ADMINISTRATIVE PROCEEDING
FILE NO. 3-6165

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

ROBERT BLAKENEY STEVENSON :

(Spaulding Securities Corporation) :

:

INITIAL DECISION

Washington, D.C.
September 6, 1983

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: Ralph A. Siciliano, Richard H. Wender, Christopher J. Rillo, Kathleen P. Schobel and Robert Pearce, of the New York Regional Office of the Commission, for the Division of Enforcement.

John A. Field, III, of Field & Halfhill, for respondent Robert Blakeney Stevenson.

BEFORE: Jerome K. Soffer, Administrative Law Judge

On August 12, 1982, the Commission issued an Order for Public Proceedings (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act), naming Spaulding Securities Corporation, William Charles Hogan, Robert Blakeney Stevenson, and James N. Cooney as respondents.[1/]

The order is based upon allegations of the Division of Enforcement (Division) that the respondents willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act of 1933 (Securities Act), and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the offer, purchase or sale of various government securities.

The order directed that a public hearing be held before an administrative law judge to determine the truth of the allegations set forth and what, if any, remedial action is appropriate in the public interest for the protection of investors. Hearings were held New York, New York, on December 13 and 14, 1982, on January 12, 13, 14, 15, 18, 19, 20, 25, 26, 27 and 28, and February 7, 8, 9 and 17, 1983.

Following the close of the hearings, successive proposed findings of fact, conclusions of law and supporting briefs were

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1/ As a result of offers of settlement accepted by the Commission, the administrative proceedings have been terminated and remedial sanctions imposed upon respondent Spaulding by an order dated December 7, 1982 (SEA Release No. 19302); upon respondent Cooney by order dated January 18, 1983 (SEA Release No. 19438); and against respondent Hogan by order dated January 28, 1983 (SEA Release No. 19460). While the decision herein may contain references to these respondents, the findings are binding only upon Stevenson, the remaining respondent.

filed by the Division and by the sole remaining respondent, Stevenson. A reply brief was filed by the Division.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the demeanor of the witnesses. The preponderance of evidence standard of proof has been applied. See Steadman v. S.E.C., 450 U.S. 91 (1981). 2/

The order charges the respondents with having engaged in fraudulent practices designed to generate inflated profits for Spaulding, whereby Spaulding purchased government securities from and sold them to the firm of Paine, Webber, Jackson & Curtis, Inc. (Paine Webber), a registered broker-dealer, at prices more favorable than the prices generally available in the government securities market, thereby generating large gains which were shared among the respondents. The acts complained of are alleged to have occurred during two distinct time periods, from in or about August through December 1978 ("the 1978 period") involving all of the named respondents, and again from in or about July 1979 through June 1980 ("the 1979-1980 period") involving Spaulding,

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2/ Respondent's brief urges, at length, that in this proceeding, a "clear and convincing" standard of proof should apply, restating all of the arguments and decisions expressly rejected by the Court in Steadman. See also, Herman and McLean v. Huddleston, 459 U.S. __, 74 L. Ed. 2d 548, 103 S. Ct. 683 (1/24/83).

Hogan and Stevenson. [3/]

The Parties

Spaulding Securities Corporation

Spaulding, a Nevada corporation, with it principal office in New York City, was since January 3, 1970 a registered broker-dealer with the Commission. [4/] From the fall of 1978 until his death on April 27, 1982, one Frederick Fiske Tuck owned all of the outstanding shares of Spaulding with the exception of the period March 1979 thru June 1980 when respondent Stevenson became the owner of approximately 10% of the shares. At all times, Tuck was the president and control person of Spaulding. Tuck also controlled TBG Petroleum, Inc. (TBG) a Delaware corporation, and Carlyle Investment Corp. (Carlyle), a Delaware corporation incorporated in December 1979, in both of which he was president and his wife was secretary-treasurer. Both corporations have an important place in these proceedings.

3/ At the outset of the hearing, the Division was allowed to amend the Order, based on newly discovered evidence, to include separate but identical allegations to those contained in the Order for trading in an account of one Judith A. Jones during the period January through June 1979, or roughly the period intervening between the two periods stated with respect to the Spaulding transactions. At the close of the Division's case, it withdrew its allegations in the amendment, thereby leaving the order in its original form as adopted by the Commission on August 12, 1982. However, the Division moved to have all evidence concerning the Jones acccount remain in the record as evidence of conduct similar to the alleged scheme against Paine Webber for any appropriate purpose, such as to rebut allegations of mistake or lack of intent and to explain cash deposits which were made into Hogan's checking account during the period. This motion was granted. However, see discussion at pages 39-40, *infra*.

4/ As a result of the settlement order against Spaulding, its registration was revoked effective December 7, 1982.

Robert Blakeney Stevenson

Between March 1972 and June of 1978, respondent Stevenson had been employed as a registered representative by various broker-dealer firms. This included employment at "L.F. Rothschild" from 1972 to 1975. In June of 1978 he joined Spaulding with the primary duty of trading in long-term government bonds for the firm's account. For his compensation, he was to receive between 25% and 30% of all profits generated from such trading activities. He also was to get a percentage of commissions earned from occasional agency-type transactions, although his participation therein was relatively minor. (He also attempted one or two private placements, apparently without success).

Stevenson exclusively controlled Brevard Investors Co. (Brevard), 5/ a New York corporation organized in March of 1979 of which he was the president and Margaret Tull was secretary-treasurer. 6/

Paine Webber, Hogan and Cooney

Paine Webber is a broker-dealer registered with the Commission and a trader in principal transactions involving long coupon government bonds. 7/ In December 1979, it merged with Blyth Eastman

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5/ Respondent, in his post-hearing pleadings, asserts that Tuck, not respondent, was the control person and primary beneficial owner of Brevard. This will be discussed hereinafter.

6/ Tull later married Stevenson in May of 1981.

7/ For the purpose of this proceeding, long coupon government bonds are those having a maturity of more than 10 years beyond the issue date.

Dillon Company (Blyth), another registered broker-dealer. Paine Webber is one of the 36 reporting dealers in government bonds, as hereinafter described.

From 1975 and particularly through the relevant periods herein, Hogan was employed as the head trader of government securities at Paine Webber. As head trader, Hogan had the responsibility for, and unsupervised discretion in, setting the prices at which Paine Webber would trade government bonds. His compensation was based upon a salary plus a bonus according to the profitability of the trading department.

In 1970, Cooney had been employed as a registered representative at L.F. Rothschild where he became acquainted with Stevenson who also worked there. He subsequently entered the employ of Paine Webber in 1978 where he remained until July 1979, as a salesman in the institutional sales branch.

Within one month following the employment of Stevenson by Spaulding in the summer of 1978, Spaulding, through Cooney's introduction, opened an account for trading in long coupon government securities at Paine Webber. Cooney was assigned to be its account executive. 8/ Since he left Paine Webber in July of 1979, Cooney had no direct involvement with the events occurring during the 1979-1980 period. Upon his leaving, the Spaulding account was transferred to another registered representative, Michael Boghsian.

8/ Cooney had an arrangement with another Paine Webber salesman, Charles Golden, to pool their commission earnings and to split them. Despite this arrangement, Cooney handled the Spaulding account almost exclusively.

During the relevant periods herein, Cooney, Stevenson and Hogan had numerous social and business contacts between and among themselves.

The Government Bond Market

The government bond market is an over-the-counter market which is largely controlled by 36 "reporting dealers." They report daily to the Federal Reserve Bank in New York their positions and trading volumes in government securities, and also furnish periodic financial reports to the Bank.

The Federal Reserve, as agent for the U.S. Treasury, holds auctions of treasury bills and other securities at which the reporting dealers are usually the largest bidders.

The reporting dealers, including Paine Webber, trade with each other on a principal basis only, either directly or through some four inter-dealer brokers. These brokers provide video-screen quotation services available only to the reporting dealers showing the prices at which the reporting dealers will trade.

All other dealers who trade in government securities are known as non-reporting dealers, and would include small ones such as Spaulding. The reporting dealers, always acting as principals, will trade with them and with institutions.

In effect, the market price of a government security is what a reporting dealer is willing to quote. Its quotation, in turn, is determined by the dealer's trader who, in his judgment utilizes a number of factors, including the price quotes

shown by his video screens, his opinion as to the state and direction of the market, his firm's position at the time and the position it would like to assume, and the general tenor of supply and demand for a particular security. In essence, the trader makes the market. His overriding concern is to advance the best interests of the firm for which he is the trader.

Generally, the reporting dealers rely for their profit upon the spread between the bid and asked prices they are quoting, as well as the risk they assume as principals. Since the market in long term goverment bonds is highly competitive, differences between the various dealers' quotations are rather small.

In trading long coupon government bonds, settlements are usually done on the day following the trade by either delivering bonds or paying for their purchase. In some instances, such as with new issues, settlements could occur a number of days after execution. Transactions among the reporting dealers and with large institutions are usually in one million dollar units (1,000 bonds at $1,000). Transfers of bonds are accomplished by "book entries" on the books at the Federal Reserve recording the owners rather than by a physical transfer. Individual ownership is recorded on the books of commerical banks or of brokers.

The allegations against respondent

The Divison charges that a scheme was perpetrated among Stevenson, Hogan, Cooney and Tuck whereby Spaulding through its

trader Stevenson would trade long-coupon government bonds with Paine Webber through its trader, Hogan, who would fix prices more favorable to Spaulding both on the buy and sell side in such a way that there would be a net profit to Spaulding in almost all instances. It is further charged that these profits added up to large sums and were shared among the alleged conspirators through various devices.

Since all of the principals to the alleged fraud, when called as witnesses, asserted their Fifth Amendment rights not to testify to all questions (except for Tuck who is deceased), the Division is relying upon circumstantial evidence in order to prove its case. These circumstances include the manner in which these individuals performed within the relationships that existed among them, the relative frequency with which Spaulding profited in its trades with Paine Webber, the comparative prices at which the Spaulding trades were executed with Paine Webber, and the disposition of the Spaulding profits.

At the outset of the hearing, the Division had requested over the strenuous opposition of the respondents Stevenson, Hogan and Cooney (prior to the settling out by the latter two), that adverse inferences be drawn against them because of their silence under their Fifth Amendment pleas. The Administrative Law Judge ruled, under the authority of Baxter v. Palmigiano, 425 U.S. 308 (1978), that to the extent there was independent proof to support the various

allegations of the order, he might deem respondents' silence as one of the factors for consideration, including the drawing of adverse inferences therefrom, and that he would indicate in this decision the extent to which he would use such silence in the face of the proof adduced.

The Trading

Prior to Stevenson joining Spaulding in June of 1978, the firm had done very little, if any, trading in long coupon government bonds. Most of its income was from broker commissions. Stevenson had no previous experience as a trader, in government securities or otherwise, having worked primarily as an account executive. As stated, within a month Spaulding opened its trading account in such securities with Stevenson as its trader, Cooney as the registered representative, and Hogan, of course, the other-side trader for Paine Webber.

Paine Webber did not permit transactions in government bonds to be executed on a discretionary basis. Hence, the Spaulding account was non-discretionary, so that presumably Stevenson was to make the trading decisions for Spaulding and Hogan was to be making these decisions for Paine Webber, both at arms length.

When Hogan's employment at Paine Webber was terminated on July 27, 1980, Stevenson promptly left Spaulding's employ, and Spaulding ceased traded in long term government bonds. 9/

9/ It should be noted that during the six-month interval between the two relevant periods when Spaulding was not trading in government bonds with Paine Webber, it did very little government bond trading with anyone else except for a few transactions at Bache, Halsey, Stuart & Co. (Bache).

Spaulding, in its trading with Paine Webber, was allowed to engage only in "day trades". A "day trade", for the purposes of this record, consists of two transactions, a buy and sell on the same day of the same security in the same quantity, both having the same settlement date. The record also involves "pair-offs". A pair-off is a buy or sell matched by a subsequent offsetting transaction in the same security at any time prior to settlement date. Thus, a day trade could also be a pair-off.

It is understandable why Spaulding had to be a day trader. Since the usual transactions in long term government bonds were in par value units of $1,000,000, and since Spaulding did not have capital or margin sufficient to carry a position in these securities, it had to wind up flat in any given security on the day of execution or no later than settlement day.

The 1978 Period

During the 1978 period Spaulding had maintained trading accounts, in addition to the one at Paine Webber, at Pershing & Co., Bache, and at First Pennco Securities, Inc. Pershing also served as Spaulding's clearing agent for a time.

At first, during the months of June and July, 1978, the Spaulding account traded some municipal and corporate bonds. Commencing with August 4 and terminating on December 14, 1978, Spaulding traded almost exclusively in long coupon government securities. During this period, there were a total of 85 buy

transactions, and 83 sells, comprising a total of 67 day trades.[10/] Some 79 percent of all transactions were with Paine Webber. Moreover, with but one exception, at least one side of every day trade was with Paine Webber.

Of the 67 day trades, 59 (or 88%) were profitable to Spaulding, in that the price Spaulding received from the sale to Paine Webber in the paired security was greater than the amount it paid for the purchase of the same security. It suffered losses in 5 day trades, and 3 were "flat". Dollar-wise, the profitable trades earned $122,809, the losing ones totaled $36,959,[11/] for a net profit of $85,850. Further, out of 126 of the transactions with Paine Webber, Spaulding received the lowest buy or the highest sell in the same security 48 times, and the second best price another 33 times, as compared with prices paid or received by other accounts with whom Paine Webber traded the same securities on the same day.

For reasons not apparent in this record, Spaulding ceased trading in the Paine Webber account on December 14, 1978.

The 1979-1980 Period

Spaulding resumed trading with Paine Webber on or about July 25, 1979, and like the cessation, without a stated reason

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10/ The fact that the number of day trades does not equal a balancing of one buy with one sell is caused by treating several balancing transactions settling on the same day as comprising one day trade.

11/ Of this amount, losses of $20,675 were the result of one day's trading on August 18, 1978.

in this record for the resumption. It continued for the next eleven months until June 27, 1980, and involved long coupon government bonds only.

During this period, Spaulding had recorded 119 buy transactions and an equal number of sales in the Paine Webber account, and 6 buy and 7 sells in the Bache account. There were a total of 92 day trades, with at least one side of each trade transacted with Paine Webber. Thus, the number of transactions with that dealer increased from 79 percent to 95 percent of all Spaulding trades in these securities.

Moreover, the profits earned by Spaulding increased substantially over the 1978 period while its losses decreased significantly. Thus, of the 92 day trades, some 86 (or 93 percent) were profitable, only 4 (or 4 percent) were losers, and 2 wound up in a "flat" position. Dollarwise, the amounts were far greater in disparity than in the 1978 period. Spaulding derived profits of $600,924 while its losses from losing trades was only $2,344, for a net profit of $598,580.

Finally, examination of 185 of the transactions showed that Spaulding received from Paine Webber the best price of the day (lowest buy or highest sell) some 76 times, and the second best price 43 times.

Alerted by an anonymous telephone call, Paine Webber management, after examining the trades reflected in the Spaulding account, discontinued all further trading with Spaulding on June 27, 1980.

Success ratios

Assuming that the transactions between Spaulding and Paine Webber were those conceived by Stevenson (since the Spaulding account was supposed to be non-discretionary), then his surprisingly successful trading ratios and profits as a day-trader in his dealings with Hogan, would have been, as characterized by several experts testifying for the Division, "astonishing", "incredible", "highly unlikely", "highly unusual", "extraordinary", and "very unlikely". 12/ One of them even described his phenomenal success as "black magic". 13/

A trader who is successul about 45 percent of the time after accounting for transaction costs would be deemed average. 14/ One who was successful 55 percent of the time after such costs would be deemed skillful. A success ratio of 60 to 67 percent would be the sign of an extremely skillful

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12/ Transcript, pages 1626-1632, 2076-2078, and 2308-2312. These witnesses include Edward Geng, a senior vice-president of the Federal Reserve Bank of New York; Miles Slater, managing director of Solomon Brothers; and Edwin W. Dean, a former manager of the government securities trading department at Paine Webber.

13/ Testimony of David Bunting, manager of the government securities department at First Boston Corporation, one of the 36 reporting dealers (Transcript Pages 3262-3): "I've been in the trading side of the business for primarily eighteen years and these reported sequences of trades (i.e. between Spaulding and Paine Webber) defy anything but magic, black magic presumably."

14/ Assuming an equal ratio of wins to losses, less 5 percent in transaction costs.

trader. Yet mathematically, the probability of an average trader achieving an 88 percent average of successful trades in the 1978 period and a 93 percent average in the 1979-80 period is one in billions, and of a skillful trader achieving this result in the 1978 period one in millions and in the 1979-80 period is one in billions. 15/ In other words, the likelihood of such events happening would be extremely remote.

The ratio of dollar profits to losses is also unusual. Thus, in 1978, the ratio is about 3 to 1 ($129,636 to $36,958), but in the 1979-80 period it jumps to 256 to 1 ($600,924 to $2,344). Yet, an average trader would have shown a ratio of one to one in 1978 and of 1.2 to 1 in the second period.

In addition to the gross dollar profit/loss ratio, and the proportion of successful trades on Spaulding's part, there is the further factor of pricing. As seen, Spaulding received from Paine Webber a high number of best and second best prices on the buy and sell. To give some examples during the 1979-80 period, there were 15 occasions when Paine Webber engaged in a total of 5 trades for the day in the same security in which Spaulding got the best price 9 times and second best 6 times. Further, there were 7 occasions when Paine Webber engaged in 10 daily trades for the day in the same security wherein

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15/ The probability computations are based upon the use of the "Bernoulli formula" to calculate probabilities, as computed by witness Roger G. Ibbotson, a senior lecturer in finance at the Graduate School of Business of the University of Chicago.

Spaulding had the best price 4 times and second best price once, and no worse than the sixth best price.

Using the Bernoulli probability formula, as applied by Professor Ibbotson, the likelihood that in the 1978 period Spaulding would have received 62 first and second highest prices out of 107 occasions was 1 in 2,500. In the 1979-80 period, the likelihood that it would received in its trading with Paine Webber 112 best and second best prices out of some 178 occasions is 1 in 1,000 billion. 16/

In assessing the significance of the trading patterns shown, it should be noted that Spaulding was a small-dealer account with Paine Webber and limited to day-trading only and hence unable to maintain a position to await favorable market turns. Paine Webber was a market-maker setting its own bid and asked prices with an appropriate spread to insure profitability. Spaulding had to trade against that spread. Moreover, Paine Webber, as a reporting dealer, had available a number of closed-end quotation services not available to a small dealer like Spaulding. It is incongruous to believe that Spaulding would consistently get better prices than those Paine Webber made available to the other reporting dealers and large institutional accounts with whom it

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16/ There were some 6 days during the 1978 period and some 55 days in the 1979-80 period for which no record could be found of the transactions. It is presumed that the same pricing patterns would be found among them, since there is nothing in the record to indicate otherwise.

customarily dealt. 17/

Further it is inconceivable that Stevenson, who had no prior trading experience in government bonds or anything else until he suddenly burst upon the scene at Spaulding, would garner such an incredible ratio of successful trades and record of profitability in his dealings *vis-à-vis* Hogan, who has been characterized as very bright and a very good financially successful trader 18/

Testimony on behalf of respondent relating to the likelihood of his achieving so favorable a success ratio does very little to overcome the conclusions drawn with respect thereto by the Division's witnesses, as stated above, all of whom are knowledgeable and experienced in the long coupon government bond market.

Respondent called Sheldon Cooper, a corporate bond trader, who opines that between March and June of 1980 when there was a pronounced "bull" market, one could trade with a better than 80 percent success ratio. He agrees that absent such a market and over a one-year period, a trader who achieves a 60 percent ratio would be doing well. This witness never traded government bonds.

17/ Respondent argues that preferential pricing can only be proven by evidence of the exact times when sales were made and the exact market prices existing at that time. This contention is rejected since such proof may be, and in this case has been, established circumstantially.

18/ Hogan had to be good since the keeping of his position as head trader at Paine Webber and his earnings were dependent upon the success with which he traded.

Another respondent witness, Anthony K. Moulton, in the printing business since 1978, but formerly a bond (not government) trader sees no reason why, in a period of defined market trends, a trader such as respondent could not have a success ratio of 75 to 80, or even 90, percent. However, he does not know of a defined market trend until 1981.

Respondent's witness Richard Fentin, a salesman at Paine Webber between 1977 and 1980 specializing during the later period in government securities of various types, boasts of a high success level while "paper trading" (i.e., fictitious transactions) in these securities. He further asserts that thereafter he handled some actual 12,000 transactions during 1980, with 100 percent profitability. He ultimately conceded, however, that these 12,000 really amounted to only 135 transactions, half of them for one account, very few of which were in long coupon government bonds, and in no instance was any customer restricted to day trading but could, in fact, hold positions to take advantage of favorable market moves.

Based upon observation of the demeanor of these witnesses it is concluded that their opinions are not sufficient to overcome the opinions expressed by the Division's witnesses and actually reinforce them.

Furthermore, respondent offered no proof from these or any other witnesses concerning the probability of Spaulding receiving from Hogan so high a portion of favorable prices far beyond those which one would expect a small day-trading

dealer to obtain. If Stevenson were in fact negotiating the price against the spread of a market-maker like Paine Webber in an alleged volatile market, he would have had to possess an uncanny knack of getting in and out at the right moment in the face of being forced to day-trade, or have had an unbelievable run of luck, to have performed so well price-wise. [19/] The failure of respondent to testify in this regard is considered adversely to him.

It is concluded that the proof establishes that the success ratio of Spaulding, the high profits and few losses derived, and the uncanny sequence of favorable prices obtained were all due to factors other than normal market forces. [20/] What these other factors were can be determined

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19/ Concerning Stevenson's ability as a trader: in June of 1980, just before cessation of Spaulding's trading with Paine Webber, he caused Brevard to open an account with Bache through a friend who was the account salesman, to trade in treasury bond futures, which have similar market characteristics as government bonds. For the next 9 or 10 months, Stevenson trading for Brevard resulted in net losses to his company of some $15,000. About half the trades were day trades. The commodities account was successful only 47 percent of the time; and winning trades were smaller in amount than losing trades. Although the time frame is not contemporary with those embracing the Spaulding/Paine Webber trades, and perhaps market conditions were dissimilar, nevertheless the suggestion is clear that respondent did not exhibit the phenomenal trading ability evidenced when Hogan was trading with him on the other end.

20/ Respondent objects to the use of Bernoulli probability formula for not taking into account such factors as market volume, market volatility and defined market trends However, there is no proof that there existed any of these factors, and if so, that the ultimate conclusions as to probabilities would have been significantly altered. Moreover, the testimony of the expert witnesses supported the conclusions derived, and tended to minimize the effect of these factors upon respondent's probabilities of success.

from the circumstances in this record.

Paine Webber Trading Procedures

Since the Division asserts that in order to carry out the alleged fraudulent scheme, Hogan had deviated from the required procedures at Paine Webber in the handling of the Spaulding account, an examination of these procedures and Hogan's actions under them is in order.

Customarily, a customer opening a trading acount would be assigned a registered representative ("salesman", "account executive") through whom all transactions would be executed. The customer would contact his salesman to state his investment desires (no discretionary accounts were permitted at Paine Webber in long term government bonds), and the representative would, in turn, ask the firm's trader in the security desired for the current quotation. The salesman would convey the information to his customer, and, if the price was agreeable and a deal made, would verbally advise the trader and proceed to write up an order ticket in triplicate. He would insert the name and account number, the security involved, the amount of shares sold or bought, the selling or buying price, the trade date, the execution date, and delivery instructions. The completed order ticket was then passed to the trader who would review it for accuracy and insert the "sales credit" (i.e., the salesman's commission rate) and then submit the ticket for processing.

Paine Webber required prompt writing of the order ticket and prompt processing thereof. There was no time stamping, however, of the ticket by either the salesman or trader.

It was not customary for the trader to deal directly with the customer; that was the salesman's function. 21/ Under infrequent circumstances, the salesman might have the customer talk to a trader when some assistance or information was needed. The only other exception would be in the case of large institutions or other reporting dealers, whose traders were expected to deal directly with the Paine Webber trader. But for those accounts no salesman was assigned. Spaulding was not in the latter category.

Procedures in the Spaulding account

I.

During the relevant 5-month 1978 period, Cooney, as the account executive, wrote almost all of the trade tickets on Spaulding transactions. After Cooney and Golden left Paine Webber, the company assigned Michael Boghosian as the salesman for this account. He served in this capacity during the entire 11 months of the relevant 1979-1980 period. And, during this latter period, a complete reversal of the usual roles occurred in that virtually all of the trades

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21/ In fact, when the salesman was away from his desk when a customer called, the call would be answered by another salesman rather than by a trader even though they were in the same room at Paine Webber.

were handled not through the account executive, but on a direct basis between Hogan for Paine Webber and respondent for Spaulding. Boghosian handled only 2 of 3 trades out of more than 200 Spaulding transactions. 22/ Although Boghosian recognized that this procedure was not customary, and was the only instance where a trader in fact covered an account to which a salesman had been assigned, he never questioned this procedure because he continued to receive commissions on these trades, and because of Hogan's superior status as head trader. Although there was no written prohibition at Paine Webber against a trader talking with a customer, and nothing "wrong" with this practice, the almost exclusive trading between Hogan and Stevenson without the intermediation of the account salesman was not only singularly unique, but, along with Hogan's writing up of order tickets, a significant

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22/ The actual writing of the trade tickets during the 1979-1980 period was done in two ways, based upon whether the trader used a so-called "supplementary" trading ticket (also known as a "government trading ticket"), a memorandum written by the trader containing all the terms of the transaction. The making up of this ticket by the trader was required between July 26 and December 7, 1979. During this period, therefore, after Hogan would enter a trade with respondent, he would make up a supplementary ticket and give it to Boghosian who would then make up the trade ticket from the information supplied, after which Hogan would insert the sales credit. After the use of the supplementary ticket was discontinued on December 7, and until June, 1980, Hogan would make up the Spaulding trade ticket himself and write in all the terms of the transactions, leaving Boghosian to write in such routine things as the account number and standard delivery instructions.

factor among other circumstances comprising the "circumstantial evidence" theory of the Division's case. 23/

II.

The Division further charged that Hogan was providing Spaulding with favorable off-market prices in one or both of two ways: (1) by writing up both order tickets simultaneously with slight price differentials to guarantee Spaulding a profit; and (2) by holding the order ticket for the first transaction of a day trade until he was assured that the second one would be completed successfully; if not, he would destroy the order ticket without further processing.

As seen, there was no time stamping of the order tickets at Paine Webber so that the exact time sequence of transactions is not determinable. Under the firm's usual procedures, as noted before, the ticket was prepared by the account salesman, and sent to the trader for the insertion of the commission rate. (In Hogan's case, however, since he was writing up the Spaulding tickets himself during the 1979-80 period, he would already be in possession of them).

23/ Respondent's witness Richard Fentin testified that while employed as a salesman by Paine Webber between 1977 and 1980 in fixed income securities (other than long term government bonds) his clients dealt exclusively with him and not through a trader. Another of respondent's witnesses, Sheldon Cooper, while employed as a corporate bond trader for L.F. Rothschild never handled a salesman's account exclusively, nor does he know of a trader who did. All agree, however, that there is nothing wrong with a direct contact between a client and a trader on an occasional basis.

During the 1978 relevant period and until December 1979, tickets would be picked up by the "position clerk" from a box on the trader's desk about every 15 to 20 minutes, sorted by bond maturity date, and sequentially numbered with a "government number" (also referred to as "position number"). Buys and sells would not be matched or paired, however. After the pertinent information was posted on position cards maintained for each security, the tickets would be forwarded to the "wire operator" who would stamp it with a consecutive "wire number" and enter the ticket information into the teletype machine. The teletype would generate an "execution report" or ("hard copy") which would reflect, in addition to the trade information, the time of day when the information had been put in.

Under the above Paine Webber procedures, about 15 minutes would elapse from the time the trader put the trade ticket in his pickup box until the teletype would generate the execution report. On busy dates, however, the process could take up to a half hour.

Thus, although there was no way of knowing the exact order in which trades were executed, the sequence of batches of order within a 15-minute time segment could be determined once the tickets were placed in the trader's box. Also, closeness of government numbers, wire numbers and execution report times would serve to show closeness of trades within the time frame.

There were subsequent changes in the procedures, none of which resulted in significant time sequence changes. Thus,

from December 1979 until April 25, 1980, trade tickets went via a conveyor belt from the trader directly to the wire operator who would send it to the position clerk for posting and receive it back for teletyping. Thereafter, except for a brief one-week period, the process became computerized. The wire operator would first enter the trade in the computer while giving it a wire number, and would then forward the ticket to the position clerk, but no government number would be assigned. Although the computer continued to produce an execution copy, it was no longer time-stamped.

Under the later computerized system, order tickets bearing wire numbers within a ten-digit range would have been placed on the conveyor belt within minutes of each other, and in no event more than an hour.

Examination of the government and trade numbers placed on the trade tickets prepared at Paine Webber reflecting both sides of Spaulding day trades, together with the times shown on the execution report generated therefrom, discloses significant patterns as to elapsed times between both parts of the trade. 24/

Firstly, it is important to note that throughout both relevant periods almost every Spaulding transaction was designated "pair-off" or "paired" by Hogan, making readily ascertainable which buy was paired with which sell.

24/ Excluded from the examination are those tickets paired off with other brokers, and those from which execution time or government and position numbers could not be ascertained. However, such exclusion is not deemed significant in affecting the patterns found, since it can be presumed that they would remain the same, and they were relatively minor in number.

During the first three months of the 1978 period, there were some 27 paired trades in only 2 of which were the time or number sequences of the paired buy and sell close enough to have been entered for processing almost simultaneously (i.e., within ten numbers and/or 15 minutes of each other). Then, commencing November 2, 1978, and for the next six weeks there were 8 paired trades out of a total of 11 which were separated by only one or two minutes in time and only 1 number apart sequentially, indicating that the pairs were being put in process together by the trader, Hogan.

When Spaulding resumed trading in long term government bonds with Paine Webber in July of 1979, the closeness of time and number sequence patterns observed in the last part of the 1978 period continued. Thus, there were a total of 73 paired transactions during the nine months elapsing between the commencement of trading and April 25, 1980. On a recorded time basis (and excluding four in which no time is shown) there were 44 pairs (64%) in which the time interval between the buy and sell is 5 minutes or less and a total of 56 pairs (81%) in which the interval is 15 minutes or less. The differences in the recorded government numbers show 41 instances (56%) where there were one or two numbers between the buy and sell, 58 instances (81%) where the difference was 5 or less, and 61 instances (85%) where the difference was 10 or less.

During the remainder of this period, from April 25 until June 26, 1980, changes in procedures eliminated recorded execution report times as well as government numbers. During

these dates, however, there were some 23 paired trades, every one of which had wire operator numbers only one digit apart between the buy and the sell. 25/

During the relevant 1979-80 period, there were instances of several paired transactions in one day in the same security all of which were close together. Thus, on January 29, 1980, there were eight order tickets representing 4 paired transactions (Exhibit 423) all of which were timed within 15 minutes, and all of which had position numbers one digit apart within a range of 8, which would appear to have all been processed at the same time. There were a number of other instances involving 2 pairs of day trades where all four tickets were obviously put through the process by Hogan at the same time, as seen from the closeness of wire numbers, government numbers and recorded times.

To the foregoing analysis must be added the admission to Paine Webber's compliance officer by Hogan that he developed the practice of holding rather than promptly processing order tickets for the opening side of a Spaulding day trade, and if

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25/ The Division prepared and offered its own exhibit (No. 655) to show the time and number sequence relationships for the 1979-80 period which showed that 86 percent of the paired transactions were processed within one-half hour, that 78 percent of the government number range had a difference of 5 or less, and 86 percent had 10 or less; and 72 percent had a wire number range of 5 or less and 80 percent of 10 or less. The Division had also prepared a similar study for the 1978 period, but chose not to offer it in evidence, presumably because it did not show for the first three months of that period such a proximity of time and numbers as to sustain its theory of Hogan's handling of pair-offs.

they later resulted in a "flat" transaction he would destroy the tickets so that no record remained of them. [26/] Moreover, Hogan asserted that in eighty percent of the trades, Stevenson would follow Hogan's trading recommendations; and except for the 1978 period when Cooney was the Spaulding account executive, Hogan was doing all of the trading directly with Stevenson.

Finally, it was company policy at Paine Webber that all transactions should be entered into the system and all trade tickets be processed as soon as possible after being written. Even in a pair-off situation, or when a day-trader was involved, the separate buy and sell making up the transaction was to be processed separately and promptly. Moreover, no one was to destroy a trade ticket even though the position might wind up flat at the end of the day. It was felt by Paine Webber management that for the sake of accurate record keeping, as required by law or regulation, every transaction was to be processed.

Respondent, on the other hand, offered testimony through his witnesses that it was not an uncommon practice in a pair-off situation for a trader to hold the opening trade ticket to await the making of the corresponding closing transaction, in order to economize on record keeping and to keep the trader reminded of the outstanding pair-off to be executed. However,

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26/ This raises the question of whether he also destroyed opening order tickets when a profitable (to Spaulding) closing transaction could not be made.

none of these witnesses was familiar with practices or policy at Paine Webber. One respondent witness, Richard Fentin, who was a former salesman at Paine Webber in fixed income securities, claims to have developed the practice of holding the opening ticket of a pair-off. This was his own idea, not based upon any instructions to do so, and done without the knowledge of his superiors since he professes to have occupied an unusual position at the firm with respect to the work he was doing.

It is concluded from all of the circumstances surrounding the processing of the Spaulding trades with Paine Webber, including the numbering and timing systems, that Hogan was either improperly holding the opening ticket of a day trader until a propitious time arrived for completing the transaction profitability to Spaulding (since almost all of the day trades were thus profitable), or was executing both sides of the day trade at about the same time in a way to insure profitability for Spaulding, while marking them as "pair-off transactions.[27/]

The actions of Hogan with respect to the processing of the Paine Webber trade tickets of the Spaulding transactions are part of the circumstances to be considered in the determination of the issues herein. The failure of respondent to

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27/ It is interesting to note that during the 1978 period, when both sides of the trades were not being processed simultaneously, the ratio of profits to losses was significantly less than in the later 1979-80 period, and the average profit per transaction to Spaulding was less and the average loss more. The account did much better in the later period. when Hogan was controlling the trading directly.

testify as to the facts within his knowledge concerning the way he traded with Paine Webber for Spaulding has been considered as an adverse circumstance. 28/

Distribution of Profits

An important aspect of the Divison's proof of the existence of a scheme to defraud Paine Webber relates to the distribution of the profits accruing to Spaulding in its trading in government bonds with Paine Webber.

Spaulding did not trade in long term government bonds prior to Stevenson's joining the firm and ceased doing so after he left. It had some fifty individual accounts and 1 or 2 institutional accounts which were handled by Tuck. During the period prior to Stevenson, about 60 to 70 percent of the firm's income was from commissions as a broker, ten percent from consulting fees, and the balance from principal transactions. After Stevenson joined the company, Tuck

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28/ The Division also relies upon a comparison of the Paine Webber order tickets with those drawn up for the same transactions by Stevenson as the Spaulding trader. At Spaulding order tickets were normally made up and time stamped within a 15 minutes of the trade, compared with a maximum of one-half hour at Paine Webber. Thus, one would expect no more than 15 minute differential in the time stamping of a trade at both firms. However, on many occasions, the differences observed were quite lengthy. Trades would be shown by Spaulding records as having taken place many hours before - or after - the times shown on Paine Webber records. The comparison is, to some extent, unreliable, since the record shows that the Spaulding time clock frequently broke down, or was inaccurate, for varying periods. In any event, the conclusions to be drawn therefrom would merely be cumulative, at best, to those already found concerning Hogan's handling of Spaulding transactions.

continued to deal with the other clients, with 1 or 2 of them assigned to respondent. Stevenson's primary function, however, was trading for Spaulding with Paine Webber (plus several other market-makers) in the government bond transactions, earning for his firm the large profits heretofore described.

To understand the way these profits were distributed one must consider the way Tuck used the corporations he controlled, Spaulding, TBG and Carlyle, and the relationship between Stevenson and his corporation, Brevard.

Tuck utilized both TBG and Carlyle as conduits for his earnings and income derived from Spaulding in such a way that he was able to subsist in very high style (he owned and operated a $200,000 fully paid yacht, for example) without ever having a bank or checking account of his own, and without directly drawing a salary, commission or dividend to meet any of his personal needs.

The manner in which he accomplished this was to cause Spaulding to transfer monies to TBG and Carlyle, obstensibly for "consulting" fees, and then drawing checks or cash from these corporations to pay his personal expenses and obligations. Another device was to have Spaulding draw checks for "petty cash" designated for the account of the "consulting" services of TBG or Carlyle, and then cashing them and using the cash for his needs. Based upon the testimony of Spaulding's only bookkeeper, neither of Tuck's satellite corporations had any business or other source of income, no employees or offices of

their own, and surely performed no consulting services for Spaulding or anyone else.

Stevenson's corporation, Brevard, also figures prominently in the distribution of the Spaulding profits (although not during the relevant 1978 period when it was not in existence). It is undisputed that during the 1979-1980 period, Brevard's shares in the distribution was its only source of income and it apparently performed no other functions and surely not that of a consultant.

The 1978 period

As noted, Spaulding's profits from its trading in long term government bonds mostly with Paine Webber during this five-month period amounted to some $85,850. The firm paid Stevenson $48,859 for his services as trader in these securities which sum also included a small amount of commissions and fees for occasional trading for a few other Spaulding accounts.[29/]

Spaulding during this period paid some $27,560 to TBG and $9,000 to Carlyle for "consulting" services. As stated, these sums were then diverted to Tuck's personal needs. In addition, on November 8, 1978, TBG issued a check signed by Tuck payable to "cash" in the sum of $4,570 which was then endorsed by Hogan and deposited in his own bank account. On

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29/ Although under his original employment Stevenson was to have been paid 25 to 30 percent of his profits, in fact the sums received amounted to about 57 percent of the profits he generated from trading with Paine Webber.

December 7, 8 and 11, 1978, TBG issued three more checks made out in the same way in the sums of $3,983.22, $4,905.83 and $3,085.85, respectively, each marked for "consulting" and each endorsed by Hogan and deposited in his own bank account. 30/ Thus, a total of some $16,545, or almost 20 percent of the Spaulding profits from its trading with Paine Webber, found its way into the hands of Hogan.

Finally, on January 4, 1979, Spaulding issued a check in the sum of $9,689 (or some 11 percent of the Spaulding profits), payable to Cooney's order for "consulting", which was endorsed by him and deposited in his own personal account.

The remainder of the 1978 profits, amounting to about 10 to 12 percent of the total, ultimately inured to the benefit of Tuck through petty cash withdrawals or by checks from Spaulding, TBG and/or Carlyle to pay for his personal living expenses.

The record is abundantly clear that, although there were numerous payments all around for "consulting" services,

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30/ The last three checks totaling almost $12,000 were dishonored on presentment by December 14, (the last day that Spaulding traded with Paine Webber during the 1978 period). On that day, Spaulding issued a "petty cash" check for the account of Carlyle in the sum of $9,000 and there is a corresponding deposit on the same day of $8,000 in Hogan's account. On January 2, 1979, a similarly designated check in the amount of $3,085 was issued by Spaulding, and on the same day Hogan deposited $3,000 in his account. The closeness of the total amounts to that of the three dishonored checks leads to the conclusions that Spaulding had cashed the "petty cash" checks and turned over the proceeds to Hogan to make good the dishonored TBG checks of a few weeks earlier.

it is not disputed that TBG and Carlyle did no consulting for Spaulding and neither Hogan or Cooney did any consulting for any of the Tuck controlled firms. 31/

Moreover, although the receipt by a Paine Webber trader or sales representative of funds from a customer without disclosure was strictly against company policy, and might even result in dismissal from employment, neither Cooney nor Hogan ever reported the receipt of these consulting fees to his employer. 32/

The 1979-1980 period

When trading in long coupon government bonds between Spaulding and Paine Webber resumed in July of 1979, there were changes in the way Spaulding's profits were being distributed. As noted, respondent caused Brevard to become incorporated in March of that year. Thereafter, upon Tuck's instructions to his bookkeeper respondent was to receive from Spaulding 20 percent of the profits generated from this trading and Brevard

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31/ The record also shows that on December 14, 1978, the last day of Spaulding trading during this period, Stevenson drew a check payable to "cash" in the sum of $1,300 which was endorsed by Cooney. Whether this payment was part of the distribution of the Spaulding profits, or represented a private matter between these two is not clear.

32/ Some elements of payments such as canceled checks and deposit slips were not produced by the Division, allegedly as being unavailable. However, other records produced, such as ledger sheets, journal entries, corporate and bank statements, plus the testimony of witnesses, were adequate to sustain the conclusions drawn as to the distribution of Spaulding profits both during the 1978 period and the subsequent 1979-80 period.

was to get 40 percent as a "consulting fee", making Stevenson an initial distributee of a total of 60 percent of the Paine Webber trading profits.

As seen, during this approximate 11-month period, Spaulding had derived from its trading in government bonds with Paine Webber net profits of about $598,580. According to the Internal Revenue Service Form W-2 for both years, Spaulding paid Stevenson a total of $127,381 for his services, or some 21 percent of the net profits.[33/]

During the same period, Spaulding paid Brevard for "consulting" services[34/] a total of $245,567 (as shown in I.R.S. Form 1099 reports by Spaulding), or about 41 percent of the profits from government bond trading. Thus, the sums paid to respondent and to his corporation were in the range of the agreed upon compensation as stated above. However, Stevenson was involved with some expense items from his share, as hereinafter discussed.

The remainder of about 38 to 40 percent of the profits was Tuck's share (Cooney already being out of the picture), some of which found its way into his affiliate corporations

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33/ In computing his earnings for the purpose of preparing a "flow-of-funds" chart, the Commission's investigator Charles D. Murphy fixed Stevenson's compensation at $86,861, at variance with the W-2 forms. The latter will be deemed the true report of his earnings from Spaulding.

34/ With each payment, usually on a monthly basis, Brevard would bill Spaulding in the amount due "for financial services rendered". There is nothing in this record to show that Brevard performed any financial or consulting services for Spaulding. In fact, its sole and controlling party, Stevenson, was already giving Spaulding such advice as its trader.

for "consulting" fees, but used, as in all instances, to pay Tuck's personal living expenses. And, unlike the 1978 period, he no longer was paying Hogan out of his share.[35/]

Hogan was no longer receiving direct payments from the Tuck controlled corporations during this latter period. Instead, there were some significant transactions involving Stevenson and Brevard, on the one hand, and Hogan, on the other. Specifically, there was a number of checks drawn by Stevenson, first on his personal account and later on the Brevard account, all payable to "cash" and each endorsed and cashed by him, followed shortly thereafter by a corresponding cash deposit by Hogan in his personal account. The following table shows this comparison:

35/ Since Tuck's share of the profits in the 1978 period was much lower than in the 1979-80 period, this may well account for the termination of government bond trading with Paine Webber at the end of 1978 (and the initial dishonoring of three "consulting" checks to Hogan), and for the resumption thereof some 6 months later when Tuck's share was increased.

	Stevenson/Brevard Cash Withdrawal		Hogan Cash Deposit	
	Date 1979	Amount	Date 1979	Amount
Stevenson Account	8/3	$1,560.	8/10	$800.
	9/18	3,500.	9/21	3,100.
	10/5	9,300.	10/9	5,000.
	11/9	8,100.	11/9	7,200.
	11/13	7,700.	11/14	7,000.
Brevard Account	12/11	14,300.	12/12	5,000.)
			"	9,000.)
	1980		1980	
	1/9	1,650.	1/11	1,300.
	2/7	10,000.)		
	2/8	18,200.)	2/11	22,800.
	3/12	9,750.	3/14	9,000.
	4/9	8,000.)	4/16	9,000.)
	4/14	7,950.)	4/17	6,000.)
	5/8	8,000.)		
	5/9	8,000.)	5/12	9,000.
	6/10	8,000.	6/11	8,000.

The total cash deposits by Hogan during this period, made on virtually a monthly basis, amounted to $102,200, or about 17 percent of the net profits. The total of Stevenson cash withdrawals, is $124,010. Whether he kept the difference, or whether it was turned over to Hogan but not deposited is not shown in the records.

One further aspect of these cash transactions requiring consideration is the record of Brevard "diamond purchases" found in its journal maintained by Stevenson personally in his handwriting and covering the period from April 1, 1979 to at least October 20, 1980. These entries were made in check-number order showing the payee, the amount of the check, and the "reason for the payment.

In identifying cash withdrawals from both Stevenson's personal account and later Brevard's account, and especially including those referred heretofore in the table above as correlated with Hogan cash deposits, the reason written by Stevenson in each instance was "diamond purchase". This would apparently indicate that the cash was used to purchase diamonds for the benefit of either Brevard or of respondent, since all other checks were issued for their respective benefits.

When Brevard had previously been directed by a U.S. District Court in a subpoena enforcement action during the investigatory phase of this proceeding to produce the diamonds so purchased and the documents corroborating the purchase and subsequent sale thereof, Stevenson appeared "as an authorized records custodian for Brevard" (Exhibit 739, p. 6), and testified that he had neither possession, custody or control of the diamonds or of any documentation concerning them <u>from the time the subpoena was issued</u> until the day of his testimony. This was the only answer he gave concerning the subject since he asserted his Fifth Amendment rights to refuse to answer all other questions at that time. Thus, the one response given

appears to have been carefully framed to conceal whether diamond purchases had in fact been made at the times shown in the journal, all prior to the issuance of the investigating subpoena.

Respondent's counsel in his brief suggests that perhaps the diamond purchases were arranged for or ordered by Tuck, now deceased, and that he would have been the person able to shed some light on the transactions. However, Tuck's widow testified that Tuck had a profound hate for and animosity against the subject of "diamonds", so that the mere mention of them was forbidden in his presence, and he would never have owned or dealt in them.

Given the fact that respondent controlled Brevard and personally made the book entires, his failure to come forth in this proceeding with any testimony on the subject or to offer any documentation thereon leads to the obvious conclusion that the book entries ostensibly linking cash withdrawals to diamond purchases were intended to cover up the true intent of the cash withdrawals, i.e., to pay Hogan, and did not reflect that there ever were such purchases. 36/

From all of the foregoing, it is concluded that:

1. The "consulting" fees paid directly by Spaulding to Hogan during the 1978 period were derived from and arose out

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36/ See S.E.C. v. Holschu, 1982 C.C.H. Transfer Binder, Fed. Sec. L. Rep., ¶99,000 (7th Cir., 1982) wherein the Court of Appeals said, at p. 94,629: "A scheme to defraud may well include later efforts to avoid detection of the fraud".

of Spaulding's profits in its trading with Paine Webber and with which he was connected.

2. The cash deposits by Hogan during the 1979-1980 period were derived from Stevenson, whose share of the Spaulding profits had been increased in order for him to pass through to Hogan a significant share of Spaulding's profitable trading with Paine Webber during that period.

3. Stevenson also shared in the profits of the trading in both periods to the extent of about $200,000 (The receipt of $324,089 less his payments to Hogan).

The Judith Jones Account

The Division had offered evidence concerning a trading account at Paine Webber opened by Judith Jones, the then fiancee of Cooney, in which she was to trade long coupon government bonds at Paine Webber and Cooney was to be the account representative. This trading occurred during the period of suspension of Spaulding trading from the end of 1978 to July of 1979, with Hogan as the trader for Paine Webber. It was highly profitable, with Cooney taking two-thirds of the profits for himself. This evidence was admitted (over respondent's objections) on the theory expressed in Section 404(b) of the Federal Rules of Evidence, allowing proof of other crimes for such purposes as to show absence of mistake, criminal intent, etc. It was also received in order to explain cash deposits made into Hogan's account during this period. (See foonote 3, *supra*).

Respondent has asked that all references to and evidence concerning the Judith Jones account be stricken. Since there is no proof that respondent was a party to these transactions, and since the nature of the other proof in this record does not require the type of substantiation sought by the Division, the Jones testimony and documentation will be disregarded in the disposition of the issues embraced herein. 37/

DISCUSSION AND CONCLUSIONS

Section 17(a) of the Securities Act makes it unlawful for any persons in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce, or by the use of the mails, directly or indirectly -- to do any of the following:

> (1) to employ any device, scheme or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

37/ It is interesting to note that although counsel for respondent had vehemently opposed any of the testimony and exhibits relating to the Jones matter, he nevertheless relies in his brief upon a portion of the testimony by Jones showing that respondent reacted coolly upon learning of the Commission's investigation into the affairs of Spaulding. This testimony, too, will be disregarded.

Section 10(b) of the Exchange Act makes it unlawful, in connection with the purchase or sale of any security to use or employ,

> "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 promulgated thereunder, extends, in effect and with a few language changes, the provisions of 17(a) relating to the sales of securities to both the purchase or sale thereof.

It is clear from all the evidence presented that Stevenson, Hogan and Tuck (and Cooney during the 1978 period) had entered into and carried out a scheme to defraud Paine Webber through the Spaulding account in the trading of long coupon government bonds during the relevant periods herein in violation of Section 17(a), and Section 10(b) and Rule 10(b)-5 thereunder.

This conclusion emerges when all of the circumstances found in this case are combined and examined together. First there are the vehicles utilized: Spaulding, on the one hand, a small broker-dealer owned and controlled by Tuck, described as an avaricious and determined individual; and, on the other, Paine Webber, a market-maker and large reporting dealer in government bonds whose head trader in such securities is Hogan, with complete discretion to set offering and selling prices. Hogan's friends from former personal and business contacts include Cooney, a Paine Webber account executive, and Stevenson, the remaining respondent.

These individuals come together in the late Spring of 1978 when Tuck hires Stevenson. Shortly thereafter, Spaulding, which has had very little previous activity in government bond trading, opens a trading account with Paine Webber (and a few other market makers). Stevenson, who has had no prior trading experience especially in long term government bonds, is trading for Spaulding against his friends Cooney and Hogan on the other side. Because Spaulding could not take a position due to insufficient capital and bond inventory, it is compelled to be a day trader and hence never at principal risk.

Thereafter, and for the next 5 to 6 months, some 67 day trades take place between Spaulding and Paine Webber in long coupon government bonds, and in some 88 percent of them Spaulding winds up at the end of the trading day with a profit, paid for by Paine Webber. Not only is this an unheard of success rate for a neophyte trader or anyone else, but the prices charged to Spaulding on its buys and paid on its sells, as set by Hogan, are consistently more favorable than those accorded to others trading with Paine Webber.

At the end of the first period, large Spaulding profits are divided up. Tuck gets his share, Stevenson gets a portion as compensation, and Cooney and Hogan get significant amounts as "consulting" fees. Thus, the outlines of the scheme are in place. Then, for some reason, trading stops, to be resumed again some 6 months later.

During the ensuing 11-month period commencing July, 1979, Spaulding engaged in some 92 day trades with an even greater

success rate (about 93%), larger profits to loss ratio, and substantially increased profit total. However, some changes have taken place.

First, since Cooney is no longer in Paine Webber's employ, the Spaulding account is assigned to another salesperson, a stranger to the scheme. This requires that Hogan proceed to deal directly with Stevenson and by-pass the new salesman, a most unusual arrangement but a necessary one if the scheme is to continue. Secondly, Hogan adopts the practice of personally preparing and then of holding the order tickets representing both sides of paired Spaulding transactions and placing them into the Paine Webber records simultaneously, rather than entering each one as it was made as he did in the earlier part of the 1978 period. He professes to destroying paired tickets when they came out "flat" (or showing no Spaulding profit). Finally, his share of the profits no longer comes to him by check for "consulting" fees, but in a series of cash transactions between himself and Stevenson and/or his corporation, Brevard, through which a large share of the profits are now funneled.

In June of 1980 Paine Webber ceases further trading with Spaulding, after taking a cursory look into the account, causing the scheme to split. Hogan quits his job rather than produce his bank records, and Stevenson leaves Spaulding to go into another business.

When all of the circumstances found in this record are added together - such as the close relationship among the individuals involved, Stevenson's inexperience as a trader,

Hogan's taking over all of the details of trading with Spaulding including the holding and destroying of trade tickets, the granting of favorable prices by him to Spaulding, the manner in which the Spaulding profits were shared by the parties, the "diamond purchase" cover-ups, Stevenson's failure to testify, and all the other unusual practices described heretofore - then the conclusión is inescapable that the unheard of high level of Stevenson trading successes and profits are the result of conscious and deliberate acts of fraud through the manipulation of the buy and sell prices afforded Spaulding by Hogan with the active collaboration with the others in the scheme, including Stevenson.

Accordingly, it is concluded that respondent violated Section 10(b) of the Exchange Act and the provisions of Rule 10(b)-5 prohibiting the employment of any device, scheme or artifice to defraud in the purchase and sale of securities (including government bonds), and violated the third paragraph of the Rule by engaging in transactions, practices and course of business which operated as a fraud and deceit upon Paine Webber. It is further found that his conduct constituted a violation of the like provisions of Section 17(a)(1) and (3) of the Securities Act relating to purchases of securities, since every paired transaction involved a purchase as well as a sale, and were actually paired off against each other in the trade tickets, and on the books of Paine Webber and Spaulding.

The record herein also spell out a violation by respondent of the second subsections of Section 17(a) and Rule 10(b)-5, respectively, relating to the making of an untrue statement of a material fact or the omission to state material facts. Specifically, Stevenson failed to disclose to Paine Webber the existence of the scheme to defraud it by the devices heretofore recited while he was trading on behalf of Spaulding. He further failed to disclose the fact that Spaulding was giving Hogan a share of the proceeds. Also, as a member of the conspiracy, he bore responsibility for the failure of Cooney and Hogan to disclose to Paine Webber the fraud being committed and the moneys they were receiving from Spaulding.

<u>Materiality</u>

The matters which respondent failed to disclose to Paine Webber were material, since it is reasonable to conclude that Paine Webber would not have continued to trade in government bonds with Spaulding had it known of the manner in which the trading was being carried on. In fact, as soon as it had some indication of the fraud it immediately ceased all such activities.

<u>Scienter</u>

One of the elements required to be established to show a violation of Rule 10(b)-5 and the first subsection of Section 17(a) is that the respondent acted with "scienter", defined as "a mental mental state embracing intent to deceive, manipulate, or defraud". <u>Ernst & Ernst v. Hochfelder</u>, 425 U.S. 185, 193, n.12 (1976).

Scienter is established by knowing or intentional conduct. Aaron v. SEC, 446 U.S. 680, 690 (1980). It may also be established by reckless conduct. Nelson v. Serwold, 576 F.2d 1332, 1337-8, (9th Cir.), cert. den., 439 U.S. 970 (1978). Courts recognize that absent an admission by defendant, scienter may be inferred from circumstantial evidence which "can be more than sufficient". Herman & McLean v. Huddleston, supra, n.30. There is no question that respondent acted with the requisite scienter. He had actual knowledge of each step of the fraudulent scheme. He was a party to its inception, since trading government bonds with Paine Webber did not start until he joined Spaulding; he participated in the acts of Hogan by dealing with him directly; he shared in the profits and participated in their distribution to Hogan; and he attempted to cover his tracks by recording fictitious "diamond purchases".

As observed by the Court of Appeals in Mawod & Co. v. SEC, 591 F.2d 588, 596 (10th Cir. 1979), the Supreme Court in Hochfelder "recognized that the carrying on of a manipulative or deceptive device was itself evidence that knowledge existed".

Of course, respondent also acted "wilfully", as that term is understood in securities laws. 38/ A finding of scienter carries with it a finding of wilfullness. First Pittsburgh Securities Corporation, S.E.A. Rel. No. 16897 (June 16, 1980), 20 SEC Docket 401, 405, n.19.

38/ It is well established that a finding of wilfullness does not require an intent to violate the law; it is sufficient that the one charged with the duty consciously performs the acts constituting the violation. See Tager v. S.E.C., 344 F.2d 5, 8, (C.A. 2, 1965); and Arthur Lipper & Co., v. S.E.C., 547 F.2d 171, 180 (1976).

In any event, scienter is not a required element of violation of subsections (2) and (3) of Section 17(a) of the Securities Act (Aaron v. SEC, supra), both of which have been found to have been violated by Stevenson.

Riskless Transactions

In defense of Hogan's activities, respondent places great reliance upon the fact that Hogan, when questioned about his handling of the Spaulding account by Paine Webber's compliance officer, said that he had been engaging in "riskless transactions" with Spaulding to the profit of Paine Webber. These are said to be transactions where he would go out "into the street" to match a Spaulding buy (or sell) order and acquire the bonds from (or sell them to) other traders at a price which would guarantee a profit to Paine Webber without having to take a position in the bonds. (Admittedly, when the firm took a position it was "at risk".) Thus, respondent would have it believed that Paine Webber was actually profiting from its trading involving Spaulding.

In support of this defense, respondent asserts that an examination of Paine Webber's position cards would demonstrate that on any day there was a Spaulding trade there could also be found a trade in some opposite side transaction with another trader in the same security which would show a profit for Paine Webber when both were matched. Respondent has attached "Schedule A" to his Proposed Findings of Fact outlining a total of only 6 possible match-ups. 39/

39/ If this Exhibit is intended to be representative, the basis of sampling is not given so that a proper evaluation can be made.

Apart from the fact that respondent offers no justification for matching the trades the way he did other than to show that they could possibly have happened, the defense of "riskless transactions" must fall in the face of the evidence showing the repetitive giving of preferential prices to Spaulding, the destroying of trade tickets by Hogan, and the pay-offs to Hogan out of the Spaulding profits. Even assuming that Hogan was engaged in riskless transactions he was duty-bound under the most elemental principles of agency to obtain for his employer the best possible price in any trade. It was not enough that he made a profit for Paine Webber; he must have made the best profit available under the circumstances.

From the record in this case, it is concluded that respondent has failed to show that Hogan's transactions with Spaulding were in the best interests of his principal, Paine Webber, and that his defense of "riskless transactions" is merely an afterthought.

The Ownership of Brevard

As indicated previously (foonote 5 supra), respondent seeks a finding that Tuck was "a participant, control person and primarily beneficial owner" in Brevard, and that the acts by that corporation in furtherance of the scheme, were really the acts of Tuck and not of Stevenson. The only claimed support for this assertion is based upon the way Tuck used his two other corporations, Carlyle and TBG, for his own purposes, and upon his reputation for being tight with money and selfish about its use. Starting with the fact that the Tuck corporations were both incorporated in Delaware, not in New York as was Brevard, the record clearly points the other way.

On the one hand, Tuck signed or directed the issuance of all checks for Carlyle and TBG personally, and checks and cash were withdrawn primarily for his own personal expenses and no one else's. His control of these entities was well known. On the other hand, neither his widow nor his bookkeeper knew of any association he might have had with Brevard. In fact, she never heard of Brevard until the night before she testified herein, and the bookkeeper had assumed all along that Brevard was respondent's firm.

Respondent Stevenson and his bride-to-be Margaret Tull signed Brevard's bank account opening statement as its only officers. Respondent signed all checks. He kept the corporate books in his own handwriting. They show that records of his personal checking account deposits and withdrawals were kept in Brevard's books, that both accounts were used at different times to pay both corporate and personal obligations (such as rent for his apartment at 179 E. 80th Street, New York City, for Tull's charge accounts, etc.). After Stevenson caused Brevard to open a commodities trading account at Bache, entries as to these transactions were made in Brevard's corporate books by Stevenson at a time after he severed his relationship with Spaulding.

Although Brevard's certificate of incorporation does not name its incorporators, nor were stock records available, still the manner in which Stevenson intermingled his personal affairs with corporate ones is a clear indication that he was in sole control of its affairs. Additionally, Stevenson admitted in a

civil injunctive action brought against him by the Commission (U.S.D.C., S.D.N.Y. 82 Civ. 4678) that he was the president and sole shareholder of Brevard.

Besides, the one person who could have resolved any doubts about the status of Brevard, the respondent, chose not to testify about it, thereby justifying the conclusions reached that he and only he owned Brevard, and is responsible for its acts as part of the fraud.

Due Process Contentions

Respondent urges that his rights to due process have been denied him because: (1) he was not given sufficient opportunity to prepare his defense, and (2) the Commission (and this judge) had refused to grant or seek immunity for Hogan in order to permit him to testify on respondent's behalf in the face of Hogan's Fifth Amendment posture.

Opportunity to Prepare

Respondent asserts in his Statement of the Case (Proposed Findings, p. 2):

> After many false starts and after Respondent Stevenson had made numerous motions for a continuance in order to prepare his case, all of which were effectively denied by the Administrative Law Judge (hereinafter ALJ) the hearing in this matter commenced on December 13, 1982.

The record, however, indicates the contrary to be the fact.

Counsel for respondent was given reasonable postponements; hearing weeks were shortened in order to permit him to handle other matters and to attend to other cases; and continuances

were allowed to await availability of witnesses and to study documents or prepare charts and exhibits.

For example, while the hearings technically commenced on December 13, 1983, only preliminary testimony relating to admissibility of documents was taken. A motion by respondents at that time for a continuance was granted for 4 weeks over the Division's objection with this comment by the Administrative Law Judge addressed to Division's counsel (Tr., p. 60):

> "I am also going to grant the motion for a continuance. I believe that the Respondents shouldn't have to spend weekends on the eve of trial examining and analyzing the stack that you (Division's counsel) gave them there."

Actually, the hearing effectively commenced on January 12th, 1983, one month later. [40/] Moreover, the record shows that a continuance was granted from January 28 to February 7, 1983, to permit respondent to prepare some charts, and again from February 9th to the 17th, 1983, in order to permit the availability to him of two witnesses who were out of the country at the time. Based upon these and other instances, the claim that respondent was not allowed time to prepare his case is without merit.

Hogan Immunity

Respondent had called Hogan as his witness who declined on Fifth Amendment grounds to offer any testimony (as he had

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40/ During this interval, counsel for respondent wrote the Judge to advise that he had retained one Adelaide Blizter, an expert in market reconstruction, who had rendered a preliminary opinion to him that based upon Paine Webber's procedures it was not possible to determine at what time during the day a particular trade was executed. Ms. Blitzer was never produced as a witness, and it was never claimed that lack of time was a reason for the failure to call her.

also reacted when called by the Division). Respondent then moved the Administrative Law Judge to fashion some sort of protective order to permit Hogan to testify (without fear of self-incrimination), or to direct the Commission to seek "use immunity" for his testimony pursuant to 18 U.S.C. §§6002 and 6004. In the alternative, he sought an indefinite postponement of the proceedings until there was a final resolution of Hogan's possible criminal liability. Respondent urged that Hogan was the only one who could testify with knowledge as to the issues herein, and that such testimony would exculpate respondent.

This motion was denied in all respects at the hearing for the reasons set forth at length in the record.

Thereafter, respondent sought review by the Commission which affirmed the denial of the motion by Order dated April 1, 1983.

Respondent seeks a Finding of Fact (no. 102) that this Commission, "by requiring the witnesses Cooney and Hogan to maintain their refusal to testify has improperly thwarted" him from obtaining their testimony and has thereby "rendered him incapable of adequately defending himself in this proceeding". 41/

41/ Respondent persists in an unsubstantiated allegation that as part of the Hogan settlement, the Comission required inclusion of language that he continue to invoke his Fifth Amendment privilege. As the Commission pointed out in footnote 3 of its Order of April 1, 1983, no such language appears in Hogan's offer of settlement nor in its order accepting it. It is also surprising to see an alleged inhibition of Cooney's testimony included in the proposed finding since at no previous time did respondent seek to call him as a witness.

Outside of the fact that both the Commission and the Judge have already found that respondent has had adequate means of defending himself (including use of his own testimony, if he so chose), the law is clear that a defendant cannot compel the government to grant use immunity to witnesses he desires to call [Fricke v. U.S., 684 Fed. 2d 1126, 1130 (5th Cir. 1982)], even where the testimony sought to be adduced is both exculpatory and unavailable from any other source. [U.S. v. Chagra, 669 F.2d 241, 258-61 (5th Cir. 1982)]. See "The Case Against a Right to Defense Witness Immunity", 83 Columbia Law Rev. 139 (January, 1983).

It is concluded that respondent's due process claims based upon alleged lack of opportunity to prepare his defense and the refusal to grant immunity to Hogan are without merit.

Other Matters

Respondent's contention that the anti-fraud provisions of the securities laws apply only to transactions involving a customer or client, on the one hand, and a broker-dealer or registered representative, on the other, based upon U.S. v. Naftalin, decided by the 8th Circuit in 1978, 579 F.2d 444, ignores the fact that Naftalin was expressly reversed on this point in the Supreme Court the following year (441 U.S. 768).[42/] Naftalin also disposes of the contention that

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42/ As the Court said, at P. 775:

> But neither this Court nor Congress has ever suggested that investor protection was the sole purpose of the Securities Act. *** Prevention of frauds against investors was surely a key part of that program, but so was the effort "to achieve a high standard of business ethics . . . in every facet of the securities industry." SEC v. Capital Gains Bureau, 375 U.S. 180, 186-187 (1963) (emphasis added).

Stevenson owed no duty to disclose to Paine Webber the fraudulent acts of Hogan, his receipt of a share of the Spaulding profits, or any of the other factors in the scheme. As the Court said, at page 776:

> Moreover, the welfare of investors and financial intermediaries are inextricably linked - frauds perpetrated upon either business or investors can redound to the detriment of the other and to the economy as a whole.

Respondent's reliance upon Chiarella v. U.S., 445 U.S. 222 (1980) is misplaced. Chiarella involved the possessor of inside information who was unrelated to the principals involved and who did not derive his information from one of their fiduciaries. Here, Stevenson was dealing with Hogan, a trusted employee and fiduciary of Paine Webber. Transactions of those who knowingly participate with the fiduciary in a breach of trust to his principal are as as forbidden as transactions on behalf of the fiduciary himself. (Dirks v. S.E.C, ___ U.S. ___, No. 82-276 (July 1, 1983, slip op. p. 12, citing Mosser v. Darrow, 341 U.S. 267, 272 (1951).)

Public Interest

The violations which respondent has been found to have committed herein are serious ones. He and his friends, Hogan and Cooney, and along with Tuck, were engaged during the relevant periods in a scheme to defraud Paine Webber through blatant manipulations in transactions in long term government bonds. They had their collective hand in Paine Webber's pocket from which they extracted and divided among themselves close to $700,000.

In assessing a sanction, due regard must be given to the facts and circumstances of each particular case, since sanctions are not

intended to punish a respondent but to protect the public interest from future harm. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963) and Leo Glassman, 46 S.E.C. 209, 211 (1975). Sanctions should also serve as a deterrent to others. Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976).

This record has been searched for any factors which would mitigate in respondent's favor and has been found wanting. There were several character witnesses who vouched for his reputation for truth and veracity, but since Stevenson never testified there is no way to apply this reputation.

Consideration has been given to the egregiousness of the violations, the wilfull and eager participation of respondent in them, his failure to give assurances against future violations, his unwillingness to recognize the wrongful nature of his conduct, and the likelihood that his remaining in the securities business would present opportunities for future violations. See Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, supra.

As the Supreme Court stated in SEC v. Capital Gains Bureau, supra, at pp. 186-187: "It takes but little appreciation *** to realize how essential it is that the highest ethical standards prevail in every facet of the securities industry".

In this case, the sanction must be of sufficient severity as to impress upon the respondent and others that the type of violative conduct engaged in by him cannot be tolerated. Nothing less than a total bar from future association with any broker or dealer would be adequate to protect the public from future harm

caused by the type of conduct exhibited by respondent. 43/

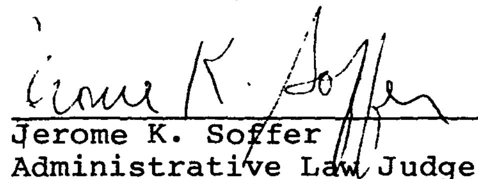
ORDER

Under all of the circumstances herein, IT IS ORDERED:

That respondent Robert Blakeney Stevenson be barred from association with any broker or dealer.

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 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.



Jerome K. Soffer
Administrative Law Judge

September 6, 1983
Washington, DC

43/ In their briefs and arguments, the parties have requested the Administrative Law Judge to make findings of fact and conclusions of law and have advanced arguments in support of their respective positions other than those heretofore set forth. All such arguments herein have been fully considered and the Judge concludes that they are without merit, or that further discussion is unnecessary in view of the findings herein.