

IN THE MATTER OF
BABCOCK & COMPANY
LOUIS W. BABCOCK
ROBERT T. STEAD

File No. 3-1512. Promulgated June 19, 1970

Securities Exchange Act of 1934—Section 15(b) and 15A

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Offer, Sale and Delivery of Unregistered Securities

Failure to Disclose Participation in Distribution

Failure to Comply with Record-Keeping Requirements

Inaccurate Financial Report

Improper Extension of Credit

Where registered broker-dealer and associated person or persons offered, sold and delivered unregistered securities, failed to furnish purchasers with written notification of its participation in distribution of securities, failed to comply with record-keeping requirements, and filed inaccurate financial report, and where broker-dealer improperly extended credit to customers, in willful violation of Securities Act of 1933 and Securities Exchange Act of 1934, held, in public interest to revoke broker-dealer's registration and expel it from membership in registered securities association and to bar associated persons from association with any broker-dealer with provision for supervised association after specified periods upon appropriate showing.

APPEARANCES:

Joseph F. Krys and *G. Gail Weggeland*, for the Division of Trading and Markets of the Commission.

Alexander H. Walker, Jr., for Babcock & Co. and Louis W. Babcock.

Norman S. Johnson, of Gardiner & Johnson, for Robert T. Stead.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these proceedings pursuant to Sec-

tions 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner issued an initial decision in which he concluded that the registration as a broker and dealer of Babcock & Co. ("registrant"), a partnership, should be revoked and that it should be expelled from membership in the National Association of Securities Dealers, Inc. He further concluded that Louis W. Babcock, registrant's only active partner, and Robert T. Stead, a salesman and trader for registrant, should be barred from association with any broker or dealer, with the proviso that after six months each of them may become associated with a broker-dealer in a supervised capacity upon a showing that he will be adequately supervised. We granted the petitions of registrant, Babcock and Stead for review of the initial decision. Respondents and our Division of Trading and Markets ("Division") filed briefs, and we heard oral argument. Our findings are based upon an independent review of the record.

Registrant became registered with us in April 1964. Registrant's principal office was in Ogden, Utah, and Stead was employed in its only branch office, which was located in Salt Lake City and accounted for about 80 percent of registrant's business.

TRANSACTIONS IN UNREGISTERED SECURITIES

The record establishes that from about April 20 to June 1967, respondents willfully violated the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933 in the offer, sale and delivery of the common stock of Triumph Corporation, and that during August and September 1967 registrant willfully violated those provisions in the offer, sale and delivery of the stock of Silver Shield Corporation.

Registrant offered and sold Triumph stock on behalf of the issuer when no registration statement under the Securities Act had been filed or was in effect as to such stock. Sales of the stock were effected by Babcock through an account in registrant's principal office in Triumph's name, and by Stead through an account in the branch office entitled "R & E Investment" which replaced the Triumph account and was opened on April 20, 1967.¹ Both accounts were opened by Hugo Emery who, as Babcock and Stead knew, was president of Triumph, and the only transactions in those accounts were sales of Triumph stock. The R & E account contained Triumph

¹ Babcock testified that the earlier account was mistakenly opened in the name of Triumph instead of R & E.

stock that was borrowed by the company and was to be sold to raise funds for its drilling program.² Registrant purchased for its trading account a total of 17,000 shares of Triumph stock from the Triumph account on March 22 and April 19, 1967, and thereafter sold a number of such shares, and, in addition, it sold around 70,000 shares of Triumph stock in the R & E account between April 20 and May 1, 1967.

Stead claims that he was not involved in the transactions in the R & E account that were effected prior to April 28 because he assertedly did not commence his employment with registrant until April 27.³ While there is some uncertainty in the record as to the exact date of the beginning of Stead's employment, taken as a whole the evidence supports the examiner's finding that such date was around April 20. The first transaction in the R & E account with registrant which Stead handled as a salesman was effected on that date, and the record indicates that the account was opened by Stead. Moreover, on that date the last sale of Triumph stock was effected in a similar account maintained with Stead's previous employer which had also been opened by Emery for the purpose of selling such stock and was handled by Stead, and also on that date Stead effected the first transaction in his personal trading account with registrant. It further appears that Stead ceased trading in his personal account with his prior employer on April 21. Stead additionally participated in the distribution of Triumph stock in that from April 24 to May 1, 1967 he purchased 20,000 Triumph shares from the R & E account for his own trading account with registrant and resold virtually all of such shares during that period.

Respondents assert that reasonable inquiry concerning the status of Triumph stock had been made by Stead when he handled the R & E account for his previous employer. Stead testified that he had questioned Emery who stated that he did not own that stock, that it was not control stock, and that he was acting as agent for certain stockholders who did not want their identities disclosed. Stead also testified that he communicated with the transfer agent who stated the stock was freely tradeable. Stead further testified that he was not aware that the transfer agent was also an officer of Triumph. Registrant and Babcock also assert that a subsequent inquiry of the

² The Stockholders who loaned the shares to Triumph had the option of accepting a certain payment for or the return of such shares.

³ Stead's answer originally recited that his employment began about April 15, and was amended at the hearing to state April 23.

transfer agent was made by Stead at the instance of registrant after Stead became employed by registrant, and that such inquiry confirmed the free trading status of the stock.

In our opinion, respondents could not properly rely on the statements made to Stead by Emery and the transfer agent regarding the status of the Triumph stock in the R & E account maintained with Stead's previous employer, particularly since Emery had refused to disclose the identity of the persons for whom he was purportedly acting as agent and had previously demonstrated to registrant and Stead his strong interest in selling Triumph shares.⁴ That further investigation was necessary is evidenced by the transfer agent's testimony that had Stead asked her to identify the beneficiary of the R & E account, she would have named Triumph.⁵ The subsequent inquiry by Stead while employed by registrant was made long after the sales in question and after our staff had inquired into the propriety of registrant's transactions in Triumph stock. We conclude that Babcock and Stead failed to make sufficient inquiry despite the various circumstances which should have alerted them to the need for such inquiry.⁶

Registrant effected transactions in Silver Shield stock in an account maintained in registrant's branch office in the name of "J. J. Minerich & Co.". The account was opened by William Campbell, Jr., who was president of Silver Shield as well as president of Minerich, for the purpose of selling Silver Shield stock as to which no registration statement under the Securities Act had been filed or was in effect. The only transactions in the account were sales of Silver Shield stock at Campbell's direction, and 125,000 shares were sold from August 21 to September 4, 1967. Those shares were subject to registration because Campbell controlled both the issuer and Minerich and the latter was therefore an "issuer" and registrant an underwriter within the meaning of Section 2(11) of the Securities Act. In addition, at least a portion of those shares had been

⁴ Pursuant to an option granted by Emery in March 1967, registrant's purchases of 17,000 shares from the Triumph account on March 22 and April 19, 1967 were effected at 10 per share, when the market price was considerably higher as evidenced by substantially contemporaneous prices of 14¢ and 17½¢ at which registrant purchased or sold such shares. We find, as did the examiner, that this option was given to registrant as a special inducement to sell Triumph stock. We further note that, in the course of Stead's previous employment, Emery had offered compensation for inserting quotations for Triumph stock in the sheets, although such offer was declined by Stead.

⁵ Stead refers to testimony of the transfer agent indicating that she had had a legal opinion that the Triumph stock "involved" was freely tradeable. However, that opinion, which apparently was oral, did not relate specifically to the stock in the R & E account.

⁶ See *Strathmore Securities, Inc.*, 43 S.E.C. 575, 585-86 (1967), *aff'd* 407 F.2d 722 (C.A. D.C. 1969); *S.E.C. v. Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959); *S.E.C. v. Mono-Kearsarge Consolidated Mining Company*, 167 F. Supp 248, 259 (D. Utah, 1958).

acquired by Minerich from the issuer around the time of the sales and registration of such shares was required because Minerich and registrant were statutory underwriters. Checks for the proceeds of the sales, which were prepared by registrant's principal office, were sent to Minerich at the same address Campbell had as a customer of registrant and were endorsed by Campbell as its president.⁷

The salesman who handled the account testified that, pursuant to his inquiry in connection with opening the account, he was advised by Campbell that the stock was not insider or control stock. We agree with the examiner that the salesman failed to make adequate inquiry with respect to the tradeability of the stock. The salesman knew that Campbell was president of Silver Shield but did not inquire as to the nature of Campbell's relationship with Minerich, whose account was opened by Campbell, with a view to determining whether Minerich and Silver Shield were subject to his common control.

As further found by the examiner, registrant, while participating in the distribution of Triumph stock, effected transactions in the stock without giving to purchasers at or before the completion of each purchase written notification of the existence of its participation in the distribution in willful violation of Section 15(c)(1) of the Exchange Act and Rule 15c1-6 thereunder. We also find, as did the examiner, that Babcock and Stead willfully aided and abetted registrant's violations of those provisions.

FAILURE TO COMPLY WITH RECORD-KEEPING REQUIREMENTS

The record supports the examiner's finding that registrant, willfully aided and abetted by Babcock, willfully violated the record-keeping provisions of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, in failing to make and keep current and accurate certain required books and records.

An inspection by our staff in late September and early October 1967 disclosed that registrant failed to maintain a commission payable account and a record of monies borrowed and loaned and securities pledged, that the general ledger had not been posted since May 31, 1967, and that current trial balances had not been prepared for June, July or August 1967. Belated trial balances for those months prepared at the request of our staff were deficient in failing to indicate, among other things, securities pledged, monies borrowed, and sales

⁷ The same salesman also opened and handled Campbell's personal account.

commission payable. And the brokers' and customers' accounts showed only net figures instead of separate aggregate debit and credit balances. In addition, registrant's stock position records were not current or accurate.

The condition of registrant's records was such that registrant's chief cashier had characterized them as being in a state of "turmoil" and registrant ceased doing business from October 6 to December 29, among other things, to reconstruct the books and records and install a new bookkeeping system.

We further find, as did the examiner, that Stead willfully aided and abetted registrant's bookkeeping violations to the extent that they involved deficiencies in his individual trading account with respect to matters that were subject to his control. Stead's account was rendered inaccurate by virtue of, among other things, the arrangements involving the delivery of his own securities to registrant for the purpose of future sale. As Babcock advised Stead, such securities were not entered in Stead's account. Babcock did not wish to have those securities reflected on registrant's books because of the additional work and expense that would be involved in connection with an impending audit of registrant's books and because he considered many of them to be of poor quality. Following the sale by Stead of such securities, Babcock in some instances entered them in the Stead account for the first time. In other instances no entry was made to reflect receipt of a security whose sale was recorded, thereby giving the misleading appearance of a short sale. A reconstructed account subsequently prepared by registrant's chief cashier also showed substantial differences in money balances and securities received, with the disparity in money balances amounting to \$23,875 as of May 31, 1967.

Registrant and Babcock urge that any violations were not willful, and that the problems in this respect resulted from an increase in business and the difficulty of obtaining and retaining competent help and were similar to those experienced by other firms. It is well established, however, that a finding of willfulness does not require an intent to violate the law; it is sufficient that the person charged with the duty intentionally commits the act which constitutes the violation.⁸ Although registrant and Babcock were warned by our staff in 1965 and 1966 of record-keeping deficiencies and registrant was unable

⁸ See *Tager v. S.E.C.*, 344 F. 2d. 5, 8 (C.A. 2, 1965), and cases there cited.

to maintain its records on a current basis, Babcock engaged Stead in April 1967 to increase business volume, and following his employment, registrant's volume increased 60 percent. Although it appears that registrant contracted to purchase a bookkeeping machine prior to Stead's employment, there was a delay in its arrival and programming, and it kept breaking down.

Stead points out that, as found by the examiner, he was not employed in a managerial capacity, and argues that he is not responsible for registrant's record-keeping deficiencies with respect to his own account which was kept in the principal office and supervised by Babcock. As previously indicated, however, we have limited his culpability to the deficiencies found in his own account of which he knew or should have known because they involved matters subject to his control.

INACCURATE FINANCIAL REPORT

Registrant's report of financial condition as of May 31, 1967, which was signed and sworn to by Babcock and was filed with us in July 1967, contained materially inaccurate statements. That report showed a net worth of \$53,880 and current liabilities of \$185,099, including commissions payable of \$3,024. Liabilities were understated by at least \$9,152, representing commissions and other moneys payable to Stead.⁹ In addition, the report referred to the existence of an "automatic" bank loan of up to \$25,000 in the event of an overdraft position when, in fact, no such loan existed.

We agree with the examiner that in the above manner registrant, willfully aided and abetted by Babcock, willfully violated the reporting provisions of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder. Although Babcock asserts that he signed the report in reliance upon the certified public accountant who prepared it, it is clear that he had the primary responsibility for the accuracy of the information to which he swore and that he cannot shift such responsibility to the accountant.¹⁰

⁹ The figure of \$9,152 is based on corrections made to the financial report submitted by registrant's auditors in January 1968. An earlier reconstructed version of Stead's account prepared in November 1967 by registrant's cashier showed an understatement of \$23,875 in moneys payable to Stead, but it is not clear whether the auditors took the changes reflected in the cashier's version into account.

¹⁰ See *Thompson & Sloan, Inc.*, 40 S.E.C. 451, 456 (1961); *Interstate Hosiery Mills, Inc.*, 4 S.E.C. 706, 721 (1939).

The examiner also found that Stead willfully aided and abetted registrant's violation of the reporting provisions. The record before us, however, does not contain sufficient evidence to support this finding.

IMPROPER EXTENSION OF CREDIT

Registrant and Babcock do not dispute the hearing examiner's conclusion, and we find, that between April 1967 and January 1968 registrant violated the credit provisions of Section 7(c) of the Exchange Act and Sections 4(c)(2) and 4(c)(8) of Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System. We further conclude, as did the examiner, that such violations were willful. As found by the examiner, registrant in a number of instances failed promptly to cancel or liquidate purchases by customers in cash accounts handled by a salesman in registrant's branch office in which full payment was not made within seven business days. Registrant also permitted customers to purchase securities in cash accounts which did not contain sufficient funds for such purchases prior to execution and in which during the preceding 90 days securities were purchased and, without full payment being made, were sold.¹¹

These respondents assert that registrant was denied adequate time to prepare a defense by virtue of an amendment to the charge of Regulation T violations in the order for proceedings requested by the Division and granted by the hearing examiner in the course of the hearings. The amendment changed the allegation charging a violation of Section 4(c)(5), which requires payment within 35 days against delivery, to one charging a violation of Section 4(c)(2), which requires payment within seven business days. In our opinion no prejudice has been shown. Registrant had adequate time to prepare a defense to the amended charge, and additional time was not requested by it. In any event, the charge as amended was based upon registrant's own records, and not upon unexpected evidence.

OTHER MATTERS

Respondents assert that the hearing examiner's treatment of certain charges as to which he determined not to find a violation or, in one instance where he found a violation, not to consider it in imposing a sanction, prejudicially influenced his evaluation of the sanctions to be imposed,¹² and evidenced bias

¹¹ In our opinion the record does not support the hearing examiner's further finding that Babcock and Stead aided and abetted the violations of Regulation T. Moreover, Babcock was not charged with a failure of adequate supervision.

¹² The examiner held that the conduct involved in one of the charges did not constitute a violation of the designated statutory provisions; refused to sustain another charge on the ground that the conduct in question was not willful; held that a third charge was not sustained by a preponderance of the evidence; and determined not to base any sanctions upon a fourth charge, as to which he found a violation, because he was unable to find any precedent for such finding.

against them. There is no substance to this assertion. In our opinion, it was appropriate for the examiner, in considering the Division's contentions with respect to those charges, to discuss them fully and explain his reasons for rejecting them so that the Division could determine whether to seek review of his findings. We consider that the examiner who is legally trained and judicially oriented, would not be prejudicially influenced by those findings. Moreover, our determination of the question whether the sanctions ordered by the examiner should be set aside or reduced is based on our independent examination of the record with respect to the issues raised by respondents' petitions for review.

PUBLIC INTEREST

Registrant and Babcock contend that the sanctions imposed upon them by the examiner are unduly severe and not comparable to those imposed in analogous cases. They assert among other things that customers have suffered no losses, and that registrant "voluntarily" suspended business for almost three months to make its books and records current and accurate and has maintained proper records since, has closed its Ogden office and no longer employs Stead, has prohibited its traders from maintaining personal accounts with it, and has retained a new accounting firm and legal counsel to insure future compliance with applicable requirements. Finally, they state that our staff has lodged no complaints against them since the hearings which were held in May 1968, and that barring Babcock from all but supervised association (after six months) will remove him permanently from any meaningful participation in the securities business and is penal in nature.

In our opinion, the factors presented by registrant and Babcock and the fact that we have made no adverse finding against Babcock as to the Regulation T charge are not sufficient to warrant a reduction in the sanctions imposed upon them by the examiner. The violations we have found here demonstrate either an inability or unwillingness to operate registrant's business in conformity with applicable requirements, even after these respondents were alerted to certain of those requirements by our staff. It is mere speculation to affirm that no customer suffered a loss where securities are distributed without the safeguards provided by full disclosure of pertinent information, and where records are not properly kept. The suspension of registrant's operations to correct its records was pursuant to Babcock's understanding from con-

versations with our staff that otherwise steps would be taken to close the business. With respect to the asserted absence of any staff complaint against these respondents since the hearings, we note that in April 1969 (prior to their assertion), upon the recommendation of our staff, we instituted broker-dealer proceedings against them charging willful violation of the registration provisions of the Securities Act in 1968.¹³

The remedial action which is appropriate in the public interest with respect to any particular respondent depends on the applicable facts and circumstances and cannot be measured precisely on the basis of the action taken against other respondents.¹⁴ The sanctions imposed are remedial, not penal, in nature and are designed to protect investors and the public interest by barring registrant from the securities business and deterring Babcock as well as others in the industry from committing violations of the securities laws. The requirement of supervised association in any future employment will not necessarily be permanent. A future employer would not be precluded from making a showing in favor of permitting Babcock to occupy a supervisory position.¹⁵

Stead urges that no sanction be imposed upon him. As we have seen, Stead's participation in the violations found, except for those relating to the distribution of Triumph stock, was more limited than Babcock's, and we have exonerated him from responsibility in connection with registrant's inaccurate financial report and Regulation T violations. He states that, unlike Babcock, he did not occupy a managerial position with registrant and had received no prior warnings of misconduct, that he has been in the securities business for 15 years without any other complaint, and that he is now the owner and principal of a broker-dealer firm employing about 20 persons and the sanction ordered by the examiner would close that business. We note, however, that Stead, as well as registrant and Babcock, was named as a respondent in the broker-dealer proceedings instituted in 1969, and that those proceedings are pending against him. Under all the circumstances, while Stead has not made a sufficient showing to warrant setting aside the

¹³ Pursuant to an offer of settlement in those proceedings submitted by registrant and Babcock without admitting or denying the allegations, those respondents were found, among other things, to have willfully violated the registration provisions as alleged, registrant's broker-dealer registration was suspended for 30 days, and Babcock was suspended from association with any broker-dealer for a like period. Securities Exchange Act Release No. 8804 (January 21, 1970).

¹⁴ See *Dugash v. S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967); *Century Securities Company*, 43 S.E.C. 371, 384 (1967), *aff'd sub nom. Nees v. S.E.C.*, 414 F.2d 211 (C.A. 3, 1969).

¹⁵ See *Melvin Hiller*, 43 S.E.C. 969, 974 (1968), *aff'd sub nom. Gross v. S.E.C.*, 418 F.2d 103 (C.A. 2, 1969). :

sanction imposed by the examiner, we consider that it would be appropriate to reduce such sanction by changing the proviso to the bar order so that Stead may become employed in a supervised capacity after three months, upon a showing of adequate supervision.

An appropriate order will issue.¹⁶

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

¹⁶ The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.