

FILE COPY

ADMINISTRATIVE PROCEEDING
FILE NO. 3-1789

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
:
:
WELLINGTON HUNTER d/b/a
WELLINGTON HUNTER ASSOCIATES
:
File No. 8-1271
DUNHILL SECURITIES CORP.
:
File No. 8-11616
PATRICK REYNAUD
:
GRIFFITH C. LINDQUIST d/b/a
LINDQUIST SECURITIES CO.
:
File No. 8-4126
ALFRED BLUMBERG
:

INITIAL DECISION

Washington, D.C.
March 8, 1973

Sidney L. Feiler
Administrative Law Judge

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Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
: Wellington Hunter d/b/a
Wellington Hunter Associates :
File No. 8-1271 :
Dunhill Securities Corp. : INITIAL DECISION
File No. 8-11616 :
Patrick Reynaud :
Griffith C. Lindquist d/b/a :
Lindquist Securities Co. :
File No. 8-4126 :
Alfred Blumberg :

APPEARANCES: Robert W. Taylor, Esq., 160 Broadway, New York, N.Y.
10038, for Wellington Hunter, d/b/a Wellington
Hunter Associates.

Dunhill Securities Corporation by Patrick Reynaud, an
officer thereof, 923 Fifth Avenue, New York, N.Y.
10021.

Patrick Reynaud, 923 Fifth Avenue, New York, N.Y.
10021, pro se.

Harry R. Pollak, Esq., 299 Broadway, New York, N.Y.
10007, for Griffith C. Lindquist, d/b/a Lindquist
Securities Co.

Alfred Blumberg, 1 University Place, New York, N.Y.
10003, pro se at the evidentiary hearing. Proposed
findings and brief filed by Gerald H. Cahill, Esq.,
of Cahill, McPhillips, Sobol, Stone & Munzer, 130
East 40th Street, New York, N.Y. 10016.

Gerald Gordon and Roger M. Deitz, Esqs., of the New
York Regional Office of the Commission, for the
Division of Enforcement.*

BEFORE: Sidney L. Feiler, Administrative Law Judge**

* This Division was formerly known as the Division of Trading and
Markets and is so referred to in the record.

** This is a title change. Record references to the undersigned in
the record are as "Hearing Examiner".

I. THE PROCEEDINGS

These proceedings were instituted by order of the Commission pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, as amended ("Exchange Act") to determine whether certain allegations set forth in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.

The order for the proceedings sets forth allegations by the Division of Enforcement that during the period from on or about April 24 to July 31, 1967, Wellington Hunter, d/b/a Wellington Hunter Associates, a registered broker-dealer ("Hunter"), Dunhill Securities Corporation, a registered broker-dealer ("Dunhill"), Patrick Reynaud, an officer, director, and holder of more than 10% of the equity securities of Dunhill ("Reynaud"), Griffith C. Lindquist, d/b/a Lindquist Securities Co., ("Lindquist") and Alfred Blumberg, an individual and part-owner of a corporation which had filed an application for registration as a broker-dealer during the time here relevant, ("Blumberg"), and other persons acting in concert with them,^{1/} willfully violated and willfully aided and abetted violations of Sections 5(a) and (c) of the Securities Act of 1933, as amended ("Securities Act"), in that said persons, in connection with the offer and sale of the common stock of North American Research and Development Corporation ("NARD"), offered to sell, sold and delivered after sale such securities when

^{1/} The proceedings were originally brought against fifteen individuals or entities. Prior orders of the Commission have disposed of the cases against all the respondents except those named above. Only those portions of the order applicable to the remaining respondents have been summarized.

no registration statement was in effect as to said securities pursuant to the Securities Act;^{2/} that these respondents and other persons acting in concert with them, singly and in concert willfully violated the anti-fraud provisions of the Securities Acts in the offer and sale of NARD common stock;^{3/} and that the named respondents, except Blumberg, failed reasonably to supervise persons subject to their supervision with a view to preventing the violations alleged. It is also asserted that in the activities set forth in the order the respondents made use of the mails and the means and instruments of transportation and communication in interstate commerce. The respondents filed answers in which the material allegations of the order were denied.

Pursuant to notice, a hearing was held in New York, New York. Hunter, Lindquist, and the Division were represented by counsel. Reynaud appeared pro se and also represented Dunhill as an officer thereof. Blumberg appeared pro se during the evidentiary hearing. Proposed findings and a supporting brief were filed on his behalf by

2/ Section 5 of the Securities Act provides, in pertinent part, that it shall be unlawful to make use of the instruments of transportation or communication in interstate commerce or of the mails to offer to sell or to sell a security unless a registration statement is in effect as to it.

3/ Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

counsel. Full opportunity to present evidence and to examine and cross-examine witnesses was afforded the parties. All parties submitted proposed findings and briefs.

On the basis of the entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

II. FINDINGS OF FACT AND LAW

A. The Respondents

Wellington Hunter, doing business under the firm name and style of Wellington Hunter Associates, a sole proprietorship, became registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act on March 14, 1954, and was so registered at all times material herein (File No. 8-1271). He also was a member of the National Association of Securities Dealers, Inc., ("NASD"), a national securities association registered pursuant to Section 15A of the Exchange Act at all relevant times.

Dunhill Securities Corporation succeeded to the business of a registered broker-dealer on January 24, 1967, and was so registered at all times material herein (File No. 8-11616). Patrick Reynaud was president during this period and Guido T. Volante was vice-president. The registrant also was a member of the NASD. Reynaud owned a majority interest in the registrant.

Griffith C. Lindquist, doing business under the firm name and style of Lindquist Securities Co., a sole proprietorship, became registered as a broker-dealer on April 7, 1955, and was so registered at all times material herein (File No. 8-4126). He also was a member

of the NASD. He filed an application for withdrawal of his registration on January 3, 1969. This application has not been acted upon.^{4/}

Alfred Blumberg at all times here material was vice-president and a holder of more than 10% of the equity securities of S.J. Rothman Corp., a New York corporation which filed an application for registration with the Commission on July 25, 1967, which application became effective on August 24, 1967, but which was subsequently cancelled on June 6, 1968.

B. Activities of the Respondents with Respect to the Stock of NARD

1. Sequence of Events

This is a classic case of an attempt to evade the protective provisions of the registration requirements of the Securities Act. In successive steps it involved the acquiring of control of a publicly-owned corporation with no assets ("a shell"), a concentrating of acquired shares in one place (in this case, Canada), dressing up the shell with assets that could be puffed as having tremendous value but which could be acquired at small cash expenditures, and funnelling acquired shares into the over-the-counter market in the United States where cooperating brokers would help in the sale and distribution of the shares at higher and higher prices.

^{4/} Lindquist also formed another registered broker-dealer firm, Lindquist Securities, Inc. (File No. 8-14099). This registrant was named in this proceeding. An offer of settlement submitted by it was accepted by the Commission (Exch. Act Rel. No. 9286, August 11, 1971). Lindquist was not then associated with that registrant.

In the instant case, the steps preparatory to the entry into the U.S. market took place between March and June 27, 1967. On the latter date, NARD shares were first quoted in the "pink sheets" (quotations published by the National Daily Quotation Service, Inc.). These quotations continued until July 20, 1967, when the Commission suspended trading in the stock. During this period of less than a month 197,397 shares of NARD were channeled from Canada into the United States and sold to U.S. investors.

2. The Legal Proceedings

The factual and legal issues involved in the various phases of the NARD stock accumulation and distribution were examined in the course of an injunction proceeding brought by the Commission against NARD and 42 other defendants. All of the respondents herein were named and were active participants in the proceedings, except Reynaud.^{5/} After a full hearing on the record, Judge Mansfield issued his opinion discussing the evidence in detail and concluding that a preliminary injunction should issue against the respondents named here, except Blumberg.^{6/} On appeal, the principal findings of the Court were affirmed, but the findings as to Blumberg and three other defendants were vacated and remanded for further proceedings.^{7/} Thereafter, an order of preliminary injunction was issued against Blumberg.

^{5/} Reynaud was not specifically named, but Dunhill and Guido Volante, a co-officer of Dunhill with Reynaud, were parties defendant.

^{6/} S.E.C. v. North American Research and Development Corp. et al., U.S.D.C.S.D.N.Y., 280 F. Supp. 106, 133 (1968).

^{7/} 424 F. 2d 63, 86 (CA 2, 1970), opinion by Judge Medina.

In later proceedings permanent injunctions on default were granted against Hunter, Lindquist, and one other defendant. Summary judgment on affidavits was denied against Blumberg in view of unresolved questions of fact.^{8/}

The undersigned has taken official notice of the injunction proceedings and the formal opinions rendered. As previously noted, all parties in this proceeding were given full opportunity to present evidence and to examine and cross-examine witnesses.

3. The Accumulation of Stock

The first phase of what was later to become a distribution of unregistered stock in the United States was the effort of a promoter, Edward White, assisted by two Canadian associates, Sam Freeman and Frank M. Naft, to find a shell corporation. Such a corporation was found in the Salt Lake City area -- Utah Fortuna Gold Company. Local participants engaged in a series of transactions whereby 1,000,000 of the 1.8 million outstanding shares of Utah Fortuna were sold to White and his nominee for \$10,000 on April 27, 1967. The transfer was made by a Richard Whitney, who with the cooperation of Robert A. Johnson, a person in control of Utah Fortuna, had obtained an option without consideration to purchase 1,202,000 shares of Utah Fortuna from another corporation. Commencing on April 24, 1967, Whitney and others working

^{8/} S.E.C. v. North American Research & Development Corp., (U.S.D.C.S.D.N.Y. July 18, 1972) CCH Federal Securities Law Reporter ¶93,575.

with him embarked on a campaign to acquire the remaining outstanding shares of Utah Fortuna for nominal consideration. Eventually 753,000 shares were acquired by these participants and on instructions from White and Freeman they were transferred to two Canadian brokerage firms where they ended up in accounts of friends and relatives of White and his associates. Thus by June 27, 1967, 96.8% of all Utah Fortuna shares were under control of these persons.^{9/}

Lindquist played an important part in the transfer of the Utah Fortuna shares to Canada. He was approached by Richard Whitney and an associate, Ralph Bowman, and asked whether he would sell Utah Fortuna stock for them. Lindquist knew nothing about the stock or where it could be sold (Div. Ex. 28), but Whitney and Bowman supplied him with the names of the two Canadian brokers, who by pre-arrangement were ready to purchase the shares. Between April 24 and June 5, 1967, in thirteen transactions, Lindquist sold 653,000 shares to the Canadian brokers. All sales except the final one for 14,500 shares were from accounts in the name of Whitney, Bowman, their relatives and Robert Johnson. The price was one cent a share except for two blocks of 25,000 shares each, sold at five cents a share and the last block of 14,500 shares, sold at ten cents a share (Div. Ex. 29).

Neither Utah Fortuna nor NARD stock was ever registered with the Commission.

^{9/} On May 19, 1967, the name of Utah Fortuna was changed to North American Research and Development Corporation, ratified and made effective at a stockholders meeting held June 19, 1967. White was elected chairman of the board at that meeting.

White always intended to use the corporate shell he acquired as a vehicle to market its shares without complying with the registration provisions under Section 5 of the Securities Act. To make these shares interesting to the investing public, assets had to be placed in the shell and had to be of a type that could hold the promise of huge gains. Originally, White intended to put some mining claims into NARD, and ultimately some unpatented Canadian copper mining claims of unproved value, acquired for NARD stock never actually issued, were placed in the NARD portfolio. White, on a visit to Salt Lake City in April 1967 when he made arrangements to acquire control of Utah Fortuna, visited the inoperative pilot plant built to test production under a process known as the Storrs Process, and claimed to produce pollution-free coke. The plant was owned by Thermal Dynamics Corp. which, in turn, was owned by K. Ralph Bowman, one of the group which had assisted White to obtain control of Utah Fortuna. White decided to add the Storrs Process to NARD and on May 19th, 1967 entered into an agreement with Bowman for the purchase by NARD of all of Thermal's assets, including its patent application on the Storrs Process, for 330,000 NARD shares plus a royalty on coke produced by the process. The mining claims referred to above were transferred to NARD a week later.

The next step was to prepare the way for the successful introduction of NARD shares into the U.S. securities markets. White and his associates spoke personally with broker-dealers and registered representatives to arouse interest in NARD and to create demand. White and another officer of NARD prepared a "Progress Report", a brochure stressing the need for air-pollution devices and claiming that there would be a great future for the Storrs Process in meeting a large market demand. This report was

distributed to the financial community in early July 1967 and helped spur demand.

4. Distribution of NARD Shares in the U.S.

The distribution of the NARD shares in the U.S. was the goal of those in control of NARD. All the prior steps of finding a shell corporation, buying its outstanding shares at nominal consideration, transmitting those shares to Canada, placing in it assets costing little, but which could be puffed up as having great prospects, all these steps were part of, but preliminary, to the distribution contemplated in the U.S.

All the respondents herein played very important parts in U.S. phase of the total distribution process. NARD was first quoted in the Over-the-Counter Market on June 27, 1967. Between that date and July 20, 1967, when the Commission issued its order suspending trading in the stock, 197,397 shares were transmitted from Canada into the U.S. and sold there. The price of the shares rose from $\frac{1}{2}$ cent a share, the price the insiders had paid, to \$6 a share.

Wellington Hunter

Wellington Hunter was the first broker on the East Coast to publish quotations for NARD stock. In the June 26, 1967 ^{10/} issue of the "pink sheets" (the Eastern Stock Section of the National Daily Quotation Service, Inc.) his name is the sole listing of interest in the stock. He quoted a two-sided market of $2\frac{1}{4}$ bid, $2\frac{3}{4}$ offered.

10/ This issue was distributed on the next day, June 27th.

According to Hunter, he first heard of NARD about a week or ten days before the first listing when he began receiving telephone calls from Frank Naft.^{11/} (Hunter had known Naft when the latter had been in the securities business in New York and also knew that Naft could not act as a broker in New York because of sanctions issued against him). Naft told Hunter there was some NARD stock which his wife, using her maiden name of Corinne White, wanted to sell.^{12/} Hunter could find no market for the stock but was told that there would be buyers and was asked to go into the pink sheets and offer the stock for sale.^{13/} (Div. Ex. 22, p.4). White gave Hunter basic information about the company, its officers, and the amount of stock outstanding. Hunter gave this information to the quotation bureau by phone when he placed the listing of NARD. He also got a block of 28,000 shares from Naft or White, which he forwarded to the NARD transfer agent with instructions to break them down into small denominations and reissue them in his name. Naft or White fixed the original selling price that Hunter inserted in the pink sheets (Div. Ex. 22, p.7). No specific quantity was set for the initial sales.

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- 11/ The findings of fact as to Hunter's activities in the purchase and sale of NARD stock are based primarily on his testimony given in the course of an investigation (Div. Exs. 22 and 23) and at the hearing (Tr. pp. 961-1029). While there were some contradictions in Hunter's testimony and he had a hazy recollection of some details, the general course of what took place is clear.
- 12/ Hunter also learned that Corinne White was Edward White's sister.
- 13/ Hunter kept using the word "they" throughout his testimony in referring to Naft, White, and Sam Freeman. As previously noted all three were cooperating in the accumulation of NARD stock in Canada and its planned distribution in the United States.

On the first day of trading Hunter sold 26,000 shares. He continued to quote NARD in the pink sheets every trading day until the Commission's order of suspension. White or Naft or Freeman telephoned him every day to check on his activities in NARD. They would tell him how many additional shares to sell and at what price (Div. Ex. 22, p. 11). They also told him that he could make a market if he wanted to, that they would protect him and if he needed stock he could get it from them. He was given a phone number to call when he needed more stock. He used this number, and would talk to Naft, White, or Freeman about his requirements (Div. Ex. 23, p. 38). He was given the names of brokers or other firms who had stock to sell and stock was sold to him at prices that yielded him a profit of 1/8 of a point (Div. Ex. 23, p. 51).

Hunter had no knowledge of the operations of NARD. He did receive some copies of the Progress Report when it was issued in July, but made no study of it. He never met or spoke with Corinne White and checks due her for \$50,000 and \$46,017.68 were given to Naft or White (Div. Ex. 23, p. 61-63). In all, Hunter sold 83,840 shares and purchased 70,740 shares.^{14/}

It is alleged in the order for these proceedings that Hunter violated the registration provisions of the Securities Act, Sections 5(a) and (c), in that he offered to sell, sold, and delivered after sale the common stock of NARD when no registration statement was in effect as to the said securities. It is undisputed that Hunter offered

^{14/} Some of the trades of Hunter and other brokers were not completed because of the issuance of the Commission's suspension order. The facilities of interstate commerce and of the mails were used by all the respondents herein.

to sell, sold, and delivered NARD stock and that no registration was in effect as to these securities. Therefore, Hunter's sales activity in NARD was violative of Section 5 unless some exemption from the registration provisions can be established. The burden of proof is on the party seeking to establish the availability of an exemption.^{15/}

The exemption relied on must be strictly construed against the person claiming its benefit,^{16/} as public policy strongly supports registration.^{17/}

It is urged on behalf of Hunter that in the aforementioned court proceeding he was not found to have "willfully" violated or willfully aided and abetted violations in the sale of NARD stock, that he was a dupe or victim rather than a perpetrator of "willful violations", that his entering quotations in the pink sheets was his only violation, and that there is some question whether an exemption from registration existed for NARD.

A contention was made during the court proceeding previously referred to, that an exemption for the NARD securities was available by reason of the provisions of Section 3(a)(1) of the Securities Act. Under this section, securities sold prior to July 27, 1933 are exempt from registration under the Securities Act. However, the exemption does not apply to a new offering of such security subsequently made.

^{15/} SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953); Pennaluna & Co., Inc. v. SEC, 410 F. 2d 861 (C.A. 9, 1969), cert. den. 396 U.S. 1007 (1970); SEC v. Culpepper, 270 F. 2d 241, 246 (C.A. 2, 1959).

^{16/} U.S. v. Custer Channel Wing Corp., 376 F. 2d 675, 678, cert. den. 389 U.S. 850 (1967); SEC v. Sunbeam Mines, 93 F. 2d 699 (C.A. 9, 1938).

^{17/} Garfield v. Strain, 320 F. 2d 116, 119 (C.A. 10, 1963).

The Utah Fortuna shares were originally sold prior to 1933. However, it is apparent that White and his associates, who were in control of NARD at the relevant times herein, were making a new public offering when they sought to sell a substantial amount of the NARD stock in the U.S. market. The exemptive provisions of section 3(a)(1), therefore, are not applicable.^{18/}

Certain transactions are exempt from the provisions of Section 5 of the Securities Act pursuant to the provisions of Section 4 of that Act. However, no exemption is available under this section to an issuer or underwriter. The term "underwriter" is defined in Section 2(11) of the Securities Act as:

". . . any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; . . ."

With respect to an "issuer", the section states:

". . . As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. . . ."

"Distribution" has been held to comprise "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public."^{19/}

^{18/} Court of Appeals decision *supra*, p. 71-72; Ira Haupt & Company, 23 S.E.C. 589, 599 (1946).

^{19/} Oklahoma - Texas Trust, 2 S.E.C. 764, 769 (1932), *aff'd* 100 F. 2d 888 (C.A. 10, 1939); Ira Haupt & Company, *supra*, pp. 596-599; Lewisohn Copper Corp; 38 S.E.C. 226, 234-235 (1958).

It is evident that at all times here relevant White was an "issuer" within the meaning of the Securities Act as a person in control of NARD both by reason of his position as Chairman of NARD and his control over its stock personally and by his associates and nominees of the White-Naft-Freeman group.

The close sequence of events in Salt Lake City, Canada, and New York further establishes that the activities in NARD stock in those areas were all links in a chain whereby a substantial distribution of NARD stock was sought to be achieved. Hunter played a key role in the disposition of NARD shares in the New York market. He placed the opening quotations in the pink sheets, thus helping to make a market in the shares. He sold the original block of 28,000 shares Naft brought in and continued to sell shares he obtained from the White group. He thereby was performing the functions of an "underwriter" by these activities since he engaged in a distribution of NARD shares for an issuer, in this case White and his associates.

Hunter was certainly not an innocent dupe in this distribution. He originally dealt with Naft as an intermediary for Corinne White. He learned that she was related to White and he learned of her relationship to Naft. Hunter never met Corinne White, but opened an account for her and gave substantial checks due her to Naft and/or White.

His daily conversations with White, Naft and Freeman and his dealings with them certainly should have alerted Hunter, a person with fifty years experience in the securities business, that he was not dealing with ordinary investors. This was especially true of their offer to

direct him to sources of supply and to protect his profit on at least some transactions. The undersigned concludes that the respondent, Wellington Hunter, by his aforesaid conduct, violated and aided and abetted violations of the registration provisions of the Securities Act and that these violations were willful.^{20/}

It is further alleged in the order for the proceedings that the respondent, Wellington Hunter, violated the anti-fraud provisions of the Securities Acts by offering and selling NARD shares and lending his prestige and name in connection with the trading market for NARD shares without having made reasonable and diligent inquiry as to the past and present financial condition of NARD, its products, offices, officers and principals.

It has been pointed out in the Special Study of the Securities Markets that "the sheets" published by the National Quotation Bureau, Inc. . . . are the primary medium for the dissemination of wholesale or "inside" quotations among professionals. They are of crucial importance to the over-the-counter markets. . . . Professionals use the sheets to find and communicate buying and selling interests in securities and to judge activity."^{21/} These quotations are affected with a public interest (Exchange Act, Sec. 2) and have been held to constitute proof of prevailing market prices.^{22/}

^{20/} Tager v. SEC, 344 F. 2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. SEC, 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S. E. C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946).

^{21/} Report of Special Study of Securities Market, Part 2, p. 585.

^{22/} Merritt, Vickers Inc. v. SEC, 353 F. 2d 293, 296 (C.A. 2, 1965).

Thus quotations may be used to establish apparent market prices bearing no relation to the intrinsic value of the security and for the purpose of deceiving others. What is planned is the publication of quotations, either as bid or ask prices, or both, which can be pointed to as evidence of market price and value.

Broker-dealers have the obligation to take precautions to avoid aiding such frauds by inserting bid or ask prices^{23/} or indicating a two-sided market. The Commission has pointed out that the amount of inquiry which should be made depends on the circumstances.

The Commission has summarized applicable principles and key decisions in a release published in 1962.^{24/} In it, it cautioned broker-dealers of steps they must take to avoid participation in an illegal stock distribution. In particular, it stated:

". . . a dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept 'self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts'.

The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer

^{23/} See, e.g., Franklin National Bank v. L. B. Meadows & Co., Inc. 318 F. Supp. 1339 (1970) (quotations used to establish value of collateral for bank loans).

^{24/} Sec. Act Rel. No. 4445 (Feb. 2, 1962).

is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.

The problem becomes particularly acute where substantial amounts of a previously little known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933. In such situations, it must be assumed that these securities emanate from the issuer or from persons controlling the issuer, unless some other source is known and the fact that the certificates may be registered in the names of various individuals could merely indicate that those responsible for the distribution are attempting to cover their tracks." (footnote omitted)

Hunter, as previously pointed out, had ample warning that he was dealing with persons in the status of issuers when he dealt with White and his group. He knew or should have known that their chief goal in the United States was to establish a market which would yield them a quick, high profit. As an outlet for their shares, Hunter served this goal by inserting quotations in the pink sheets at the very beginning of U.S. sales activity and continued to do so daily even as the evidence that he was dealing with a control group became stronger and stronger.

Hunter admittedly made no inquiry about NARD and its assets. He had no idea whether the quotations he inserted in the pink sheets had any relation to any basic value of the shares or were arbitrary determinations by insiders.^{25/} Under the circumstances existing here the undersigned concludes that Hunter was a participant in a scheme

^{25/} See, D.H. Blair & Co., Sec. Exch. Act Rel. No. 8888, p. 11 (May 21, 1970).

to defraud investors, that this participation was a key to the success of the scheme, and that by this conduct Hunter willfully violated the anti-fraud provisions of the Securities Acts.

The clerical staff at Hunter's firm also participated in the violations found to the extent that they took care of stock transfers and financial arrangements incidental to the completion of transactions arranged by Hunter. While the more serious part of the violations found were committed directly by Hunter, it is also concluded that within the meaning of the Exchange Act he failed reasonably to supervise persons subject to his supervision with a view to preventing their participation in the violations found.

Griffith C. Lindquist

In addition to his activities in the sale of Utah Fortuna shares to Canadian brokers previously summarized herein (p. 6-7), Lindquist played an important part in the market which developed after quotations for NARD appeared in the pink sheets. He placed bid and ask quotations in those sheets for every trading day beginning on July 3, 1967 until the Commission's suspension order was issued (Div. Ex. 26). He engaged in transactions involving almost 10,000 shares in approximately 40 transactions. In most of the transactions he acted for members of the Whitney and Bowman families, persons for whom he had acted in the prior transactions with Canadian brokers.

It is urged on Lindquist's behalf that he did not commit any willful violations of the Securities Acts, that the shares sold through him to Canadian brokers could have been merely mailed rather than sold

through him, that an exemption under Section 4(4) of the Securities Act is applicable to those transactions, that Lindquist was not found in the aforementioned court proceedings to have violated the anti-fraud provisions of the Securities Acts, and that his later activities in the sales of NARD stock were no different from those of other broker-dealers who traded in NARD stock.

The rationale of the Commission and the courts as outlined in the prior section relating to Hunter's activities is fully applicable here. Lindquist performed an essential service in transmitting Utah Fortuna shares from control sources in the U.S. to Canadian brokers from whom control persons could accumulate outstanding stock. He made no effort to determine whether he was thereby participating in illegal activity. He had no information about Utah Fortuna or later, about NARD, nor about the Canadian brokers to whom he was directed. He ignored very suspicious circumstances and cooperated with those engaged in the distribution process. Brokers have a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act, and should be reasonably certain that such exemption is available before engaging in transactions which raise a question of compliance with those requirements.^{26/} The dealer's exemption is not available to a dealer selling unregistered securities for an underwriter and neither is the broker's exemption available when the broker has reasonable grounds to

^{26/} Merrill Lynch, Pierce, Fenner & Smith Incorporated, Sec. Exch. Act Rel. No. 9959, p.4 (Jan. 24, 1973).

believe that his principal is an underwriter. It is concluded that Lindquist violated and aided and abetted violations of the registration provisions of the Securities Act ^{27/} and that such violations were willful. ^{28/}

Lindquist's later transactions in NARD cannot be considered independently of his prior dealings in the stock of its predecessor company. Through those dealings he had sufficient information to alert him that control persons were engaging in steps looking towards an illegal distribution of NARD stock. When market trading developed, Lindquist did not use his background knowledge to make further inquiries into the validity of that sales activity, but participated in it to a substantial extent. The undersigned concludes that he cannot be considered an ordinary dealer, but rather one who lent his name to spur further trading in the unregistered shares and their distribution to the public. The undersigned concludes that thereby he engaged in a course of business which operated as a fraud and deceit upon customers and prospective customers and which was willfully violative of the anti-fraud provisions of the Securities Acts. ^{29/}

^{27/} See District Court decision, supra, p. 122.

^{28/} Brokers and dealers are under a duty to investigate and their violation of that duty brings them within the coverage of the term "willful". Hanley v. S.E.C., 415 F. 2d 589, 595-6 (C.A. 2, 1969); Quinn and Company, Inc. v. S.E.C., 452 F. 2d 943, 947 (C.A. 10, 1971).

^{29/} The record does not indicate what part, if any, employees of Lindquist may have played in the violations. This issue was not litigated in the injunction proceedings. No findings have been made on any failure on his part to supervise.

Dunhill Securities Corporation

Another outlet for NARD shares used by the White-Naft-Freeman group was Dunhill Securities Corporation. Through an account in the name of Gail Dombrofsky , 39,500 shares were sold between June 27 and July 11 at prices ranging from \$3 5/8 to \$5. Another account in the name of Frances Oventhal, was then used to dispose of 8,500 shares between July 14 and July 17 at prices from 5 1/2 to 5 3/4. (Div. Ex. 7). Gail Dombrofsky was a sister of Morris Cooper, a close business associate of Freeman and Naft. Frances Oventhal was Cooper's mother-in-law. All were Canadian residents. Guido Volante, a principal of Dunhill and its trader, executed all stock trades for Dunhill during this period, including those in NARD.^{30/} He had never met Dombrofsky or Oventhal. He had previously been introduced to Morris Cooper by a respondent herein, Alfred Blumberg. Since Volante knew Cooper and not Dombrofsky nor Oventhal, it is likely that Cooper acted for them and directed the disposition of their shares.

The shares that were sold by Dunhill for the aforementioned Canadian accounts were part of the block controlled by those also in control of NARD and were being distributed in the United States in violation of the registration provisions of the Securities Act. This was a classic case of the type of transactions the Commission had warned brokers to avoid in the release previously referred to.^{31/}

^{30/} Volante was named in this proceeding. An offer of settlement submitted by him has been accepted by the Commission.

^{31/} Sec. Act Rel. No. 4445 (Feb. 2, 1962).

It has been argued that Dunhill fulfilled its obligation to investigate to avoid committing violations, Volante claimed he made inquiries of Cooper, the transfer agent of NARD, White, and one other officer. He maintained that he was assured by all these persons that there was no impediment to Dombrofsky and Oventhal selling their NARD shares. He also claimed that he relied on the fact that the stock was quoted in the pink sheets by Hunter and that the stock certificates he received from Dombrofsky and Oventhal bore no restrictive legend.

The Commission pointed out in the aforementioned release that inquiry from those who might have a financial interest in arranging for a disposition of shares is insufficient. Those of whom Volante asserted he made inquiries all had such an interest. His conduct was not sufficient to satisfy the obligation of careful inquiry under the circumstances. ^{32/} Inquiry from the transfer agent was insufficient. Although the transfer agent could furnish information on the state of transfer records he was not an arbiter of the validity of transactions. ^{33/} Nor could Volante rely on quotations in the pink sheets. There is no blanket exemption under Section 4 for all trades in a stock. Only certain transactions may be exempt. Nor was the fact that certificates tendered did not bear restrictive legends any justification for trading them in the circumstances herein. It is concluded that Dunhill, which was responsible for the conduct of Volante under the doctrine of respondent superior, ^{34/} violated and aided and abetted violations of Section 5 of

^{32/} District Court Opinion, supra, p. 126.

^{33/} Stead v. S.E.C. 444 F. 2d 713, 716 (C.A. 10, July 2, 1971).

^{34/} Armstrong, Jones & Co., Sec. Exch. Act Rel. No. 8420 (Oct. 3, 1968), aff'd 421 F. 2d 359, 362 (C.A. 6, 1970), cert den. 398 U.S. 958 (1970)

the Securities Acts by participating in the distribution of NARD shares in the accounts of Dombrofsky and Oventhal. Those violations were willful under the cases cited, supra.

Dunhill engaged in other activities in the disposition of NARD shares. In addition to purchases and sales with other broker-dealers, sales were made to forty-four public customers of Dunhill. Some of these transactions were unsolicited orders placed by Blumberg or his friends. However, at least 13 sales aggregating approximately 2000 shares were solicited and made by Marvin Osias, a registered representative employed by Dunhill.^{35/} Since these were offers to sell unregistered securities, no exemption for these transactions is applicable. Dunhill was responsible for the conduct of Osias and knowingly processed the orders. It is concluded that it thereby also willfully violated Section 5 of the Securities Act.

The record establishes that Osias knew very little about NARD. He learned from Blumberg that the company was in the air pollution business. He also obtained a copy of the Progress Report at Blumberg's office. Beyond that, he made no effort to obtain detailed information on the financial status or the past history of NARD. His presentation to customers was at best sketchy and incomplete. He told his customers that the stock was moving up, that it was a good speculation, it was in the air pollution field, and was "worth a shot!" (Tr. 301).

He did not tell his customers anything about the state of development of the process the company sought to exploit, the need

^{35/} The Commission has imposed sanctions on Osias for his activities. (Sec. Exch. Act Rel. No. 8612, May 27, 1969).

for testing it or the cost of such tests, the past history of the company's pilot plant, or the methods being used to market the NARD shares. Under any standard, the information Osias furnished his customers was incomplete, **false** and misleading and willfully violative of the anti-fraud provisions of the Securities Acts. These violations are also chargeable to Dunhill.

Osias, as a part-time salesman for Dunhill, made the above-mentioned sales away from the premises of Dunhill. No supervision was exercised over his activities in the sale of NARD shares. It is concluded that the registrant failed reasonably to supervise Osias with view to preventing the violations found to have been committed by him.

The question of Patrick Reynaud's responsibility for the violations charged to Dunhill is at issue in this proceeding. Dunhill was incorporated by Guido Volante and was registered as a broker-dealer with the Commission in January 1967 as a succession to an inactive firm which Volante had previously acquired (File 8-11616-1). In March, Reynaud provided securities on which funds were borrowed to enable Dunhill to commence operations. Reynaud was made president and acquired a stock interest in the firm which later was increased to a majority holding. There was an oral arrangement for an equal division of any profits. During the period relevant here it was understood between Volante and Reynaud that the latter would only come to the Dunhill office part-time and that when he did he would devote his time to back-office matters, attempt to learn the operations there and supervise the cashier and the other back-office employees. By arrangement, Volante was in charge of all trading operations, including the NARD trades,

and Reynaud did not attempt to supervise or control these operations in any way.

In the first half of 1967 Reynaud spent little time at the Dunhill offices. He appeared there once or twice a week and spent two to four hours there each time. In the June - August period of 1967 (during which the NARD transactions occurred) Reynaud operated a French-speaking camp and only appeared at the office once or twice.

It is contended that since Reynaud never played any role in the distribution of the NARD securities, was not active in the affairs of Dunhill at that time, and could not exercise any supervisory authority at that time since he had not successfully completed a general securities examination prescribed for supervisory personnel pursuant to provisions of the Exchange Act (Rule 15b8-1) and the By-Laws of the NASD, he cannot be found to have violated the Securities Acts.

At the period here relevant Reynaud was the owner of a majority stock interest in Dunhill and was its president. As chief officer of the registrant he necessarily assumed the obligation of keeping himself informed of the registrant's activities, providing adequate supervision, and taking whatever steps were necessary to secure compliance with the law.^{36/} The fact that Volante, as an officer and minority stockholder was on the premises, did not absolve Reynaud of his responsibility. However, functions of the registrant could be delegated to a qualified person.^{37/} Volante did have experience which qualified him for the

^{36/} Albion Securities Company, Inc., Exch. Act Rel. No. 7561 (Mar. 24, 1965); L.A. Frances, Ltd., Exch. Act Rel. No. 9220 (Jan. 22, 1971).

^{37/} Weston and Company, Inc., Sec. Exch. Act Rel. No. 9312 (Aug. 30, 1971).

task of conducting front-office operations and could be designated to conduct these operations. Under the circumstances the undersigned concludes that Reynaud is not chargeable with the substantive violations of the registration and anti-fraud provisions alleged in the order.^{38/}

However, this did not end Reynaud's responsibility in view of his position and controlling stock interest. The fact that he had not passed qualifying examinations and did not spend much time at Dunhill merely emphasizes his failure to carry out his responsibilities of supervision and does not excuse it.^{39/} As a registered broker-dealer, Dunhill had certain public responsibilities which those in control of its operations had a duty to see were properly performed. Reynaud, as chief officer and majority stock owner, failed in his supervisory duties to prevent the violations found to have been committed by Dunhill and its staff in connection with the sales of NARD stock, as alleged in the order for the proceedings.

^{38/} Compare another case involving Dunhill and Reynaud (Exch. Act Rel. No. 9066, Jan. 26, 1971) where the Commission affirmed conclusions of a hearing examiner rejecting defenses entered by Reynaud similar to those made here, based on findings that during the period there relevant (the first part of 1968) Reynaud actively participated in transactions at Dunhill found to be part of fraudulent activities at that firm.

^{39/} Albion Securities Company, Inc., *supra*; L. A. Frances, Ltd., *supra*, See also, John T. Pollard & Co., Inc., 38 S.E.C. 594, 598 (1958); Aldrich, Scott & Co., Inc., 40 S.E.C. 775, 778, Advanced Research Associates, 41 S.E.C. 579, 613 (1963).

Alfred Blumberg

Alfred Blumberg occupied a central position in the NARD sales activity in the United States in that he had at least an acquaintance with members of the NARD control group operating from Canada and also placed orders for the initial retail purchases in the Eastern market.

Blumberg has had extensive experience in the securities field. He began working in that field in 1956 and has since been employed as a registered representative. He has also acted as a finder and has had experience in underwritings. He has passed the NASD principals examination and also has served on the boards of public companies. In April 1967 he left a brokerage firm with which he had been associated and thereafter bought and sold securities for his own account and for approximately ten accounts for which he had powers of attorney. There were a number of people who had been his customers in the past and Blumberg maintained contact with them and referred them to Dunhill for the execution of their orders hoping to retain them as customers until the time he went into business himself as a broker-dealer. About a week after the issue of the Commission's suspension order, an application for registration was filed by S.J. Rothman & Co., a firm in which he had more than a 10% interest. The registration became effective but it was subsequently cancelled.

Blumberg was friendly with Volante. At one time before Reynaud acquired an interest in Dunhill, Blumberg and Volante considered going into business together. At the times here relevant, the Dunhill offices were in the same building as Blumberg's and the latter had a

direct telephone to Dunhill. Blumberg had recommended Osias to Volante and it was at his suggestion that Volante directed some commissions to him, even though Osias had not made the particular sales. These included NARD sales from the Dombrofsky account. Blumberg and Volante saw each other frequently and Volante respected the former's judgment.

The evidence establishes that what little information Volante and Osias had about NARD came from Blumberg. According to Volante, he made no effort to sell NARD shares to his customers and all retail sales by Dunhill were to Blumberg, to accounts he controlled, and to his friends.

Blumberg had had business dealings with Morris Cooper in 1966 and maintained a connection with him during the relevant period here. Blumberg introduced Cooper to Volante, and Cooper did some trading at Dunhill. Volante knew Cooper as a friend of Blumberg. As previously noted, Cooper was close to the control group in NARD.^{40/}

According to Blumberg,^{41/} in the May - June 1967 period he made trips to Toronto for social reasons. On one occasion he met Cooper and by chance they met White, whom Blumberg knew, and another man introduced to Blumberg as Naft. Blumberg stated that there was no discussion of stocks on that occasion.

Continuing his testimony, Blumberg stated that on another visit to Toronto about two weeks later he and Cooper met White at a restaurant.

^{40/} He was a close business associate of Freeman and Naft, two of the control group and part of the distribution of NARD shares in the U.S. was made from accounts of Dunhill in the names of his wife and mother-in-law, probably on his orders. (District Court opinion, supra, p. 115).

^{41/} Blumberg testified in these proceedings (Tr. p. 1120-1267). His testimony at the injunction proceeding and in the course of an investigation are also part of this record (Div. 17, 18, 19).

White asked if Blumberg had any interest in air pollution. Blumberg replied that he was interested in anything. White stated that he was trying to acquire a process but there was no company as yet. Blumberg told him that if White went ahead with a public company he would like to look at it. Blumberg also got for White at the latter's request a book on the chemistry of coal utilization.^{42/} On another visit about ^{43/} a week later Blumberg skimmed a report that White had in his possession.

Blumberg did receive a phone call the day before NARD appeared in the pink sheets, was given the name of the company, and was told it would be traded. He testified he could not recall who telephoned him.^{44/}

Blumberg had Volante check the pink sheets on June 27 and when the latter reported that Hunter was quoting NARD, Blumberg gave Volante an order to buy 1000 shares and later bought an additional 1000 shares. Blumberg's order was probably the initial over-the-counter transaction in the New York market. As previously noted, a number of customers of Dunhill bought NARD shares on recommendations from Blumberg. Some of these received allocations from Blumberg's purchases. Their names appear on the Dunhill records (Div. Ex. 7). He testified these were

^{42/} "Chemistry of Coal Utilization", H.H. Lowry (Editor), 1963.

^{43/} This was a report by an engineering firm The Lummus Company, dated February 16, 1965, entitled, "A Technologic and Economic Appraisal of a Coal Carbonization System." It was in the nature of a preliminary analysis of the Storrs Process, proposing certain testing procedures and further analysis if that firm would participate in a venture with the persons in control of the process. (Blumberg Ex. 12).

^{44/} In his investigative testimony he named Cooper as his source of that information (Div. Ex. 20, p. 47). See also Tr. 1232-1233.

persons who were friends to whom he owed favors, persons whom he respected and who relied on him to make them some money in the stock market.

(Tr. 1130). Some of these accounts were:^{45/}

Donald Bachman - 200 shares, 6/27 - (Blumberg had a power of attorney from him and placed the order directly.)

Bernard Birnbaum - 300 shares, 6/27 - (Blumberg spoke with him prior to his purchase).

Diam Trading - 800 shares, 6/27 - (this was a corporation Blumberg headed).

Peter Diaz - 200 shares, 6/27 - (an office associate of Blumberg).

Molly Goldberg - 300 shares, 6/27 - (a grandmother of Blumberg's accountant, to whom Blumberg had mentioned the stock).

S.J. Rothman Co. - 700 shares, 6/27 a company in which Blumberg had an interest.

Sol Schneider - 300 shares, 6/27 - a manager of a country club to whom Blumberg said he could have part of his own purchase up to \$1,000.

Adele Spurio - 200 shares, 6/27 - a friend.

Barry Schneider - 100 shares, 6/29 - Sol Schneider's son. Blumberg did not speak directly to him, but Barry probably learned of the stock from his father.

Marvin Osias - 500 shares, 6/30 - Osias has been mentioned before. He was a friend of Blumberg who had gotten him a part-time job as security salesman at Dunhill. Osias heard of NARD from Blumberg and interested approximately 13 customers in making purchases. He obtained a copy of the "Progress Report" either directly from Blumberg or at his office.

Other major purchasers Blumberg mentioned were:

Stanley Snyder - 5800 shares, 6/30 - Blumberg had a power of attorney for him.

^{45/} Blumberg's testimony on this point appears in the transcript p. 1222 et seq and Div. Ex. 19, et seq.

Edwin Menlinger - 2,000 shares, 7/3 - same basis as above.

There were approximately ten other persons whom Blumberg mentioned as persons to whom he told of NARD.

Violations of the Registration Provisions of the Securities Act.

It is alleged in the order for the proceedings that Blumberg violated the registration provisions of the Securities Act (Section 5(a) and (c)) in connection with the sale of NARD stock. The Division relies primarily on Blumberg's sales activity in the New York market immediately after the NARD shares were offered for sale in the pink sheets. It is contended on Blumberg's behalf that he was not part of any group seeking to effect an unlawful distribution of NARD shares, that he did not receive any compensation from the control group and, in effect, that he had the status of an ordinary investor.

Blumberg maintained that he relied on the fact that NARD was quoted in the pink sheets and on his respect for Wellington Hunter for his conclusion that the NARD stock could be freely traded. Yet there is no blanket exemption for trading in any stock. Particular transactions may or may not be exempt and the duty of careful inquiry remains.

What is remarkable is that even if Blumberg's assertion that he had no connection with the control group is accepted, it also is evident that he learned from White that he was a promoter of the company whose stock would soon come on the market. Yet he made no inquiry of him about the company and its background to determine whether there would be any problems under registration provisions for the sale of the shares. His only expressed interest was to be informed

when the stock would be traded. This, despite his background which included experience in preparing and filing registration statements.

Moreover, when he learned that NARD was coming on the market he spread word among many persons of his interest in the stock. He knew that these persons had confidence in his judgement and would act on his advice. The records at Dunhill show that Blumberg's activities had a ripple effect. Not only were purchases made by those to whom he spoke directly but also by their friends and relatives. Osias in turn sold NARD stock to his customers. It is pointed out in the aforementioned opinion of the Court of Appeals that most of the activities of Blumberg consisted of inducing others to purchase or to promote the distribution of unregistered stock and that these are not exempt activities.^{46/} No financial stake was required to be shown to support a charge of violation of Section 5. Blumberg's activities were of the type needed by those attempting to dispose of the unregistered NARD shares and to spread them in the U.S. market. (The orders he generated at Dunhill were filled from the Dombrofsky and Oventhal accounts, in the main). The undersigned concludes that Blumberg by his conduct participated in steps necessary to a distribution of unregistered securities and he thereby aided and abetted violations of Section 5 of the Securities Act.^{47/} These violations were willful.^{48/}

^{46/} Supra, p. 81-82.

^{47/} The mails were used directly by Blumberg and also in the completion of transactions in NARD he caused others to engage in.

^{48/} See authorities cited, supra, n. p. 15.

Violations of the Anti-Fraud Provisions of the Securities Acts.

Blumberg is charged in the order for the proceedings with violations of the anti-fraud provisions of the Securities Acts. He admitted mentioning the stock to a substantial group of investors. Some of them testified in this proceeding or at the injunction proceeding.

Blumberg had acted as broker for A.B. and recommended stocks to him. He told A.B. of NARD as a company which had a process for low sulphur content for fuel or coal which was in the developmental stage. A.B. told Blumberg to buy 300 shares for him in his wife's name. The order was processed at Dunhill. A.B. testified he would not have bought the shares if he knew they were unregistered. No mention was made to him of the cost of testing the process. A.B. told his grandmother of the stock and she made a purchase prior to his.

A.B. recalled being shown a brochure by Blumberg but never looked at it. He relied on Blumberg's recommendations in low-priced speculative stocks, he testified. A.B. ultimately received his money back from Dunhill.

J.J.C., a trader at an investment banking house, bought 500 shares of NARD in his wife's name after Blumberg brought the stock to his attention at a luncheon meeting. According to J.J.C., Blumberg told him the company was in the business of removing sulphur from coal and that the people behind it were sound. No mention was made of the financial condition of the company, its background, or the

need to register the stock.

S.S. testified in the injunction proceeding (Div. Ex. 13). He was general manager of a golf club at the relevant period here and asked Blumberg if he could recommend a stock he could invest or speculate in. Blumberg told him that NARD was a "good thing" to get into and if he wanted to speculate with a few dollars he could buy it. S.S. bought 300 shares of NARD at Dunhill on June 27th. According to S.S., a short time later, when NARD had almost reached 6, Blumberg asked him whether he wanted to sell in order to add to his funds since he was about to open his own business. S.S. asked Blumberg whether he thought the stock was good and when Blumberg said that he thought so, S.S. kept his stock. S.S. further testified that about a week after his purchase Blumberg told him there was some talk of General Electric going to build a plant and that the stock should be very good. Blumberg testified in this proceeding and denied referring to General Electric. His denial is credited, but otherwise the testimony of S.S. is accepted.

M.C. testified both at the injunction proceeding (Div. Ex. 15) and at the hearing herein (Tr. 799-844). M.C. knew Blumberg as a customer of a dry cleaning store he managed. He testified that Blumberg mentioned NARD to him, although he was uncertain whether he asked Blumberg to recommend a stock to him or Blumberg had volunteered it. He testified that Blumberg told him that NARD owned a process

49/ On other occasions, J.J.C. gave testimony and affidavits which were contradictory. His testimony is credited to the extent indicated above.

which would produce a fuel from coal which would have the effect of reducing pollution and that the stock was good and he thought it would go up. He had a recollection that Blumberg told him he was a member of a syndicate handling the public sale of NARD. M.C. bought NARD through a broker after the conversation.

On cross-examination, M.C. testified he was never a customer of Blumberg and that the latter told him to use his own broker. He stated that Blumberg did not tell him he was connected with NARD or the extent of any stock interest he may have had in it, nor did he furnish any details about the financial condition of the company or its history.

M.C. indicated in his testimony at the injunction proceeding that he did not have a clear understanding of what the term "syndicate" means (Div. Ex. 15, p. 646-647). His testimony as to Blumberg's connection with a syndicate marketing NARD stock is not credited, but otherwise his testimony and that of the other investor witnesses, as outlined above, is credited.

Blumberg testified that he bought NARD stock for himself, his family and close friends on the basis of his investigation of the process which had been acquired by NARD. While he admitted that he mentioned NARD in the course of casual conversations with social friends, he denied every using "hard sell" tactics. He denied making any use of the Progress Report, which was condemned in the aforementioned court decisions as incomplete, false and misleading. He stated that he received five copies and gave two of them to brokers who had requested them. Volante and Osias each took a copy and he kept the last copy, according to his testimony.

Blumberg assumed that the company had been "checked out" by others because it was appearing in the pink sheets. He also testified that exhaustive investigation could not be made for all investments when the amounts involved were not very large and very often purchases are made solely on "hunches" and trading activity.

Blumberg denied having any connection with those in control of NARD. He emphasized that he had done research in the field of Chemistry and coal utilization, including purchasing and reading the aforementioned book on coal utilization and general literature in the field of pollution. He also noted that he had looked at the Lummus Report (Blumberg Ex. 12), which White had shown him. He summed up his position by stating that he bought NARD stock and recommended it to others because he had "a gut reaction to the process and the economics at the time, and its proven to be correct.

Q. Any other reasons?

A. Do you need more reason to buy a \$3 stock?" (Tr. 1245)

He also maintained that later information showed that the plant NARD acquired could be made operational at little expense, that it could have proceeded with a licensing program, and that an accountant's statement showed that NARD had assets in excess of \$500,000 (Blumberg Ex. 11).

The most important fact that emerges from Blumberg's testimony, giving full credit to it, is that he had very little information about NARD when he decided to invest in it and to recommend it to others. He had thumbed through the Lummus Report which had recommended a testing program for the Storrs Process. Apparently nothing had been done about

it in the two years since it had been written. White had spoken to him of his plans, but only in generalities. Blumberg maintained he had studied a book on the subject of the chemistry of coal utilization. Yet that same book noted that there had been tremendous interest in low-temperature carbonization after World War I, hundreds of processes had been tried, almost all of which had been unsuccessful. It was estimated that between 1920 and 1930 over 50 million dollars had been expended on unsuccessful commercial ventures without tangible returns. It was also noted that broad study after World War II had still not resulted in successful commercial applications.^{50/} Mention was made of the Storrs Process, but while expected yields were noted it was also reported that there had been no definite results as of the date of publication of that book, 1963. (supra, p. 447-448).

Actually, the evidence establishes that Blumberg was interested only in finding out when the NARD stock would appear on the market. He probably only learned its name when he received a telephone call the night before he placed his orders. He made no effort to obtain any information about NARD, whether it actually had any rights to the Storrs Process, the history of its testing of the process, or other matters of importance in making a considered judgment.

Blumberg was within his rights in deciding to plunge ahead insofar as he risked his own money for his own account. However, his recommending NARD to others on the basis of the little he actually knew is on another footing. The obligations of brokers and their salesmen to investors

^{50/} Supra, n.42 , p. 395-396

has been spelled out in many decisions by the Commission and the courts. A number of these have been analyzed and applied in the leading case of Hanley v. S.E.C., 415 F. 2d 595, 596-597 (C.A. 2, 1969), quoted in the Court of Appeals decision in NARD, supra. It was pointed out in Hanley that brokers and salesmen are under a duty to investigate and their violation of that duty brings them within the term "willful" as used in the Exchange Act, that they impliedly represent that they have an adequate basis for the opinions they render, and that there is a special duty imposed upon those who sell over-the-counter stocks where information on a particular stock may not be readily available. The opinion summarized the obligations of a broker and his salesmen as follows:

"In summary, the standards by which the actions of each petitioner must be judged are strict. He cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.

A salesman may not rely blindly upon the issuer for information concerning a company, although the degree of independent investigation which must be made by a securities dealer will vary in each case. Securities issued by smaller companies of recent origin obviously require more thorough investigation." (p. 597, footnote omitted, underlining added to last sentence).

Blumberg made no investigation of the type outlined in Hanley, nor did he disclose to those to whom he mentioned NARD the limits of his knowledge of the affairs of NARD. While each individual purchase resulting from his activity may not have been large in dollar amount, the total of the transactions was substantial and played an important

part in the entire distribution process of the sale of NARD shares on the U.S. market.

At the times material herein Blumberg was not associated with any broker-dealer. Yet he had had extensive experience in the securities field and he apparently had a substantial following of investors who had confidence in his financial ability and relied and acted upon his advice. Blumberg was trying to maintain his contacts with that group, since he was contemplating re-entering the brokerage business.

Under Section 15(b)(7) sanctions may be imposed upon any ^{51/} person who willfully violates provisions of the Securities Acts. The undersigned concludes that the standards set forth above are applicable to Blumberg. He made no independent investigation of the NARD stock, but recommended it to many persons although he had no ^{52/} knowledge of its history and the background of the Storrs Process. It is therefore found that Blumberg willfully violated the anti-fraud provisions of the Securities Acts in connection with the offer and sale of NARD stock by recommending the purchase of NARD stock and

^{51/} Norman Pollisky, Sec. Exch. Act Rel. No. 8381, p. 3 (Aug. 13, 1968).

^{52/} Later developments that Blumberg noted as justification for his position on NARD, such as the accountant's report, do not offer any defense. The accountant's report notes several qualifications which raise questions about the financial future of NARD. The report was prepared after the events in issue here and, as far as the record indicates, after public stock sales were stopped by the injunction proceedings operations by NARD did not go forward.

lending his prestige and name in connection with the trading market for NARD without having made reasonable and diligent inquiry as to the past and present financial condition of NARD, its products, officers, and principals; by making incomplete and misleading statements of material facts and omitting to state material facts to purchasers and prospective purchasers of NARD stock concerning, among other things, the state of development of the Storrs Process, the need for testing it and the cost thereof, the history of the process and the plant which was to be used for tests; and the trading by insiders and control persons in NARD and the need for registering NARD stock prior to its sale to the public.

III. CONCLUDING FINDINGS, PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(5) of the Exchange Act, so far as it is material herein, is required to censure, suspend for a period not exceeding twelve months or to revoke the registration of any broker or dealer if it finds that such action is in the public interest and that such broker or dealer, subsequent to becoming such, has willfully violated any provision of the Exchange Act, the Securities Act, or any rule or regulation thereunder, or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. It also may, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, censure, bar, or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer if it finds that such sanction is in the public interest and that such person has willfully violated any provisions of the Exchange Act, the Securities Act, or any rule or regulation thereunder.

Furthermore, pursuant to Section 15A of the Exchange Act it may expel or suspend a member of a registered securities association who has violated any provision of the Securities Acts or rules and regulations thereunder.

It has been found that Griffith C. Lindquist d/b/a Lindquist Securities Co. willfully violated the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Acts, and applicable rules thereunder, in the offer and sale of NARD stock and that of its predecessor company.

The Division urges that in view of the serious nature of the violations found it is in the public interest to revoke the broker-dealer registration of Lindquist, to bar him from further association with any broker or dealer and to expel him from membership in the NASD. It is argued in Lindquist's behalf that any violations committed by him were, if anything, negligent and that a period of suspension would be an adequate sanction.

The violations found were most serious and go to the heart of the Securities Acts. They were willful. Lindquist, ignoring suspicious circumstances requiring an investigation, played a key role in routing substantial blocks of Utah Fortuna stock to Canada from where it could be directed into the U.S. market as part of an unlawful distribution. He also played an active role in the U.S. market where he engaged in transactions in the unregistered NARD stock.

On previous occasions, Lindquist has shown an inability to comply with standards applicable to NASD members. On November 2, 1955 he was fined \$100 by the NASD District Business Conduct Committee for District 3 for failure to maintain customer accounts and failure to reflect all

daily transactions on the sales blotters, as required. (Div. Ex. 47). On October 16, 1963, he was censured and fined \$100 for use of misleading sales literature and for failure to maintain current books and records (Div. Ex. 44). On May 20, 1964, he was censured for bookkeeping violations and use of flamboyant and exaggerated language in sales literature. On July 26, 1968, he was censured and fined \$300 for bookkeeping and net capital violations.

The undersigned concludes that in view of the violations found here, the injunctions issued against Lindquist, and the NASD violations set forth above, it is in the public interest to revoke the registration as a broker-dealer of Lindquist, to bar his association with any broker or dealer and to expel him from membership in the NASD.

It has been found that Wellington Hunter d/b/a Wellington Hunter Associates willfully violated the registration provisions of the Securities Act, the anti-fraud provisions of the Securities Acts, and failed reasonably to supervise persons subject to his supervision with a view to preventing their participation in the violations found. As previously noted, injunctions were issued against him in the NARD court proceedings.

In another proceeding before the Commission involving other issues a decision was rendered by a hearing examiner revoking Hunter's registration as a broker-dealer and expelling him from registration in the NASD. No appeal from that decision was filed and it became the final decision of the Commission.^{53/} Therefore, the issue raised as to the remedial action to be taken against him in these proceedings has

53/ Wellington Hunter, Sec. Exch. Act Rel. No 9480 (Feb. 8, 1972).

become moot.^{54/} However the findings herein are noted for the record should he seek to return to the securities business.^{55/}

It has also been found that Dunhill willfully violated the registration provisions of the Securities Act, the anti-fraud provisions of the Securities Acts, and failed reasonably to supervise an employee with a view to preventing violations found to have been committed by him. It has further been found that Reynaud failed in his supervisory duties to prevent the violations found to have been committed by Dunhill and its staff in connection with the sales of NARD stock. As to the matter of the appropriate sanction which should be imposed in the public interest, matters stand in the same position as in the case of the respondent, Hunter. On January 26, 1971, the Commission issued an order revoking the broker-dealer registration of Dunhill, expelling it from membership in the NASD, and barring Reynaud from association with any broker-dealer. A petition for review of the order was filed in the Court of Appeals for the Second Circuit. On June 12, 1972 an order was entered in that court in which, after noting that no brief for the appellant had been filed within the applicable time limit, the appeal was dismissed. Thus the order of the Commission is final and has full force and effect. The additional violations found here are noted for the record.

^{54/} While no bar ordered was entered, the effect of the findings made and the sanctions imposed would result in proceedings against any broker-dealer who sought to form an association with Hunter. Hunter indicated in his testimony that he was retired from the securities business and had no intention to return to it.

^{55/} Benjamin Werner, Sec. Exch. Act Rel. No. 9579 (April 24, 1972).

It has further been found that Alfred Blumberg willfully violated the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Acts. The Division urges that in view of the serious nature of the violations an order should be entered barring Blumberg from association with any broker or dealer.

On Blumberg's behalf it is pointed out that prior to the inception of the NARD proceedings he was never censured, disciplined, or named as a respondent or witness in any proceeding before the Commission, the NASD, and/or any other professional association. It is further claimed that since the inception of the NARD proceedings Blumberg has ceased to be active in the securities business.^{56/}

It is further pointed out that in the original NARD injunction proceeding, Judge Mansfield denied a preliminary injunction as to Blumberg, holding that Rule 10b-5 should not be extended to a person who does not derive gain as a result of his promotional activities and is not an essential participant in a scheme of distribution (280 F. Supp. 106, 133). While the holding of the necessity of showing financial gain was reversed on appeal (424 F. 2d. 63, 81) and a preliminary injunction later issued, it is emphasized that Judge Medina stated in his opinion that Blumberg was by no means a prime mover in the general operation. (However it was further stated that ". . . the findings with respect to them (Blumberg and one other) show that their participation in taking "steps necessary to the distribution" was not so slight that it could be described as de minimis."

^{56/} While this is very doubtful in view of business engagements Blumberg was trying to keep during the hearings, it is true that he has made no attempt to engage in business as a broker-dealer.

As previously noted, a permanent injunction was denied as to Blumberg in order to permit a full development of controverted facts. This has taken place in this proceeding. Blumberg's part in the distribution has been clarified. As Judge Medina noted, the scheme of distribution used here required a considerable amount of "aiding and abetting" to insure success. Blumberg's part was by no means insignificant. He placed the original purchase order in the New York market and his recommendations led to substantial purchases by ordinary investors. This formed a base on which a trading market was established. The undersigned concludes that Blumberg's violations were serious, but that in view of his prior good record a bar order is not warranted here, but a period of suspension should be imposed in the public interest. Accordingly,

IT IS ORDERED that the registration of Griffith C. Lindquist, d/b/a Lindquist Securities Co., is revoked, he is expelled from membership in the National Association of Securities Dealers, Inc., and he is barred from association with any broker or dealer.

FURTHER ORDERED that Alfred Blumberg is suspended from association with any broker or dealer for sixty days

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. This initial decision pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or 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 to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.^{57/}

Sidney L. Feiler

Sidney L. Feiler
Administrative Law Judge

Washington, D.C.
March 8, 1973

^{57/} All contentions and proposed findings and conclusions have been carefully considered. This initial decision incorporates those which have been accepted and found necessary for incorporation therein.