IN THE MATTERS OF

EDWARD SINCLAIR

JOHN HARDY

RICHARD CLARK ANDERSON

File Nos. 3-1596 and 3-1597. Promulgated March 24, 1971

Securities Exchange Act of 1934—Sections 15(b), 15A and 19(a)(3)

BROKER-DEALER PROCEEDINGS

Grounds for Bar from Association with Broker-Dealer

Interpositioning

Classification of Records

Where order clerk in over-the-counter department of registered broker-dealer, in execution of transactions for customers, interposed broker-dealer, who did not make market in security, between registrant and best available market pursuant to reciprocal arrangement to generate listed business for registrant which paid clerk commission on such business; and, in order to conceal interpositioning from registrant, falsely listed on order tickets as executing dealer a broker-dealer who quoted security in daily quotation sheets, *held*, order clerk willfully violated and aided and abetted violations of antifraud and record-keeping provisions of Securities Act of 1933 and Securities Exchange Act of 1934 and applicable rules thereunder, and under all the circumstances appropriate in public interest to bar him from association with broker-dealer.

Where order clerks in over-the-counter department of registered broker-dealer, in execution of transactions for customers, interposed broker-dealer between registrant and best available market pursuant to secret arrangement under which interpoed broker-dealer paid them percentage of gross profits on such transactions, and failed to record on order tickets time when customers' orders were transmitted for execution, *held*, order clerks willfully violated and aided and abetted violations of antifraud and record-keeping provisions of Securities Act of 1933 and Securities Exchange Act of 1934 and applicable rules thereunder, and under all the circumstances appropriate in the public interest to bar them from association with broker-dealer.

Lack of Due Diligence in Execution

Where order clerk in registrant's over-the-counter department obtained quotations with respect to securities from three or more dealers, who quoted such securities in daily quotation sheets, before giving another dealer who did

not make market in such securities opportunity to meet best price, but where latter dealer, although in no better position than registrant to negotiate for best price, was able to obtain better price from market-makers in large number of transactions either simultaneously or within short period of time, *held*, order clerk failed to exercise due diligence to obtain best execution for customers.

PRACTICE AND PROCEDURE

Contention that prior Commission decision, which pursuant to offer of settlement imposed sanction upon registered broker-dealer for alleged failure to supervise order clerk, prejudged issues with respect to order clerk, *rejected*.

APPEARANCES:

Lawrence Greenapple and *Arthur S. Olick*, of Otterbourg, Steindler, Houston & Rosen, for Edward Sinclair.

John Hardy, pro se.

Lawrence F. Westlock, for Richard Clark Anderson.

William D. Moran, Kenneth S. Spirer, Samuel M. Feder and *Ralph K. Keffler*, for the Division of Trading and Markets of the Commission.

FINDINGS, OPINION AND ORDER

These were private consolidated broker-dealer proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") with respect to, among others, Edward Sinclair, who was the order clerk in the over-the-counter trading department of Filor, Bullard & Smyth ("Filor"), a registered broker-dealer, and John Hardy and Richard Clark Anderson, who held similar positions with Folger, Nolan, Fleming & Co., Inc. ("Folger"), a registered broker-dealer. The issues pertaining to Filor and Folger and the other respondents named in the proceedings have been resolved.[1] Following hearings, the hearing examiner filed an initial decision in which he concluded that Sinclair, Hardy, and Anderson should be barred from association with a broker or dealer, provided that after a period of 6 months applications may be made for our approval of their employment upon assurance as to assignment and supervision designed to prevent a recurrence of the violations found. We granted a petition for review filed by our Division of Trading and Markets ("Division") with respect to the adequacy of the sanctions imposed upon respondents, and a petition for review filed by Sinclair. Briefs were filed by the Division and Sinclair and we heard oral

[1] *Folger, Nolan, Fleming & Co., Inc.*, Securities Exchange Act Release No. 8489 (January 8, 1969); *Hoit, Rose & Co.*, Securities Exchange Act Release No. 8563 (April 7, 1969).

argument.[2] Our findings are based upon an independent review of the record.

INTERPOSITIONING

Between January and December 1965, Sinclair willfully violated or aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b–5, 15c1–2, and 15c1–4 thereunder.[3]

Sinclair, pursuant to Filor's policy, received 30 percent of the commissions realized by Filor on business generated by him. In order to increase such business and commissions, he entered into a reciprocal arrangement with Hoit, Rose & Co. ("Hoit"), then an over-the-counter firm registered as a broker-dealer, under which Hoit directed business in securities listed on the New York Stock Exchange to Filor, and Sinclair, who handled all orders for unlisted securities for Filor, directed over-the-counter business to Hoit. When he directed a transaction to Hoit, Sinclair, as required by Filor, first called at least three broker-dealers who quoted the security involved in the daily sheets published by the National Quotation Bureau, Inc. He then advised Hoit of the best quotation obtained and offered to deal with Hoit at that figure irrespective of whether Hoit made a market in that security and notwithstanding Filor's instruction that all over-the-counter orders be executed with market makers listed in the sheets. In 1965, Sinclair directed 189 orders to Hoit in a large variety of securities which Hoit did not quote in the sheets or in which it did not maintain a position.[4] In 90 percent of the transactions where Hoit was thus interposed, it was able to execute the transaction simultaneously or within 10 minutes with another broker-dealer who customarily quoted the security in the sheets. An average of nine broker-dealers listed quotations in the current sheets for each of the securities involved in the transactions in question. In many instances the broker-dealer who executed the transaction for Hoit was one of those from whom Sinclair had obtained a quotation. Hoit's profit generally ranged from 1/8 to 1/2 and reached a high of 5 1/2, and its total profit on the 189 transactions in question amounted to about $8,500. About

[2] Hardy and Anderson did not file briefs on review or participate in the oral argument.

[3] Since the only issue before us on review with respect to Hardy and Anderson is the adequacy of the sanctions imposed upon them by the examiner, their violations are described below in our discussion of the "Public Interest".

[4] The 189 orders represented about 60 percent of the total number of over-the-counter orders directed by Sinclair to Hoit in 1965.

55 percent of Sinclair's commissions in 1965 were derived from the reciprocal business received from Hoit pursuant to their arrangement.

In order to conceal the interpositioning of Hoit from his supervisor, Sinclair as a rule falsely listed on the order ticket as executing dealer one of the broker-dealers appearing in the sheets, usually one he had called for a quotation. However, his practice was to enter Hoit's name on the copy of the ticket from which accounting entries were made and confirmations sent but which was not reviewed by the supervisor.[5] In 41, or 22 percent, of the transactions, the broker-dealer falsely listed by Sinclair was the one Hoit had used, and in two of those instances such executing dealers had not entered quotations in the sheets for the securities in question.

Sinclair argues that he exercised due diligence to obtain the best execution for Filor's customers because he obtained quotations from three or more dealers listed in the sheets before giving Hoit the opportunity to meet the best quotation and that there is no evidence that he could have obtained a better price by dealing directly with a dealer in the sheets. We reject this argument. As found by the hearing examiner, Sinclair has not overcome the case of interpositioning presented by the Division.[6] Hoit was in no better position to negotiate for and obtain the best price than Filor, which was a much larger firm than Hoit and had direct lines to about 20 over-the-counter dealers, including a number with whom Hoit executed some of the transactions.[7] Sinclair knew or should have known that he could obtain a better execution from the fact that Hoit was able to obtain a better price in a large number of transactions, simultaneously in 70 percent of them and within ten minutes in 20 percent more, and in many cases with the same dealers Sinclair had called for quotations. Indeed, the short amount of time needed by Hoit to better the so-called "best price" obtained by Sinclair would seem to indicate that the quotations recorded on the order tickets by Sinclair were false, or that he did not negotiate with the dealers from whom he obtained quotations, or that he did not negotiate in good faith to

[5] Filor terminated Sinclair's employment in December 1965 following discovery of his failure to comply with its directive requiring execution of over-the-counter transactions with broker-dealers quoting the particular security in the sheets and of his entry of false information on order tickets.

[6] See *Thomson & McKinnon*, 43 S.E.C. 785, 789 (1968): "In view of the obligation of a broker to obtain the most favorable price for his customer, where he interposes another broker-dealer between himself and a third broker-dealer, he *prima facie* has not met that obligation and he has the burden of showing that the customer's total cost or proceeds of the transaction is the most favorable obtainable under the circumstances."

[7] Cf. *H. C. Keister & Company*, 43 S.E.C. 164, 168 (1966).

ascertain the best price obtainable.[8] We cannot sanction any erosion of the broker's obligation to secure the best execution for his customers. As stated in *Thomson & McKinnon:*

> "We have on numerous occasions stressed the importance of the broker's fiduciary obligation to get the best price for his customer. Footnote omitted. That obligation is basic and vital to the broker-customer relationship. However, notwithstanding that obligation, . . . respondents engaged in the practice, over an extended period, of interposing a number of broker-dealers between their customers and the best market. It is evident that respondents subverted the interests of their customers to obtain profitable business in listed securities . . ., thus enriching themselves at the expense of their customers."[9]

We further note that Sinclair failed to disclose or cause disclosure to the customers that he interposed Hoit between them and the best available market, or the extent to which they paid more or received less than they would have if there had been no interpositioning and Sinclair had secured the best execution. This is not to imply, however, that disclosure of the interpositioning practice would have obviated its fraudulent character.[10]

There is also no merit in Sinclair's argument that because interpositioning is not expressly proscribed by statute or rule, the Commission should have adopted a rule outlawing it rather than doing so by adjudication. It is clear that we may interpret the antifraud provisions decisionally and that a specific rule is not necessary.[11]

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[8] See *Report of Special Study of Securities Markets*, 88th Cong., 1st Sess., H. Doc. No. 95, Pt. 2, pp. 616–17 (1963).

Sinclair denied that he ever referred Hoit to another dealer with whom it could profitably effect the transactions, and asserted that his entry on order tickets of the names of the dealers who actually executed the transactions with Hoit was the result of coincidence. However, the number of tickets listing the names of such actual dealers, as well as the number of transactions executed simultaneously by Hoit at a better price than Sinclair quoted, would appear to cast doubt upon his assertion that only chance was involved.

[9] *Supra*, at pp. 788–89.

[10] We do not reach the question whether Sinclair's reciprocal arrangement with Hoit would be *prima facie* inconsistent with his duty to obtain best execution because of an inherent conflict of interest on Sinclair's part even in those transactions where Hoit made a market in the security so that no interpositioning as such was involved, or whether the reciprocal arrangement should have been disclosed to customers in such transactions.

[11] See *S.E.C.* v. *Chenery Corporation*, 332 U.S. 194, 203 (1947); *Charles Hughes & Co.* v. *S.E.C.*, 139 F.2d 434, 437–38 (C.A. 2, 1943). See also *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), where, in holding that the use of adverse inside information in the sale of a security violated the antifraud provisions although not expressly prohibited, we stated (at p. 911):

> "These anti-fraud provisions are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others.

Contrary to Sinclair's assertion, the prohibition against interpositioning is not based upon our 1968 ruling in *Thomson* v. *McKinnon*, *supra*, quoted above, which deals with the broker's burden of overcoming a showing that he interposed another broker between himself and a third broker. We held interpositioning to be violative of the antifraud provisions as early as 1942. *W. K. Archer & Company*, 11 S.E.C. 635, 642, *aff'd* 133 F.2d 795 (C.A. 8, 1943). Subsequent cases dealing with interpositioning and decided before *Thomson & McKinnon* include *H. C. Keister & Company, supra; Thomas Brown III*, 43 S.E.C. 285, 286 (1967); and *Delaware Management Company, Inc.*, 43 S.E.C. 392 (1967).

RECORD-KEEPING VIOLATIONS

In entering false information on the order tickets as to the name of the executing broker-dealer, Sinclair willfully aided and abetted violations of the record-keeping provisions of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder. He also caused violations of those provisions in 19 instances in which he inadvertently recorded as the executing broker on copies of the order tickets the same false names as the ones on the original tickets, which resulted in erroneous accounting entries and confirmations. He cannot escape responsibility for these additional violations because of their unintentional nature and the fact that they resulted from his own negligence in his efforts to conceal the interpositioning from his employer.

We disagree with Sinclair's contention that his falsification of the executing broker's name on the order tickets did not violate the records provisions because Rule 17a–3(b) does not require the order ticket to show the name of the executing broker. Sinclair was required by Filor's rules to enter the name of the executing broker on the order ticket, in addition to the names of the brokers he called and the quotations he received from them. We think that such information, which pertained to the order in a significant way and, if false, could mislead an investigator, was material and that entering material false information on an order ticket, although such information is not specifically required, constitutes a violation of the Rule.[12] Moreover, the requirement in Rule 17a–4 that order tickets be preserved would have little meaning if such tickets may contain material false information.

OTHER MATTERS

Sinclair filed a motion requesting that any Commissioner who participated in the Commission decision of January 8, 1969, which pursuant to an offer of settlement suspended the over-the-counter stock department of Filor for a period of days because of its alleged failure to supervise Sinclair,[13] should disqualify himself in the instant case. The motion further requested that consideration of this case be postponed until there were three Commissioners who had not participated in that decision.

There is no merit in the motion and it is denied. No prejudgment was involved. The 1969 decision was based on a stipu-

[12] *Cf. Southeastern Industrial Loan Company*, 10 S.E.C. 617, 631-32 (1941): "We have uniformly held that a volunteered statement not required in answering an item in a registration statement, if false and material may be the basis for a stop order."

[13] Securities Exchange Act Release No. 8489.

lated record and expressly stated that it was not binding on other respondents.[14] Our present decision is based solely on the record before us and in no way is influenced by our findings as to Filor based on its offer of settlement.

PUBLIC INTEREST

Sinclair asserts that the sanction imposed upon him by the hearing examiner is harsh in comparison to that imposed in other cases involving more serious misconduct and should be substantially reduced; that the customers were not harmed; that he was only 25 years old in 1965 and relatively new in the securities industry, having started in 1960 as a teletype operator and order clerk for Filor on the floor of the New York Stock Exchange; and that his previous record is clean.

It is well established that the remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other cases.[15] It is clearly untenable to urge that customers who did not receive the best execution were not harmed. Sinclair's youth, asserted inexperience, and prior clean record do not detract from the gravity of the violations found.[16] He "should have been aware of his obligation to give the benefit of the best price to the customer and of the impermissibility of obtaining reciprocal business . . . at the expense of a customer." [17] And he knew and attempted to conceal that he was flouting for personal profit his employer's rules, which were obviously designed to secure the best price for customers. Under all the circumstances, including the serious nature and extent of the misconduct shown and the scheme he devised and carried out to conceal it from his employer, we find that the sanction which the examiner imposed on Sinclair is inadequate in the public interest. We do not believe that the investing public should be exposed to further risks of fraudulent conduct by a respondent who has demonstrated such disregard of the basic duty of fair dealing required of those engaged in the securities business. Accordingly, we conclude that he should be barred from association with any broker-dealer without qualification.

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[14] See *Atlantic Equities Company*, 43 S.E.C. 354, 366 (1967), *aff'd sub nom. Hansen* v. *S.E.C.*, 396 F.2d 694 (C.A.D.C. 1968). *Cf. F.T.C.* v. *Cement Institute*, 333 U.S. 683, 701 (1948), which held, applying the rule of necessity, that an agency was not disqualified from deciding an administrative proceeding to determine the legality of certain practices even though it had already formed an opinion as to such legality, where it was the only agency empowered to make that decision.

[15] See *Winkler* v. *S.E.C.*, 377 F.2d 517, 518 (C.A. 2, 1967); *Dlugash* v. *S.E.C.*, 377 F.2d 107 (C.A. 2, 1967); *Hiller* v. *S.E.C.*, 429 F.2d 856 (C.A. 2, 1970); *Martin A. Fleishman*, 43 S.E.C. 185, 190 (1966).

[16] See *Ross Securities, Inc.*, 41 S.E.C. 509, 516 (1963).

[17] *Thomas Brown III*, 43 S.E.C. 285, 287 (1967).

With respect to Hardy and Anderson, the hearing examiner made the following findings: About October 1963, Hoit entered into a secret arrangement with them to obtain over-the-counter business from Folger. Hoit agreed to pay them 25 percent of its gross profits on such business.[18] Hardy or Anderson would check the market as to a particular security,[19] quote a price to Hoit, and Hoit would accept the order if it could execute the order at a better price. Between October 1963 and February 1966, Hoit accepted 1,456 orders in securities which it did not quote in the sheets or in which it did not maintain a position.[20] Of those orders, over 85 percent were executed by Hoit with a market maker in the sheets within 20 minutes for a risk-free profit of 1/8 to 1/2. In over 54 percent, the execution was simultaneous or reasonably contemporaneous. An average of 12 brokers were listed in the current sheets for each of the securities involved in the 1,456 transactions. Hoit realized a gross profit in excess of $100,000 on those transactions.[21] Hardy and Anderson each received about $12,000 from Hoit on all the over-the-counter transactions it effected with Folger during the period, and the amounts received by them monthly exceeded their maximum monthly earnings as order clerks. The arrangement between Hoit and these respondents was kept secret from Folger and Folger's customers. These respondents also failed to record on the order tickets the time when customers' orders were transmitted for execution. The examiner concluded, among other things, that Hardy and Anderson willfully violated or aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b–5 and 15c1–2 thereunder, and the record-keeping provisions of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder.

The only specific reasons cited by the examiner for granting leniency to Hardy and Anderson were that they were very young when they entered into the arrangement with Hoit, had no previous business experience, and received low salaries which may have acted as a temptation. Their misconduct,

[18] This arrangement succeeded a similar one Hardy and Anderson had for about a year with another broker-dealer who was going out of business and referred Hoit to them. These respondents each derived an income of approximately $150 to $200 per month from the earlier arrangement.

[19] Anderson testified that, although Folger's procedures required the checking of three market makers for the best price, he was seldom able to take the time to do so because of his workload.

[20] During the period, a total of 1,615 over-the-counter trades were referred to and effected by Hoit.

[21] Hoit's gross profit on the remaining 159 over-the-counter transactions directed to it during the period was $2,927.

however, extended over a longer period and was even more reprehensible than Sinclair's. We do not think that the reasons cited by the examiner provide a sufficient basis, with due regard to the public interest, for assessing sanctions upon them of less than an unqualified bar.[22]

Accordingly, IT IS ORDERED that Edward Sinclair, John Hardy, and Richard Clark Anderson be, and they hereby are, barred from being associated with any broker or dealer.

By the Commission (Commissioners SMITH, NEEDHAM and HERLONG), Commissioner OWENS not participating.

[22] The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent that they are inconsistent or in accord with our decision.