by registrant to other brokers in accordance with IOS directed "give-ups."

Registrant's commission charges on over-the-counter transactions during the period in question were the same as those listed under the NYSE minimum-rate schedule, and, as Lipper anticipated, directions were received from Cowett regarding the give-ups to be paid on those commissions. By letter dated June 29, 1967 Cowett, as president of FOF Prop., directed registrant to give to IPC "the maximum give-up (50%)" on commissions earned on over-the-counter transactions for the account of FOF Prop. That letter was followed by a letter dated July 11, 1967 containing similar instructions to registrant, but relating to over-the-counter transactions for the account of IIT. A third letter dated March 15, 1968 confirmed an earlier request that registrant pay IPC similar give-ups on the over-the-counter transactions effected on behalf of Regent Fund, Ltd. Each of the last two letters

was also signed by Cowett, the former as a representative of IIT Management Co., the latter as vice-president of Canadian Fund Management Company, Limited.

In keeping with Cowett's directions, acceded to by Lipper without question, registrant remitted approximately $1,275,000 to IPC during the period from July 10, 1967 to August 5, 1968, that amount representing about 50% of the Commissions paid to registrant during that period by FOF Prop., IIT, and Regent Fund on over-the-counter transactions.[4/] However, because IPC required cash in order to meet a contract deadline of September 30, 1968, Cowett sought an additional give-up of $300,000 from registrant. In a letter dated August 14, 1968 signed by Cowett as president of FOF Prop., reference was made to the previous give-up instructions and registrant was requested:

> Over and above such regular 50% "give-up," we herewith request that you make the following "give-up" payments to Investors Planning Corporation of America:
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> 1. $175,000 on/before August 30, 1968
> 2. $175,000 on/before September 30, 1968.

Lipper demurred to the size of the request, telling Cowett that registrant should not be required to pay out more than another $175,000. The lower amount suggested by Lipper was eventually sent to IPC on August 28, 1968, bringing registrant's give-ups to IPC on over-the-counter transactions for FOF Prop., IIT, and Regent Fund to slightly more than

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4/ Registrant's records reflect give-ups to IPC of $950,821 on FOF Prop. transactions, $312,175 on IIT's, and $12,521 on Regent Fund's, out of respective gross commissions of $1,974,064, $636,423, and $28,670.

$1,450,000. No benefits were received by those funds as a result of registrant's give-ups and no service appears to have been rendered by IPC as consideration for the $1,450,000.

It is clear that adequate disclosure of the arrangements existing between Lipper and Cowett for the payments of give-ups by registrant to IPC was never made to FOF shareholders who had a material interest in the fortunes of FOF Prop., nor made to shareholders of IIT or Regent Fund. It is likewise clear that those shareholders were not told that IPC was providing neither benefits nor services to the funds in exchange for 50% of the commissions the funds paid to registrant on their over-the-counter transactions. It further appears that no such disclosures were made to the board of directors of Regent Fund or IIT, but that discussions regarding Cowett's arrangements with Lipper took place at FOF board meetings. During those discussions one of the directors, then also Lipper's attorney, advised the FOF board that in his opinion "this mode of operation was appropriate, since he did not know of any legal way the Fund could get any benefit from these commissions,"[5/] and also that FOF "had no alternative but to pay the minimum commission of the New York Stock Exchange."[6/]

The substantial benefits enjoyed by IPC under the give-up arrangements worked out between Cowett and Lipper can be regarded only as obtained at a corresponding and unjustifiable expense to the

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5/ Transcript, 594.

6/ Id., 1071.

shareholders of FOF, IIT, and Regent Fund. 7/ As observed by the Commission in December 1966:

> A directed give-up of a portion of the commission charged for handling a transaction for a fund in the over-the-counter market would be a patent waste of investment company assets. Since the over-the-counter market in both listed and unlisted securities is a negotiated market, which is not governed by fixed prices or minimum commission rate schedules, any willingness of the executing broker or dealer to allow his customer to direct a give-up of a portion of his commission or mark-up to dealers in fund shares in and of itself shows that a lower price or commission could have been negotiated. 8/

Obviously the crux of the arrangement entailed an understanding between Cowett and Lipper regarding commissions to be charged to the funds for effecting their over-the-counter portfolio transactions. Such commissions of necessity had to provide Lipper with adequate compensation for his risk and services, but at the same time had to be sufficient in amount to fulfill the objective Cowett sought for IPC.

It appears from the practice adopted by registrant that the commissions Cowett and Lipper found most nearly meeting their requirements were at rates equal to the minimum rates the NYSE required on

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7/ "In an over-the-counter transaction, those who perform no service should not participate in commissions or profits and there should be no give-up arrangements with them. Obviously, if a negotiated commission or price allows for a give-up of a portion of the commission or profit, a better execution for the investment company could have been negotiated if no give-up had been involved." Robert S. Driscoll, Procedures of Affiliated Fund and American Business Shares in Buying and Selling Portfolio Securities, 14 (1965).

8/ Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966), 178.

NYSE transactions. Clear evidence of how well those rates fit their needs is also found in the $175,000 settlement of Cowett's additional $300,000 give-up demand which Lipper initially resisted in August, 1968 as being excessive. That settlement indicates a mutual realization that registrant's previously retained 50% of the commissions represented a reasonable charge for registrant's services during that period.

But the willingness of Lipper to give-up 50% of registrant's commissions to IPC makes manifest that Cowett was disinterested in the welfare of IOS funds and failed to discharge fiduciary responsibilities owed to them. As president of FOF Prop., and as a vice-president of the companies managing IIT and Regent Fund, Cowett was cloaked with the authority to control and direct the execution of portfolio transactions of those funds. He thereby became a fiduciary in relationship to those funds charged with responsibility for obtaining executions of their portfolio transactions at the least possible cost.[9/] Since Lipper was satisfied to have registrant retain only 50% of the commissions paid by the funds on their over-the-counter transactions, Cowett could and should have negotiated a 50% reduction in those commissions rather than directing a 50% give-up to IPC. In short, by preferring to bolster IPC's balance sheet for the eventual profit of IOS,[10/] Cowett abused the fiduciary positions reposed in

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9/ Provident Management Corporation, Securities Exchange Act Release No. 9028 (December 1, 1970); Consumer-Investor Planning Corp., Securities Exchange Act Release No. 8542 (February 20, 1969).

10/ In April, 1969 Equity Funding Corporation paid IOS $9,400,000 for assets of IPC which had been acquired by IOS in April, 1965 upon payment of $1,783,424 cash plus approximately 20% of IPC's outstanding stock.

him by the funds.

Lipper knew in 1967 when registrant received give-up instructions that Cowett was an officer and director of the IOS related funds for whom registrant effected transactions and a senior executive of the management companies of those funds. He was aware, too, that Cowett was a senior executive and director of IOS. Knowing these relationships, Lipper also knew or should have known that Cowett had an obligation to obtain registrant's services for the IOS funds he represented at the least possible cost to them. Under the circumstances, registrant's and Lipper's acquiescence and participation in give-up arrangements which drained from and wasted nearly $1,500,000 of the assets of the IOS related funds constituted participation with Cowett in a scheme to defraud and in a practice which operated as a fraud and deceit upon FOF, FOF Prop., IIT, and Regent Fund, and their shareholders. 11/

Additionally, respondents' participation in Cowett's scheme was in derogation of registrant's fiduciary responsibility to deal fairly with its IOS fund customers. Those funds and not IPC should have received the benefit of respondents' willingness to execute the funds' transactions at 50% of the commissions actually charged the funds. Nor can respondents be heard to say that the funds were aware of the arrangement with Cowett because he was their representative.

11/ Cf. Provident Management Corporation, supra.

The knowledge of Cowett, the architect of the scheme in question, cannot be imputed to the targets of the fraud. As noted by the Court in Schoenbaum v. Firstbrook: 12/

> However, as in other situations governed by agency principles, knowledge of the corporation's officers and agents is not imputed to it when there is a conflict between the interests of the officers and agents and the interests of the corporate principal. [citations omitted]

Similarly, it cannot be said that Cowett's disclosures to the FOF board of directors concerning the give-up arrangement negated the existence of the fraud involved in that arrangement. Again, as stated in the Schoenbaum case:

> [A] corporation may be defrauded in a stock transaction even when all of its directors know all of the material facts, if the conflict between the interests of one or more of the directors and the interests of the corporation prevents effective transmission of material information to the corporation in violation of Rule 10b-5(2). [footnote omitted] 13/

Here, the record indicates that the disclosures at the FOF board meeting were accompanied by an opinion of the FOF director, who was also Lipper's counsel, that there was no legal way that FOF could obtain any benefit from the commissions being paid to registrant. The expression of that opinion under the circumstances undoubtedly chilled the likelihood of meaningful discussion regarding the give-up arrangement or the possibility of negotiating a lower commission rate with Lipper.

12/ 405 F.2d 200, 211 (2d Cir. 1968), en banc 405 F.2d 215 (2d Cir. 1968), cert. denied 395 U.S. 906 (1969).

13/ Id.

Accordingly, it is concluded that registrant and Lipper wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondents' argument that registrant could not have charged the IOS related funds a 50% lower commission rate cannot be accepted. Central to that position is respondents' assertion that under then prevailing rules of the NYSE, registrant was required to charge the minimum NYSE standard commission on over-the-counter transactions. The record, however, does not support respondents, but rather the contrary.

It is quite true that as a NYSE member registrant was required to abide by the constitution and rules of the NYSE, and that it was the practice of NYSE members to charge the minimum NYSE standard commission on over-the-counter transactions. But neither NYSE requirements nor the practice of its members precluded a reduction of commissions on such transactions if the reduction did not in reality amount to an illegal rebate on NYSE business. 14/ Indeed, Robert Bishop,

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14/ During the period in question, Article XV, Section 1 of the NYSE Constitution provided:

> Sec. 1 Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for the account of members or allied members or of parties not members or allied members of the Exchange, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a rule adopted by the Board of Governors, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member or allied member of the Exchange or member firm or member corporation.

NYSE vice-president in charge of the Department of Member Firms, testified that NYSE minimum commissions applied to NYSE trades and not to over-the-counter transactions, and further that the NYSE did not feel it had authority to establish rates in the over-the-counter market.

The only apparent concern of the NYSE with respect to commissions charged by its members on over-the-counter trades was whether such commissions were used as a vehicle for providing illegal rebates on commissions charged on NYSE transactions. A member firm charging less than NYSE minimum rates on over-the-counter trades would be called upon by the NYSE to demonstrate that the lower charges did not involve an indirect rebate, but the NYSE could be satisfied with a showing that the reduced commission was sufficient to cover the firm's cost of effecting the over-the-counter transaction.

Respondents seize upon this limited interest of the NYSE in over-the-counter commissions charged by its members as evidence that registrant was required to charge the IOS funds the minimum NYSE rates on their over-the-counter transactions, and offer the evidence that NYSE members customarily used those rates as further support of that position. Clearly the argument is to no avail, for the limited interest of the NYSE in this area cannot be so readily transformed into a prohibition against negotiation of commission rates on over-the-counter business. The fact that member firms

undoubtedly found it more expedient and even more profitable to charge NYSE rates on over-the-counter business rather than attempting to justify a lower rate upon challenge by the NYSE can in no wise excuse respondents from giving the IOS funds the benefit of the 50% reduction which Lipper clearly recognized would still leave registrant with a very profitable operation. That Lipper realized registrant's over-the-counter rates could be reduced may also be inferred from the fact that in 1969 registrant began to charge all of its customers 6 cents per share on over-the-counter trades, far less than the NYSE rate, and did so without suffering more than the expected challenge from the NYSE to demonstrate that the 6 cent charge was sufficient to cover registrant's costs. Moreover, since the NYSE rules were the same during the period in question as they were in 1969, it would appear that the failure to afford the IOS funds a reduction in commissions must be attributed to respondents' desire to accommodate Covett in his objectives and not to any proscription to be found in the NYSE rules.

No comfort can be obtained by respondents from the absence in 1967 of objection by the NYSE to give-ups shared with other broker-dealers. The attitude of the NYSE toward then existing give-up practices reflected an industry-oriented approach that cannot be considered objective in relation to the

interests of the customers of member firms.[15/] In any event, the acceptance by the NYSE of the practice of over-the-counter give-ups cannot establish the legality of the practice.[16/] On the other hand, as argued by respondents, statements of the Commission staff on the subject of give-ups are not to be accorded the weight of judicial or administrative decisions. However, such statements are relevant in considering the public interest after a finding that respondents have committed the charged violations.

Another facet of respondents' defense suggests that the give-ups here involved have the sanction of the Commission as expressed in the release that accompanied the Commission's proposed Rule 10b-10.[17/] Whatever merit there might be in respondents' views that

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15/ For example, Division Exhibit 78, entitled Across the President's Desk, A Periodic Report to the Exchange Community from G. Keith Funston, Issue #13, February 1, 1967, is devoted to the first report of the NYSE Special Committee on Member Firm Costs and Revenues and covers problems relating to give-ups. In the course of that report the Committee's approach to the problems under consideration is set forth as follows:

> In considering possible solutions of these problems let it be emphasized that at all times the Committee has been guided by two basic concepts - the promotion of the central market for listed securities on this Exchange, and the economic health of NYSE members and member firms - both of which in the Committee's view are essential to maintaining and improving investment service to the public.

16/ Chasins v. Smith, Barney & Co., Inc., CCH Fed. Sec. L. Rep. ¶92,962, at 90,557 (2d Cir. 1971).

17/ Securities Exchange Act Release No. 8239 (January 26, 1968).

the release in question contradicts the Division's assertion that give-ups in the over-the-counter market have long been recognized as illegal, the release does not sanction the conduct of respondents. The release does, however, call attention to the fact that the proposed Rule 10b-10 "reflects a duty on the part of mutual fund managers as fiduciaries not to use commissions paid by their beneficiaries for the benefit of the fiduciary when practices, procedures, and rules of the markets in which fiduciaries act permit their beneficiaries to receive tangible benefits in the form of reduction of the charges now borne by them." 18/ While registrant may not have been in a position, as contended by respondents, to cause IOS to reduce the advisory fees charged the IOS related funds by the amount of the give-ups paid to IPC, a procedure contemplated under the proposed Rule 10b-10, there was nothing to prevent respondents from refusing to participate in Cowett's scheme, thereby honoring registrant's obligation to deal fairly with its customers.

Were this a case where a duly authorized representative of the IOS related funds had negotiated with Lipper, respondents' view that they had no obligation to shareholders of those funds to disclose the arrangements entered into with Cowett would be apposite. But, as indicated, respondents knew or should have known that the conflicts of interests represented by Cowett precluded the possibility that they were dealing with a person whom they now insist they regarded as "a

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18/ Id. at 8-9.

duly authorized officer and/or director of each of the IOS related funds." Under the circumstances, respondents' reliance upon Cowett's official capacities with the IOS funds, without consideration of the conflicts represented by his other known official positions with IOS, was wholly unwarranted. Without disclosure to the boards of directors of the IOS funds, or, in the alternative, to the shareholders of those funds, registrant cannot be said to have obtained the requisite informed consent to arrangements adverse to the interests of its fund customers.[19/]

There is merit to respondents' position that the Division has not shown that registrant should have reduced the cost borne by the IOS funds by effecting transactions on a principal instead of an agency basis. The choice of whether to act as principal or agent in effecting transactions involves many conflicting considerations, not the least of which are the disclosure problems that respondents point out were highlighted in the Arleen W. Hughes case.[20/] Except under unusual circumstances, that choice should be left to the business judgment of the broker-dealer without fear that hindsight may develop reason to criticize his judgment in that respect. Here, respondents were not required to consider acting as a principal as an appropriate alternative to registrant's agency relationship with the IOS funds,

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19/ Arleen W. Hughes, 27 SEC 629, 634-39 (1948), aff'd sub nom., Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949).

20/ Id.

but respondents were required to refrain from participating in Cowett's scheme to defraud registrant's customers.

Respondents' attack upon the Division's citation of Commission releases Delaware Management Company, Inc., Consumer-Investor Planning Corporation, Dishy, Easton & Co., Hertz, Warrer & Co., and Providence Management Corp.,[21/] cannot be sustained. While those releases involved "consent orders" entered on the basis of offers of settlement, the views expressed by the Commission therein are certainly entitled to weight in the consideration of the issues in this matter. The argument that certain of the releases which followed earlier orders in the same matters by as much as nine months are no more than purported "rules" issued in violation of the requirements of the Administrative Procedure Act for rulemaking[22/] is not supported by logic or authority. In each instance that the Commission's order preceded its findings and opinion, the order specifically stated that definitive findings and an opinion would follow. Such statement must be construed as a reservation of the Commission's jurisdiction over the matter for that limited purpose and is a complete answer to respondents' contention that the order terminated the adjudicatory process. Further, it appears that the supplementation of the earlier order is in keeping with the principle that the basis of an agency decision should be clearly stated on the record.[23/]

21/ Respectively, Securities Exchange Act Release Nos. 8128 (1967), 8542 (1969), 8702 (1969), 8874 (1970), and 9028 (1970).

22/ 5 U.S.C. 553.

23/ Cf. Medical Com. for Human Rts. v. SEC, 432 F.2d 659 (D.C. Cir. 1970); Environmental Defense Fund, Inc. v. Hardin, 428 F.2d 1093 (D.C. Cir. 1970).

Respondents also assail the jurisdiction of the Commission, arguing that the Exchange Act does not have extra-territorial application with respect to the obligations owed by IOS to the IOS related funds, and that since IOS and the IOS funds were foreign corporations, their respective rights must be determined by application of appropriate foreign law, the provisions of which are not shown on the record. That argument is unconvincing in light of the fact that not only were the United States mails used to place Cowett's scheme in motion, but the very securities transactions that were required if the scheme were to bear fruit were effected on the United States over-the-counter markets. Where a scheme is one which is necessarily accomplished by use of the mails or interstate facilities within the United States, it seems clear that the remedial protections of the Exchange Act are properly invoked in the interests of maintaining and assuring the integrity of this nation's securities markets.[24/] Although this conclusion has the effect decried by respondents of extending the protective provisions of the Exchange Act to foreign corporations and their foreign shareholders, that benefit is merely incidential to the primary objective of carrying out the intent of the Exchange Act to prevent inequitable and unfair practices on the over-the-counter markets in the United States. Being remedial legislation, the Exchange Act must, under recognized principles of statutory interpretation, be given a liberal

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24/ SEC v. Gulf International Finance Corp., 223 F. Supp. 987, 995 (S.D. Fla. 1963).

construction, that which will best conform with the general purpose of the legislation.[25/] Further on the point, it has been long settled that "any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends."[26/]

Public Interest

Although the respondents' violations were serious and long continuing, it does not appear necessary in the public interest to impose the revocation and bar sanctions recommended by the Division. Taking into consideration the mitigating factors urged by the respondents as well as the offsetting aspects detailed by the Division, a suspension of registrant's right to effect transactions in the over-the-counter markets for a period of twelve months and, as to Lipper, a suspension from association with a broker or dealer for the same period are found to be appropriate.

Contrary to respondents' assertion, it does not appear that Lipper was sensitive regarding the overcharges registrant was making on the IOS funds' over-the-counter transactions, or, if he was, he did nothing to ameliorate that fraudulent practice until his own and registrant's financial success were assured. The picture that emerges

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25/ SEC v. Capital Gains Bureau, 375 U.S. 180, 195 (1963); SEC v. Joiner Corp., 320 U.S. 344, 350-51 (1943).

26/ United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).

from the record is of a man intent on personal gain and willing to take the risk that the scheme by which he could reach his goal would not be found illegal. Mitigating that portrayal, however, is the established fact that the customer-directed give-up practice had become embedded in the financial community and had not been judicially determined to be illegal during the years of respondents' violations,[27/] and the fact that Lipper relied upon advice of counsel.

But unlike the circumstances in those cases cited by respondents where uncertainty of the law was a factor, or advice of counsel was relied upon, respondents acted in the face of published comment of the Commission and its staff which was extremely critical of customer-directed give-ups,[28/] and did so after having been informed by their counsel that the Commission staff was in disagreement with the advice of counsel.[29/] To so proceed, with knowledge that their conduct was

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27/ In Moses v. Burgin, 316 F. Supp. 31, 57 (D. Mass. 1970), the court noted:

> No court has yet decided, and this court finds it unnecessary to decide, whether the customer-directed give-ups for the benefit of broker-dealers which were both customary and widely practiced before December 5, 1968 were lawful or unlawful.

28/ Public Policy Implications, supra at 17, 169-88; 4 SEC, Special Study of Securities Markets (1963), 226-27; 5 Id., 171-73; Division Exhibit 47 - Irving Pollack, Letter, Re: Commission Rate Structure (July 18, 1966).

29/ Transcript, 1054-55.

likely to invite attention from the Commission staff and possible action by the Commission, makes respondents' pleas with respect to the state of the law and the advice of counsel far less appealing, and certainly not entitled to the weight accorded similar pleas found in respondents' cited cases.

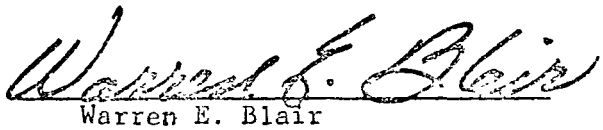
As noted, other mitigating factors advanced by respondents, including the reduction in registrant's commission charges in 1969, the absence of concealment from regulatory authorities of the give-up arrangements, the likelihood that respondents' misconduct will not be repeated, and the publicity regarding these proceedings, have been carefully weighed. On balance, the indicated remedial action is found to be necessary in the public interest. 30/

Accordingly, IT IS ORDERED that Arthur Lipper Corporation be, and it hereby is, suspended for a period of twelve months from the effective date of this order from effecting transactions in over-the-counter markets, and that Arthur Lipper III be, and hereby is, suspended from association with a broker-dealer for a period of twelve months from the effective date of this order.

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

30/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

Pursuant to Rule 17(f) of the Rules of Practice, 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.



Warren E. Blair
Chief Hearing Examiner

Washington, D.C.
June 11, 1971