

ADMINISTRATIVE PROCEEDING
FILE NO. 3-1512

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED

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SECURITIES & EXCHANGE COMMISSION

In the Matter of
BABCOCK & CO.
LOUIS W. BABCOCK AND
ROBERT T. STEAD
(8-11902)

INITIAL DECISION

David J. Markun
Hearing Examiner

Washington, D. C.
December 24, 1968

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Appearances: G. Gail Weggeland, attorney-in-charge of the Salt Lake City office of the Commission, and Joseph F. Krys, Assistant Regional Administrator of the Denver Regional Office, for the Division of Trading and Markets.

Alexander H. Walker, Jr. of Salt Lake City for Babcock & Co. and Louis W. Babcock.

Norman S. Johnson, of Christensen and Jensen, Salt Lake City, for Robert T. Stead.

Before: David J. Markun, Hearing Examiner

THE PROCEEDING

This proceeding was instituted by an order of the Commission dated March 22, 1968, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether, singly and in concert, the respondents willfully violated and willfully aided and abetted violations of the Securities Act of 1933 ("Securities Act") and the Exchange Act and rules thereunder as alleged by the Division of Trading and Markets ("Division") and the remedial action, if any, that might be appropriate in the public interest.

The Commission's order for public proceeding was amended by its order of May 6, 1968, which added allegations that the respondents violated the anti-fraud and registration provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, as amended, with respect to Silver Shield Corporation common stock.

The Commission, by order of May 16, 1968, amended its Order so as to eliminate from the proceeding the question whether Babcock & Co., pending determination of the questions presented in Paragraphs A and B of Section III of the Order for Public Proceeding, should be suspended.

On May 23, 1968, in the course of the evidentiary hearing, the Hearing Examiner granted a motion by the Division to amend the order for public proceeding over the objection of respondents. The amendment substitutes the phrase "seven business days" for the words

"thirty-five days" and strikes the language "delivery of said securities" in Section II, Paragraph F of the Order, which alleges violations of Section 7(c) of the Exchange Act and Regulation T thereunder, prescribed by the Board of Governors of the Federal Reserve System.

Under the Order as thus amended the Division alleges, in substance, that the respondents, singly and in concert, willfully violated and willfully aided and abetted violations:

- of Sections 5 and 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 15c1-2, and 15c1-6 thereunder, by selling shares of the common stock of Triumph Corporation for which no registration statement was in effect or had been filed and failing to give purchasers of such securities written notification of Babcock & Co.'s participation and financial interest in the primary distribution of such securities;
- of the same sections and rules mentioned immediately above in like manner in connection with sales of Silver Shield common stock;
- of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, by failing to keep current and proper books and records relating to the business of Babcock & Co.;
- of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder by filing a false report of financial condition on Form X-17A-5;

= of Section 7(c) of the Exchange Act and Regulation T thereunder;

= 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, by exchanging checks in a "check kiting" activity;

= of the provisions mentioned immediately above, by failing to disclose to customers, in cases in which Babcock & Co. acted as broker both for customers and for Respondent Stead (trading for his own account) that Stead was on the opposite side of the trade, and by failing to give information regarding commissions etc. alleged to be required;

= of the provisions mentioned above, by converting customers' fully paid securities by using them in the business of Babcock & Co. without the consent of the customers; and

= of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, by violations of the net capital rule.

Respondents appeared and filed answers. At all stages in this proceeding each respondent has been represented by counsel. Babcock & Co. and Louis W. Babcock are represented by common counsel.

Prior to the evidentiary hearing, the Hearing Examiner on May 15, 1968, denied a motion of respondent Robert T. Stead to modify a subpoena served upon him; and on May 13, 1968, denied an application by all respondents for an order allowing discovery depositions to be taken.

The evidentiary hearing in this proceeding was held in Salt Lake City, Utah, from May 21 through May 27, 1968. An initial decision by the Hearing Examiner was requested by the respondents. The findings and conclusions herein are based upon the record and upon observation of the various witnesses.

FINDINGS OF FACT AND LAW

The Respondents

Respondent Babcock & Co. (generally hereafter referred to as "Registrant") has been registered with the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 since April 5, 1964, and is still so registered. It has its principal place of business in Ogden, Utah, with a branch office in Salt Lake City.

Registrant is a member of the NASD. It was a member of the Salt Lake Stock Exchange, a registered exchange, until it resigned its membership on January 9, 1968.

Respondent Louis W. Babcock (hereafter generally referred to as "Babcock") is a partner of registrant. His wife, the only ^{other} partner, is inactive. Babcock's experience in the brokerage business prior to the time registrant commenced operations consisted of one year's experience as manager, during 1963, of the Ogden branch office of Lindquist Securities, a broker dealer having its principal office in Salt Lake City.

Respondent Robert T. Stead (generally hereafter referred to as "Stead") is a trader for over-the-counter stocks and a registered representative of the registrant dealing with customers. Stead

commenced employment with the registrant on or about April 20, 1967,^{1/} and has continued as an employee to the time of the hearing. During the period involved in this proceeding he worked in the Salt Lake City Branch Office along with one other trader and registered representative, Paul Barraco, and a couple of supporting personnel. Stead had formerly been employed by Lindquist Securities and H. Wayne Stead Company, and has been engaged in the securities business for approximately 15 years.

The registrant commenced its operations as a small broker-dealer in Ogden, Utah, in April, 1964. In February, 1967, it opened a Branch Office in Salt Lake City, employing Paul Barraco as a trader and registered representative. At its two offices registrant has employed roughly 11 or 12 people: two traders and registered representatives were employed at the Salt Lake City office (i.e., Barraco and respondent Stead); two full-time registered representatives (i.e., John Davis and respondent Babcock (the latter also being a trader) and one part-time representative (Vaughn Allen) functioned in the Ogden office; and supporting personnel existed in both offices. Babcock estimated that the Salt Lake City office accounted for roughly 80% of the business done by the firm.

When respondent Stead commenced employment with the registrant, he expected to become a partner in the firm before too long. However,

^{1/} See discussion below, at p. 18, concerning his date of employment.

although some discussions toward that end were had, particularly a proposal that would have permitted not only Stead but the other registered representatives to participate as partners, nothing ever came of the discussions, and Stead never achieved the status of a partner. Although there was some effort to elicit testimony suggesting that Stead was in fact manager of the Salt Lake City Branch of the registrant, the record does not support such a conclusion. The management of both offices was in the hands of respondent Babcock, though he spent far less time in the Salt Lake City office than in the Ogden office.

The compensation paid to respondent Stead by the registrant was based on commissions, and did not include any salary. Stead received 37-1/2% of the commission earned by the registrant on transactions on the Salt Lake Stock Exchange where the transaction was generated either in Stead's personal cash trading account that he maintained with the firm, or in the accounts of those customers for whom Stead was the registered representative; he received 50% of the commission earned by the registrant on all other transactions that were made in his (Stead's) personal trading account or in accounts for which he was the registered representative. In addition, Stead shared, along with respondent Babcock and with Barraco, in the profits or losses of the registrant's trading account.

Triumph Corporation Stock: violations of registration and anti-fraud provisions

The Division charges that the registrant, aided and abetted by Babcock and Stead, using the mails and instruments of interstate commerce, sold the stock of Triumph Corporation ("Triumph") and delivered such shares after sale in transactions that were distributions of unregistered securities in behalf of the issuer or its controlling person, thereby willfully violating Section 5 of the Securities Act of 1933, as amended. The Division further charges that the registrant was acting as an underwriter for Triumph and that the respondents willfully violated Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 15c1-2 and 15c1-6 thereunder by (a) making false and misleading statements and omitting statements of material fact and engaging in acts and a course of business which would and did operate as a fraud and deceit upon its customers in that they sold Triumph stock when no registration statement was in effect or had been filed as to said securities and (b) failing to give or send to the purchasers of the securities at or before the completion of the transactions written notification of the registrant's participation and financial interest in the primary distribution of the securities.

Triumph is a Utah corporation originating as a "spinoff" from Kennebec Consolidated Mining Company. The corporation is engaged in the oil and gas business. Its president is one Hugo Emery. No registration statement has been filed with the Commission under the

Securities Act of 1933, or the Securities Act of 1933, as amended, relating to securities of this corporation.

"R and E Investment" is a bank account opened by a Mrs. Etta Eldredge at the request of Hugo Emery at the American National Bank in Salt Lake City, Utah, for the benefit of Triumph Corporation. Mrs. Eldredge was the Transfer Agent and Vice President of Triumph prior to her resignation a couple of weeks before the evidentiary hearing.

The registrant was active in trading Triumph stock. A schedule of its trading in Triumph from March 15 through October 6, 1967, was introduced as Division's Exhibit 6. Altogether, 501,800 shares were traded by the firm. Of this total, respondent Stead, through his individual cash trading account with the registrant, traded 232,050 shares or 47% of the total transactions of the firm. The firm's trading account traded 23% of the total volume, or 117,550 shares, and the R and E Investment account was responsible for 18% of the total volume, having traded 88,500 shares. The R & E Investment account had only sale transactions, and all were sales of Triumph Corporation stock.

The evidence establishes that the registrant made use of the mails to sell and deliver Triumph stock.

Respondent Stead opened an account^{2/} entitled "R & E Investment" with the registrant on April 20, 1967, and thereafter sold

^{2/} Division's Exhibit 17.

shares of Triumph out of this account on the order of Hugo Emery. It is not contested that Stead was the account executive for the R and E account. Prior to his employment by the registrant on or about April 20,^{3/} Stead had opened and handled as registered representative an "R & E Investment" account, at the instance of Hugo Emery, with his former employer, Lindquist Securities. In that account, Stead accepted sell orders for the sale of Triumph stock from Hugo Emery, a person then known to Stead to be the president of Triumph Corporation. While with Lindquist Securities, Stead caused quotations to appear in the National Quotation Sheets (pink sheets) for Triumph Corporation stock.

Prior to the commencement of sales transactions in Triumph stock in the R & E Investment account for which Stead was the account representative at Babcock & Co., sales of Triumph stock were made through the registrant in an account entitled "Triumph Corporation" (no address).^{4/} Sales of Triumph Corporation stock were made in this account on March 22 and April 19, 1967. The account, maintained in the Ogden office of the registrant, was opened by Hugo Emery, who was known to respondent Babcock to be president of Triumph Corporation and who stated to Babcock his intention to sell Triumph stock. The record shows clearly that respondent Babcock was the account

^{3/} See discussion below, at p. 18, concerning his date of employment.

^{4/} Division's Exhibit 16.

representative for this account. He accepted orders from Hugo Emery and caused checks to be paid for sale transactions of Triumph Corporation stock made payable directly to Triumph Corporation.

Respondents Babcock and Stead both acknowledged in their testimony that the "Triumph Corporation" account maintained by the registrant was the same account as the "R & E Investment" account. Babcock testified that the "Triumph Corporation" account had been misnamed and that it should have been opened as the "R & E Investment" account. Evidently, when Stead came to the registrant and opened the R & E Investment account on April 20, the anomaly in having two differently named but identical accounts within the same brokerage firm became apparent, and the "Triumph Corporation" account was thereafter in effect closed out. See Division's Exhibits 16 and 17, which show the Triumph Corporation account closing on April 19 and the R & E Investment account commencing on April 20.

Babcock made no customer's account card for the "Triumph Corporation" account when it was opened. Likewise, Stead did not make a customer's account card for the "R & E Investment" account that he opened at Babcock & Co. The implausible reason he gave for not having done so was that there already was a customer's account card for the R & E Investment account at Lindquist Securities. In fact, the proprietor of that firm, Griffith C. Lindquist, testified that no account card for the R & E Investment account could be located in his firm. While Stead testified that he had made such a customer's

account card for the R & E Investment account at Lindquist, he could not recall what information the card contained. Under all the circumstances, it is concluded that Stead's testimony was mistaken and that in fact no customer's account card had been prepared by him at Lindquist for the R & E Investment account there. The failure by respondents Babcock and Stead to make a customer's account card for either the "Triumph Corporation" account or the "R & E Investment" account with the registrant suggests awareness of, and a desire to disguise, the true purpose of such accounts, namely, as found below, the distribution of unregistered Triumph Corporation stock.

Sales of Triumph Corporation stock through the R & E Investment account and the Triumph Corporation account were sales on behalf of the issuer, Triumph Corporation, and were part of a distribution. This is made clear by the testimony of Etta Eldredge, Vice President of Triumph Corporation prior to her resignation shortly before the hearing. She testified that she was asked by Hugo Emery, the President of Triumph Corporation, to open a bank account for R & E Investment. The account was opened to service and assist Triumph Corporation. The witness took orders from Hugo Emery with respect to the account. At the request of Hugo Emery the witness signed the checks payable to R & E Investment Company issued by Lindquist Securities and by the registrant. Some of these checks the witness cashed, giving the money to Triumph Corporation to pay for oil drilling costs pursuant to Emery's instructions. Other checks she deposited in the bank account of R & E Investment and thereafter

the proceeds went to Triumph Corporation. On the instructions of Emery, she wrote checks on the account on behalf of Triumph Corporation. Mrs. Eldredge further testified that the stock being sold had been loaned to Hugo Emery by various stockholders and was to be sold in order to allow the drilling program of Triumph Corporation to continue. The stockholders were to be allowed the privilege of accepting either 15¢ a share for their loaned stock or the return of a like amount of stock in Triumph Corporation. This arrangement was pursuant to a resolution of the Board of Directors of Triumph Corporation.

The registrant sold 84,000 shares in the Triumph Corporation and R & E Investment accounts, representing 3% of the approximately 2,750,000 outstanding shares in April, May, and June 1967.^{5/} These sales were made within a 36-day period from March 22 to April 28, 1967. That the proceeds from the stock sales were used directly by the corporation is further established by the 8 checks which were identified as Division's Exhibits 58 and 40.^{6/} These 8 checks were endorsed by Etta Eldredge on behalf of Triumph Corporation, except for two checks which were made payable to Triumph Corporation by Babcock & Co., on which the endorsement was "Triumph Corporation, Hugo Emery, President." The checks which Mrs. Eldredge endorsed were received from Hugo Emery.

^{5/} There may have been only 2,500,000 shares outstanding in April 1967.

^{6/} Exhibit 58 contains cancelled checks of the registrant, while Exhibit 40 contains cancelled checks of Lindquist Securities.

Additional evidence that the registrant, assisted and aided by the individual respondents, was knowingly participating in a distribution of Triumph Corporation stock on behalf of the issuer, stems from the fact that Emery offered both Babcock and Stead special financial inducements in connection with the sale of Triumph stock. Thus, the registrant through respondent Babcock was given an option to purchase shares of Triumph Corporation at 10¢ a share. This option was exercised by the purchase first of 10,000 shares of Triumph Corporation stock at 10¢ a share and later an additional 7,000 shares at the same price. These purchases of Triumph stock by the registrant from the Triumph Corporation account were at a price below the market, and thus provided the registrant with additional compensation for effecting Triumph Corporation stock transactions beyond the usual commission charged to customers. This price differential is established by the quotations for Triumph Corporation stock on the dates that the registrant, pursuant to the 10¢ per share option, purchased the stock through its firm trading account. On March 22, 1967, the market, as indicated by the "pink sheets," was 14 to 15 cents per share. Two days before this date the registrant had made trades at 15¢ a share and on the succeeding day at 14¢ a share. On April 19, when the registrant purchased for its trading account 7,000 shares of Triumph Corporation stock at 10¢ a share from the "Triumph Corporation" account, the registrant's daily "spread sheet" shows a quotation for Triumph stock for that day at 14 to 17 cents. The registrant executed for the R & E Investment account on the following day, April 20, 1967, a

sale at 17½¢ per share with another broker, and on the next day, the 21st of April, the price had risen to 18¢ per share for 3,000 shares. The "pink sheets" on April 19, 1967, quoted Triumph Corporation stock at 14 to 17 cents on the quotation of Lindquist Securities. Without considering the probative value of the evidence regarding quotations in the pink sheets, it is clear from registrant's own trading that the actual market was well above the ten cents a share the registrant paid.

Respondent Stead testified that he could not recall having been given an option to purchase Triumph stock by Hugo Emery. He did testify however that he had been offered special compensation by Emery at least to the extent of reimbursement for the costs of "going the sheets" in connection with maintaining a market in Triumph Corporation stock. This offer, Stead testified, he declined, saying "There is nothing to it. There is not any compensation involved there anyway, and I didn't want anything to do with it."^{7/} This offer was made to Stead while he was employed by Lindquist Securities, before coming to the registrant, and should clearly have put Stead on notice that further and diligent inquiry was in order to insure that distribution of unregistered stock was not involved, particularly when coupled with the fact that Stead already knew that Hugo Emery was the President of Triumph Corp. As respects the testimony that Stead could not recall whether an option had been offered him, it seems unlikely that he would

^{7/} R. 900,901.

not have recalled one way or the other, particularly since he also testified that the entire circumstances under which he was approached by Hugo Emery made him "very suspicious."^{8/}

The respondents failed to give or send to purchasers of Triumph securities, at or before the completion of each transaction, written notification of the existence of registrant's participation and financial interest in the primary distribution of the stock. The registrant did not mark its confirmations or give customers any written statement to disclose its participation in the distribution of Triumph Corporation stock. Confirmations to customers who had purchased Triumph Corporation stock on cross trades with the R & E Investment account do not have any marking or stamp thereon. No other writing or document indicated the participation in the distribution of Triumph Corporation stock. The witnesses who purchased Triumph Corporation stock all testified that they were told nothing about the firm's being involved as an underwriter for the stock; they received no prospectus, and were not told the firm was receiving a special commission or remuneration for making the trade. This nondisclosure establishes the violations of the anti-fraud provisions charged by the Division unless respondents could show that their conduct was not willful.^{8a/}

^{8/} R. 889.

^{8a/} Under Section 15(b) of the Exchange Act it is held that willfulness means "no more than that the person charged with the duty knows what he is doing. It does not mean that in addition, he must suppose that he is breaking the law". Hughes v. S.E.C., 174 F. 2d 969, 977 (1949).

The respondents defend against the charges respecting their transactions in Triumph Corporation stock essentially on the ground that they were the victims of deception on the part of the issuer and that they had made reasonable and prudent inquiry to determine whether the stock was freely tradeable. Curiously, the registrant and respondent Babcock defend on the basis of the inquiry and investigation supposed to have been made by respondent Stead while he was with Lindquist Securities, before he came to be employed by the registrant. They do this, apparently, for the reason that the evidence indicates that respondent Babcock, when he initially opened the "Triumph Corporation" account in Babcock & Co., at the instance of Hugo Emery, evidently made no inquiry into the free tradeability of the Triumph Corporation stock, even though he then knew Hugo Emery to be the President of Triumph Corporation. It would seem, in these circumstances, that the registrant's and Babcock's reliance on any investigation which Stead may have made while at Lindquist, before coming to his employment by Babcock & Co., is entirely misplaced.

Respondent Stead, likewise, when he opened the R & E account on April 20, 1967, at Babcock & Co., made no inquiry at that time into the free tradeability of the Triumph Corporation stock. This, he said, for the reason that he had previously, while at Lindquist Securities, made inquiry as to its free tradeability. There is no indication that he checked or consulted with Babcock before opening the R & E Investment account on April 20. Stead

testified that on more than one occasion while he was at Lindquist Securities, he checked with Hugo Emery and with the Transfer Agent, Mrs. Eldredge, to ascertain whether the Triumph Corporation stock that was being sold in the R & E account was freely tradeable and not being unlawfully distributed. He stated that he was told that Emery was selling the stock in the R & E account on behalf of certain anonymous holders of the stock who became shareholders at the time that Triumph Corporation resulted as a spin-off from Kennebec Corporation. He testified that Emery refused to disclose the identity of the individuals purportedly owning the stock. Mrs. Eldredge testified that when Stead made his inquiry of her, he did not in fact ask her what the R & E Investment account was. On cross-examination by Stead's counsel, she stated that it was possible that he had asked her what the R & E Investment account was. She went on to testify, on redirect, that if she had been asked that question by Respondent Stead she would have told him "that it was an account that Hugo was selling some stock in" and that the money was going to the benefit of Triumph Corporation.^{9/}

Respondent Stead urges that he was not connected with the sale of stock from the R & E Investment account opened at Babcock & Co. on the basis that the public trading out of that account took place within a 36-day period from March 22 to April 28, 1967, prior to the date, which he claims to have been April 27, on which he

^{9/} R. 587-589.

commenced employment with the registrant. Actually, the record in this proceeding discloses considerable vacillation as to the precise date on which respondent Stead commenced employment with the registrant. Thus, Stead's answer alleged that he commenced employment about April 15, 1967. Thereafter, at the evidentiary hearing Stead amended his answer to state that he commenced employment on April 23, 1967.^{10/} The answer of registrant asserted that Stead's employment with it commenced on or about April 21 but in its proposed findings it submits merely a finding to the effect that the employment commenced some time in April, 1967. The Division, although submitting a proposed finding that the employment commenced April 27, states that the date is not "clearly set forth in the record." On the basis of all relevant portions of the entire record it has been concluded, as indicated above, that Stead's employment with the registrant commenced on or about April 20, 1967. Among the factors supporting this conclusion is the fact that the R & E Investment account with the registrant, for which Stead admittedly was the account representative, commenced on April 20, 1967.^{10a/} Also, Stead made his first purchase transaction in his personal trading account at Babcock & Co. on April 20, 1967.^{10b/} He had delivered into that account stock on receipts evidently dated April 18, 1967.^{10c/} Moreover,

10/ R. 23

10a/ Division's Exhibit 17.

10b/ Division's Exhibit 10.

10c/ Division's Exhibit 64.

Stead stopped trading in his account at Lindquist Securities on Friday, April 21, 1967. Lastly, Stead's statement of his commission earnings for April 1967 as compared with his earnings for subsequent 10d/ months suggests an employment date for him of April 20, give or take a day or so, more than it does an employment date of April 27. However, even if Stead had commenced employment on April 27, 1967, he would not escape involvement. The record establishes clearly that Stead bought 1,000 shares of Triumph Corporation stock from the R & E Investment account on April 24, another 1,000 shares on April 25, 13,000 shares on April 28, and 1,000 shares on May 1, 1967. Given the nature of Stead's individual trading account, it is clear that these shares were taken into his account for trading, not investment, purposes. Subsequently, these shares were disposed of and in so doing Stead participated in the distribution of the unregistered Triumph stock.

The respondents question that it was "firmly established that a public distribution of Triumph Corporation stock was being engaged in by the registrant." But the record fully supports the Division's position that this case follows the classic characteristics of unregistered distributions through a broker. First, orders of substantial size for the sale of Triumph Corporation stock were given to both Babcock and Stead by Hugo Emery, known to each of them to be the president of Triumph Corporation. Secondly, as already noted,

both Babcock and Stead were given or offered special financial inducement for trading the securities. The account salesmen dealing with the seller, i.e., Babcock and Stead, as already indicated, either made no evident effort to check (Babcock) or made only perfunctory efforts to do so (Stead). Although the circumstances were such that they were clearly both put on notice that an extensive and productive inquiry was in order, they failed to make such inquiry. This, notwithstanding the fact that both of them testified that they were "suspicious" concerning the proposals from Hugo Emery.^{11/} Having been thus put on notice, it would not be unreasonable to require or expect both Babcock and Stead to have checked (or caused to be checked) the endorsements on cancelled checks returned to Babcock & Co. for Triumph stock sale proceeds.^{12/} These cancelled checks bore endorsements clearly indicating that the beneficiary of the transaction was the issuer or its president. Where respondents by their own testimony were highly suspicious, and had the objective means available for verifying their suspicions, their ready reliance upon the statements of interested parties, i.e., the president of Triumph Corporation and the transfer agent, Mrs. Eldredge, whom reasonable inquiry would have disclosed to be the vice president of the corporation, can hardly be taken as fulfilling their obligation to inquire. Lastly, the failure at Babcock & Co. to make customers' account cards for the Triumph Corpora-

^{11/} R. 889, 1008. Babcock was suspicious partly because of the persistence Hugo Emery showed.

^{12/} See In the Matter of Reynolds & Co., et al, 39 S.E.C. 902, at 915-916, respecting the duty of management to examine check endorsements

tion account or for the R & E Investment account indicates that the respondents were well aware of their participation in the distribution of unregistered Triumph Corporation securities. If they did not affirmatively know it, they at least willfully failed to take appropriate and available steps to ascertain the true facts when a host of factual circumstances made it clear that there was a need for such inquiry.

The law is clear that knowledge of given circumstances can impose the duty of making further inquiry, and that a failure to make the inquiry will result in the imputation of knowledge that makes conduct willful. Securities & Exchange Com'n v. Mono-Kearsarge Con. Min. Co., 167 F. Supp 248 (1958). What the court said there, at p. 259, is particularly pertinent to this proceeding:

" . . . Probably the facts directly known by them were sufficient to acquaint them with the true situation. If not, they were sufficient to impose upon them the duty of making further inquiry. Under the circumstances, they were not entitled to rely solely on the self-serving statements of Pennington and the other Canadians denying those facts which would have indicated that they were representing controlling persons, or were under common control with an issuer. With all these red flags warning the dealer to go slowly, he cannot with impunity ignore them and rush blindly on. . . He cannot close his eyes to obvious signals which if reasonably heeded would convince him of, or lead him to, the facts and thereafter succeed on the claim that no express notice of these facts was served upon him. The transactions. . . were not exempt and such distributions in the absence of registration were unlawful."

To the same effect is S.E.C. v. Culpepper, 270 F. 2d 241, 251 (1959).

Accordingly, it is concluded that from on or about April 20, ^{13/}1967 through October 6, 1967 ^{14/} the registrant and respondents Babcock and Stead willfully violated or aided and abetted violations of Section 5 of the Securities Act of 1933 as amended, in that during the stated period they would and did offer to sell and sell and deliver after sale by use of the mails and means and instruments of transportation and communication in interstate commerce, shares of the common stock of Triumph Corporation when no registration statement was in effect or had been filed with the Commission under the 1933 Act as to the said securities. It is further concluded that from on or about April 20, 1967 ^{13/} through October 6, 1967 ^{14/} the registrant was participating in a primary distribution of Triumph Corporation stock and it would and did induce customers to purchase Triumph Corporation stock and failed to give or send to purchasers of said stock at or before the completion of such transactions written notification of the existence of the registrant's participation and financial interest in the distribution of said securities in willful violation of Section 15(c)(1) of the Securities Exchange Act of 1934, as amended, and Rule 15c1-6 thereunder. Respondents Babcock and Stead directly aided and abetted these violations, and, indeed, were the primary instruments through whom registrant committed the violations.

^{13/} Violations by registrant and respondent Babcock commenced earlier, i.e., March 22, 1967. See Division's Exhibit 16.

^{14/} The date registrant voluntarily suspended operations. See also Division's Exhibit 6, which reflects registrant's trading in Triumph through October 6, 1967.

Inasmuch as use was made of the mails and means of transportation and communication in interstate commerce to carry out this activity, the activity was violative also of Section 17(a) of the Securities Act of 1933, as amended. In addition, the conduct described violated, as charged, Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder and Rule 15c1-2.^{15/}

Silver Shield Corporation Stock: violations of registration and anti-fraud provisions

On motion of the Division, the order for public proceeding was amended on May 6, 1968, to add allegations that the respondents, in the offer and sale of stock of Silver Shield Corporation, willfully violated, or willfully aided and abetted violations of, the anti-fraud and registration provisions of the securities laws, i.e., Sections 5 and 17a of the Securities Act of 1933, and Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 and Rules 10b-5, 15c1-2 and 15c1-6 thereunder by participating in a primary distribution of stock of Silver Shield Corporation for which no registration statement was in effect or filed and failing to give its customers notification that it was so participating.

^{15/} Since registrant is a registered broker-dealer and Babcock and Stead were acting on behalf of registrant, a registered broker-dealer, in all respects mentioned in these conclusions, use of the mails or any means or instrumentalities of interstate commerce is not a prerequisite to a finding or conclusion that prohibited activity was violative of the Securities Exchange Act of 1934, as amended, and the rules adopted thereunder, in view of the provisions of Section 15(b)(4) of that Act.

It is established that no registration statement has ever been filed for Silver Shield Corporation with the Securities and Exchange Commission under the Securities Act of 1933, or under that act as amended.^{16/}

Silver Shield Corporation is a Utah corporation that was inactive when it was acquired from Utah residents by William L. Campbell, Jr., who became president and a controlling person thereof.

An account was opened at Babcock & Co. in Salt Lake City by William L. Campbell, Jr., in the name of J. J. Minerich and Company for the purpose of selling Silver Shield stock. Campbell was known to the account representative of the registrant, Paul Barraco, when Campbell appeared in person at the registrant's office in Salt Lake City to open the account. At that time Barraco knew that Campbell was the president of Silver Shield Corporation and that he was also then acting as transfer agent for the stock of the corporation.

Barraco does not appear to have inquired whether William L. Campbell, Jr. was an officer or controlling person of J. J. Minerich & Co. What the actual identity of J. J. Minerich & Co. is and what its relationship to William L. Campbell, Jr. and to Silver Shield Corporation may be, does not appear in the records of the registrant. No account card was made by the registrant for the account. Had such a card been made and maintained, it would have disclosed necessary information concerning the identity of J. J. Minerich & Co. and its

^{16/} Division's Exhibit 19.

officers, and likely recorded the board of director's authorization for the sale of stock.

William L. Campbell, Jr. was a director and the only active officer of J. J. Minerich & Co. The record shows that he was then only 21 years of age - just the minimum legal age to contract for himself. Barraco testified that a call to Campbell concerning the transferability of stock was made to him at a grocery store.

Barraco testified as follows concerning his inquiries of William L. Campbell, Jr. as to the free tradeability of Silver Shield stock: "I asked him a lot of questions about the stock, whether it was insider's stock or whether it was controlled stock, or if it was over 1% or over 10%, and he answered no to every single one of the questions." That such questioning in fact occurred seems doubtful; however, assuming that it did, it is evident that the questioning, given the total background against which it was made, was superficial and inadequate.

Silver Shield Corporation stock was sold in the J. J. Minerich & Co. account on instructions from William L. Campbell, Jr. A total of 125,000 shares of Silver Shield Corporation stock was sold in that account from August 2, 1967 through September 11, 1967.^{17/}

The Silver Shield Corporation had approximately 1,667,949 shares outstanding at the time the registrant was selling its stock on the order of Silver Shield's president. Registrant did not request

17/ Division's Exhibits 23, 59.

an attorney's opinion as to the transferability and alienability of the stock.

Payments for sales transactions of Silver Shield Corporation stock were made in the J. J. Minerich & Co. account by Babcock & Co. ^{18/} checks. The checks, prepared by registrant's Ogden office, were endorsed by W. L. Campbell, Jr., President, J. J. Minerich & Co. Three of the checks were made payable to J. J. Minerich & Co., P. O. Box 225, Davenport, Washington. ^{19/} A fourth check, No. 5402, in the amount of \$3,870.50, which was paid in the William L. Campbell, Jr. account, ^{20/} was made payable to the First Security Bank.

It is significant that shares of Silver Shield Corporation were received into the J. J. Minerich & Co. account registered in the name of Babcock & Co. ^{21/} These shares were issued directly to the name of J. J. Minerich & Co. from the unissued treasury stock of Silver Shield Corporation shortly before it was transferred into the name of the registrant. Further, some shares were issued directly into the name of Babcock & Co. from previously unissued shares of Silver Shield

18/ Division's Exhibits 24, 25.

19/ Evidently the checks were mailed to this address, the account address, which is the same address as that of William Campbell Jr. See Division's Exhibits 23, 24.

20/ This appears to have been an attempt to pay cash to William L. Campbell, Jr., but the record is not clear as to what the payment was designed to cover (Record 241).

21/ Division's Exhibit 49.

Corporation stock. Some of the shares issued in the name of Babcock & Co. were from a previous record ownership in the name of William L. Campbell, Jr.

Paul Barraco also testified that he sold Silver Shield Corporation stock for Carl F. Myers and Donald D. Glenn. Glenn had informed Barraco that the stock being sold had been obtained by Myers for properties which had been sold to Silver Shield Corporation. Glenn had bought some of this stock from Myers; that is, stock Myers had acquired for the sale of property. Glenn requested that Barraco determine whether the stock was "free trading." In response to this, Barraco called William L. Campbell, Jr. Purportedly relying upon the statements or opinion of William L. Campbell, Jr., the common stock of Silver Shield Corporation was sold for both the accounts of Donald D. Glenn and Carl F. Myers. Barraco did not request an attorney's opinion from either Glenn or Myers or Silver Shield Corporation or William L. Campbell, Jr. relating to the transferability and alienability of the stock.

The record also shows that Paul Barraco purchased Silver Shield Corporation stock directly from William L. Campbell, Jr.

The registrant made a market in Silver Shield Corporation stock. ^{22/} Quotations in the pink sheets (National Daily Quotation Service, Daily Quotation Sheets) were placed by the registrant for Silver Shield Corporation stock during this time.

So far as appears, the registrant left determinations as to whether a stock was freely tradeable or not up to the account representative, at least in the Salt Lake City office. There is no indication that the registrant had any written or otherwise established procedures requiring account representatives to check with the active partner, i.e., Babcock, before making such determinations, even in cases where the suspicions of the registered representative may have been aroused. The registrant's "Rules of Office Procedure"^{23/} do not contain instructions on this point nor do they indicate the nature or extent of the inquiry that the registered representative should make before concluding that a stock is freely tradeable. In these circumstances, the registrant, having delegated authority to make the decision as to free tradeability to Barraco, must be charged with responsibility for Barraco's failure under all the circumstances to make adequate inquiry.

Accordingly, it is concluded that the registrant willfully violated Section 5 of the Securities Act of 1933, as charged, by participating in a primary distribution of unregistered Silver Shield Corporation stock.

Turning to the alleged violations of the anti-fraud provision, it is clear that the registrant failed to send to purchasers of Silver Shield Corporation stock, at or before the completion of each

23/ Division's Exhibit 79.

transaction, written notification of the existence of the registrant's participation in the primary distribution of Silver Shield securities.

The registrant did not have a stamp or other marking device which would indicate on customers' confirmations the fact that the registrant was engaged in a distribution. There is no claim by respondents that any such marking was placed on the confirmations.

Therefore, under the rationale stated above in discussing violations relating to Triumph stock, it is concluded that registrant willfully violated the anti-fraud provisions, as charged, in its transactions respecting Silver Shield Corporation stock.^{24/}

The Division urges that respondent Louis W. Babcock should be held to share responsibility for the violation of Section 5 by the registrant on the theory that Babcock failed to exercise the necessary supervision over Paul Barraco, the account representative. However, a failure to supervise is not alleged in the order for proceeding. In view of Section 15(b)(5)(E) of the Exchange Act as added by the 1964 amendments,^{25/} which made inadequate supervision an independent ground for the imposition of a sanction, a failure of supervision cannot be held to constitute violations of other provisions which are charged as grounds for remedial action.^{26/} Thus, although the

^{24/} Registrant made use of the mails and of means of communication in interstate commerce (telephone) in the sale of Silver Shield Corporation stock.

^{25/} 78 Stat. 565, 571.

^{26/} Armstrong, Jones & Company, Securities Exchange Act Release No. 8420, Administrative Proceeding File No. 3-336, October 3, 1968, footnote 27.

record would clearly support a conclusion on a factual basis that Babcock had failed to supervise Barraco adequately, either in the sense of establishing procedures or enforcing them, due-process considerations preclude such a conclusion.

Respecting respondent Stead's involvement, Division's Exhibit 59 sets out a list of persons, including public customers and brokerage customers of the registrant who purchased stock of the Silver Shield Corporation on sell transactions made in the J. J. Minerich & Co. account. Such sales were made between August 11, 1967 and September 4, 1967. Two of the ten trades were with respondent Stead, who purchased on September 1 23,000 shares and on September 4 1,000 shares. The account of Robert T. Stead shows subsequent sale transactions of this Silver Shield Corporation stock. Accordingly, respondent Stead would be a participant in the distribution of Silver Shield Corporation stock, assuming he had the necessary awareness of facts which would indicate that he knew, or should have known, upon reasonable inquiry, that he was participating in a distribution. In view of the fact that Stead and Barraco were working in the same office in Salt Lake City, and in view of the fact that Stead participated in a distribution of Triumph Corporation stock, as found above, it is perhaps unlikely that Stead was unaware of essentially the same facts that Barraco possessed regarding the Silver Shield Corporation stock. Nevertheless, the record falls considerably short of establishing on the part of Stead the kind of knowledge that

Barraco had. Accordingly, respondent Stead cannot be held to have participated in the distribution of unregistered Silver Shield Corporation stock.

Failure to keep current and accurate books and records

It is charged that during the period from about April 1, 1967 to the time of the hearing, registrant willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder and that Babcock and Stead willfully aided and abetted such violations, directly and indirectly, in that the registrant failed to make and keep current and accurate accounts, correspondence, memoranda, books and other records relating to the business as prescribed by Rule 17a-3, including, among other things, general ledger accounts, customer ledger accounts, daily blotters, security position records, proofs of money balances, and computations of the firm's net capital.

The respondents concede that there were a number of violations of the bookkeeping rules, but they seek to minimize the extent or importance of them and they urge that such violations as occurred were not willful. To place the violations being examined in this proceeding in some kind of perspective, and as bearing on the question of willfulness, it is necessary to inquire into the business history of the registrant antedating the charging period here involved.

The registrant, in February 1965, was warned by the Commission staff concerning what it considered to be violations of bookkeeping rules. This warning followed an inspection of the books and

records of the registrant which commenced September 9, 1964. At that time, it appeared that the general ledger had not been posted to include auditors' adjusting entries, and discrepancies between registrant's ledger accounts and the X-17A-5 report filed with the Commission purporting to set forth the condition of the registrant as of May 31, 1964, could not be reconciled. It appeared that the general ledger had not been posted from May 31, 1964 to September 5, 1964. The capital account in the general ledger failed to record \$16,000, and approximately 20 customers' fully paid securities were not tagged and identified as being in safe keeping. The Commission's inspector discussed with respondent Babcock the need for maintaining books and records in conformity with the Commission's regulations. Babcock sent a letter dated February 25, 1965, acknowledging the questions that had been raised, reporting on the actions he had taken to meet the Commission's requirements and stating his intention to continue to abide by the Commission's requirements. ^{27/}

In January 1966, the registrant was again inspected and additional violations of the bookkeeping rules and regulations were charged by the inspector. The general ledger accounts did not appear to balance with the subsidiary ledgers due to errors. The Administrator of the Denver Regional Office of the Commission sent a letter advising Babcock & Co. of the discrepancies and warning again of the need for compliance. Notice was also given of violations of

27/ Division's Exhibit 39.

regulation T. Respondent Babcock responded by letters of February 25, 1965, and March 7, 1966. ^{28/}

Turning now to the bookkeeping transgressions charged in this proceeding, the record discloses a number of serious violations.

Trial balances (proof of money balances) and computations of the firm's net capital for the months of June, July and August 1967 had not been prepared or maintained by registrant as required by Rule 17a-3(a)(11) and 17a-4(b)(5) under the '34 Act.

When trial balances were ultimately prepared for these months, long after they should have been, they did not indicate, among other things, securities pledged, money and securities borrowed or loaned, or commissions payable to salesmen. Further, the brokers' accounts and customers' accounts were carried as a control figure, that is, the difference between total debits and total credits, instead of presenting separately the sum of all accounts with credit balances and the sum of all accounts with debit balances. Also, the trial balances failed to disclose what portion of the firm's trading account was the property of respondent Stead or of Paul Barraco. ^{29/}
The trial balances were not adequate for capital computation.

28/ Division's Exhibit 66.

29/ The records as a whole were likewise inadequate for purposes of net capital computation, and did not meet the requirements of Rule 17a-3. See discussion below, under the point treating the issue of net capital violations.

Securities delivered into the account of respondent Stead were not recorded on the ledger record of the account.^{30/} This caused the appearance of short sales in Stead's cash account. In other cases, the Stead account recorded delivery of securities as having occurred after the actual date of delivery. Division's Exhibit 27 is a list of 35 securities that up to October 2, 1967, had not been, but which should have been, posted into that account. Division's Exhibit 28 is a list of securities which were delivered by Stead to the registrant for his account and posted onto the Stead ledger record and onto the stock position record at dates after the receipt. The list, containing 22 securities, discloses delays in posting of from one day to 48 days. Moreover, when posted, the record shows the delivery to the account as having occurred on the posting date instead of on the actual delivery date. Thus, the entries ultimately posted were inaccurate in this respect.

The registrant failed to maintain a commissions-payable account, and failed to maintain a record of moneys borrowed and moneys loaned and securities pledged as required by rule 17a-3 under the Exchange Act.

The general ledger was not posted currently. When the Commission's inspectors examined the record on October 5, 1967, they found that it had not been posted since May 31, 1967.

30/ The circumstances giving rise to this anomalous condition, and some of the consequences, are discussed more fully below under the section treating the false filing of a form X-17A-5 report.

Likewise, the stock-position record was not posted currently and, in some instances, was not posted at all. It was necessary for the newly hired cashier, Mrs. Pat Rose, to completely reconstruct the firm's stock-position records by using receipts and customers' ledgers. This was necessary because of errors made in prior postings and because of lack of current postings.

Again, the registrant failed to inform customers quarterly of credit balances in their accounts as required by Rule 15c3-2 under the Exchange Act.

The record discloses substantial errors in various customers' accounts. Perhaps the most serious errors are to be found in the account of respondent Stead.^{31/} Two reconstructions of this account were received in evidence. Division's Exhibit 10 is a reconstruction undertaken on the instructions of the auditor after errors in the audit report of May 31, 1967, were called to the auditor's attention. This reconstruction disclosed errors in money balances which required an adjustment of \$1,197.49 to the audit report. The second reconstruction was by Mrs. Pat Rose, recently hired cashier of the registrant, who rebuilt the account completely. She discovered numerous errors and

^{31/} The errors in this account are due in part, but by no means entirely, to the fact that when Stead commenced employment with the registrant, he delivered to registrant a substantial number of stocks which, for reasons discussed more fully below in connection with the discussion of the false filing of a Form X-17A-5 financial report by the registrant, were not entered into the Stead account in timely fashion.

mispostings. For May 31, 1967, the disparity between Mrs. Rose's reconstructed account and the original Stead account and the first reconstruction thereof, in terms of money balance, involved a difference of \$23,874.61. Very substantial differences in money balances between the Rose-reconstructed Stead account and the original Stead account and its first reconstruction can be found throughout the period covered by Division's Exhibits 1, 10, and 64.

Mrs. Patricia Rose, who is employed as chief cashier of registrant, testified that shortly after her employment she found the records to be in a "turmoil."^{32/} She reported her view that there was an inadequate "fail system" maintained by the registrant prior to its suspension of business on October 6, 1967. She thought that a complete new bookkeeping system was required, which would be quicker and more accurate. Confirmations and trade tickets did not reconcile, and she could not determine whether they had been posted. She also considered that the general ledger should be posted by machine instead of by hand. She found no way to double check figures on the general ledger. If a mistake was made in entering a figure in the general ledger, there would be no way to discover the error. The general ledger figures were not current. They were not balanced and brought forward. There were errors in postings of credits and debits so that brokers' accounts and customers' accounts would not balance. The stock-position records were

^{32/} Respondent Babcock testified that he needed Mrs. Rose desperately to overhaul the books and records and that he told her "she was an angel from heaven." R. 997, 998.

not current. In reconstructing the records of the registrant Mrs. Rose prepared new ledger cards for all accounts and prepared new stock-position records. As much as possible she attempted to flatten out customers' and brokers' accounts by delivering securities.^{33/}

The registrant ceased doing business voluntarily on October 6, 1967, on the basis of respondent Babcock's understanding that if he did not do so voluntarily steps would likely be initiated promptly by the Commission staff to close him down.

To rehabilitate its records, the registrant used all available employees, including five office girls, respondent Babcock, as well as the wives of respondent Stead and Paul Barraco, working on a part-time basis. Some Saturday and other overtime work was done. The reconstruction and correction of the records was still not complete when the auditors started their audit on November 28, 1967.

Mrs. Rose testified that it was approximately a three-month period before business resumed. She felt it would have been impossible to reconstruct the books and records and get everything in balance unless the firm ceased operations. During this three-month period, when no customers' transactions were being effected, the full energy of the registrant's staff was employed to correct the old books and records and to completely set up a new bookkeeping system. The

^{33/} In this connection, the registrant obtained permission from the Commission staff to purchase certain short positions while its business was suspended. Some of the short positions were covered (Division's Exhibit 61), while others remained and were later reported by the auditors (Division's Exhibit 7, p. 8 and Division's Exhibit 8).

magnitude and duration of this task is some indication of the state of the registrant's books and records before it ceased doing business.

The respondents, particularly the registrant and Babcock, urge strongly that the sorry state of the registrant's records was caused by an increase in the amount of business and by the inability to get and to keep experienced personnel. They argue that these conditions are chronic in the industry and that therefore the inadequacies should not be regarded as giving rise to willful viola-
34/ tions. But this argument overlooks the very significant fact that the registrant sought the addition of respondent Stead to its staff for the express purpose of building up its volume. The registrant cannot soundly urge this excuse when it failed to take steps to insure that its staff would be adequate to the task of keeping the firm in compliance with record and bookkeeping requirements before adding to its staff a trader in the Salt Lake City office for the express purpose of substantially building up its activity.

Respondent Stead defends further on the ground that whatever may have been the record-keeping deficiencies of the registrant, he, not having been in a managerial capacity, had no responsibility for them.

34/ Whether or not other brokers are guilty of similar bookkeeping violations is of course not relevant in this proceeding.

The Division made some effort to establish that Stead was in fact the manager of the Salt Lake City office. However, this contention is not supported by the record. Respondent Babcock testified that he was in charge of both the Ogden and Salt Lake City offices of the registrant. The Salt Lake City office had two salesmen (respondent Stead and Paul Barraco) and two girls. Babcock and Stead both testified that Stead had no management duties nor did he have the title of manager. Although Stead did hire two girls, it appears that he rather than Barraco did so primarily because Stead was more often available, since Barraco spent half a day on the Salt Lake City Stock Exchange. The Division urges that Stead must have had some duties in connection with bookkeeping and transaction recording inasmuch as the trading desk closed with the end of the business day and respondent Stead testified that he had to work extremely long hours - 18 to 20 hours a day sometimes - to keep current. The record does not establish how Stead may have been occupied at the office outside of trading hours, nor is the testimony regarding the long hours necessarily to be taken at face value. In any event, the record lacks any substantial evidence that Stead had any managerial functions or duties.

Thus, Stead's argument that he is not accountable for the record-keeping violations of the registrant is essentially sound, except for the inaccurate status of Stead's individual cash trading account that he maintained with the firm, to the extent that the

disparities in it were matters subject to his control. ^{35/}

On the other hand, it is clear that respondent Babcock, an active partner and officer of the firm, aided and abetted the registrant's violations of law and rules ^{35a/} by, among other things, failing to establish an adequate record-keeping system and by deliberately choosing to substantially increase the firm's volume by employing another trader (Stead) at a time when registrant clearly was not keeping up with book and record-keeping requirements.

The respondents urge that the violations of bookkeeping rules that occurred here should not be regarded as serious for the reason that, after all, the record does not indicate that any losses to customers occurred during the period in question. However this argument overlooks the very significant fact that for approximately a three-month period, i.e., June through August of 1967, the registrant was operating without knowing what its net capital position was and

35/ Stead's involvement in this regard is treated in greater detail below under the point involving a false filing of the form X-17A-5 financial report.

35a/ Babcock, the only active officer of registrant, recognized his obligations respecting record keeping, e.g., the filing of trial balances, but he nevertheless failed to file trial balances, as found above. He thus aided and abetted registrant's bookkeeping violations. Empire Securities Corporation, 40 S.E.C. 1104, 1106 (1962). As a principal officer and stockholder, Babcock, being aware of the chaotic condition of the books and records, must share in the responsibility for that state of affairs (apart from questions of supervision). Johnston & Company, Securities Exchange Act Release No. 7391, August 14, 1964. A principal officer and stockholder is under a duty to use reasonable care to see to it that the every day operations of the firm's business are properly performed. Madison Management Corp., Securities Exchange Act Release No. 7453, October 30, 1964.

its books and records were in such a state that it was not possible to ascertain from the books and records what the net capital position was without a great deal of time consuming effort such as registrant ultimately went through in an attempt to bring its books into compliance.

Moreover, it was the registrant's haphazard and uncoordinated bookkeeping and record keeping system, or lack of a system, that caused or contributed to its use of customers' securities in its business, a point treated separately below.

Further, it is significant that the registrant seemed perfectly willing to continue operating at high business volumes notwithstanding the fact that he must have been aware that he was not complying with the bookkeeping requirements; it was only after Commission personnel commenced investigating that it finally saw the necessity for suspending its operations in order to bring his books and records into compliance. Had the investigation that occurred not happened, it would seem that it would have been only a matter of time before the registrant's activities would have resulted in losses to customers.

As has been stressed repeatedly, the requirement that books and records be kept current and in proper form is at the heart of the regulatory scheme since it bears significantly on ability to determine whether other types of violations have occurred.

^{36/} Pennaluna & Company, Inc., et al., Securities Exchange Act Release No. 8063, April 27, 1967; Palombi Securities Co., Inc., et al., 41 S.E.C. 266, 276 (1962); Midland Securities, Inc., et al., 40 S.E.C. 333, 339-340 (1960); Olds & Company, 37 S.E.C. 23, 26-27 (1956).

False report of financial condition
on Form X-17A-5

The order for public proceeding includes a charge that the registrant willfully violated, and that respondents Babcock and Stead willfully aided and abetted the registrant's violations of Section 17(a) of the Securities Exchange Act of 1934 37/ and Rule 17a-5 thereunder by causing the registrant on July 19, 1967, to file a report of financial condition on Form X-17A-5 dated as of May 31, 1967, which did not contain all of the information required by Form X-17A-5 and which did contain information that was false with respect to material items, including, among other things, information concerning commissions payable, total net worth, moneys owed customers (cash accounts) and cash. The record fully substantiates the occurrence of this violation.

Respondent Babcock caused to be forwarded to the Commission a report of registrant's financial condition pursuant to Rule 17a-5, knowing that the information contained therein was false and misleading, 38/ notwithstanding the fact that he had sworn that to the best of his knowledge and belief the financial statement and supporting schedules were true

37/ The Division urges also that respondents should be found to have violated Section 32(a) of the Exchange Act. However, such violation was not charged in the order for proceeding nor would the section appear to be relevant to this administrative proceeding, it being a section that sets forth certain penalties applicable upon conviction of stated criminal offenses.

38/ The requirement that reports be filed necessarily embodies the requirement that such reports be true and correct. Great Sweet Grass Oils, Ltd., 37 S.E.C. 683 (1957).

and correct. This report was signed on July 19, 1967, and purported to report the financial condition of the registrant as of May 31, 1967. 39/ The report had to be amended.

By letter dated January 15, 1968, the auditing firm of Alexander, Currin, Greer & Bennett filed with the Commission corrections to the audit report of May 31, 1967 for the registrant, together with a revised report, this last being unsigned by respondent Babcock.

The differences between the original report and the revised X-17A-5 report appear in Division's Exhibit 85, a comparison prepared by an inspector of the Commission. The changes show first, an increase in the bank overdraft of \$8,739.13, caused by the return of a check issued by Robert Stead. 40/ Secondly, the customers' account credit balances were decreased in the sum of \$7,541.64, which figure represents a net difference between the figure \$8,739.11, representing the returned check in the Stead account, and the figure \$1,197.49, which represents an error in the Robert Stead account. 41/ These changes increased the net liability of registrant by \$1,197.49. Thirdly, the commissions-payable liability was increased by \$7,954.48. In total, the liabilities were thus increased by

39/ Official notice was taken of the report in the course of the hearing. R. p. 37.

40/ See discussion of returned checks of respondent Stead under the point discussing the kiting of checks below.

41/ R. 277.

\$9,151.97, and the firm's capital was reduced by that amount.

The increase in commissions-payable in the sum of \$7,954.48 was with respect to respondent Stead. This appears from item 4 of Division's Exhibit 31, the corrections to the original audit report submitted by the auditors, wherein the salesman entitled to the additional commissions is identified as one who also claimed additional commissions in the sum of \$6,307 which was disputed. The evidence discloses that Stead was the only one claiming additional commissions predicated on an assumption that he should have been entitled to a higher commission rate.

The audit report of May 31, 1967 is also incorrect with respect to note number 3 "answers to financial questionnaires - Part 1." Item 3 therein refers to a so-called "automatic loan" of up to \$25,000 in the event the account were to come into an overdraft position. The auditors testified that they were told by respondent Babcock of the existence of a so-called automatic loan. In fact, as established in the testimony of the vice president of the bank, no such "automatic loan" was in existence. While the bank apparently tolerated substantial overdrafts in the registrant's account, apparently at least in part on the basis of the fact that there were on deposit with the bank certain securities of the registrant, no "automatic loan" in the amount of \$25,000 or in any other sum actually existed at the bank. The

omission of the auditors to obtain confirmation of the so-called "automatic loan" does not excuse Babcock's responsibility for, first, having imparted such false information and, second, for having signed the report containing such a false and misleading statement.

In addition to the inaccuracies made apparent by the amended report, it would also appear that the Form X-17A-5 report was inaccurate by virtue of major errors in the Robert T. Stead account. Thus, as noted above in connection with bookkeeping violations, the reconstructed Stead account (Division's Exhibit 64), as compared with Division's Exhibits 1 and 10, indicates a cash difference of over \$23,000.

That respondents Babcock and Stead both acted willfully in aiding and abetting the registrant's filing of a false report of financial condition is abundantly apparent from the fact that both had knowledge of, but failed to disclose meaningfully to auditors, circumstances that made the Robert T. Stead account substantially in error.

Respondent Stead, about the time his employment commenced with the registrant, delivered to respondent Babcock a brown manila envelope containing stock certificates to be held in his personal cash trading account. Respondent Babcock received the stock but advised Stead that he would not record the securities into the account. Babcock's reasons for not doing so were stated to be two-fold: first, there was an impending audit of

the registrant, and Babcock did not want the registrant to sustain the time and expense that would be involved in the audit if such stocks were brought into the Stead account; secondly, Babcock explained that most of the securities Stead delivered were low-value, speculative issues of the kind that Babcock preferred not to have reflected on the registrant's books at that time.

Respondent Stead did not demand return of these securities to him, notwithstanding he had been advised clearly by Babcock that they would not be reflected in his account. The securities so delivered by respondent Stead were not recorded on the records of registrant, but instead were maintained in a manila envelope separate from the "safekeeping securities" of the firm, 42/ and, of course, they were not posted to the customer ledger of respondent Stead. From time to time, however, as already noted above in connection with discussion of the bookkeeping violations, when respondent Stead would sell a particular stock that happened to be included in the brown manila envelope, Babcock would record such stock into the Stead account, showing, however, the posting date as the date of delivery rather than the original delivery date.

During the course of the audit being performed by the audit firm of Alexander, Currin, Greer & Bennett, Stead received the usual auditor's confirmation showing his account with Babcock & Co. as the records of registrant disclosed it. Stead

42/ They cannot be regarded as having been held in "safekeeping" since they did not appear on the records of the registrant.

was aware that the audit was being made for an official report to the Securities and Exchange Commission.

It was apparent to respondent Stead that the confirmation delivered to him by the auditors was incorrect in a number of respects. First, the securities being held in a brown manila envelope had not been posted, which caused the erroneous appearance of short positions in his account. Secondly, the cash figure shown was in error. Stead failed to sign the confirmation or to communicate directly with the auditors any information indicating the disparity between their information and what he, Stead, knew or considered to be the true status of his accounts, either as to securities or money. Stead testified that he told Babcock of the disparities and that he assumed that Babcock would straighten the matter out with the auditors. The auditors made one additional request of Stead through Babcock to provide correct information in response to the auditor's confirmation, to which Stead failed to respond. Babcock urged Stead to sign the confirmation even though both knew the confirmation was incorrect. While Stead declined to do this, he took no affirmative step to advise the auditors as to the true status of his account.

As already noted, Stead knew through conversations with Babcock that the securities Babcock was holding in a manila envelope which should have been posted to the Stead account had not in fact been so posted. When Stead received the confirmation statement from the auditors, the fact that his securities had not been posted to his account was further brought home to him, as was the

fact that such failure to post created practical problems, i.e., his inability to certify the confirmation statement submitted to him. This fact should have made both Stead and Babcock highly conscious of the significance of their act in not posting the Stead securities to his account. This development should have emphasized to Stead his duty to insist that the matter be rectified. A simple way for him to have insured that that would be done would have been to respond candidly and honestly to the inquiry submitted to him in the form of a confirmation statement. Whatever may be the normal obligation of a customer to respond to an auditor's confirmation statement, it is clear that under all the circumstances present in this situation Stead had a duty to rectify the anomalous condition so that known and flagrant errors in his account would not become the source of false data furnished in a required report.

As already noted, the information submitted to Stead in the confirmation statement derived from the records of the registrant was incorrect both as to securities held and as to money balances. The auditor's information as to any inaccuracies came from Babcock. The record is not entirely clear in this respect, but it appears that the auditor's information was incomplete in this regard, respondent Babcock having evidently brushed the thing off with statements to the effect that the registrant was a little bit behind in their books and that the discrepancies apparently didn't amount to much. Babcock seemed

to be washing his hands of it. He testified that he assumed that the auditors together with Stead or his (part-time) employee were working the thing out. Thus, it seems clear that the auditors never had adequate information regarding the nature or magnitude of any inconsistencies either from Stead or from Babcock^{42a/}. Stead testified that he told Babcock that the confirmation was in error and that he (Babcock) should tell the auditors. It does not appear, however, that Stead told Babcock, either, of the precise nature and extent of the discrepancies as he (Stead) saw it.

Respondent Stead argues that his simple refusal to sign the confirmation statement should exonerate him from any responsibility for the false filing of the Form X-17A-5 report, and argues that he should not have been called upon to volunteer "discrediting information against his employer". But this argument places Stead in an untenable position: if he admits that a true and correct response to his confirmation request would have resulted in the disclosure of discrediting information against his employer he in effect admits that he was aware of the existence of "discrediting" circumstances, i.e., things which, without correction, would lead to violations, and that, notwithstanding his knowledge thereof, he failed to come forward with the facts. Under the circumstances here involved, it is concluded that this amounted to his aiding and abetting the registrant's violation.

On the question whether the false filing of the Form X-17A-5 was willful or not, it is also illuminating to examine the conduct of the registrant in a number of other particulars, as

^{42a/} Babcock clearly had a responsibility to verify the information to which he swore. Thompson & Sloan, Inc., 40 S.E.C. 451, 456 (1961).

disclosed by the record, which bear on the question of the registrant's fidelity or lack of it, to truthful and correct reporting. Thus, the record shows that on June 7, 1967 Babcock and the registrant borrowed the sum of \$3,100. Although registrant thereafter belatedly filed three "trial balance sheets" with the Commission for the months of June, July and August of 1967, he failed to disclose therein the evidence of the loan. The failure to do so is particularly striking in view of the fact that the form used by the registrant carried an item entitled "Notes Payable to First Security Bank," which item was left blank.

Again, the audit performed by the firm of Alexander, Currin, Greer & Bennett, failed to recognize the existence of a loan at the First Security Bank in the Annual Financial Report filed by the registrant Babcock pursuant to Rule X-17A-5. This is the report for the date of May 31, 1967, that failed to disclose a loan of \$275.75. This loan should also have been reflected in the trial balances for the months of June, July and August of 1967, just mentioned above, since the loan was not paid until September 11, 1967. But the trial balances do not mention this loan.

Still another evidence appears from Division's Exhibit 41. This amendment to the Division's Exhibit 7, the certified audit report for the registrant for November 28, 1967, filed with the Commission, states in part as follows:

"We now understand that Babcock did not file a subordination agreement. Therefore, this report should be amended to include the amount of \$1,135 as item 9-B. All other accounts are general partners."

Finally, there occurred an indication in connection with the registrant's trial balance for the month of January 1968. 42a/ This trial balance, mailed to the Denver Regional Office of the Commission for the information of the staff, failed to disclose the existence of substantial liabilities representing an undertaking of underwriting for New Products Corporation common stock. The registrant had undertaken to guarantee, under an agreement dated January 10, 1968, to pay to New Products Corporation out of stock sales at least \$25,000 by the end of January, 1968, and an additional \$10,000 by the end of February, 1968. 43/ Registrant had not sold by January 31, 1968, stock of New Products Corporation in the amount of \$25,000, thus had a liability of something over \$21,000 due and owing the New Products Corporation which was not shown on the January 1968 trial balance. This omission is particularly significant on the question of willfulness, coming as it does after the registrant had become the subject of an investigation by the Securities and Exchange Commission and after it had for a number of months voluntarily suspended operations in order to completely revise its bookkeeping procedures.

The cumulative effect of all of the omissions mentioned above, coupled with the failure of both Babcock and Stead to disclose to the auditors known and substantial anomalies in the Robert T. Stead account, compels the conclusion that the registrant wilfully filed a false report of financial condition on Form X-17A-5 and that respondents Babcock and Stead each aided and abetted the registrants' violation willfully.

42a/ Division's Exhibit 62.

43/ There are indications that Stead was active in negotiating the agreement with New Products Corporation.

Regulation T violations

The order for proceeding included allegations that during the period from about April 1, 1967 to January 31, 1968, the registrant, a member of the National Securities Exchange, and doing business through the medium of the National Securities Exchange, aided and abetted by respondent Babcock and respondent Stead, extended and maintained credit and arranged for the extension and maintenance of credit to and for customers on securities in contravention of Regulation T promulgated by the Board of Governors of the Federal Reserve System pursuant to Section 7(c) of the 1934 Act.

On motion of the Division, the order for public proceedings was amended at the evidentiary hearing over the objection of respondents. The change amends paragraph F. 1 under Section II by substituting for the phrase "35 days", the phrase "7 business days", and strikes from the paragraph the phrase "delivery of said securities".

The Salt Lake Stock Exchange is registered as a National Securities Exchange with the Securities and Exchange Commission under the Securities Exchange Act of 1934. 44/ The registrant was a member of the Salt Lake Stock Exchange until January 9, 1968 and since that date has done business through the medium of a member of the National Securities Exchange. 45/

44/ Official notice was taken of this fact in the course of the hearing. R. p. 385.

45/ R. 386.

Section 4(c)(2) of Regulation T (12 CFR 220.4(c)(2)) as here pertinent, provides that a broker or dealer shall promptly cancel or otherwise liquidate the transaction where a customer purchases a security in a special cash account and does not make full cash payment within 7 business days. The record discloses numerous violations of this rule and also of the so-called freeze requirement of Regulation T. This requirement (12 CFR 220.4(c)(8)) is to the effect that purchases may not be made in an account, without the security having been paid for in full prior to purchase, in any case in which the account during the preceeding 90 days showed the purchase of a security, and without the security having first been paid for in full, a sale of that security. Among the special cash accounts in which one or both of these violations were shown to have occurred are the accounts represented by Division's Exhibits 89, 91, 92, 93, 94, 95, 96, 97, 98, and 10, this last being the personal cash trading account maintained by respondent Stead at Babcock & Co.

It is not seriously disputed by any of the respondents that these Regulation T violations occurred. But all the respondents urge that the charge respecting these violations should be dismissed for the reason that the allowance of an amendment by the Hearing Examiner at the evidentiary hearing denied them adequate time to prepare a defense to such charges. This argument is groundless. First, the violations are established on

the basis of records, i.e., the account ledgers maintained by the registrant. While respondents suggested that perhaps extensions had been requested and granted in some cases, they made no serious effort to establish that such was the case. Second, none of the respondents requested a continuance at the conclusion of the Division's case in order to allow them additional time to prepare a defense to the Regulation T charges, or for any other purpose. If the respondent seriously had a defense available, there is no doubt that experienced and able counsel would have requested a continuance in order to prepare it.

In short, the record contains no evidence whatever to suggest that the respondents were prejudiced in any manner by the allowance of the amendment to the order for proceeding in the course of the evidentiary hearing.

Beyond these assertions of prejudice, respondent Babcock would seek to avoid responsibility for the Regulation T violations of the registrant by urging that it was the responsibility of the account representatives (respondents Stead and Barraco, both in Salt Lake City) to properly police such accounts for any possible Regulation T violations. Respecting this argument, respondent Stead urges that while it was technically the responsibility of traders Barraco and Stead to police Regulation T violations, it was in fact done by Babcock and Company at its principal offices in Ogden, 40 miles removed from the Salt Lake City office where Barraco and Stead worked. The registrant did evidently attempt to

assign a substantial measure of responsibility to the account representatives, at least nominally, in connection with the policing of Regulation T violations. Thus, paragraph 15 of its "Rules of Office Procedure", Division's Exhibit 79, provides as follows:

"15. Regulation 'T' must be watched with care -- no violation will be permitted. On the fourth day account representative must contact customer. Fifth day supervisor or partner advised. Sixth day decision must be made to either receive money or cancel trade and must be completed in full by the Seventh day. Do not request extensions -- they will be denied. If you have a customer that might have the money on a certain day -- do not accept order -- as partner will cancel order if known. Make the trade when the customer is able to pay -- not on a hoped to be received and thinking that they must buy today to make a profit. This is not only protection for you but for the customer."

The registrant can hardly avoid its responsibilities for compliance with Regulation T by delegating authority to its employees. If it has in fact delegated such authority, it has made those employees its agents, and must be responsible for their actions or their failures in complying with the requirements.

Neither can the registrant find an excuse based on the generally high trading activity of the firm. 46/ The number and extent of the violations suggests that no serious efforts were made to comply with the requirements and that the violations were willful. 47/

46/ J.A. Hogle & Co., et al., 36 S.E.C. 460, 465 (1955).

47/ Shelley, Roberts & Co. of Calif., 38 S.E.C. 744, 751 (1958).

Respondent Babcock's personal involvement would appear to have two aspects: first, the failure on his part to supervise to insure that the regulations that he himself promulgated as rules of office procedure were being carried out. The Order for Public Proceeding does not allege failure to supervise, and therefore, as already noted in connection with another issue, a failure to supervise cannot be found. 48/ However, a second aspect of respondent Babcock's involvement in his action is taking on another trader (Stead) at the Salt Lake City office for the express purpose of building up the volume of business, at a time when office help was hard to get and hard to keep. In these circumstances it would seem that the inevitable result of increasing the volume without at the same time increasing the capacity of the supporting personnel to take care of the increased volume was an unwarranted risk of the very kind of result that ensued, namely, numerous violations of Regulation T, along, of course, with numerous violations of the bookkeeping rules and other regulations. For this reason, it is fair to conclude that respondent Babcock aided and abetted the registrant's violations of Regulation T, irrespective of the question of failure to supervise. (The registrant, likewise, was responsible for the Regulation T violations on this rationale.)

48/ See p. 30 above, footnote 26.

As respects respondent Stead, it seems clear that the rules of office procedure assigned him substantial responsibility for policing Regulation T violations as respects those accounts for which he was the registered representative. Respondent Stead concedes that at least three of these and perhaps, as respondent Babcock testified, four of the accounts in which violations occurred were the accounts of respondent Stead. The record does not show any substantial effort on the part of either Stead or Barraco to comply with the requirements stated in paragraph 15 of the Division's Exhibit 79. Without concluding precisely as to the scope of duties Stead may have had under that internal office procedure, it seems entirely clear that he failed in his duty to his employer with respect to policing Regulation T violations, and that in so doing he aided and abetted the registrant's violations.

Moreover, Stead as a registered representative should have been aware of the status of his own cash trading account. 49/ Numerous Regulation T violations occurred in that account. Respondent Stead testified that he expected that commissions due him as a salesman of the registrant would be paid into his account to cover stock purchases. But this testimony is contradicted by the testimony of other salesmen in the firm to the effect that the office procedure of registrant would not permit a credit into their special cash account of the commissions due them. Babcock testified to this effect also.

49/ Naftalin & Co., Inc., et al., 41 S.E.C. 823, 832 (1964).

During the period May 31, 1967 through June 8, 1967, Stead issued a series of five checks that were returned. During the time that these checks were being returned for insufficient funds, Stead received payments amounting to \$46,422.86 as payment for the sales in his account from Babcock & Co. Taking these returned checks into consideration, the Stead account would show a continuous running debit balance from June 1, 1967 through September 1, 1967. At no time was the account of Stead frozen. From the time of June 8, 1968, when the first check was returned, through September 1, 1967, not less than 392 purchases were effected in the Stead account.

Whatever may be the responsibility of an ordinary customer who has knowledge that his transactions in his account are violating Regulation T, it is clear that respondent Stead, with his specialized knowledge as a registered representative, and being obliged under the registrant's internal rules of office procedure to police Regulation T violations in the accounts for which he was the registered representative, had a responsibility to make at least minimum efforts to make sure that his own account was not in violation. In failing to do so he aided and abetted the registrant's violations of Regulation T. 50/

50/ Naftalin & Co., Inc., et al., supra, footnote 47; V. Lester Yuritch, Securities Exchange Act Release 7875, April 29, 1966.

Check kiting

The Division contends that registrant and respondents Babcock and Stead, from about April 1, 1967, to approximately June 16, 1967, in connection with the purchase and sale of securities, engaged in a course of exchanging checks, drawn by each of them against their respective bank accounts, which, at the time the checks were drawn and exchanged, did not contain sufficient funds to cover the checks. It is urged that this practice operated as a fraud and deceit upon the customers of the registrant in that the respondents failed to state to the public customers that the practice was taking place. 50a/

Babcock & Co. was in an overdraft position in its checking account. The Division's Exhibit 29, being the audit report as of May 31, 1967 for Babcock & Co. as revised by the certified public accountants, shows an overdraft of \$46,774.52. Division's Exhibit 15, the bank statement of the registrant, indicates overdraft positions from time to time.

The overdraft that existed on May 31, 1967, continued in the bank account of the registrant during the time while respondent Stead was writing checks payable to the registrant that were also against insufficient funds. 51/

Respondent Stead issued checks on a personal bank account at the Valley Bank & Trust Company to the registrant.

50a/ The order for proceedings alleges violations 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.

51/ R. 1098-1099.

He did not write checks payable to the registrant on any other bank accounts from April 1, 1967 through September 30, 1967. Four of the checks issued to the registrant dated May 31, June 5, June 6, and June 7, 1967 were returned to the registrant marked either "returned, referred to maker," or "drawn against uncollected funds" or both. One check, issued on May 30, 1967, was returned to Babcock & Company also marked "referred to maker" and "drawn on uncollected funds", but it was later paid by the bank on resubmission of the check. 52/

Respondent Stead was writing checks in favor of the registrant which were drawn against deposits that consisted of the registrant's checks. He was drawing checks in favor of the registrant in amounts roughly approximating those which he was receiving by check from the registrant. Respondent Stead did not have funds to pay the accumulated amounts of the checks issued. Likewise, the registrant was issuing checks to respondent Stead drawn in part on the checks of Stead deposited in the Babcock account. 53/

Division's Exhibit 83 is an analysis of checks paid to and received from the trading account of Robert Stead. It was prepared from the account ledger and partly from debit memo slips maintained with bank records of the registrant. 54/ The

52/ Division's Exhibits 14, 68.

53/ Division's Exhibit 83.

54/ R. 1092.

exhibit demonstrates that by charging the four unpaid checks to the account it becomes evident that the account was in a continuous debit position from June 1, 1967 to June 14, 1967.

Division's Exhibit 67 is the bank statement issued by Valley Bank & Trust Company for the account of respondent Stead and his wife, on which account respondent Stead wrote the mentioned checks payable to the registrant. The account shows overdrafts ranging up to five figures on the following dates in 1967: March 2, 3, 21, 23, 24; April 18, 21; May 1, 2, 3, 4, 5, 8, 18, 23; June 21; and July 19, 20, 21 and 25.

Respondent Babcock attempted to explain the circumstances giving rise to the exchange of checks between himself (for the registrant) and respondent Stead as follows: 55/

"A. We were trying to keep up. We were behind. We were several days behind and we weren't sure whether Bob had the credit balance or credit balance as you can tell by the ledger card the volume was quite tremendous. We were concerned on the Reg. T. We were concerned on getting money. We wanted money and so we thought Bob and I discussed this with him, the best way to do is for everything he bought that he gives me a check and everything he sold I would mail him a check and we would do that at the end of the day's business. This way until the girls got caught up at least we would be keeping in balance. He thought that was a good idea and so did I. That is why these checks started coming into being."

But the evidence establishing what actually occurred does not appear to support this explanation of what gave rise to the practice of check exchanges. Thus, although his purported

explanation refers to a daily settlement, other testimony both of himself and respondent Stead indicates that on a number of occasions the registrant would issue three or four checks on the same day to respondent Stead, but with instructions to Stead to hold the checks and deposit them on different days so that they wouldn't all "hit the bank" on the same day. This clearly indicates the registrant's concern about the status of its bank balance during the period in question. Also, Babcock's purported explanation conflicts with his present position 56/ that the exchanges of checks were prompted in part by the payment to Stead by the registrant of commissions due him.

The checks exchanged were reflected in the Robert Stead account maintained at Babcock & Company. The Division's Exhibit 83, prepared by personnel of the Division, setting forth the revised status of the Stead account taking into consideration the checks drawn against uncollected funds, shows the dates and amounts in which checks were exchanged. There is no readily-apparent relationship between the amounts of the checks and transactions in securities, either particular transactions or aggregate daily transactions. The exchanging of checks did not in fact operate to keep the Robert Stead account "in balance", which Babcock had testified was the purpose. Thus, Stead would issue checks even though his customers cash account with the registrant at a particular time had a credit balance. 57/

56/ Babcock brief p. 20.

57/ Division's Exhibit 83.

The respondents take the untenable position that they did not know that Stead's account was in a credit balance. Stead stated he had no way of knowing whether or not he owed Babcock. This is inconsistent with his statement that he had an employee working at the time to reconcile his account so that he could respond to an auditor's confirmation. Moreover, if true, it would be a breach of a registered representative's duty to know the status of his own account. 58/ As respects the registrant and respondent Babcock, it would be, if true, a most serious reflection upon the status of the registrant's operations for it not to know the balance in the customer account that was perhaps the most active customer account that registrant had.

Respondents have made no real effort to relate moneys paid to either Stead or Babcock & Co. by virtue of the exchanged checks to transactions in securities. No such relationship is apparent from an examination of the Robert Stead account (Division's Exhibits 1, 10, 64) or of Division's Exhibit 83. Neither did the exchanging of checks serve to bring the Stead account into balance, for at no point was the account brought down to a zero balance. All that can be gleaned from the check exchanges is the fact that the checks exchanged over a period of time were roughly equal in total amount.

58/ Naftalin & Co., Inc., et al., 41 S.E.C. 823, 832 (1964).

While the Division's Exhibit 83 suggests no proper reason for the exchanges of checks that occurred between the respondents it does suggest that the purpose was the improper one of check kiting -- that is to provide apparent additional working capital in the bank account of the registrant. For example, the exhibit shows that on April 24, 1967 Stead had a debit balance of \$7,656.57. On that date Babcock gave Stead checks in the total amount of \$42,156.25, and Stead gave Babcock checks in the amount of \$42,833.38. The net effect was a remaining debit balance of \$6,979.44.

Babcock's bank informed him that they regarded the practice of exchanging checks with Stead as a "kiting of checks" and indicated that a bank examiner had so characterized it. The bank expressed concern about the practice. Because of this reaction the respondents discontinued "exchanging" checks.

That the practice being engaged in the exchanges of checks was check kiting ^{59/} is established by the sum total of a number of considerations including: first, both registrant and the respondent Stead had substantial overdraft positions in their checking accounts; second, five of Stead's checks were returned because drawn against uncollected funds; third, registrant's bank considered the practice to be check kiting, and so characterized it to respondent Babcock; fourth, after the objections from the registrant's bank, the practice was promptly discontinued;

^{59/} It should be noted that it is not alleged that the practice was violative of any particular statutory provision designed to prevent check kiting.

fifth, Stead would issue checks even when his securities account position showed a credit balance; sixth, Babcock indicated concern about the registrant's bank balance by telling Stead to deposit registrant's checks issued on the same day on different days so that they would not all be presented to the bank for payment on the same day.

The Division contends that the admitted failure to disclose to customers that the check kiting was being engaged in violates the anti-fraud provisions, as charged. It so contends on the dual grounds that the principle of "fair dealing" requires such disclosure and by analogy to the decisions holding fraudulent a broker's failure to disclose his inability to meet his financial obligations as they become due, e.g. Joseph J. Wilensky & Co., 39 S.E.C. 327, 329 (1959).

The decisions involving the requirement that a broker deal fairly with his customers do not seem pertinent here since the check kiting activity did not directly affect or involve customers. While the practice indirectly affects customers in the sense that it would ordinarily reflect a shaky financial condition, no decisions have been cited, and none have been found, in which the Commission has found anti-fraud violations predicated upon check kiting. The evidence here does not establish that registrant was unable to meet its financial obligations as they came due.

Accordingly, it is concluded that the check kiting practice engaged in by the respondents does not violate the anti-fraud provisions referred to in the order.

Confirmation violations: Stead on other side

The Division contends that the respondents violated section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder in that the registrant regularly failed to advise customers, in situations in which the registrant was acting as double agent both for such customer and for respondent Stead on the other side, that Stead was the person on the other side of the trade and the true amount of commission charged to Stead as compared with that charged to the customer. The Division further charges that such practice violated additional anti-fraud provisions of both the securities Act and of the Exchange Act and the Rules thereunder. ^{60/}

Division's exhibit 5 is a schedule of transactions of the registrant from April 24, 1967 through September 29, 1967, recording those trades in which the registrant acted as agent for a customer and where respondent Stead was on the other side of the trade, purchasing or selling in his own personal cash trading account maintained with Babcock & Co. ^{61/} A total of 283 such trades occurred during the period mentioned. In general the registrant charged respondent Stead the same commission as was paid by its other customers in such transactions.

^{60/} The order alleges violations of section 17(a) of the Securities Act and of sections 10(b) and 15(c)(1) of the Exchange Act and of Rules 10b-5, 15c1-2 and 15c1-4 thereunder. Similar allegations are made in the order for proceedings regarding trades in which the firm's trader Paul Barraco was on the other side of the trade. Barraco is not a respondent in this proceeding.

^{61/} The transactions described involved use of the mails.

However, ultimately, under the arrangements that existed for Stead's compensation by the registrant, Stead would "get back" a portion of the commissions he paid in such transactions and would also get a portion of the customer's commission if the customer happened to be one of his accounts. As mentioned earlier, Stead received under the compensation arrangement with the registrant one-half of the commissions earned by the registrant that were generated in the accounts of Stead's customers and the same applied to Stead's own trading account. Thus, in a cross trade of the kind here under discussion if the customer account was one of Stead's customers Stead would ultimately receive, as a part of his compensation, one-half of the commission he had paid in the transaction and one-half of the commission the customer had paid in the transaction. 61a/ The net result of this would be that the commission paid by Stead to make the transaction would be completely offset by the compensation received by Stead resulting from the transaction. However, where the customer involved was not one of Stead's accounts, the compensation received by Stead from the transaction would offset only half of the commission cost to him for the transaction. The Division contends that the failure of the registrant to confirm in writing these facts to the customers constituted violations of the anti-fraud provisions mentioned.

Under the Commission's Rule 15c1-4, the written confirmations there required of a broker or dealer must disclose whether he is acting as a broker for the customer, as a dealer for his own account, or as a

61a/ Where the transaction was on the Salt Lake Stock Exchange Stead's portion of the commission was less. See p. 7 above.

broker for some other person, or as a broker for both such customer and some other person. In addition, the written confirmations must disclose two other things: (1) the name of the person from whom the security was purchased or to whom it was sold for the customer and the date and time when the transaction took place (or the fact that such information will be furnished upon the request of the customer) and (2) the source and amount of any commission or other remuneration received or to be received by the broker or dealer in connection with the transaction.

The registrant used two different confirmation forms during the period in question. Prior to April 20, 1967, the form used was that appearing in Division's exhibits 42 and 43. This form was sufficient insofar as it advised the customer that the registrant was "acting as agent both for you and for another," but it was insufficient in the respect that it told the customer only the commission that had been charged him and not the commission that had been charged the person on the other side of the trade. The form advised the customer that he could obtain, upon request, "the source and amount of any commission or other remuneration received or to be received in connection with the transaction." This offer to furnish information on request did not meet the requirements of the rule that the source and extent of the commission be disclosed to the customer. Beginning with April 28, 1967, and thereafter, the registrant used a revised confirmation form. See exhibit 44, and others. This form cured the defect mentioned in the earlier form, by providing for notification as

follows: "We have acted as agent for both buyer and seller and have charged each the same commission." This change, when coupled with the statement of the monetary amount of the commission charged the customer, served to advise the customer as to the source and extent of the commissions earned by the registrant.

However, neither of the forms utilized by the registrant informed the customer, as the Division contends it should have, that Stead, an employee of registrant, was on the opposite side of the trade. Both confirmation forms utilized by the registrant did advise the customer that he could obtain the name of the person on the other side of the trade upon request, and in so doing it would appear that the forms complied with the literal requirements of Rule 15c1-4. It would seem that Rule 15c1-4 did not contemplate the kind of situation here presented. Its language suggests that the writers were thinking of clear-cut situations in which the broker-dealer was acting as a dealer for his own account or acting as a double agent for the customer and some other outside person, not an employee of the broker-dealer. The kind of situation here involved lies somewhere between those two extremes. Thus, it would appear that the registrant, in using the two confirmation forms mentioned above, did comply with the literal terms of Rule 15c1-4 even though it did not advise that Stead was on the opposite side. There remains for consideration, however, the question whether the anti-fraud provisions required the registrant to go beyond formal compliance with Rule 15c1-4 and to at least name the person on

the other side of the transaction (Stead) and identify him as an employee of the registrant. The Division argues, with considerable merit, that the same reasons that are the basis for the requirement that a broker-dealer disclose when he is acting as a dealer for his own account should prompt him in the circumstances here present to disclose that the person on the other side of the transaction was Stead, an employee of the firm. This, the Division argues, for the reason that respondent Stead under the circumstances here present necessarily has an interest adverse to that of the customer. The problem of actual or potential adverse interest is compounded by the fact that respondent Stead was the person charged generally with insuring that the best price was obtained for persons in over-the- transactions. When trading out of his personal cash account, Stead's self-interest and his responsibility to his employer and to his customers could readily come into conflict.

Whether or not such conflicts actually had any effects cannot be established from the record, since the registrant made no record of its efforts to obtain for the customer the best possible price before handling a transaction involving Stead on the opposite side.

Respondent Stead testified that he regularly gave oral advice to his customers before taking the other side of a trade, i.e. he always got their permission to do so before going ahead. He indicated that he did not advise his customers as to the dollar amount of the commissions that would be paid by him (Stead) but he testified that his customers were generally aware of the fact that he worked on a

commission basis and he assumed that they could do the mathematics themselves if they were interested. In addition, Mrs. Rose testified that she had overheard Stead in at least one or two instances advise his customers over the phone that he would be taking the other side of the trade. However, Stead's testimony as to his customary oral advice is strongly contradicted by the testimony of numerous customer witnesses called by the Division who testified that no such advice was given by Stead. These customer witnesses were not people who had lost any money in the transactions in question and, in general, they exhibited no hostility whatever towards respondent Stead or the other respondents. Indeed, several of them spoke in highly complimentary terms of respondent Stead. In these circumstances, there is no reason to discredit or discount their testimony. Accordingly, it is concluded that respondent Stead, although he may on isolated occasions have advised a customer that he was taking the opposite side of the trade if the subject came up incidentally, did not customarily advise his customers that he was taking the opposite side of the trade.

Actually, there is no regulation requiring oral advice and the Division does not urge that there is. It urges that Rule 15c1-4 does require written disclosure. However, the effort by the respondents to make out a showing that oral disclosure was made suggests that the respondents do recognize that the anti-fraud provisions may have required disclosure of the fact that Stead was on the opposite side in these transactions. However, Stead did maintain at the time that Commission personnel first began investigating the matter that he was

unaware of any requirement that written notification in a confirmation be given customers, and still takes that position on the briefs, in addition to asserting that whatever obligation there may be for written confirmation is that of the registrant and not his.

The registrant and respondent Babcock state that they had no established forms or stamps for giving written confirmation and state that they were "of the understanding" that Stead was giving oral confirmation (impliedly they seem to be arguing that such oral advice, had it been given, would have been sufficient). This reliance by the Babcock respondents seems misplaced, since it is quite obvious that they had issued no instructions as to what was to be done in the circumstances. They were obviously either acting under the impression that no written confirmation was required of this kind or were deliberately ignoring the requirement.

On balance it is concluded that the respondents did violate the anti-fraud provisions of the '33 and '34 Acts by failing to advise the customers that respondent Stead was on the opposite side of the transaction and that he was an employee of the registrant. It seems clear that the written confirmation misleads the customer into assuming that the person on the opposite side is someone other than an employee of the registrant and that this relates to a material point because of the potential conflicts of interest involved. However, since the Division cites no decisions of the Commission finding a violation of the anti-fraud provision in these circumstances, and none has been found, it is concluded that no sanctions should be imposed

upon the registrant on the basis of this violation of the anti-fraud provisions. Having so concluded, it is unnecessary to consider the nature and extent of the individual participation in this matter of respondents Babcock and Stead, although it would be clear that each had a strong personal involvement.

It should be emphasized that it is not here concluded that the advice to the customer should necessarily have been in writing as distinguished from oral advice. Nor is it concluded that the registrant had an obligation to go beyond advising the customer that the person on the opposite side of the transaction was Stead and that he was an employee of the registrant. In other words, it does not appear to this writer that a case has been sufficiently made for requiring the registrant to advise the customer as to the details respecting a salesman's scheme for compensation as it might bear on the total cost to that salesman of engaging in transactions in his own trading account. These are details that could well be left to be developed on the basis of inquiry by the customer. The important thing, it seems clear, would be to advise the customer that the person on the other side is a named employee of the registrant. From that fact could flow the inquiry that might develop other relevant information.

Conversion of customers' securities

It is charged that the respondents willfully violated the anti-fraud provisions of the Securities Act of 1933 and the Exchange Act of 1934 62/ in that they converted customers' fully paid securities to their own use and benefit by using securities for the registrant's business without the consent of the customers.

The accounting firm of Birrell, Zimmerman and Thomas, certified public accountants, conducted an audit of the registrant as of November 28, 1967.

The auditing firm, which examined the books and records of registrant after the firm had been closed for nearly two months was unable to find certain customers' fully paid securities held for safekeeping. During the time that the registrant's business activities had been suspended it concentrated its efforts on getting the books and records of the company into compliance with the regulations and "flattening out" customers' positions. They requested and obtained permission of the staff of the Denver Regional Office of the Commission to "buy-in" certain short positions which were outstanding when the firm suspended operations. Thus, the list of securities found short by the auditors -- Division's Exhibit 8 -- is in addition to whatever short positions may have been bought in by the registrant during the intervening period of suspension.

62/ The order for proceeding alleges violations of Section 17(a) of the '33 Act and Sections 10(b) and 15(c)(1) of the '34 Act and Rules 10b-5 and 15c1-2 thereunder. The record establishes use of the mails in connection with this charge.

The registrant was unable to produce the customers' securities which the accounts and audit indicated the customer was long and the firm was unable to find the securities in the possession of the registrant. In most cases, the auditors were unable to determine what had happened to the securities. The names of customers whose securities were not in the box are shown on Division's Exhibit 8. No authorization by these customers to allow use of their securities was found in the records of the registrant.

Due to the inadequate state of the records maintained by the registrant it would have been difficult to determine, in cases where two or more customers appeared by the records to be long securities, which customer's account should be considered short. Accordingly, the choice of the customer's account for allocation of the short position was made arbitrarily by the auditors.

The auditors concluded that the registrant, being unable to produce the securities upon demand of the auditors, would have to assume a short position therefor in its trading account.

No claim to a bonding company of lost or stolen securities was made by the registrant. Thus it seems unlikely that the stocks found short were lost or stolen.

It does not appear from the record that the registrant's securities were comingled with customers' securities held for safekeeping.

Customarily, brokers and dealers in securities make periodic balances of customers' stock positions and cash positions to assist in determining firm liabilities for securities in safekeeping and money balances. Such a monthly or periodic balancing of customers' positions was not carried out by the registrant, and this was likely a factor in the resulting situation which resulted, in practical terms, in the use of customers' stock by the firm without written permission of the customers.

The Division urges that the auditors' action in charging the firm's trading account with the short positions here discussed reflects the fact that the registrant was utilizing the customers' securities in the operation of its business and that this, in effect, constituted a conversion of customers' securities. By failing to advise customers that it was utilizing their securities without their consent, the Division urges, the registrant and the other respondents violated the anti-fraud provisions of the 1933 and 1934 Acts.

It is concluded that the evidence falls short of showing an intentional conversion of customers' securities. While it is clear that the registrant's recordkeeping procedures were grossly inadequate both in respect to the system itself and in execution of day-to-day recordkeeping requirements, it does not appear that registrant willfully and intentionally set about to use customers' securities in its business. One of the reasons for so concluding is the consideration that the dollar value of the securities listed on Division's Exhibit 8 would appear to be relatively low. The gain to the registrant's business from deliberately using such securities in its business would be essentially slight. It could be argued, of course, that the registrant, by deliberately continuing to conduct its business in the face of its knowing or its being charged with knowing that to do so would very likely result in the kind of use of customers' securities in its business that here in fact occurred, evidenced such a reckless disregard of consequences on the part of the registrant that its conduct here as respects conversion of customers' securities should be regarded as willful. Although such an argument would not be without some force, it is concluded on balance that a willful conversion of customers' securities has not been established. The record does not show affirmatively that registrant knew that these misuses of customers' securities were occurring, and in this light it would seem unreasonable to hold that registrant should have advised its customers that it was so conducting its business that such conversions might occur, as the Division appears to contend should have been done.

The occurrence of such use of customers' securities, however, does very strikingly point up the extreme gravity of the violations by the registrant of the recordkeeping and book-keeping requirements already discussed above.

The record does not indicate that respondent Stead had any direct responsibility with respect to the charge of conversion of customers' securities.

Net capital rule

The Commission's Rule 15c3-1, promulgated under Section 15(c)(3) of the Exchange Act of 1934 and generally referred to as the "net capital rule" provides generally that a broker-dealer may not conduct business when it has an aggregate indebtedness to all persons in excess of 2,000 percentum of its net capital. 63/

No computations of net capital deficiencies were offered at the hearing. However, the Division urges that a number of facts, taken together, compel the inference that in fact violations of the net capital rule did occur.

As already indicated above, the registrant's books and records during the charging period 64/ were in deplorable condition.

63/ Since this proceeding involves a registered broker-dealer the use of the mails or other interstate facilities is not a prerequisite to establishing a violation in view of Section 15(b) of the '34 Act. The record does, in fact, show use of the mails and the interstate facilities of a national securities exchange.

64/ April 1, 1967 to date of the hearing.

In view of this it is unlikely that the registrant could reliably have determined its capital position by using then available records.

It is conceded that the firm did not maintain trial balances for the months of June, July, August and September of 1967.

When respondent Babcock finally submitted trial balances for the months of June, July, August, and September, after persistent requests therefore from Commission personnel, they were deficient in that they did not indicate commissions payable and the money balances (debit and credits) of the brokers and customers were not separately stated.

The registrant did not maintain a commissions-payable account. The commissions due respondent Stead were substantial. Thus, an SEC investigator testified that at the end of August 1967 approximately \$15,000 was due Stead in commissions. The witness further estimated on the basis of Division's Exhibit 4, that at the end of September 1967, approximately \$30,000 was due Stead in commissions. Stead and Babcock both testified that at the end of the month Stead prepared his statement of commissions due him and sent it to Babcock for checking and payment. This was certainly an unreliable way for the registrant to be ascertaining and paying commissions, particularly since the amount was substantial.

During the months June through September 1967, the registrant had approximately 4,927 transactions. Of these, respondent

Stead had approximately 1,001 transactions. Such a relatively high volume increased the likelihood of a violation of the net capital rule by the registrant in view of all the other attending circumstances.

The registrant voluntarily discontinued customer operations on October 6, 1967, in order to be able to get the books and records of the company in proper order, thus enabling an accurate capital computation.

Registrant was operating in a substantial overdraft position. The respondents were involved in a "check kiting" operation, as discussed above. When the registrant issued multiple checks to Stead, respondent Babcock instructed him not to deposit them all at one time.

The matter of computing the registrant's net capital ratio is complicated by some uncertainty as to the extent of the registrant's property interest in the firm's trading account. The long security position in the trading account was claimed as an account of the firm. However, both Paul Barraco and respondent Stead testified that they were participating in profit and losses in the firm's trading accounting, and this was confirmed by respondent Babcock. Any computations of the firm's net capital position would presumably have to exclude that portion of the trading account's profits which are the property of Stead or Barraco.

While the above considerations point to a strong likelihood that the registrant violated the net capital rule, they fall

short of establishing a violation by a fair preponderance of the evidence. In this connection, the Division does not call attention to any decision of the Commission in which a net capital violation was predicated upon indirect evidence as distinct from the introduction of computations definitely establishing a net capital violation, and independent research not disclosed such an instance.

The circumstances urged by the Division however do point up again the gravity of the registrant's violations of the bookkeeping rules, since the registrant's violation of such rules placed it in a position of operating for months without knowing what its net capital position truly was, and made it difficult, without the expenditure of unwarranted time and effort on the part of the Commission's personnel to establish conclusively the fact or absence of an actual net capital violation.

Conclusions

In general summary of the foregoing, the following conclusions of law are reached:

- (1) From on or about April 20, 1967 until October 6, 1967 registrant willfully violated Section 5 of the Securities Act of 1933, as amended, in that during said period it offered to sell and sold and delivered after sale by use of the mails and means and instruments of transportation and communication in interstate commerce, shares of the common

stock of Triumph Corporation when no registration statement was in effect or had been filed with the Commission as to the said securities.

During the same period, and by use of the same means, the registrant participated in a primary distribution of Triumph Corporation stock and failed to give purchasers of said securities at or before the completion of the transactions written notice of registrant's participation and financial interest in the distribution of said securities in willful violation of Section 15(c)(1) of the Securities Exchange Act of 1934, as amended, and Rule 15c1-6 thereunder. This same conduct also violated Section 17(a) of the Securities Act of 1933, as amended, and Section 10(b) of the Exchange Act and Rules 10b-5 and 15c1-2 under the Exchange Act.

Respondents Babcock and Stead each willfully aided and abetted the violations of, or individually violated, the provisions of law and rules mentioned in this paragraph (1).

(2) Within the period from August, 1967 until the date of the hearing registrant violated the provisions of the law and rule mentioned in paragraph (1) above by participating in a primary distribution of stock of Silver Shield Corporation for which no

registration statement was in effect or filed and failing to give its customers notification that it was so participation. For reasons described above, respondents Babcock and Stead were not shown to have aided and abetted these violations by the registrant.

(3) The registrant, notwithstanding several prior admonitions, willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that it failed to make and keep current and accurate accounts, books and records as required by the mentioned rule, including general ledger accounts, customer ledger accounts, daily blotters, security position records, proofs of money balances, and computations of the firms net capital. Respondent Babcock aided and abetted these violations. Respondent Stead aided and abetted the violations only to the extent that they involve Stead's individual trading account.

(4) The registrant willfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder by filing on July 19, 1967 on Form X-17A-5 a report of its financial condition as of May 31, 1967, that contained materially false information respecting, among other things, commissions

payable, total net worth, moneys owed customers (cash accounts) and cash. Respondents Babcock and Stead willfully aided and abetted this violation.

(5) During the period April 1, 1967 to January 31, 1968, the registrant, notwithstanding an earlier admonition, willfully committed numerous violations of Regulation T. Respondent Babcock and Stead each aided and abetted these violations.

(6) A practice of check-kiting engaged in by respondents did not constitute violations of the anti-fraud provisions of the '33 and '34 Acts.

(7) From April through September of 1967 the respondents violated Section 15(e)(1) of the Exchange Act and Rule 15c1-4 thereunder (as well as other anti-fraud provisions of the '33 and '34 Acts and the rules thereunder) in that the registrant regularly failed to advise customers in situations in which the registrant was acting as double agent both for the customer and for respondent Stead on the other side, that the person on the other side was Stead, an employee of registrant. However, no sanctions are predicated upon this violation inasmuch as it does not appear that the Commission has had occasion to impose sanctions on such a basis.

(8) Because of faulty recordkeeping procedures, the registrant in effect utilized the fully paid securities of its customers in its business without their permission. However, it is concluded that violations of the anti-fraud provisions of the '33 and '34 Acts did not therefrom result since the conduct was not willful.

(9) A charged violation of the net capital rule was not proved.

PUBLIC INTEREST

The violations disclosed by this record are numerous, serious and varied and occurred over an extended period of time. The contentions of the respondents that sanctions are not necessary in the public interest must therefore be rejected. The mitigative factors urged by respondents and the fact that they have not earlier been the subjects of disciplinary proceedings have however been taken into consideration in fashioning the sanctions that are found needed.

The remedial action appropriate as respects the registrant cannot be divorced from the question of what sanctions are indicated as respects respondent Louis W. Babcock, its only active partner. The record of the registrant and its partner, as evidenced by the violations found in this proceeding, reflects either an unwillingness or a lack of capacity to operate the registrant in conformity with applicable laws and regulations. Thus, the widespread and repeated violations of the recordkeeping requirements here found occurred after several admonitions from the Commission's staff regarding apparent prior breaches. Efforts to excuse these and other violations on the basis of alleged high volume and inadequate personnel do not succeed because, first, the record suggests that the causes went deeper than that, as discussed above, and, second, the registrant and respondent Babcock deliberately aggravated their problems in

this area by engaging an additional trader, respondent Stead, for the express purpose of substantially increasing the firm's trading volume. This was done at a time when it was known, or should have been known, that the firm was not equipped to take on the added volume and run its business properly. The gravity of the recordkeeping deficiencies is manifested by the fact that because of them the firm operated for several months without knowing what its capital position was. In addition, customers' securities were utilized in the registrant's business, though not willfully, as a result of the bookkeeping shortcomings.

The repeated violations of Regulation T suggest a willful disregard of the regulation rather than a mere lack of adequate personnel.

The violations involving the filing of a false financial statement and participation in the distribution of unregistered securities evidence a willful disregard of the rights of customers sought to be protected by the laws and regulations involved. These violations cannot by any stretching be related to high volume or inadequate personnel.

The public interest therefore requires that the registration of Babcock & Co. be revoked. As to respondent Babcock, it is considered that the nature and extent of the violations committed by him require that he be barred from association with a broker-dealer. Because it is believed that the public would

not be endangered if Babcock were allowed to work in a supervised capacity, it would be appropriate to permit him, after six (6) months, to be employed by a broker-dealer in a supervised capacity.

Respondent Stead was involved, in greater or lesser degree, in most of the violations found herein. While he had no responsibility for books and records as such, he was aware of anomalies in his own trading account that were a part of the overall deficiencies of the registrant. It is significant that a number of the violations found occurred in, or in connection with, Stead's personal trading account, which generated a significant portion of the firm's business. As a man with some fifteen years of experience in the securities business, Stead should not have been unaware of the status of his own account.

His connection with the filing of a false financial statement on Form X-17A-5 serves to display on his part a seemingly **greater** concern for not giving "discrediting" information against his employer than for his obligation to respond promptly and honestly to an audit confirmation submitted to him. His proper and timely response might have avoided the false filing.

Lastly, Stead's violation in connection with transactions in Triumph Corporation stock evidences both a certain lack of candor and a disregard for the welfare of customers sought to be protected by the registration and anti-fraud provisions breached.

These circumstances, it is felt, require that respondent Stead be barred from association with a broker-dealer. Because it is believed that the public would not be endangered if Stead were allowed to work in a supervised capacity, it would be appropriate to permit him, after six (6) months, to be employed by a broker-dealer in a supervised capacity.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer of Babcock & Co. is revoked, and the company is expelled from membership in the National Association of Securities Dealers, Inc.; and that Louis W. Babcock and Robert T. Stead are each barred from association with a broker-dealer, except that after a period of six (6) months from the effective date of this order, each may become associated with a registered broker-dealer in a non-supervisory capacity upon an appropriate showing to the staff of the Commission that he will be adequately supervised.

This order shall become effective in accordance with and subject to 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 (15) 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. 65/



David J. Markun
Hearing Examiner

65/ To the extent that the proposed findings and conclusions submitted by the parties are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected.

Washington, D.C.
December 24, 1968