

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
MARCUS, SCHLOSS & CO., INC. :
(8-17563) :
FRANK S. GROSECLOSE :
RONALD R. MICHNO :
(8-18749) :
ROBERT A. PODESTA :
(8-18739) :

FILED
AUG 22 1978
SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Washington, D.C.

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Irving Sommer
Administrative Law Judge

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APPEARANCES: Peter B. Shaeffer of the Chicago Regional
Office of the Commission for the Division
of Enforcement.

D. Daniel Barr of Bell, Boyd, Lloyd, Haddad
and Burns, for Robert A. Podesta.

BEFORE: Irving Sommer, Administrative Law Judge

This is a public proceeding instituted by Commission Order ("Order") dated January 3, 1978, pursuant to Sections 15(b), 19(h)(2) and 19(h)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the above-named respondent, among others, committed various charged violations of the Exchange Act and regulations thereunder, as alleged by the Division of Enforcement ("Division"), and the remedial action, if any, that might be appropriate in the public interest.

The Order alleges, in substance, that the remaining respondent, Robert A. Podesta ("Podesta") wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Robert A. Podesta was represented by counsel throughout the proceedings. Proposed findings of fact and conclusions of law and supporting briefs were filed on behalf of all parties. The findings and conclusions herein are based on the record and on observation of the witnesses' demeanor. Clear and convincing evidence is the standard of proof applied.

Respondent

Robert A. Podesta ("Podesta") has been registered as a

1/ The Commission has accepted offers of settlement from the following named respondents and has issued its findings and order imposing remedial sanctions: Marcus Schloss & Co., Inc., Exchange Act Release No. 14432/January 3, 1978; Ronald A. Michno, Exchange Act Release No. 14431/January 3, 1978; Frank S. Groseclose, Exchange Act Release No. 14479/February 6, 1978.

broker-dealer with the Commission pursuant to Section 15(b) of the Exchange Act since December 1, 1975. Podesta is a member of the Chicago Board Options Exchange ("CBOE") where he functions primarily as a floor broker, executing orders for members of the CBOE, specializing in the IBM class of options.

Background

Marcus, Schloss & Co., Inc. ("Marcus Schloss"), a corporation with its principal place of business located in New York, New York, is registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Act, and is a member of the CBOE, New York Stock Exchange, American Stock Exchange and the Pacific Stock Exchange.

Frank S. Groseclose ("Groseclose") was a member of the CBOE and had his membership registered for the firm of Marcus Schloss for whom he was an employee and officer between June 1975 and August 1976.

Ronald R. Michno ("Michno") is registered with the Commission as a broker-dealer, and is a member of the CBOE, acting therein as a market marker.

The CBOE began listed trading of call options^{2/} in April 1973. Trading in the options is conducted at various posts on the exchange floor. On one side of the post is the board

^{2/} A contract that entitles the holder to buy 100 shares of a stipulated stock at any time during the period the option is in being.

broker, an individual responsible for maintaining the list of orders given to him by the members. On the other side of the post on the CBOE floor are the market makers^{3/} and floor brokers.^{4/}

A. 50 Contract Spread Transactions^{5/}

On August 18, 1975 at about 9:55 a.m. Podesta, as a floor broker crossed^{6/} a spread transaction on the CBOE floor between Marcus Schloss and Michno which was publically disseminated on the Market Data Retrieval (MDR) tape. The transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 50 IBM Oct 180	11 1/2	Sell 50 IBM Oct. 180
Sell 50 IBM Jan. 180	18	Buy 50 IBM Jan. 180

Michno sold the spread at 6 1/2 (18 less 11 1/2) for a credit to his account of \$32,500 (50 contracts x 6 1/2).

At about 1:43 p.m. on August 18, 1975 Podesta, acting as floor broker for both Marcus Schloss and Michno prepared order tickets to accomplish a spread transaction. Initially the tickets

^{3/} A market maker buys and sells options for his own account.

^{4/} A floor broker acts as an agent for other members on the floor of the exchange. They are either self-employed or employed by members firms of the exchange.

^{5/} The purchase of one option and the sale of another in the same underlying stock.

^{6/} A transaction in which a floor broker is both a buyer and seller, having orders from two different customers which are executable at the same price.

reflect the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 50 IBM Jan. 180	11	Buy 50 IBM Jan. 180
Sell 50 IBM Oct. 180	17 3/4	Sell 50 IBM Oct. 180

However, this does not demonstrate a matched transaction, and thereafter a correction was made in one of the spread orders by a reversal of the buy and sell portions of the Michno spread. The corrected crossing of the spread transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 50 IBM Jan. 180	17 3/4	Sell 50 IBM Jan. 180
Sell 50 IBM Oct. 180	11	Buy 50 IBM Oct. 180

This transaction was publically disseminated, and appeared on the MDR tape.

On the same date, subsequent to 1:43 p.m. Podesta prepared standard tickets to record the following transaction:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 50 IBM Jan. 180	18	Sell 50 IBM Jan. 180
Sell 50 IBM Oct. 180	11 1/2	Buy 50 IBM Oct. 180

This transaction reflects that Michno purchased the October-January spread consisting of 50 contracts at 6 1/2 for

for a debit of \$32,500.

At or about the same time period Podesta prepared standard tickets to record the following transaction:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 50 IBM Oct. 180	11	Sell 50 IBM Oct. 180
Sell 50 IBM. Jan. 180	17 3/4	Buy 50 IBM Jan. 180

This transaction reflects that Michno sold the October-January spread consisting of 50 contracts at 6 3/4 for a credit of \$33,750; the effect of the latter two transactions was to reverse the 50 spread transactions executed previously, and cause Michno to profit rather than lose \$1,250. ^{7/} These transactions appeared in the accounts of Michno and Marcus Schloss. No correction was required in the MDR tape since the original sell transactions already appeared thereon, this change merely being a reversal of parties. ^{8/}

B. 400 Contract Spread Transaction

The record reveals that Podesta approached Michno on August 18, 1978 as he was passing on the floor of the CBOE and suggested he enter into a 400 option spread transaction which Marcus Schloss was trying to do stating, "it might be

^{7/} Michno sold the morning spread at 6 1/2 for a credit of \$32,000 and purchased a spread at 6 3/4 for a debt of \$33,250 for a loss of \$1,250. By reversing the transaction, he sustained a profit of \$1,250.

^{8/} Testimony of Doherty:

Q. What about price reporting? Would anything have — any changes have to be made in the price reporting system?

beneficial"^{9/} to him and that "Marcus Schloss wants you to know, that you should do this."^{10/} Michno had previously engaged in an option transaction with Marcus Schloss on the 4th of August in which he had lost several thousand dollars, and had been told by Groseclose that Marcus Schloss would make it up to him.^{11/} Michno told Podesta, "Go ahead and do the trade.

8/ (Continued)

A. Well, if all that was involved was that the wrong parties were listed as buyer and seller, essentially it wouldn't be any price reporting change involved.

The transaction as originally consummated would stand as reported to the public as valid and there would be no reason to change the price reporting system as long as only the names of the parties to the transaction are being changed. Transcript at 153.

9/ Testimony of Michno before the S.E.C. on November 23, 1976, Exhibit 27, page 211:

Q -- And in addition, that a spread, a 400 lot spread, involving IBM October 180's and IBM January 180's were put on by you and taken off by you on that day with Mr. Croseclose. What are the specific circumstances surrounding your putting on and taking off the 400 lot spread?

A. I remember walking by Bobby Podesta and he said -- the floor broker in IBM -- the Marcus Schloss was trying to do the spread, and he mentioned the spread to me and he said it might be beneficial for me to do it.

Q. Where did this conversation take place?

A. Outside the IBM pit.

Q. How did you and Mr. Podesta come to be at the same place at the same time?

A. I was walking by the IBM pit.

Q. Did he approach you or did you approach him?

A. I think as I was talking by he started up a conversation.

10/ Testimony of Michno before the CBOE on November 11, 1976, Exhibit 26, p. 104:

Q. August 18, you executed some IBM trades with Marcus Schloss. Do you remember the circumstances surrounding those trades?

A. As far as I remember, as far as I remember, I remember being by the IBM pit. Bobby Podesta said he had an IBM spread he was trying to do for Marcus Schloss. He said he was having difficulty doing it and he said would I like to do it.

I said I don't know and Bobby said, the conversation that "something Marcus Schloss wants you to know, that you should do this."

11/ Michno testimony before S.E.C. on November 23, 1976, Exhibit 27, page 214:
CONTINUED ON NEXT PAGE

If you think it is beneficial, go ahead and do it for me." ^{12/}
He also told Podesta that he did not want to carry the position
overnight and would "like to get out this day." ^{13/}

Thereafter, at about 2:10 p.m. on said date Podesta, as a floor broker crossed a spread transaction on the CBOE floor between Michno and Marcus Schloss which was publically disseminated on the MDR tape. The transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 400 IBM Oct. 180	10 7/8	Sell 400 IBM Oct. 180
Sell 400 IBM Jan. 180	17 3/4	Buy 400 IBM Jan. 180

Michno sold the spread at 6 7/8 (17 3/4 less 10 7/8) for a credit to his account of \$275,000 (400 contracts x 6 7/8).

During the period 2:44 p.m. to 2:53 p.m. Podesta as floor broker for Marcus Schloss executed three transactions with two members involving 15 spread contracts as follows:

Buy 15 IBM Oct. 180's at 10 3/4
Sell 15 IBM Jan. 180's at 17 3/8

11/ (Continued)

Q. Was there any reason why you decided to do this trade with Marcus, Schloss other than what Mr. Podesta told you?

A. No. I guess in my mind I thought maybe they are going to -- I felt they owed me some money. Maybe they were going to make it up to me somehow.

12/ Testimony of Michno before the S.E.C., November 23, 1976, Exhibit 27, Page 213.

13/ Testimony of Michno before the CBOE on November 11, 1976, Exhibit 26, page 111.

Michno testified that sometime later in the day he was summoned by Podesta and was asked whether he wanted to get out of his spread position, and upon answering in the affirmative with some further discussion as to his standing on the spread,^{14/} Podesta, as floor broker for both parties executed a cross of the spread between Michno and Marcus Schloss. The transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 400 IBM Jan. 180	17 3/8	Sell 400 IBM Jan. 180
Sell 400 IBM Oct. 180	10 3/4	Buy 400 IBM Oct. 189

Michno bought the spread at 6 5/8 (17 3/8 less 10 3/4) for a charge to his account of \$265,000 (400 contracts x 6 5/8).

Michno realized a profit of \$10,000 in this 400 contract spread transaction.

C. 200 Contract Spread Transactions

The record further reveals that Podesta approached Michno on August 19, 1975 and asked him whether he would like to do

14/ Testimony of Michno before S.E.C. on November 23, 1976, Exhibit 27, page 216:

A. -- Bobby said, "Marcus Schloss would like to know if you can get out of your spread position." I said, "where can it be done at? He [meaning Podesta] showed me. I said, "If you can get me a profit, get me out."

Q. Did he tell you the exact price?

A. He showed me what the market was. He said I would probably make a profit. I said I would not like to take the position home that night for sure, and I would prefer not to have a loss.

Before the CBOE Michno testified the following concerning his spread position.

CONTINUED ON NEXT PAGE

a spread with Marcus Schloss, 15/ and that it may be beneficial for him. 16/

At about 9:26 a.m. on said date, Podesta, as a floor broker crossed a spread transaction on the CBOE floor between Michno and Marcus Schloss which was publically disseminated on the MDR tape. The transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 200 IBM Oct. 180	10 3/8	Sell 200 IBM Oct. 180
Sell 200 IBM Jan. 180	17 1/4	Buy 200 IBM Jan. 180

Michno sold the spread at 6 7/8 (17 1/4 less 10 3/8) for a credit to his account of \$137,500 (200 contracts x 6 7/8).

14/ (Continued)

Q. When did you find out you had gotten out of it?

A. The runner called me over. I went over and talked to Bobby. Bobby said, "they want to know if you want to get out of your position."

I said, fine, I would like to be out of it today.

Q. And he gave you a price?

A. Yes. He said, roughly, this is where it could be done, where this spread can be taken off.

Q. At that point, did you give him an order to take the spread off?

A. I gave him verbal okay to take it off.

15/ Testimony of Michno before CBOE, November 11, 1976, Exhibit 26, p. 115:

Q. On August 19, you entered into and closed out a 200 lot IBM spread. Again, did you enter an order to get into that spread initially?

A. It was a similar situation. Bobby called me over. I talked to him, he said, "Marcus Schloss wants to do a spread, do you want to do it?"

After the 18th, I said, "Go ahead, sure." He quoted the members and I did it.

16/ Testimony of Michno before S.E.C. on November 23, 1976, Exhibit 27, p. 227:

Q. . . . : I am asking for you to describe for me how those trades [meaning the 19th of August] came into being.

A. I remember Lisa coming over and saying, "Bobby wants to see you" and Bobby said, "Got another situation here that may be beneficial for you to do, a spread with Marcus Schloss."

Shortly thereafter Michno was contacted by Podesta's clerk and directed to see Podesta. Podesta told Michno "Marcus Schloss wants to know if you want to get out of the spread", and after further discussions which were favorable from Michno's point of view, liquidation of his spread position was agreed to.^{17/} At about 10:07 a.m., Podesta, as floor broker for both parties, executed a cross of the spread between Michno and Marcus Schloss. The transaction reflected the following:

<u>Michno</u>	<u>Price</u>	<u>Marcus Schloss</u>
Buy 200 IBM Jan. 180	16 1/4	Sell 200 IBM Jan. 180
Sell 200 IBM Oct. 180	9 3/4	Buy 200 IBM Oct. 180

Michno bought the spread at 6 1/2 (16 1/4 less 9 3/4 for a charge to his account of \$130,000 (200 contracts 6 1/2). He realized a profit of \$7,500 on this transaction.

17/ Testimony of Michno before S.E.C. on November 23, 1976, Exhibit 27, pages 229-230:

- Q. What happened after that in regard to the 200 lot spread?
- A. Well, I remember Lisa finding me some place on the floor and asking me to come see Bobby and Bobby Podesta wanted to see me.
- Q. Did you go to Mr. Podesta?
- A. Yes. I walked over to him and talked to him, and briefly Bobby said, "Marcus, Schloss wants to know if you want to get out of the spread?"
- Q. What else did Mr. Podesta say?
- A. He said, "this is the price of the option and here is the spread, and basically the spread is in this range." I said to him, "I think — well, I would like to make sure I don't carry this portion home overnight."
- Q. Did you tell him you wanted to get out of the spread?
- A. I remember saying that I didn't want to carry it overnight.
- Q. Did you leave him with an order he was supposed to do, sell that spread for you?
- A. When he gave me the quotation on the price, he said, I think, "I can get out of this thing with a profit." I said, "Go ahead. Get me out of the position."

The six contract spread transactions executed by Podesta between Michno and Marcus Schloss on the 18th and 19th of August 1975 resulted in a profit to Machno of \$18,750 as follows:

August 18, 1975 - 50 lot spread \$ 1,250
August 18, 1975 -400 lot spread \$10,000
August 19, 1975 -200 lot spread \$ 7,500

Podesta's total commissions from Michno and Marcus Schloss arising out of these transactions was \$4424, divided equally between both parties.

Antifraud Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The Order charges that on August 18, 1975 and August 19, 1975, Podesta wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 ^{18/} thereunder by engaging in acts, practices of business which operated as a fraud and deceit on the public and made untrue statements of material facts and omitted to state material facts necessary to make the statements made,

18/ 15 U.S.C. 78j(b); 17 CFR Sec. 240.10b-5. Rule 10b-5 provides as follows:

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

- 1) to employ any device, scheme or artifice to defraud
- 2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- 3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

in the light of the circumstances under which they were made, not misleading.

As part of the aforesaid conduct and activities, Podesta did

1) cause the public to receive reports of transactions which purported to reflect the execution of orders in a competing market place of bona fide supply and demand between independent persons acting at market risk on the basis of competition, as to, among other things, price, quality and liquidity, when, in fact, he knew or was reckless in not knowing, that such reports did not record transactions executed in such a manner or basis;

2) execute transactions on behalf of both the account of Marcus Schloss & Co., Inc. and Ronald R. Michno which he knew, or was reckless in not knowing, were directed orders for the purpose of passing money to or creating a profit for Ronald R. Michno.

The 400 and 200 Lot Spread Transactions

The evidence portrays a clear and convincing picture of Podesta's functioning as the mainstay in the fraudulent execution of option spreads between Marcus Schloss and Michno which had as their end result the direction of money to Michno. On August 4, 1975 Michno lost several thousand dollars in an

option transaction with Marcus Schloss and was told that the loss would be made up. Two weeks later, Podesta becomes the third man in this triangle. Michno is approached by Podesta on the floor of the CBOE and told about a spread transaction (400 lot IBM) Marcus Schloss wants to enter into punctuated with the prophetic announcement that "Marcus Schloss wants you to know that you should do this," and even more pregnant with possibility is the further prognostication that it might be "beneficial" to Michno. It must be understood that we are now discussing an extremely large option spread transaction involving over \$250,000 of underlying stock. Michno had never been involved in anything so large and admitted, "it was a peculiar trade." Podesta's persuasive urgings, and Michno's feeling that this transaction was somewhat connected with the debt owed to him by Marcus Schloss were instrumental in closing the deal between them all orchestrated by Podesta. At this point we might ask, what about Podesta? Was there not a red flag fluttering about wildly proclaiming to him that this was a very peculiar transaction which required not only further information before he executed it, but that he proceed with extreme caution. Firstly, this was a very large transaction, there was a direction from one party to him that he execute it with another specified party, and we must wonder what Marcus Schloss discussed with Podesta which caused him to inform Michno of the benefits awaiting him. Let us follow this act

further as the web spins around towards eventually producing a profit in a short span of time on the 18th of August, 1975 in the amount of \$10,000 for Michno. Michno was enticed into the transaction, and wanted out immediately that very day. Podesta the floor broker and executioner of the deal herein wanted to accommodate Michno that very day. Knowing that Michno wanted to get out of his large spread portion completely, Podesta knew that he must prevent any other buyer from getting any part of the option lots. In this view, Podesta, on behalf of Marcus Schloss executed three transactions involving 15 spread contracts which cleared the account of Marcus Schloss and permitted the full recross of the 400 lot spread transaction with Michno completely clearing his account. At this point Podesta once again contacts Michno, and asks that he come to his station in the CBOE where Michno is informed "Marcus Schloss would like to know if you can get out of your spread position," and upon being shown the status of the market (that he would make a profit), Michno approved and the spread was taken off to the tune of a \$10,000 profit. The very next day this same beneficence directed from Marcus Schloss to Michno orchestrated and executed by Podesta continued as Podesta once again approached Michno with the words, "Got another situation here that may be beneficial for you to do, a spread with Marcus Schloss." Of course Michno

jumped at this beautiful offer considering the previous days promise and performance. But what about Podesta. Once again he was the third man. Once again he was indicating the trade would be beneficial. There is no question he has discussed this with Marcus Schloss since he is going to execute the trade between Marcus Schloss and Michno. Thusly once again Podesta either knows something violative in nature is brewing, or has put on blinders to destroy any vision present. After Podesta's introductory speech, Michno entered into another large spread transaction with Marcus Schloss (200 lot spread), executed by Podesta, and lo and behold, a short time later Michno is called into the presence of Podesta and is told, "Marcus Schloss wants to know if you want to get out of the spread". Podesta further tells Michno that he can get out "with a profit," and thereupon Michno assents. His profit on this whirlwind transaction is \$7500. In two short days of executing transactions for Marcus Schloss and Michno, Podesta saw Michno reap a profit of \$17,500. The second day's performance was a replica of first. Once again the facts cry out that Podesta either knew of these directed transactions or was incredibly reckless in his dealings so as to close his eyes to the obvious, i.e. that these was non bona fide transactions directed toward's funneling money to Michno. For his services in executing these trades Podesta received commissions of \$4300.

It must be noted that prior to the execution of the 400 lot spread on August 18, 1975, Podesta executed a 50 lot

spread transaction between Marcus Schloss and Michno. The Division alleged this transaction was similarly non bona fide and for the purpose of directing money from Marcus Schloss to Michno. The record shows that on the morning of August 18, 1975, Michno sold a 50 lot spread transaction at 6 1/2 and later bought a 50 lot spread at 6 3/4. If allowed to stand as noted, Michno would have lost \$1250. However, because of an alleged mistake in the buyer and seller portions of these transactions, new order tickets were drawn up resulting in a profit of \$1250 for Michno. The facts surrounding the transactions are vague, uncertain and inconclusive, and while they raise a suspicion that these transactions were also part of an overall course of fraudulent conduct which had as its purpose the transfer of money from Marcus Schloss to Michno, with Podesta as director, I cannot say that this suspicion of fraud rises to the level of clear and convincing evidence thereof. Suspicious circumstances do not establish clear and convincing proof. Accordingly, the allegation of fraud concerning the 50 lot spread transactions is deemed not proven.

The respondent denies any wrong doing, and states that these transactions were consummated in full view on the floor of the exchange. In light of the attending circumstances, this self-serving denial is expected and is of no avail. Granted there is no direct proof of an agreement between the three participants herein, it must be said that frauds are

incubated in stygian darkness where they remain undisturbed by the light of day. Hence fraud normally must be inferred from the surrounding circumstances.^{19/}

Here, the circumstantial evidence reveals Mr. Podesta's activities for what they were from start to finish. Podesta was the conduit for the smooth execution of these fraudulent transactions. Initially he dealt with Marcus Schloss, became apprised of the desire of Marcus Schloss to trade with Michno, learned the raison d'etre of these transactions (that is to make a profit for Michno), contacted Michno and actively steered him into the trading herein saying it would be beneficial, and contracted Michno at the proper moment for approval to close out the spreads, showing him the profit thereon. Podesta orchestrated these transactions on both days, executing all the documents, and in the end everyone was happy including Podesta whose commissions were large. The evidence is clear and convincing of Podesta's active participation in this ménage a trois, and if he did not know what was occurring which I cannot fathom considering all the circumstances herein which put him on notice, it was sheer recklessness not to have been aware. Here, the "attendant conditions were more than sufficient

^{19 /} See Laurence H. Ripp, Securities Exchange Act Release No. 13198 (January 24, 1977) 11 S.E.C. Docket 1555, 1556; cf. The Federal Corporation, 25 S.E.C. 227, 230 (1947): "since its impossible to probe into the depths of a man's mind, it is necessary in the usual case (that is, absent an admission) that the finding of manipulative purpose be based in inferences drawn from the circumstances." cf. Halsey, Stuart & Co., Inc., 30 S.E.C. 106, 112 (1949); cf. Collins Securities Corporation, Securities Exchange Act Release No. 11766 (October 23, 1975), 8 S.E.C. Docket 250, 255. cf. Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 794 (C.A. 2, 1969), cert. denied, 400 U.S. 833 (1970).

to put [Podesta] on notice that something was wrong."^{20/} He knew or showed an utter disregard for the signs readily available to him that the securities transactions he was executing were not bona fide but a "stage-managed performance"^{21/} being acted out with the final curtain going down as Michno received the money owed to him from Marcus Schloss. The securities markets are no place for such performances.

Respondent argues that the Division is essentially charging that "the spread transaction executed by Podesta caused a misleading appearance of active trading" and as such, had failed to allege and prove a violation of Section 9(a)(1) of the Exchange Act. Respondent cites numerous cases, including Blue Chip Stamp v. Manor Drug Stores, 421 U.S. 837 (1975) for support of its position that the conduct alleged is not actionable under Section 10 of the Exchange Act and Rule 10b-5 thereunder, but must be brought under the specific statute (meaning Section 9) proscribing such activities. This allegation is without merit. The Blue Chip case does not have the reach that respondent alleges. As a private action it differs significantly from these public proceedings which are being conducted to protect the public interest under the Congressional mandate. That decision limited the scope of private

^{20/} Dlugash v. Securities and Exchange Commission, 373 F.2d 107, 109 (C.A. 2, 1967).

^{21/} Halsey Stuart & Co., Inc., 30 S.E.C. 106, which refers to market manipulation no less applies to the fraud practiced here.

actions, and is not appropriate herein. Rule 10b-5 was designed to encompass all types of manipulative and deceptive conduct that were not specifically covered or contemplated when promulgated. In Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 11 n. 7 (1971), the Supreme Court quoted with approval from the decision of the Second Circuit in A.T. & Co. v. Perlow, 375 F.2d 397 (C.A. 2, 1967), "[Rule 10b-5] prohibit[s] all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws." (Emphasis in the original)

In the Matter of Michael Batterman, Administrative Proceeding File No. 3-4519, SEC Docket Vol. 9, No. 6, p. 307 (April 13, 1967), The Commission held that Section 10(b), and Rule 10b-5 are violated by conduct "which operates as a fraud or deceit as to the nature of the market for the security." Furthermore, the Commission found that the same violative activities are actionable under Section 9(a)(1).^{22/} Similarly in United States v. Charnay, 537 F.2d 341 (C.A. 10, 1976) at page 351, the Court in denying the exclusivity of Section 9(a)(1)

^{22/} Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787. In this case the Court found the deceptive and manipulative activities were actionable under both Section 9 and Section 10(b), and Rule 10b-5.

stated, "[S]ection 78i(a)] cannot be read as a limitation on Rule 10b-5. The legislative and judicial history of Section 78j(b) make it clear that the statute and rules promulgated thereunder are to operate independently of other securities laws provisions."

Respondent further contends that the Division has failed to show that he acted with "scienter" — that is, an intent to deceive, manipulative or defraud. His argument is predicated upon the decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), which held that something more than "mere negligence"^{23/} is required in a private damage action under Securities Exchange Act Rule 10b-5. Whether the Hochfelder culpability standard applies to administrative proceedings instituted by the Commission need not be determined here. Mr. Podesta's conduct, in light of all the circumstances was gross recklessness^{24/} demonstrating scienter under the standards imposed by that case.

The respondent further alleges that the reports of the transactions herein did not constitute material misrepresentations to the public. This argument is without merit and demonstrates a particularly narrow viewpoint by the respondent of his obligations to the public. The antifraud laws prohibit all omissions to state

23/ Santa Fe Industries Inc. v. Green, 430 U.S. 462, 472 (1977).

24/ Cf. Ernst & Ernst v. Hochfelder, at 193, n. 12; Rolf v. Blyth Eastman Dillon & Co. ['77-'78], Fed. Sec. L. Rep. [CCH] Section 96-225 (C.A. 2, Jan. 3, 1978); Nelson v. Serwold, [current] CCH Fed. Sec. L. Rep. Section 96-399 (C.A. 9, April 3, 1978).

material facts which are necessary to be stated under the circumstances including the fact that particular transactions are not bona fide trades in a free and open market but are the result of prearrangement in a noncompetitive conspiratorial atmosphere which is "alien to the 'climate of fair dealing', Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180, 201 -- (1963), that Congress sought create and maintain".^{25/}

As a broker-dealer and floor trader Podesta is fully aware that members of the public rely upon reported market transactions as fairly representing the state of the market in a particular security or option class. The investing public is interested in the state of the market, i.e., the amount of activity as a particular security or option class, the pricing thereof, and the volume of trading. All these factors assume great importance to the investing public who are concerned about the liquidity of their investment and the opportunities for resale.

"The statute and rule [Section 10 and Rule 10b-5] are designed to foster an expectation that securities markets are free from fraud -- an expectation on which purchasers should be able to rely."^{26/}

^{25/} Cf. Herpich v. Wallace, 430 F.2d 792, 802 (C.A. 5, 1970).

^{26/} Cf. Blackie v. Barrack, 524 F.2d 891, 907 (C.A. 9, 1975).

The evidence shows that on August 18 and 19, 1975 the aforementioned transactions between Marcus Schloss and Michno were a significant percentage of the total option transactions and seriously distorted the market statistics for these days. The breakdown is as follows:

1) On August 18, 1975, of a total of 991 IBM Jan. 180 contracts publically reported on the CBOE, Podesta executed 900 or 91% representing transactions between Marcus Schloss and Michno, ^{27/}

2) On August 18, 1975, of a total of 1414 IBM October 180 contracts publically reported on the CBOE, Podesta executed 900 or 63% representing transactions between Marcus Schloss and Michno, ^{28/}

3) On August 19, 1975, of a total of 456 IBM January 180 contracts publically reported on the CBOE, Podesta executed 400 or 88% represented transactions between Marcus Schloss and Michno. ^{28a/}

A member of the public viewing the option trading for those days would be seriously misled as to liquidity. Podesta's allegation that these option transactions were executed on the floor of the exchange does not detract from the evidence which shows these were all directed and non-bona fide. One of

^{26/} Division's findings #47 at p. 14, Div. Exh. 16.

^{27/} Division's findings #48 at p. 15, Div. Exh. 16.

^{28a/} Division's findings #50 at p. 15-16, Div. Exh. 16.

witnesses, Mr. Doherty testified as to the general workings of the exchange. His testimony is valuable to describe the market when the participants are genuinely conducting competitive transactions, not when the participants are fraudulently using the exchange for their own nefarious purposes.

There is "a substantial likelihood that the disclosure of the omitted fact [the non-bona fide nature of the options transactions between Marcus Schloss and Michno] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."^{29/}

Accordingly, I find the failure to disclose that the reported transactions were not the result of "the normal operation of the law of supply and demand",^{30/} but were directed and prearranged transactions, not reflecting "free and open"^{31/} market trading is an omission of a material fact.

Podesta further argues that he cannot be found to have aided and abetted any antifraud violations since the principals have not been found to have violated the Act, and even if the violations are established, there is no clear and convincing evidence demonstrating that he "knowingly assisted or participated in such arrangement."^{32/} The Division argues on the other

^{29/} TSC Industries, Inc. v. Northway, 426 U.S. 438, 449 (1976).

^{30/} S. Rep. No. 1455, 73d Cong., Second Session, (1934, p. 68.

^{31/} H.R. No. 1383, 73d Cong., Second Session, (1934), p. 11.

^{32/} Brief for the Respondent, at 46.

hand, that Podesta "actually was involved in each step of the violative conduct which he clearly knew or was reckless in not knowing," ^{33/} and was therefore guilty of aiding and abetting the violations. Under the facts herein, Podesta's position is not tenable. The evidence is clear and convincing that he affirmatively assisted Marcus Schloss and Michno in executing their security transactions which he knew or was reckless in not knowing were not bona fide and which operated as a deceit on the public. Both Marcus Schloss and Michno violated the antifraud provisions of the Act by their conduct, ^{34/} and Podesta "knowingly and substantially assisted the violation." ^{35/}

^{33/} Brief for the Division, at 15.

^{34/} Cf. United States v. Deutsch, 451 F.2d 98 (C.A. 2, 1971), cert den., 404 U.S. 1019 (1972), a criminal case where the Court stated:

"To sustain the conviction of one who has been charged as an aider and abettor, it is necessary that there be evidence showing an offense to have been committed by the principal and that the principal was aided and abetted by the accused. It is not incumbent upon the prosecution however, to prove that the principal has been either convicted or acquitted of the offense."

^{35/} Securities and Exchange Commission v. Coffey, 493 F.2d 134 (C.A. 6, 1976), cert. den. 420 U.S. 908 (1975); See also Woodward v. Metro Bank of Dallas, 522 F.2d 84 (C.A. 5, 1975). As the Commission said in H.C. Keister & Company, 43 S.E.C. 164, 169 (1966):

"A finding that a person is an aider and abettor is established by a showing that the performed acts which he knows or has reason to know will contribute to the carrying out of the wrongful conduct."

The evidence is clear and convincing as to Podesta's knowing active participation or his utter recklessness in not comprehending what was occurring.

Accordingly, it is found that Podesta wilfully ^{36/} violated, and wilfully aided and abetted violations by Marcus Schloss and Michno of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the respondent. The Division suggests that Podesta's registration as a broker and dealer be suspended for three months. On the other hand, respondent does not address itself to the necessity for remedial action, contenting itself with continued assertions of innocence of any wrongdoing. Respondent's wilful violations of the Exchange Act and Rule 10b-5 thereunder require that a sanction be imposed in the public interest. The kind of fraudulent conduct which occurred is a serious threat to the integrity of the securities markets. Members of the public must have confidence in the honesty and fairness of the market place for securities.

^{36/} Podesta's reckless conduct demonstrated wilfulness. Furthermore as the Court of Appeals for the Second Circuit observed in Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8 (1965):

"It has been uniformly held that 'wilfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts."

The public interest requires, in my opinion, the imposition of a sanction in order to impress upon Podesta the need for integrity and propriety in his securities dealings.

After careful consideration of the record, including the absence of any serious blemishes on his past record, 37/ the nature and extent of his misconduct, his demeanor at the hearing, and that the publication of this decision will serve to impress upon the respondent the requirement of utmost care in considering his activities in light of the requirements of the Securities laws, it is concluded that the public interest requires that the registration of Podesta as a broker-dealer be suspended for one month, and that Podesta not be permitted to associate with a broker-dealer for a period of one month. 38/

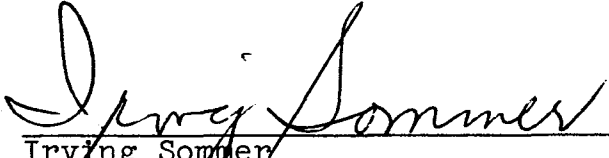
37/ In February 1977, the CBOE issued a Letter of Caution to Podesta concerning exchange rules.

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

Accordingly, IT IS ORDERED that the registration of Robert A. Podesta as a broker-dealer is suspended for a period of one month, and Robert A. Podesta is suspended from association with a broker or dealer for a period of one month from the effective date of this order.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review as to a party, the initial decision shall not become final with respect to that party.



Irving Sommer
Administrative Law Judge

Washington, D.C.
August 22, 1978