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Office of Administrative Law Judges

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2572

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
COLLINS SECURITIES CORPORATION TIMOTHY COLLINS VERN KORNELSEN GARRY SMITH	(Private Proceedings)

INITIAL DECISION

Washington, D. C.
April 6, 1973

Sidney Ullman
Administrative Law Judge

ADMINISTRATIVE PROCEEDING
FILE NO. 3-3272

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
COLLINS SECURITIES CORPORATION TIMOTHY COLLINS VERN KORNELSEN GARRY SMITH	:	INITIAL DECISION (Private Proceedings)

APPEARANCES: Joseph F. Krys, Matthew J. Zale and William J. Klein, of the Denver Regional Office, for the Division of Enforcement.

Manuel F. Cohen, Arthur F. Matthews, and James W. Beasley, Jr., of Wilmer, Cutler & Pickering, Washington, D. C., Lawrence L. Levin, of Holme, Roberts & Owen, Denver Colorado, for Respondents Collins Securities Corporation and Timothy Collins. Of Counsel: Peter D. Bewley, of Wilmer, Cutler & Pickering.

Vern D. Kornelsen, Pro Se.

Garry W. Smith, Pro Se.

BEFORE: Sidney Ullman, Administrative Law Judge

The Proceedings: General Statement

The central situation in these private proceedings involves activity by the broker-dealer firm Collins Securities Corporation ("CSC" or "registrant") in June, July and August 1968, in the acquisition and sale of shares of common stock of a young Wyoming life insurance company, Big Horn National Life Insurance Company ("Big Horn"). The order for these proceedings ("Order") was issued by the Commission on August 4, 1970 pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 (Exchange Act) and Section 203(d) of the Investment Advisers Act of 1940 (Advisers Act) to determine whether CSC, its president Timothy Collins (Collins), its vice president Vern Kornelsen (Kornelsen), its vice president and secretary Garry Smith (Smith), singly and in concert violated the anti-fraud provisions of the securities laws,[1/] whether some of these respondents violated or aided and abetted other violations of the securities laws and regulations thereunder, and whether some of them committed violations in connection with registrant's records and in the requirement for the supervision of the employees of a broker-dealer and investment adviser.

In July 1968, CSC had furnished to shareholders of Big Horn almost $400,000 for the exercise of warrants for the purchase of 75,694 shares of Big Horn common stock at the exercise price of $5.00. CSC thus acquired a beneficial interest in these shares, and at the same time it sold a substantial portion of them to its customers, sometimes by placing them into customer accounts at $5-1/8 per share. (A prospectus of July 2, 1968 with a sticker of July 11 was involved and is discussed later). These

1/ Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the composite effect of which prohibits the offer or sale of securities by a scheme to defraud or by untrue or misleading statements of material facts or any act or practice of fraud.

customer accounts were "managed" by CSC under oral authority but without the written authority on which the "discretionary account" between a broker-dealer firm and its customer is normally based. Other portions of these shares were sold by negotiation in over-the-counter transactions to CSC customers or clients, including its officers and employees, and institutional accounts, also at 5 1/8 per share. Thereafter, trading in the shares of Big Horn became active in the over-the-counter market, and prices reached a peak of about 9, and thereafter declined.

The Division of Enforcement (formerly the Division of Trading and Markets) asserts, among other things, that acquisition and disposition of the shares by registrant were accomplished under a scheme fraudulently conceived and fraudulently accomplished; that the over-the-counter market for Big Horn stock had been and continued to be manipulated and controlled by it in pursuance of the scheme; that registrant falsified its records in order to cover up fraudulent activity, and that its customers were defrauded by being sold stock at excessive prices under fraudulent circumstances and without adequate disclosure of material facts.

The Collins respondents and respondent Kornelsen[1a/] defend the activity of CSC and its agents as a legitimate and lawful plan

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1a/ Respondent Garry Smith was subpoenaed by the Division and testified. Except for very limited attendance because of demands on his time he did not otherwise participate in the proceedings, and he filed no post-hearing documents. He is not engaged in the securities industry and does not intend to return to it.

designed to help Big Horn achieve a status which it rightfully deserved both in the insurance industry and as a prospective conglomerate or holding company which would acquire diversified interests outside of the insurance field. They contend that the plan for the acquisition of Big Horn stock was untainted by fraud in the purchase or in the sale of the stock, that the plan or scheme was executed in accordance with the law and substantially in accordance with the advice of competent and respected legal counsel, and that all charges, with certain relatively minor exceptions, are unfair and unfounded.

The hearing in these proceedings was held at Denver, Colorado, beginning on June 7, 1971 and continued through June 18, 1971, at which time it was recessed: it resumed on July 12, 1971 and continued through July 23, 1971, when it was again recessed: it resumed on October 4, 1971 and continued through October 19, 1971, on which date it was concluded.

At the opening of the hearing on June 7, the Order was amended on motion of the Division and without objection, by adding allegations with regard to registrant's status as an investment adviser and with regard to Big Horn registration statements filed for common stock, warrants and shares relating to the warrant transaction with which we are now directly concerned. The amendments added as paragraphs G and H, Part I, are as follows:

> "G. Registrant is registered as an investment adviser pursuant to Section 203(c) of the Investment Advisers Act of 1940, and has been so registered since May 6, 1966, under the present name."
>
> "H. Big Horn National Life Insurance Company filed registration statements for its shares of common stock, employees' stock options and warrants to purchase underlying shares of common stock, which registration statements became effective on March 14th, 1966, and March 20th, 1967 respectively."

At the same time, over the objection of the Collins respondents a new paragraph "I", as follows, was added to Part II of the Order, on motion made earlier by the Division:

> "I. During the period from June 1st, 1968 to April 16th, 1969, Registrant willfully violated Section 5(b) of the Securities Act and respondent Collins willfully aided and abetted such violation in that Registrant made use of the means and instruments of transportation and communication in interstate commerce and of the mails to carry and to transmit prospectuses relating to common stock of Big Horn National Life Insurance Company with respect to which registration statements had been filed under the Securities Act of 1933, as amended, which prospectus has failed to meet the requirements of Section 10 of the Securities Act of 1933, as amended." 2/

It was stipulated by counsel and I find with respect to all charges and all respondents that the jurisdictional means of communication were used in the activities under consideration.

At the conclusion of the hearing an initial decision by the undersigned was requested by counsel for the Collins respondents.

On February 1, 1973, oral argument was held before me by counsel for the Collins respondents and counsel for the Division. The oral argument followed the filing of extensive post-hearing documents by these parties and motions and cross motions with respect to the documents. Respondent Kornelsen did not file post-hearing documents, but in a letter to the undersigned he expressed opposition to the Division's proposed findings and conclusions, and agreement with those submitted on behalf of the Collins respondents.

The findings and conclusions herein are based upon a

2/ The basis for the objection to the motion was that this was a completely new charge to the effect that a publication of National Daily Quotation Services, Inc. commonly known as "pink sheets" constitutes a prospectus and that such charge should be considered and added to the Order only by the Commission. However, the Commission had ruled, on October 20, 1970, that at the opening of the hearing this motion to amend the Order should should be ruled on by the undersigned.

preponderance of the evidence as determined from the record following the oral argument and upon observation of the witnesses and evaluation of their testimony and of all evidence in these proceedings.

The Respondents

a. CSC and Collins

Registrant is a corporation registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act and has been so registered since September 22, 1960, under its present name and under the name of a predecessor firm, Collins, Etherton & Associates. The firm also has been registered since May 6, 1966 as an investment adviser, pursuant to Section 203(c) of the Advisers Act. In 1966, when Collins acquired virtually sole ownership of the firm, its name was changed to Collins Securities Corporation. In 1968, at the time of the activity in question, the firm had over fifty employees, with offices in Denver, in New York City and in Los Angeles. Collins also had plans for opening offices in Boston and Chicago (Div. Ex. 6). In 1968 the firm became a member of the Midwest Stock Exchange and thereafter it became a member of the American Stock Exchange.

Collins is, and was during the relevant period in 1968, the president, a director, and chief executive officer of registrant. He is a graduate of the University of Denver and in 1968 had over ten years of experience in various aspects of the securities industry. As president of the registrant firm, Collins expanded its business extensively, and in 1968 the firm engaged not only in mutual fund dealership but also in research and in trading of regional or local issues for institutional clients and for its retail accounts, as well

as market-making in over-the-counter issues.

Collins regarded himself as an expert in analyzing life insurance stocks and he was the primary insurance analyst and specialist in the firm. He had studied the life insurance companies, including Big Horn, in the Rocky Mountain region. Beginning in early 1967, the commencement of the relevant ~~period~~ period of these proceedings, until 1969 or 1970, CSC acted as investment adviser for Big Horn in managing its investment portfolio, receiving a fee for its services. In early or mid-1968, under circumstances described below, Collins decided that CSC should become aggressively involved with Big Horn and its stock, and a plan for development of Big Horn into a holding company and, sometime thereafter, plans for CSC's acquisition and for selling and trading the stock were pursued. The decisions were consistent with the aggressive nature and disposition of Collins, a young man 27 years of age at that time, and conformed to the style in which he operated. The decision of Big Horn to form a holding company was also consistent with both the trend of the times towards conglomerates and with the desires of its president and of its board of directors to follow this trend, among other ~~reasons~~ reasons discussed later.

CSC conducted its business under four departments. Its corporate finance and syndications department performed for regional companies certain investment banking functions such as negotiating acquisitions and mergers, and arranged for financing, including private placements and registered offerings. The firm participated through

this department in selling groups for underwritings. Kornelsen was an employee of the department and in that capacity played a significant role in CSC's acquisition of the Big Horn stock through the exercise of the warrants held by Big Horn shareholders.

The over-the-counter trading department employed approximately five traders in 1968 in the three offices. This department was headed by Donn Douglass (Douglass), vice-president and director of CSC with over 16 years of experience as a trader in the over-the-counter market and as a specialist and odd-lot dealer on the Pacific Coast Stock Exchange. During June and July 1968, CSC was trading about 60 to 65 over-the-counter stocks in its three offices. As its chief trader, Douglass was trading about 30 of these in Denver. Douglass became involved indirectly in the warrant transaction by making a trading market in Big Horn stock at the direction of and under instructions he received from Collins in June 1968 and thereafter, as discussed in detail below. Douglass had joined the firm in July 1966, became vice president and director in September 1966, and resigned on July 19, 1969.

A third department, sometimes referred to by Collins as the capital management department, performed the firm's retail account business. Collins' testimony suggested that it was intended that the firm would accept retail accounts only from clients who desired to have the firm manage their accounts on a discretionary or "quasi-discretionary" basis. However, in 1968 written discretionary authority had not been received from the clients as required by rules of the National Association of Securities Dealers (NASD), a national securities associa tion registered pursuant to Section 15A of the Exchange Act. These accounts

were administered by Garry Smith, who worked under the direction of Collins and Dr. Delmar Hartley (Hartley), executive vice president and a director. Hartley also headed the so-called institutional research and marketing department of CSC, which employed securities analysts and salesmen who studied or sold securities primarily of companies exploring or mining natural resources in the Rocky Mountain region or engaged in finance or in "special situations". Big Horn common stock was one of several speculative issues with which this department and CSC's three other departments became involved in 1968, by making a market in the stock, by trading it over-the-counter, and in the warrant transaction which gave rise to these proceedings.

In February 1969 the firm gave up its Denver office and moved to New York City, where it is now conducting its business. With the exception of Collins, none of the personnel employed by the firm at the time of the alleged fraudulent activity is now an employee.

b. Kornelsen

Kornelsen is a certified public accountant who has had extensive experience in that capacity with large public accounting firms. For several years he also had practiced in his own independent accounting firm in Denver. Kornelsen was hired by Collins for CSC in January 1968 to work on mergers and acquisitions, and his role in the alleged scheme was significant.[3/] Soon after his employment, Collins delegated

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3/ Kornelsen earlier was brought into the Collins organization as an independent CPA in 1965 because of its bookkeeping problems and particularly because of a defalcation by a former employee. He was retained to organize the bookkeeping to obviate violations of the securities laws and regulations and to preclude further defalcations.

to him responsibility for working on a plan to convert Big Horn into a holding company, and thereafter under Collins' instructions he became the primary actor in CSC's acquisition of the warrant stock. The Division's charge of fraud involves Kornelsen's direct participation in the warrant transaction. In 1969, shortly after Kornelsen became a vice president and director of CSC, he resigned from the firm.

c. Smith

At the time of the hearing, Smith was no longer employed in the securities industry. He was studying for a degree at graduate school while being employed as night auditor for a hotel, and had no intention to return to broker-dealer activity. Smith had joined CSC in August 1964, and became secretary on October 18, 1967 and vice president in 1968. He resigned from the firm on December 31, 1969.

Big Horn

Big Horn was formed in 1962 as a small Wyoming life insurance company which sold ordinary life insurance and founders-type insurance policies. On October 25, 1965, a registration statement was filed by Big Horn under the Securities Act of 1933, as amended, (Securities Act), covering common stock and also units consisting of common stock and common stock purchase warrants. After amendments and subsequent filings, there were ultimately offered in July 1968, under a registration statement filed on November 21, 1966, as amended, 133,803 shares of common stock underlying stock warrants previously

issued and due to expire July 25, 1968.

In the Fall of 1966, Collins had met Robert E. Cole, Jr. (Cole) in Saratoga, Wyoming, and a rather close relationship began. Cole had assumed the presidency of Big Horn in May 1966, following several stormy years of proxy fights and disagreement at high levels of company management under Cole's predecessor. The company had sustained losses each year and its cumulative deficit as of December 31, 1967 was $1,030,941. Despite a substantial reduction in new business written in the latest three years (1965-1967), per share losses continued and the book value of the shares continued to decline. 4/ Collins testified that when Cole took over, the company wanted a higher quality of business, and "I think they probably wanted to write a little less business because it consumed so much surplus to write a lot of business." (Tr. 147-8).

As president of Big Horn, Cole was especially desirous of creating interest in the financial community in Big Horn stock. When they met he sought to persuade Collins to make a market in the stock,

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4/ The evidence disclosed an economic factor well-recognized in the life insurance industry--that a new company will lose money on new business when it cannot, under State Insurance Commission accounting procedures, capitalize the initial expenses of writing new policies, including cost of commissions and medical examinations.

Much evidence was introduced to support Collins' contention that the shares were worth at least the 5 1/8 price at which they were sold to managed accounts during the warrant transaction. The evaluation by a "rule of thumb" method was contested by Division evidence and is rejected as imprecise and unacceptable. I make no judgment with respect to the intrinsic value or worth of the shares when sold by CSC. My decision is predicated on other factors discussed herein, which are more significant than the book value of the stock. However, it is noted that the prospectus states that as of December 31, 1967, the per share book value was $1.37.

and these efforts continued. In 1967, CSC made a market for a brief period but dropped out of the National Daily Quotation pink sheets when no interest developed. In early 1968, Cole again sought Collins' aid in market-making and in getting other broker-dealers interested in Big Horn stock, the price of which was depressed and well below levels it had reached in earlier years.[5/] Around that time, there was indication of Big Horn response to what Collins regarded as an essential ingredient to the development of broker-dealer interest in a life insurance company, i.e., the formation of a holding company. This would conform to the pattern of the time--the creation of conglomerates: it would provide glamour and also would enable Big Horn to acquire or form companies in the mutual fund or natural resources fields, among others in which Collins was interested.

In the Spring of 1968, Cole travelled to New York City in order to develop broker interest in the stock. He visited a brokerage firm and spoke with a securities analyst who previously had been interested in the stock, and he also visited Collins, who suggested people he might see. He also visited a Philadelphia brokerage firm, Suplee-Yeatman (later Suplee-Mosley) to encourage a continuation of interest in the market for the stock, and testified that the visit "kept [Jim Mundy, the trader] in the sheets for a little longer period. . . ."

Collins introduced Cole to Douglass, CSC's trader, in late June 1968, just prior to the time he instructed Douglass to make a market in Big Horn, as detailed below. Shortly thereafter, Cole called

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5/ During this period the market for life insurance stocks was especially weak.

Douglass, asked whether CSC was making a market in the stock and inquired about price and market activity. He also asked Douglass whether he knew other traders who might be induced to make a market in the stock and he asked if Douglass would call Jim Mundy and encourage him to remain in the sheets. Douglass agreed, but received a negative response from the trader. At the request of Collins, Douglass also called Jim Geddes, the trader at the Denver firm, Bosworth Sullivan, for the same reason in early July, but was advised that the trader wanted only "to flatten out his position." Douglass reported these negative responses to Collins and to Cole.

Quite apart from Collins' regard for Big Horn and its prospects as an insurance company was his more significant interest in the holding company potential. In late January or early February 1968, at a meeting at CSC's Denver office attended by Collins, Kornelsen, Van Irvine (Irvine), who was chairman of the board of Big Horn, Cole, and possibly other Big Horn directors, the holding company concept had been seriously discussed. Collins assigned Kornelsen to work with Cole to develop a plan for its formation. Kornelsen developed a "master plan" in conjunction with Cole. The plan outlined procedures and a time table for a holding company to be called Western Resources, which would offer to exchange its stock for that of Big Horn. On June 22, 1968, the "master plan" was adopted in principle by the Big Horn board of directors. On June 27, 1968, following instructions from Collins to Douglass which are discussed infra, the pink sheets carried CSC's quote on Big Horn -- a bid of 4 for the stock. Cole's

efforts to develop an over-the-counter market for the stock, which went beyond the normal or usual efforts of a company president, had begun to bear fruit.

Collins' interest in Big Horn stock had been sparked by the holding company concept,but the company's significant problems required resolution and they constituted the reason for CSC entering the market in June 1968. Big Horn needed money if it was to create a holding company, and the most likely source of funds lay in 133,803 stock warrants held by its shareholders and exercisable at $5.00 for each share of stock. Cole and Collins recognized that unless the warrants were exercised the holding company plan would not come to fruition. In May or June, Collins assigned Kornelsen a second task -- that of developing a plan and mechanics under which the warrants would be exercised, if not by the holders, then, despite the fact they were nonassignable, by CSC. 6/ Collins and Cole recognized and discussed the possibility that CSC might acquire "substantial amounts of stock" through unexercised warrants. (Tr. 189, 190).

The Warrant History

Shortly after its organization, Big Horn had adopted a plan to issue warrants for 150,000 shares of common stock exercisable prior to July 25, 1968 at $5.00 per share. One month prior to the

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6/ Another limitation on the exercise of the warrants was the bona fide residence in Wyoming by the holder and his agreement not to acquire shares with a view to distribution to non-residents. However, this provision was subject to waiver by Big Horn.

July 25, 1968 expiration date only a small number had been exercised, and it was apparent that unless the quoted market price of Big Horn common stock approached or exceeded $5.00, the 133,803 outstanding warrants would expire. Cole was much concerned about this: the company's future depended upon improvement of its capital position. And for CSC the following benefits were also dependent upon implementation of the plan which was developed by Kornelsen with Cole for the exercise of the warrants: the future of Big Horn as a "mini-conglomerate" and the availability of funds for investment by CSC as manager of the holding company's portfolio; the availability of funds for the holding company's acquisition of subsidiary companies and the potentially substantial fees therefor to CSC as "finder"; the investment opportunity for CSC and for its customers in the stock of the holding company and the potentially profitable trading opportunity for CSC in that stock; the preservation or enhancement of the good relationship between Collins and Cole (or CSC and Big Horn); and the planned exchange offer of Big Horn stock for that of the prospective holding company, Western Resources, including the fee or commission to be earned by CSC for developing and implementing the "master plan." 7/

Moreover, eight of the directors of Big Horn, both individually and also as owners of a corporation called Security Brokerage Inc., owned warrants which could be exercised at $4.25 per share rather than at $5.00. And more importantly, these directors would receive from

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7/ The holding company, Western Resources, was formed in 1969. CSC received 25,000 shares of its common stock for services rendered, of which Kornelsen received 5,000 shares for his services.

the exercise of all of the Big Horn outstanding warrants 15 per cent or 75 cents per warrant. Collins would gain favor with the Big Horn directors for his assistance and success in effectuating the warrant transaction and for helping not only Big Horn but also the directors personally. (Other aspects of the Security Brokerage interest and participation in the transaction are discussed infra).

Apart from these prospective advantages, Collins knew that Big Horn badly needed financing. It had sustained another loss of $67,000 in 1967. When Cole learned this in February 1968 he was much disturbed. He discussed the financing need openly with Collins, just as he had on many occasions in 1966 and 1967 discussed with him the company's financial needs and the possibility of CSC assistance.

CSC's Trading in Big Horn

I am convinced by the evidence that Collins' main purpose in having Douglass commence making a market in Big Horn by bidding in the pink sheets of June 27, 1968, was to increase the depressed market price of the stock to 5, which was the point at ~~wheich~~ which they either would be exercised by the warrant holders or at which they could be exercised by CSC without danger of its sustaining any serious financial loss. As counsel for Big Horn testified, Collins "thought it was part of his job to help [Big Horn] in all areas, including figuring out ways of getting the warrants exercised." (Tr. 4599)

Douglass had no knowledge or suspicion of this purpose. He testified that in mid-June 1968, Cole visited the offices of CSC and was introduced to him by Collins, who said something to the effect that "I'd like you to meet Bob Cole who is president of Big Horn National Life with whom you may be doing some work in this stock."

Later that month, Collins called Douglass to his office and said he wanted the firm to make a market in Big Horn. Douglass recalled that he looked in the sheets and saw a bid of 3 and a bid of 3½. He suggested a bid of 3 3/4, but at Collins' suggestion a bid of 4 was made. (Tr. 2767-2769).

Collins' testimony was that in late June he told Douglass to "test the market" on Big Horn and that he wanted him to "shake loose" 500 to 1,000 shares. He also testified that he had Douglass make a market "with the idea that we would accumulate stock in the company." The bid of 4 in the June 27 pink sheets (inserted by Douglass two days earlier) was the start of activity which constituted an integral part of the scheme by way of domination, control and manipulation of the market by CSC.

As indicated above, there was very little trading interest in the stock in June 1968. The evidence disclosed that from August 1, 1967 to the bid of June 27, 1968, two brokers were quoting it in the pink sheets, Birkenmayer & Co., of Denver, and Suplee-Mosley, of Philadelphia.[8/] From August 15, 1967 to Douglass' bid of June 27, 1968, no bid had exceeded 3½. (Div. Ex. 3). Nor did the CSC bid of 4 generate much interest or activity in the thin and dull market for the stock. On July 2, CSC bought 500 shares from Birkenmayer at 4, in response to Douglass' bid. (Div. Ex. 89; Tr. 2773). At about this time, Collins told Douglass to be more aggressive in acquiring

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8/ Where there were three quotes, one was that of V.F. Naddeo & Co., a New York City firm which quoted only as correspondent for Birkenmayer.

stock and to bid higher if necessary. It was also about this time, as mentioned above, that Cole called Douglass and requested his assistance in broadening the market by enlisting the aid of other broker-dealers.

The pink sheets of July 3 carried CSC's quotes of 4¼ bid and 5¼ asked: those of the next trading day, July 8, carried its one-sided quote of 5¼ bid. Douglass attributed this jump in his bid to Collins' impatience and to the fact that the 500 shares bought from Birkenmayer ~~was~~ were not put into his trading account, and he "was still interested in acquiring stock in order to attempt to make a trading market." (Tr. 3037). On that day, July 8, Douglass received a teletype from CSC's New York office reading, in effect: "Denver - First Hanover sells to you 100 Big Horn at 5¼." First Hanover had offered 700 shares at 5¼, but Douglass, believing that he could buy more later at a lower price, took only 100 and lowered his bid to 4½. (Tr. 2791-2794). Douglass confirmed the sale and, acting properly as a trader and still without any knowledge that he was being used as an ~~unwitting~~ unwitting tool to accomplish Collins' purpose, directed that CSC's New York office lower the bid to 4½ and put its ask price at 5½. (Div. Ex. 104).[9/]

Douglass was successful in attracting additional shares at about 4½, and by July 12 he had bought 1,800 shares, all of which,

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9/ Although Douglass was an experienced trader operating in a relatively rough and highly competitive business, his naivete years later at the hearing was obvious. For example, he thought he had sold some Big Horn prior to the purchase from First Hanover on July 8. Even at the hearing he hadn't realized that all stock purchased by him had been put into a "middle account" for inventory at the direction of Collins and that no sales were made by CSC until July 16. His testimony indicated sincerity and credibility: its weakness lay only in his readiness and willingness to respond affirmatively to questions by counsel representing both sides.

at Collins' direction, had been put into CSC's "middle account". CSC had three accounts into which its over-the-counter shares might be placed. The "trading account" to some extent was operated by Douglass on his own, although under the general direction of Collins and sometimes Hartley; the "middle account" was a temporary inventory account -- neither for trading nor for long-term investment but for stock which at a later time would be put into either the trading account or the "long-term" account. The latter was for the firm's long-term holdings of its inventory and it provided the firm with tax advantages. In the "middle account" the Big Horn shares were not available to Douglass for sale to other broker-dealers or customers.

Collins knew, of course, that in the thinly traded market in Big Horn which existed prior to issuance of the warrant stock, the acquisition and retention of even a small number of shares would increase the market price.[10/] His directions to Douglass to increase his bids, to acquire stock and to put it into the middle account, thus withdrawing it from the trading supply, served his purpose, and prior to the expiration date of the warrants the stock was selling for 1/8 over the warrant exercise price of $5.00.

It is significant that while Douglass was trading the stock during this period of time he knew nothing of the existence of warrants, of their impending expiration, or of the planned exercise of the

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10/ Approximately 335,000 shares of Big Horn were outstanding, a substantial portion of which were not for sale. The number of shares in the floating supply or "float" was very small. Testimony indicated that acquisition of less than a few hundred shares would increase the market price by one point or more.

warrants by CSC. Neither Collins or Kornelsen advised him that Kornelsen and Cole were working on the warrant plan, that on July 12, 1968 they had consulted with attorneys for their respective companys concerning implementation of the plan, and that at or about that date they knew that CSC would be acquiring shares by advancing its own funds for the exercise of warrants held by Big Horn shareholders who did not want the additional stock at $5.00 per share. Only on or about July 19, 1968, after acquisition of a large amount of warrant shares under the mechanics worked out by Kornelsen and Cole did Douglass learn of the warrants and of the plan for their exercise by warrant holders or by CSC. Even then, his knowledge came by reason of CSC's acquisition of a surprisingly large volume of shares and the concern, as discussed below, which that acquisition caused among employees who had been unaware of the plan.[11/]

The first sale by CSC was not made until July 16, 1968, when 200 shares were sold to Dean Witter & Co. at 5: a second sale was made on July 18 to the same firm when 170 shares were sold at 5½. On the same day 500 shares were purchased by CSC, and then for the first time the shares were placed in the trading account. By that time, July 18, CSC had already started to acquire warrant stock under the plan of Kornelsen and Cole.

11/ As suggested earlier, the trading by Douglass was performed in an honest effort to make a market in the stock. At no time did he realize that he was being used by Collins to accomplish what I find was an illegal purpose -- the increase of the market price by artificial means.

The substantial over-the-counter trading of warrant stock started on July 23 by CSC and by other brokers who were getting into the trading action for the first time. By that date the shares were being sold by CSC at 5 1/8. Collins knew then that the large volume of warrant stock was being acquired at 5 under the "mechanics" or arrangements described infra; he knew that these shares must be sold and that CSC would place shares in the managed accounts and also would sell shares to officers, employees, and institutional clients of CSC. Big Horn's capital position was to be substantially improved by the receipt of $378,470 supplied directly by CSC for the purchase of 78,694 shares and indirectly, for the most part at least, by purchasers of the shares from CSC at 5 1/8.

Division's Exhibit 3 is a summary schedule of pink sheet quotations on Big Horn for the period August 1, 1967 to August 1, 1968. As indicated above, there was practically no broker interest in the stock until CSC's market-making. From the beginning of January 1968 until June 27, when CSC's bid of 4 appeared, no quote had exceeded 4, and that price was never bid, but only asked. Following is an excerpt from Division's Exhibit 3 for the period June 17, 1968 through August 30, 1968.[12/] It reflects the lack of interest by Birkenmayer and Suplee-Mosley in the stock (with Naddeo quoting as New York City correspondent for Birkenmayer) until interest was generated by CSC. It reflects also the aggressive

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12/ During this period of back-office problems, the markets were closed on Wednesdays, as indicated in the excerpt.

bidding by CSC at Collins' direction, the achievement of Collins' purpose on July 25, 1968, and the continued and dramatic increase in price thereafter when the warrant stock acquired by CSC was being traded. Other broker-dealer firms developed an interest in the stock following the warrant transaction and helped to increase the price of the shares, and the "market away" from CSC became active during this later period. Before then, however, CSC itself had dominated and controlled the market. From the time Collins had told Douglass to be more aggressive through July 25, Douglass was the high bidder for the stock. Birkenmayer's trader, Arnold Greenberg (Greenberg), testified that he was interested in trying to cover a short position of 120 shares at 3½, that on July 1 he bought 50 shares from Bosworth Sullivan, of Denver, and on July 2 he bought 500 shares at 3 from Harris Upham, which he sold on the same day to CSC at 4, "and then didn't have any activity in the stock till July 25." He also testified ". . . On July 26 I decided to actively trade the stock instead of passively having a leave me alone attitude . . . ." (Tr. 3782). I cannot accept Greenberg's view that CSC had competition prior to July 25 from Birkenmayer and from Supplee - Mosley "because they were in the sheets" and a broker could call them and say "This is the market away -- do you want to compete"? I find this an impractical and unrealistic position, inasmuch as those firms had little or no interest in Big Horn stock, they published no offers for it, and CSC's bid was substantially

higher every day. Nor do I find Greenberg's purchase from Harris Upham at 3 and his sale to CSC at 4 as evidence of competition. Conversely, I find that at least during the period from approximately June 25, 1968 to July 25, 1968, CSC dominated and controlled the market for Big Horn, and that it manipulated the market by artificially raising the price of the stock for the purpose and in the manner discussed earlier. Cf., Bohn-Williams Securities Corporation, Securities Exchange Act Release No. 9327, September 8, 1971; Halsey Stuart & Co., Inc., 30 S.E.C. 106 (1949).

Excerpt From Division Exhibit 3

Cont'd.	V.F. Naddeo & Co. New York		Birkenmayer & Co., Inc. Denver		Supplee-Mosley C & K Philadelphia		Collins Securities Corporation New York	
	Bid	Asked	Bid	Asked	Bid	Asked	Bid	Asked
June 17	3		3	4	3½			
June 18	3				3½			
June 19	Market closed							
June 20	3		3		3½			
June 21	3		3		3½			
June 24	3		3		3½			
June 25	3		3		3½			
June 26	Market closed							
June 27	3		3		3½		4	
June 28	3				3½		4	
July 1	3		3		3½		4	
July 2	3		3		3½		4	
July 3	3		3		3½		4¼	5¼
July 4	Market closed							
July 5	Market closed							
July 8	3		3		3½		5¼	
July 9	3		3		3½		4½	5½
July 10	Market closed							
July 11	3		3		3½		4½	5½
July 12	3		3		3½		4½	5½
July 15	3		3		3½		4¼	5¼
July 16	3½		3		3½		4¼	5¼
July 17	Market closed							

Excerpt From Division Exhibit 3 (Cont'd)

Cont'd	V.F. Naddeo & Co. New York		Birkenmayer & Co., Inc. Denver		Suplee-Mosley C & K Philadelphia		Collins Securities Corporation New York	
	Bid	Asked	Bid	Asked	Bid	Asked	Bid	Asked
July 18	3½		3½		3½		4½	5½
July 19	3½		3½		3½		4¼	5¼
July 22	3½		3½		3½		4¼	5¼
July 23	3½		3½				4	5
July 24	Market closed							
July 25	3½		3½				5¼	6¼
July 26	5-3/4	6-1/4	3½				5-7/8	6-3/8
July 29	6	6½	5-3/4	6-1/4			5-3/4	6-1/4
July 30	5-3/4	6-1/4	5-3/4	6-1/4			5-7/8	6-3/8
July 31	Market closed							
Aug 1	6-1/4	6-3/4	5-3/4	6-1/4			6-1/8	6-5/8
Aug 2	6-1/2	7	5-3/4	6-1/4			6-5/8	7-1/8
Aug 5	8-1/2	9	6-1/4	6-3/4			8-7/8	9-3/8
Aug 6	8-1/4	8-3/4					8-1/2	9
Aug 7	Market closed							
Aug 8	8-1/4	8-3/4	8-1/4	8-3/4			8¼	8-3/4
Aug 9	8¼	8-3/4	8-1/4	8-3/4			8-1/8	8-5/8
Aug 12	8	8½	8	8½			8	8½
Aug 13							8	8½
Aug 14	Market closed							
Aug 15			8	8½			7-3/4	8¼
Aug 16							7½	8
Aug 19							7-3/8	7-7/8
Aug 20							7¼	7-3/4
Aug 21	Market closed							
Aug 22			7¼	7-3/4			7	7½
Aug 23			7¼	7-3/4			6-3/4	7¼
Aug 26			6-3/4	7¼			6-3/4	7¼
Aug 27			6-3/4	7¼			6-5/8	7-1/8
Aug 28	Market closed							
Aug 29			6½	7			6-5/8	7-1/8
Aug 30			6½	7			6-5/8	7-1/8

The excerpt is significant evidence of Collins' intention. Of course it does not reflect the withdrawal of the CSC inventory from the market prior to July 25 as discussed above; it does not reflect the

plan developed by Kornelsen and Cole under which CSC would acquire stock of the warrant holders; nor the failure to inform Douglass (or Smith, as discussed later,) of the prospective acquisition; it does not reflect Collins' assistance to Cole in having other brokers initiate and maintain a trading interest in the stock; and it does not disclose the evasiveness of Collins in testimony with regard to the warrant transactions, as mentioned below. All of these factors, together with the pattern of bidding, lead to the conclusion that Collins' goal was to gain the advantages which a holding company would provide, and that the entry of CSC into the market was designed, in support of this goal, to increase the market price of Big Horn to a figure which would make it attractive to the warrant holders to exercise. To the extent they did not exercise, purchases by CSC could be made without substantial financial risk, and this was done.

Mechanics of the Warrant Transaction: Plan of Kornelsen and Cole

The working arrangements between Cole and Kornelsen began shortly after the assignment of Kornelsen

to resolve the problem of warrant non-transferability and to develop a method by which CSC could acquire a substantial amount of warrant shares. Cole had discussed the warrant problem with Collins and with Kornelsen on several occasions prior to 1968, again during early 1968, and thereafter in late June and early July when the expiration date of the warrants was drawing close.

Moreover, although respondents contend that no agreement existed between Collins and Cole under which CSC would take warrant shares, and that for this reason Collins was not an underwriter, I find, conversely, that there was a definite understanding, informal and not expressed in writing, but as clear and definite as any gentleman's agreement, that CSC would take a substantial amount of warrant shares if they were available from warrant holders who did not wish to exercise their warrants. 13/

Within this understanding, Kornelsen and Cole developed the basic mechanics for the acquisition of the shares. They explored

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13/ Cole testified that after many discussions concerning the exercise of the warrants, in response to Cole's request that CSC purchase warrant shares in registration, Collins said around July 12, 1968 that "he would, and the price at that time was coming up, I guess, in that area, so I don't know why -- I don't know why, but he said he would and that was fine." (Tr. 1145). Even assuming no discussion of amount, Cole knew Collins and his style of operation well enough to recognize that he was not considering an inconsequential amount. The work involved in the canvass of warrant holders and the ultimate result confirm the understanding.

their plans with counsel and thereafter proceeded to solicit the warrant holders and to arrange for CSC to acquire shares of those who did not want to exercise their warrants.

On July 12, Big Horn wrote to all warrant holders and transmitted a copy of the prospectus of July 2 with a sticker dated July 11. The letter advised of the July 25 expiration date, told how a current quote on the stock might be obtained, and explained how the warrants might be exercised.[14/] Also enclosed was a form for a statement of intention by the warrant holder, to be returned to the company. (Div. Ex. 72). A second "Notice to Warrant Holders" was sent on July 19, 1968, reminding of the expiration date and suggesting immediate action. (Div. Ex. 74).

On or about July 15, a telephone convass of the warrant holders was commenced by Cole and his secretary, then Lorraine Bryant, later Mrs. Goodrich.[15/] The warrant holder was asked whether he intended to exercise the warrants, and if not, whether he had any objection to their being exercised by a third party. If he agreed to third party exercise, Mrs. Goodrich advised Kornelsen of the details, confirming

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14/ The letter included language relative to the commitment of members of the Big Horn Board of Directors to exercise warrants. The Division contends the language was intentionally misleading. The substance of similar language used in the prospectus is discussed infra, in another context.

15/ Some calls were made by Kornelsen originally (Tr. 3123), but the practice was not continued: and some were made by him to warrant holders who had requested of Cole or Mrs. Goodrich further explanation of CSC's role. (Tr. 1482). A few calls were made by directors or key employees of Big Horn. (Tr. 1181-1186).

in writing by a list sent each day. CSC then sent to the warrant holder a check payable jointly to Big Horn and the warrant holder, (Div. Ex. 8A), with a form of assignment by the warrant holder to CSC of the stock "standing in my name on the books of [Big Horn] represented by certificate No. [blank]," and authorizing the transfer agent to transfer the stock to CSC. The concept, of course, was that the warrant holder was exercising the warrants for himself and was transferring to CSC shares of stock rather than non-transferrable warrants.[16/] Thereafter, CSC would send to the warrant holder a confirmation that CSC had purchased from him the shares of stock at $5.00 per share. The warrant holder, of course, had endorsed and forwarded the joint check with the assignment form to Big Horn. Kornelsen had taken the lists received from Mrs. Goodrich to the CSC comptroller, James Schneider, for preparation of the joint checks.

On receipt of the check endorsed by the warrant holder, Mrs. Goodrich had the transfer agent issue a share certificate in the name of the warrant holder, but this certificate was immediately cancelled and a new certificate issued in the name of CSC, consistent with the legal fiction that CSC had purchased the shares from the warrant holder. (On these procedures, among others, the Division predicates charges of fraudulent and improper records with regard to the acquisition of the stock).

16/ No one recalled having prepared the assignment form, Division Exhibit 7A, used by Kornelsen: not Kornelsen, not Cole, not Mrs. Goodrich and not counsel for Big Horn or counsel for CSC.

Beginning on July 17 (or July 18, if Kornelsen did not work on Wednesday, July 17) and continuing through Friday, July 19, Kornelsen knew from Mrs. Goodrich that warrant stock would be available to CSC. On July 19 it became apparent that much larger quantities were becoming available than had been anticipated. On that day Kornelsen telephoned Collins, who was in the New York office during this period, and advised that from 10 to 20,000 shares (probably around 12,000) had been acquired. Collins testified that his intention had been to acquire about 10,000 shares through the warrants, and he was surprised at the early acquisition of so many shares. 17/ He also learned that more shares would be available and he decided to keep on acquiring them. Collins was evasive in testifying on this decision, suggesting that officers and employees of the firm had agreed earlier with his initial recommendation made to the CSC investment committee that CSC obtain a position by acquisition of Big Horn shares, and his testimony sought to convey the impression that the subsequent decision to take all warrant shares that became available was that of the investment committee. (Tr. 250-260). For example, when asked by Division counsel whether there was a meeting each day of the officers of CSC during the period subsequent to July 19 to decide whether to buy the additional shares as they became available, Collins responded: "Not that I know of . . . ." He knew there were no such meetings, and that

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17/ Throughout much of the testimony of Collins and Kornelsen the figures 10,000 to 20,000 were vague and imprecise, but the original intention and expectation appear to have been within that range.

this was a decision of Collins himself, just as all of the important decisions made for CSC and relating to the warrant transaction were those of Collins alone. His efforts at obfuscation of this decision to continue to purchase all stock that became available were observed in his demeanor as a witness and are confirmed, in my view, by his testimony.[18/]

When Kornelsen advised of the 12,000 shares on July 19, Collins said he would decide what to do regarding the additional available shares. He spoke with Schneider, the firm's comptroller, later that day and directed that purchases continue, and by the end of that day approximately 25,000 shares had been bought by CSC.

On Monday, July 22, Kornelsen spoke with Collins and was directed to continue further buying. He testified, as to a telephone conversation with Collins:

> ". . . after having thought about it he decided as long as it appeared there were more shares available and in view of the fact that this was a good opportunity for the firm, it would be a good opportunity for its customers. Therefore, he had decided to resell shares to some customers, and he mentioned specifically Mr. White as one example."

Kornelsen continued to buy on that day and on July 24 and 25, and under the above procedures, CSC acquired 75,694 shares of Big Horn for $378,470. This was much more than the amount earlier contemplated by Collins and Cole.

18/ Collins also answered in response to a question: Q. "Who made the decision to continue buying in these various stages?" A. "I think it was just a -- I think -- I don't really think a decision was needed in that we had just acquired, we acquired, we filled basically filled our needs and there was more stock available so we just kept acquiring." (Tr. 251-2).
Although no confirmation of the fact is needed, the testimony of Kornelsen indicates clearly that the decision was that of Collins.

Anti-fraud Violations in the Sale of Stock

a. Section 10b and Rule 10b-6

Pertinent to this discussion are provisions of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder which make it unlawful as a "manipulative or deceptive device or contrivance" for a broker, dealer, or other person who is participating in a distribution "to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution . . . or to attempt to induce any person to purchase such security or right until after he has completed his participation in such distribution . . ." The bidding and purchasing by CSC were discussed above.

Collins' selling efforts began either on Friday, July 19, or on Monday, July 22. (Tr. 374). On July 22 or 23, he called Smith to advise of the availability of Big Horn stock as a good investment that should be put into managed accounts at 5 1/8. He asked Smith to tell some of the other people in the Denver office of the availability of the stock for sale, and to contact Kornelsen as to its continuing availability for the managed accounts. Smith had known nothing of the warrant transaction until the telephone call, and even then he assumed that CSC had purchased from warrant holders in normal or usual transactions. When Kornelsen later gave him a long list of warrant holders who were permitting CSC to exercise, Smith complained to Douglass of the need to get out "a zillion tickets" that evening in order to "move the position out" immediately. (Tr. 2814). This was the first intimation that Douglass had of the warrant transaction.[18a/]

18a/ Even Hartley, executive vice president, knew nothing of the warrant transaction until "after the facts". (Tr. 4403).

Between July 22 and July 25, CSC sold to its officers, employees and related persons 18,260 shares; to institutions a total of 35,500 shares (e.g., Thatcher Partners 15,000 shares and Berger-Kent Protected Investors 10,000 shares); and to individual customers, most of whom had managed accounts, a total of 19,700 shares. Collins was designated on CSC records as the salesman for the great majority of these transactions, but Smith was active in the sales to managed accounts. The sales were at 5 1/8, and all of the sales tickets were time-stamped within a matter of minutes on each of two days, July 23 and July 25. The time stamps were not accurate, as discussed in connection with record violations infra.

Smith sold the warrant stock to approximately 23 retail customers. Of these, approximately 16 were managed accounts into which the shares were placed without any contact or discussion with customers regarding the transactions (Tr. 706-8; Div. Ex. 18). Some of these customers received a copy of the Big Horn prospectus which the Division contends was false and fraudulent by design of Big Horn directors. Smith was kept advised by Kornelsen of the availability of the warrant shares and he learned, around July 23, the details of the acquisition of the shares he would sell to retail customers.

The prospectus for the warrant shares registered with the Commission was dated July 2, 1968, and was amended by a sticker dated July 11, 1968, which is discussed later in another context. Obviously, an authorized distribution of its stock was intended by Big Horn, as

indicated by the filings. Collins intended the increased market price to insure the distribution, and CSC did, in fact, become the prime participant in that distribution. The Division contends that CSC became a "standby underwriter", on the theory that Collins had agreed with Cole to take all of the shares which the warrant holders did not want. Whether so, or whether Collins intended that CSC would take 10,000 to 20,000 shares without fixing a number by agreement, as respondents contend, is not the significant factual issue in determining whether a 10b-6 violation occurred, for there is no doubt that CSC was participating in a distribution of the warrant shares. The elaborate mechanics developed by Kornelsen and Cole for CSC's participation and involvement in the distribution make it clear that Collins wanted and intended to take a substantial volume of the warrant shares, and CSC eventually took all but a relatively small amount, and distributed most of it to its clients during the time it was bidding for and purchasing the stock. 19/

Accordingly, that there was a distribution of Big Horn shares in which CSC participated with activity therein by Collins, Kornelsen and Smith, is clear. The Commission has held that it is not essential to a distribution that the conventional procedure of using an underwriter be followed, but that the term distribution should be interpreted "in the light of the rule's purposes as covering offerings

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19/ Following a Big Horn board of directors meeting on July 30, 1968, CSC bought from United Founders Life Insurance Company a block of 27,438 shares at $5.00 per share. The block transaction was generated by Cole and Irvine. At that time the market price of Big Horn was $6.00.

of such a nature or magnitude as to require restrictions on open market purchases by participants in order to prevent manipulative practices." Bruns, Nordeman & Company, 40 S.E.C. 652, 660 (1961). In the case cited the Commission said:

> "A person contemplating or making a distribution has an obvious incentive to artificially influence the market price of the securities in order to facilitate the distribution or to increase its profitability. We have accordingly held that where a person who has a substantial interest in the success of a distribution takes active steps to increase the price of the security, a prima facie case of manipulative purpose exists. The Federal Corporation, 25 S.E.C. 227, 230 (1947). See also Halsey Stuart & Co., Inc., 30 S.E.C. 106, 124 (1950)."

To conclude at this point that CSC's activity in bidding for, purchasing and selling Big Horn shares took place during a distribution requires neither extended discussion of the facts, nor extended citation of authority. To find otherwise would emasculate the rule and insult its purpose. Cf. Jaffee & Co. v. S.E.C., 446 F. 2d 387 (2d Cir. 1971). None of the exceptions which made the rule viable is pertinent to the instant situation in which CSC used the pink sheets and traded the stock for the purpose noted above, made arrangements with Cole to take a large block of shares, paid the issuer and immediately sold the shares to many third persons at a fixed price yielding a profit, under a major, concerted selling effort and unusual circumstances including the creation of "a zillion tickets" at one time in the single security.[20/] Cf. Loss, Securities Regulation, Vol. 3 (1961 ed.) at 1596-7; Billings Associates, Inc., Securities Exchange Act Release No. 8217, December 28, 1967. The goal of increasing the market price of the stock in order to induce the warrant holders to purchase shares flouts

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20 / Any doubt that CSC was buying and selling concommitantly would be resolved by its letter of July 25, directing the transfer of some shares to CSC and of some to its customers (Div. Ex. 22).

the prohibition of such activity as a manipulative practice under Rule 10b-6. Bruns, Nordeman & Co., supra. The involvement of CSC in the violation did not terminate until the firm had "distributed [its] participation." (Rule 10b-6(c)(3)(C)). This appears to have continued until all warrant stock had reached CSC's customers on or about April 8, 1969. (Div. Ex. 86).

Smith having learned on or before July 23, 1968, the source of the warrant shares, with knowledge that CSC had been in the pink sheets and had been participating in the distribution, joined forces with Collins and Kornelsen in aiding and abetting CSC's violation. All respondents wilfully violated Section 10(b) and Rule 10b-6.[21/]

b. The Prospectus

The Division contends that the prospectus used by CSC in the selling to managed accounts was fraudulent. This contention involves discussion of two matters: (1) Security Brokerage and its directors, with warrants held by the corporation and also by its individual directors, and (2) activity of George Hopper (Hopper), as attorney representing Big Horn.

Eight of the Security Brokerage Corporation directors were Big Horn warrant holders and most were also directors of Big Horn. Security Brokerage had acted as Big Horn's underwriter in its initial public offering. As added compensation it had received warrants to purchase 51,000 shares, of which 33,556 remained as of July 2, 1968, a portion having been given to salesmen and other persons. In

21/ CSC's responsibility for this violation, as for the others, rests on the doctrine of respondeat superior. Armstrong Jones & Co. v. S.E.C., 421 F. 2d 359, 362 (6th Cir. 1970); Cady, Roberts & Co., 40 S.E.C. 907, 911. The three individual respondents, as employees of CSC, violated the Section and Rule.

addition, the president and eight members of the Security Brokerage board each had received 2,500 warrants. (Stickered prospectus, p. 19). In 1964, in connection with termination of the employment of Cole's predecessor as president of Big Horn, the Big Horn members of its board of directors individually purchased his 49 percent stock interest in Security Brokerage for $52,500.

At the time of the warrant transaction, the only substantial assets of Security Brokerage were $4,000 in cash, 33,556 warrants for the purchase of Big Horn shares at $4.25 each, and the right to receive 75 cents per share for each of the 100,427 warrants not owned by Security Brokerage, which might be exercised. (Stickered prospectus, p. 20; Tr. 3963). On June 22, 1968, at the same meeting of the Big Horn board at which the holding company concept was adopted, the board also considered a conditional commitment by Security Brokerage for the exercise of its 33,556 warrants at $4.25. The board agreed to the conditions in the commitment.[22/]

It was recognized that if all of the warrants were exercised, the owners of Security Brokerage, who were substantially the Big Horn board, would benefit to the extent of 15% of the total sum of approximately $650,000, or ~~$90,000~~ $97,500 (including in this amount 75 cents

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22/ The commitment required, and the Big Horn board agreed to some changes in the original underwriting agreement between Security Brokerage and Big Horn, including one to insure against Security Brokerage tax liability for 75 cents per share on the 33,556 warrants to be exercised. Instead of a commission of 75 cents to be paid, the exercise price was expressly to be changed to $4.25 per warrant. (Div. Ex. 71; Collins Ex. 41).

per share discount on the 33,456 warrants owned by Security Brokerage and exercisable at $4.25). This potential revenue was one of the several reasons for efforts by those members of the Big Horn board who were also owners of Security Brokerage to get the warrants exercised. (Tr. 3961-3965).

The Big Horn board had inquired in February 1968 of its general counsel, William Brown (Brown), concerning the problems and implications involved in the exercise of the warrants. On February 23, 1968, Brown prepared a rather comprehensive memorandum relating to the Security Brokerage warrants, including tax implications, among others, and stated in part:

> ". . . it has been suggested that if and when these warrants are exercised well in advance of their expiration date and also, particularly, if the warrants held by directors of Big Horn are also exercised, such action would probably stimulate the exercise of other outstanding warrants (approximately 100,000 in number) by the persons holding such warrants. If this suggestion is valid and warrant conversion is stimulated, the benefit to Security Brokerage will be represented by the Seventy-five Cents per share commission on the shares that are issued when the warrants are exercised." (Collins Exhibit 41).

Brown then presented four alternative plans for exercise of the warrants by Security Brokerage. Alternative number three, he advised,

> ". . . would permit disclosure by Big Horn that Security Brokerage had given irrevocable notice that it was going to exercise the warrants prior to July 25, 1968, which could have some beneficial effect with respect to stimulating conversion of other warrants held by the public, although it probably would not be as effective as a report that the warrants had been exercised and the stock issued."

And alternative number four, involving a postponement of a decision whether to exercise, concluded with the language:

> "It is obvious that any possible benefits in the line of stimulating warrant conversion would be lost if the warrants of Security Brokerage are not exercised or irrevocably committed sufficiently in advance of their expiration to have an effect upon the holders of other warrants which expire at the same time."

Consistent with the theme of Brown's advice and the action of the Big Horn board on June 22, in agreeing to the conditions imposed by Security Brokerage if its shares were to be exercised, the sticker of July 11, 1968, attached to the July 2 prospectus stated, in part:

> "At a recent meeting of the Board of Directors of Big Horn National Life Insurance Company, a resolution was adopted directing the officers to initiate the organization of a holding company to acquire the outstanding shares of Big Horn National Life Insurance Company through an offer to exchange shares. This action was suggested to permit a more flexible and diversified operation. Certain of the directors who have committed themselves to exercise warrants aggregating 33,556 shares stated that their main reason in doing so was the Board's decision to initiate the formation of a holding company." (Underscoring added).

While this language may be accurate, and while it may be the product of Hopper, acting as counsel for Big Horn, I find, as the Division contends, that under the circumstances it is misleading. Firstly, the sticker did not indicate that the exercise would be (or was) [23/] at the reduced price of $4.25. More significantly, of the nine or so directors of Big Horn as of July 11, 1968 who owned warrants, it

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23/ The Division contends that the exercise by Security Brokers occurred on or about May 1, 1968. (See its proposed finding 65 and testimony of Irvine at Tr. 3971).

appears that only one used personal funds to exercise warrants.[24] Instead, the directors elected not to take the stock but allowed CSC to exercise, receiving, of course, their proportionate share of 75 cents for each warrant exercised. I cannot draw an inference which accords with the Division's contention that the underscored sticker language concerning exercise by the directors was devised or was intended by them to mislead the other warrant holders (as to whom no fraud is charged in the Order) or the purchasers of the warrant stock who received copies of the prospectus.[25] Nevertheless, I do find that the prospectus was, in fact, violative of the securities laws and was fraudulent as to purchasers of the shares from CSC. The underscored language of the sticker and the omissions of material statements, including information to the effect that eight directors of Big Horn had declined to exercise 18,700 warrants but were allowing CSC to take their shares, and that, conversely, a minimal number of personally-held warrants would be exercised by directors, obviously would have the effect of stimulating the exercise of warrants and constituted misleading information and the omission of material information. I find, in the language of the antifraud provisions, that the use of the stickered prospectus was unalwful, that the prospectus contained an untrue statement of a material fact and

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24/ C.D. Roberts owned 1,475 warrants and appears to have exercised 275. (Div. Exs. 75, 76).

25/ Apparently the directors were men of substance with a significant stake in the success of the holding company plan. While they had motive to act and press for its success, I do not find that they planned to deceive warrant holders by suggesting or adopting materially misleading statements or omissions in the prospectus. Moreover, there is no indication that they knew that the warrant shares would be sold to ultimate purchasers such as CSC's customers.

omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.[26] The materiality is discussed below.

c. Fraud in Selling Practices

In addition to the fraudulent practices discussed above which inhered in the violation of Rule 10b-6 and in the use of the misleading prospectus, serious violations occurred in the selling techniques which placed the warrant shares in customers' accounts. At Collins' direction, Garry Smith did "begin thinking about offering it to . . . managed accounts . . . ." (Tr. 4958). Of the 23 customers to whom he sold warrant shares, 18 were managed accounts.[27]

Some of these customers received the stickered prospectus from CSC. None were told the following, all of which were required disclosures:

(1) CSC obtained 75,694 shares in July 1968 from Big Horn through supplying money to warrant holders to exercise their warrants.

(2) the sales were made by CSC as principal from that block acquired by CSC because of the decision of most of the warrant holders not to exercise;

26/ Hopper indicated that he devised the language after consultation with the Commission staff, and that it was intended to provide full disclosure. Even assuming adequate and full discussion with the staff, the Commission has often held that neither reliance on counsel nor failure of its staff to comment on omissions or deficiencies of which it is apprised is a defense to violations of the securities acts, though such matters, if proven, may be considered with regard to good faith and the public interest. Telescript - CSP, Inc., 41 S.E.C. 664, 668 (1963).

27/ Smith testified that managed accounts had the right to cancel or reject any transaction made without consultation. However, the evidence reflected that this was an internal CSC policy not to be divulged to customers, and at least some customers did not know of such right. Collins testified to the same effect.

(3) CSC was a market-maker in Big Horn;

(4) CSC had dominated and controlled the market for the stock from approximately June 25, 1968 through July 25, 1968, and had artificially raised the price to $5.00;

(5) In July 1968, CSC was purchasing Big Horn stock and bidding for it in the pink sheets while it was distributing it, in violation of Rule 10b-6;

(6) CSC was engaged in a manipulative device in the purchase and sale of Big Horn contrary to Section 10(b) and Rules 10b-5 and 10b-6;

(7) Certain officers and directors of Big Horn had elected not to use their own money to exercise their personally-held warrants in July 1968.

(8) The prospectus which was sent to them contained the materially misleading statement and omitted necessary information as indicated above.

(9) Big Horn had sustained deficits in each year of its existence cumulatively totalling approximately $1,000,000 as of December 31, 1967.

Nor did Collins disclose to the more sophisticated purchasers to whom he sold approximately 29,000 shares of warrant stock between July 22 and July 25 that CSC was engaged in a manipulative device in its trading in order to increase the market price, or that it had violated the anti-fraud provisions of the securities acts and the rules thereunder, as indicated.

The persons to whom Smith sold the stock were almost without

exception unsophisticated investors: some were total novices.[28/] It was clear from the arrangements made by the investor witnesses with CSC and from their testimony that they placed their complete trust and confidence in CSC and its personnel as their investment adviser, relying on Smith, Collins, or Hartley to provide competent and trustworthy service in their best interests. The oral discretionary authority given to CSC was broad and bears witness to such trust.

CSC, acting as broker-dealer under the Exchange Act and as investment adviser under the Advisers Act, is amenable to regulation under both statutes.[29/] In Arleen W. Hughes, 27 S.E.C. 629 (1948), aff'd 174 F.2d 969 (C.A.D.C., 1949) the Commission discussed the fiduciary relationship of trust and confidence similar to that which existed between CSC and its managed accounts. That relationship grew out of the arrangements between Arleen Hughes and her clients for the handling of the clients' funds as investment adviser.

28/ For example, J.T.H., Jr. testified that he had not been told about about a right to cancel a purchase made in his managed account, but he assumed he had that right. On further questioning it developed that the witness (who had never traded except through CSC) had assumed not that he had the right to cancel but that he had the right to sell stock that had been purchased for his account. (Tr. 2627a-2631). This is not an isolated example of naivete.

29/ In Arleen W. Hughes, as here, the charge of fraud was asserted only under the Securities Act and the Exchange Act but not under the Advisers Act. The Commission found no merit in her contention that since she acted as an investment adviser she was subject only to provisions of the Advisers Act.

The Commission found that Arleen Hughes had violated her trust by allowing her own interests to come in conflict with those of her principal, where the latter had not given an informed consent to such dealings as a broker-dealer selling her own securities to her principal. At page 637, the Commission made a statement which is relevant to the instant situation:

> ". . .it would be highly improper for registrant to take a conflicting position in which, on the one hand, she is motivated to sell securities which may be most profitable to her and in her own best interests and, on the other, to recommend the purchase of securities solely on the basis of the best interests of her clients. And, of course, registrant has a free choice to avoid this conflict by confining her activities only to those of investment counsel so that she would be motivated to act only for the best interests of her clients. But, if registrant chooses to assume a role in which she is motivated by conflicting interests, under the exception we have discussed she may do so if, but only if, she obtains her clients consent after disclosure not only that she proposes to deal with them for her own account but also of all other facts which may be material to the formulation of an independent opinion by the client as to the advisability of entering into the transaction."

Thus, the Commission pointed out at 636-7 that a fiduciary must disclose to his principal all material circumstances fully and completely, including the price he paid for securities sold to the principal. Overreaching is not a condition precedent to the requirement for such disclosure.

Smith sold thousands of shares of Big Horn on July 23 and 25 without making required disclosures. For example, he said nothing to

J R A about CSC being a market-maker of Big Horn, [30/] nor that he was putting into the customer's account 200 shares from CSC's holdings acquired as described. J.R.A. had been consulted by Smith about the desirability of all purchases excepting Big Horn. And when the customer called to indicate that, being in the insurance business he resented being sold an insurance company's stock, Smith spoke only of a rancher being on the board of directors and probably mentioned the planned holding company. (Tr. 2727-38).

Smith sold 100 shares to R W B, who was particularly interested in uranium stocks. He said nothing to the customer about any of the matters listed above, but did represent that Big Horn was getting involved in minerals. The witness believed CSC would regard his interests as paramount, although such words were not spoken. (Tr. 2796-2710).

Dr. C D S opened his account with Collins in April 1968, investing $3,000. Soon thereafter, Smith called and advised that he was the account executive. Four stocks were put into the account, including 135 shares of Big Horn on July 23, 1968. None of the required disclosures mentioned above were made. The customer received a prospectus on Big Horn soon after the purchase. This witness testified that he

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30/ Failure to disclose market-making was held one of the bases of fraud found in Chasins v. Smith Barney & Co., 438 F. 2d 1167, 1172 (2d Cir., 1970). Cf. Cant v. A.G. Becker & Co. (U.S.D.C., N.D. Ill., Dec. 20, 1971), C.C.H. Transfer Binder 1970-71 ¶ 93,347.

did not believe he had the right to suggest any purchases for the account: "I felt they were in complete control . . . and that I was not to make any suggestions". (Tr. 3165).

JTH, Jr., a Division manager for an American Telephone and Telegraph subsidiary, testified that he was a complete novice with respect to securities in May 1968 when he was recommended by a friend to CSC. He opened an account with Smith "to play in the market with a few extra dollars", and delivered for sale 25 AT&T shares. The proceeds, together with a check from the customer, totalled $2,500. Smith was to purchase and sell in his own discretion.

Smith made purchases in the account without having advised the customer, who received confirmations of the transactions as well as periodic letters, approximately six in number during the year the account existed. The letters advised of the purchase and sale transactions, of the prices paid and received for securities in the account, and of their current value. The cash balance also was stated, and a plus or minus dollar figure indicated the paper gain or loss in the account as of the time the respective letters were written. The witness signed no form giving Smith written authority for a discretionary account or power at the time the account was opened. Nor was there any discussion of Collins' interest in stocks which might be purchased in large blocks and placed into the customer's account, or of any of the above-mentioned required disclosures. On July 25, 1968 the witness was sold 400 shares of Big Horn by Smith at 5 1/8, without consultation.

At or about the time of the closing of CSC's Denver office, the customer had a balance in his account of approximately $565 in cash, for which he received a check. He also received the stocks then in his account: 100 shares of Datacom, 100 shares of Vipont Mining, 50 shares of Minerals Engineering and 40 shares of Western Resources.

These are some of the witnesses whose credited testimony indicates that because of misstatements and omissions the respondents wilfully violated and wilfully aided and abetted violations of the anti-fraud provisions, as charged, in selling and distributing the shares of Big Horn acquired in the warrant transaction.[31/]

The Supreme Court spoke at length in S.E.C. v. Capital Gains Research Bureau Inc., 375 U.S. 180 (1963) regarding the duty of an investment adviser, as a fiduciary, to make full disclosure to his client and to avoid any business activity which presents the opportunity for conflict of interest, in order that his investment advice may be wholly unbiased. At 201, the Court said:

> "The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients."

CSC revealed to its managed accounts none of its many "personal interests" in Big Horn as a company and in its shares and the market price thereof.

Again, at 200, reinforcing the concept that overreaching is not a condition precedent to the disclosure requirement, the Court said:

31/ Kornelsen was not directly involved in the selling. However, his activity in acquiring the large number of shares aided and abetted the violations of the other respondents.

> "To impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute. . . . . It misconceives the purpose of the [Investment Advisers Act] to confine its application to 'dishonest' as opposed to 'honest' motives."

This case is added strong support for the requirement of full disclosure of the many conflicts of interest existing between CSC and its managed accounts with respect to Big Horn.

Even apart from the requirements of disclosure imposed by the fiduciary relationship between CSC and its managed accounts, the misrepresentations and omissions in the prospectus and in the selling activity were fraudulent. The courts and the Commission have expressed their definitions of "materiality" or "material" in the context of their usage in the anti-fraud provisions. All are in accord with the test expressed by the Second Circuit in List v. Fashion Park, Inc., 340 F. 2d 457 (2d Cir.), cert. denied, 382 U.S. 811 (1965):

> "The basic test of 'materiality' . . . is whether 'a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question.'" Cf. S.E.C. v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2d Cir. 1968), cert. denied sub nom. Kline v. S.E.C., 394 U.S. 976 (1969).32/

Not only was there the defect of non-disclosure, required because of the investment adviser relationship, but also the broker-dealer

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32/ Much evidence was introduced on the subjective evaluations by the investors of the significance or materiality of the various misrepresentations and omissions. However, the appropriate test is objective. The subjective evidence is given consideration herein in connection with evaluation of public interest.

status of CSC precluded use of the misleading statement in the prospectus and the material omissions in the sales technique mentioned above. The selling involved an implied representation by CSC that the market was a free and independent one and that the price of Big Horn was not artifically increased. This was but one of the many fraudulent representations in the selling by Smith and Collins. 33/

Violation of Section 5(b) of the Securities Act

The amendment of the Order made at the opening of the hearing added a charge to the effect that from June 1, 1968 to April 16, 1969, CSC violated Section 5(b) of the Securities Act, aided and abetted by Collins, by inserting quotations for Big Horn in the pink sheets. Section 5(b)(1) makes it unlawful for any person to transmit any prospectus relating to a security with respect to which a registration statement has been filed unless the prospectus meets the requirements of Section 10. 34/ The Division contends that the pink sheets are a prospectus under the broad definition in Section 2(10):

> "(10) The term 'prospectus' means any prospectus, notice, circular, advertisement, letter or communication, written or by radio or television, which offers any security for sale . . ."

33/ Lawrence Rappee & Co., 40 S.E.C. 607 (1961); Duker & Duker, 6 S.E.C. 386 (1939); Halsey Stuart, 30 S.E.C. 106 (1949).

34/ Here, as in other parts of this initial decision, reference to use of the mails and other means of transportation or communication is omitted because of the stipulations and findings earlier made, to the effect that the mails and interstate means were used in connection with all activities resulting in violations of respondents.

It appears that what the Division is contending is that the "asked" quotations of CSC (which began on July 3, 1968) were offers to sell Big Horn shares and that the sheets were a prospectus which did not meet the requirements of Section 10 of the Securities Act. As to the latter portion of the contention there is no doubt: as to the earlier portion, it offers a proposition apparently never expressly or specifically ruled on by the Commission or the courts.

The Collins respondents argue against the contention. Firstly, they point out that the pink sheets are necessarily out of date by the time they reach the subscriber and "cannot be bona fide legal offers," inasmuch as they are entered on one day and published and delivered the next day at the earliest. The argument is rejected, since there is no indication that the word "offer" in the Securities Act is used only in the context of a "bona fide legal offer" in the common law contract sense. The courts and the Commission have held to the contrary. Securities and Exchange Commission v. Liberty Petroleum Corp., et al., (D.C. N.D. Ohio, 1971 Civ. No. C71-178), where the court adopted a broad interpretation of the term "offer to sell", which it held included any communication which is designed to procure orders for a security, whether or not it would be considered an offer under substantive contract law.

The decision was predicated in part on the language in Section 2(3) defining "offer to sell" as including "any attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value." Cf. Securities and Exchange

Commission v. Starmont, 31 F. Supp. 264 (E.D. Wash., 1940), in support of the holding that "The SEC has consistently refused to restrict the term 'offer to sell' to the meaning employed in the area of substantive contracts law." In Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959), the Commission said, at 848, that offers to sell include "any document which is designed to procure orders for a security." Any other conclusion would defeat the purpose of the prohibition.

The argument that the pink sheets "are offers directed only at other dealers" is rejected as irrelevant, on both factual and legal bases. They are, in fact, available to members of the public not only in brokerage offices throughout the nation, at certain banks, but also in some libraries.[35] Moreover, they are certainly available indirectly through broker-subscribers to members of the investing public, and the suggested limitation is not applicable.

Respondents urge the applicability of an exemption from the Section 5(b)(1) prohibition which is stated in Section 4(3):

> "Sec. 4. The provisions of section 5 shall not apply to- (3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction) . . ."

The burden of proving an exemption from prohibitions of the securities

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35/ Cf. Report of Special Study of Securities Markets, Chapter VII at 598. An earlier reluctance of the N.A.S.D. to sanction disclosure of pink sheets by brokerage offices to their customers appears to have given way to some extent to an increased significance accorded to the concept of full disclosure.

laws is on one who claims the exemption.[36/] Under the definition of underwriter in Section 2(11) of the Securities Act, CSC was acting in that capacity in the warrant transaction. The definition states:

> "The term 'underwriter' means 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 participation in any such undertaking . . . ."

The exemptions of Section 4 do not apply to an underwriter who is still acting in that capacity. CSC acted in that capacity, as indicated above, in the purchase and disposition of the registered warrant shares. Similarly, Rule 174 under the Securities Act, cited by respondents as the basis of an exemption is also inapplicable to an underwriter who is continuing to act as such in respect of the involved security.

The result adopted here is consistent with the desirability and appropriateness of interpreting the federal securities laws in a liberal manner in order to effectuate their remedial purposes. S.E.C. v. Capital Gains Research Bureau, Inc. supra, at 195; Tcherepnin v. Knight, 389 U.S. 332 (1967). It is also consistent with the view expressed by a former General Counsel of the Commission, quoted in Loss, supra, at Vol. I, 228, in a letter to the Investment Bankers

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36/ S.E.C. v. Ralston Purina Company, 346 U.S. 119, 126 (1953); Gilligan, Will & Co. v. S.E.C., 267 F. 2d 461 (1959), cert. denied 361 U.S. 896 (1959).

Conference, Inc., of March 5, 1937, discussing "The Tombstone Ad". He stated:

> ". .although I believe that a dealer may properly include in such an advertisement a legend such as "bought - sold - quoted" to indicate that he makes a market in the security advertised, any description of the market as an "active" or "close" trading market would also in my opinion make the advertisement a prospectus . . . ."

It is obvious that the asked quotations were inserted to stimulate interest in Big Horn in order to facilitate the further distribution of the shares. The Commission said, in First Maine Corporation, 38 S.E.C. 882 (1959), at 885:

> ". . . it is apparent that the only purpose for which this material was distributed was the stimulation of interest in [the issuer] and its securities in order to further the ultimate distribution of such securities. Under these circumstances we find that these documents consistituted offers to sell or solicitations of an offer to buy Lisco stock in willful violation of Section 5(c) of the Securities Act."

I reach the same conclusion with respect to the pink sheets and find the violations by CSC and Collins as charged. That the issue had never been determined by the Commission is a matter appropriate for consideration in connection with public interest only. Provisions relating to securities law violations may be interpreted decisionally, and a specific rule that "asked" quotations in the pink sheets constitute a prospectus is not necessary. Cf. Edward Sinclair, et al., Securities Exchange Act Release No. 9115, (March 24, 1971), at p. 5, citing S.E.C. v. Chenery Corporation, 332 U.S. 194, 203 (1947), among other cases.

Violations of Bookkeeping Provisions

The Order charges a host of bookkeeping violations in CSC's records, some having occurred in connection with the warrant transaction and others unrelated to it.

The problem of recording the warrant transaction presented a dilemma to those who had to decide the appropriate procedures. At best, the transaction was unusual in nature: more than that, it consisted of a legal fiction, for CSC was ostensibly buying shares from warrant holders who had exercised their warrants but who had not acquired beneficial ownership of the shares because the funds for the purchase were provided by CSC and were transmitted to Big Horn.

Section 17(a) of the Exchange Act and Rule 17a-3 thereunder require every broker or dealer to keep records which are described with substantial precision in the many subparagraphs of the Rule. The Commission has interpreted the Section and Rule to embody the requirement that the records be true and correct. 37/

The Division argues that the improprieties in the recording of the warrant transaction occurred by design, in an effort to camouflage the true nature of the transaction. I do not agree. I find that confusion existed at the CSC back-office because of inexperience and because of the unusual aspects of the transaction, and that the inaccuracies in these records are attributable to such factors.

Rule 17a-3 requires, in pertinent part, that CSC, as a registered broker-dealer, make and keep current the following books and records

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37/ Merritt, Vickers, Inc., Securities Exchange Act Release No. 7409 (September 2, 1964); Carter, Harrison, Corbrey, Inc., 29 S.E.C. 283 (1949); Lowell Niebuhr & Co., Inc., 18 S.E.C. 471 (1945).

relating to its business:

> 17a-3(a)(1). . . all receipts and disbursements of cash. . .
>
> (3) Ledger accounts itemizing separately as to each cash. . . account of every customer. . .
>
> (5) A securities record or ledger reflecting separately for each security as of the clearance dates all 'long' or'short' positions (including securities in safekeeping) carried by such member, broker, or dealer for his account or for the account of his customers . . . and showing the location of all securities long and the offsetting position to all securities short and in all cases the name or designation of the account in which each position is carried.
>
> (6) A memorandum of each brokerage order and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order. . ., the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Orders entered pursuant to the exercise of discretionary power by such member, broker, or dealer, or any employee thereof, shall be so designated. . .
>
> (7) A memorandum of each purchase and sale of securities for the account of such member, broker, or dealer showing the price and, to the extent feasible, the time of execution; and, in addition, where such purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt, the terms and conditions of the order, and the account in which it was entered.

> (8) Copies of confirmations of all purchases and sales or securities. . .
>
> (12) A questionnaire or application for employment executed by each 'associated person' . . . of such member, broker or dealer." Associated person is defined by the rule as "a partner, officer, director, salesman, trader, manager, or any employee handling funds or securities or soliciting transactions or accounts for such member, broker or dealer."

The Division charges that over a period of years from approximately January 1, 1967 to August 4, 1970, CSC violated each of the above subparagraphs of Rule 17a-3, aided and abetted by Collins and Smith.

With regard to the warrant transaction, the Collins respondents concede the inexperience of Kornelsen in stock purchase transactions and the resulting confusion and delay in recording. But they contend that the records were accurate when made on an "as is" basis a few days later.

Customer Ledgers, Order Memoranda, Confirmations

Division Exhibit 14 comprises customer ledgers prepared for the warrant holders whose warrants were exercised with CSC funds. The ledgers are inaccurate in that they indicate that each of said warrant holders was paid by check or credit from CSC. This recording was consistent with the fiction, but incorrectly reflects the true payment by CSC which was, of course, by a joint check which actually was payment to Big Horn.

The purchase order memoranda for the warrant holder transactions were inaccurate in many instances because a handwritten trade date and the time stamp date were at variance. In addition, the order memoranda

do not reflect the fact that they were actually "as of" trades. Kornelsen hadn't considered the requirement for order tickets until several days after purchases had been made. (Tr. 1991).

Consistent with the fiction, but again inaccurate because it would be improper to exalt form over substance[38/], the order memoranda in no way indicated that Big Horn was involved in the warrant transaction. The confirmations of the purchases were typed from the order tickets prepared by Kornelsen and accordingly were inaccurate in representing that the purchases were made from the warrant holders.

Questionnaires

The defalcation in 1965 by CSC's cashier apparently gave concern not only to Collins but also to the broker-dealer investigating staff of the Commission's Denver Regional Office. On March 23, 1965, a letter was sent to CSC advising that an inspection had revealed (among other problems) that the firm failed to make and keep questionnaires or applications for employment required by Rule 17a-3(a)(12). Collins replied on April 1, 1965, to the effect that the firm had reviewed each file to comply with the Rule. (Div. Exs. 25 and 25A). However, the Division again urges a series of violations of this sub-paragraph, which required specified information to be kept for every "associated person", again to include every employee handling funds or securities.

I find a failure by CSC during the relevant period, and particularly during the time of inspections by the Denver Regional Office in October 1967 and 1968, to have on file the required questionnaire or application: for Carlton C. Okamoto, who handled funds and securities

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38/ Cf. Securities Exchange Act Release No. 9867 (November 17, 1972): ". . . the substance of the arrangement rather than its legal form, should determine the accounting treatment."

for the firm and was an "associated person"; a failure to have the required document on file for Linda Z. Roberts, who during the period of violation worked as assistant trader and as assistant cashier; a failure to have the required document on file for Janet M. Moors, who handled securities during the relevant period; a similar failure with respect to Lougene A. Gillham, who, as secretary and receptionist opened the mail, which contained securities; with respect to Uldis J. Kapostins, who handled funds and securities in the cage; with respect to Kenneth L. Gerdine, a runner who handled funds and securities; for Paul W. Morrison, cashier at the time of the inspection; for Cynthia J. Paterson, as assistant cashier; for Linda M. Moffit, as assistant cashier (only 21 days late).

I find the evidence insufficient with respect to Betty Ann Wampler, a registered representative whose NASD application may have been on file although not observed during the inspection; Dorothy Lorenz, with respect to whom there is some credible evidence that she did not handle funds or securities while serving as assistant bookkeeper (Tr. 2389); Kirby Burkett, who prepared the joint checks used in the warrant transaction; and Debra Matthews, who posted the stock position record at a location "near the cage". And despite

the "probabilities", in a firm of CSC's small size, that Wanda Stiney, bookkeeper, and Margaret Potter, assistant bookkeeper, also handled funds or securities in performing their functions, the record contains testimony to the contrary which leads to the conclusion that the burden of proof has not been sustained as to them. (Tr. 2390, 4734).

Although argument or suggestion to the contrary is made by respondents, the credible evidence indicates that bonding applications, or copies thereof, on file at CSC's offices did not provide all of the information required by the Rule. Belatedly, at the suggestion of the staff of the Denver Regional Office, appropriate forms were filed for the CSC personnel. Respondents do not concede that such forms were required for each person, suggesting that in many instances the filings were gratuitous. I agree only as to the instances mentioned in the preceding paragraph.

Securities Record or Ledger

Prior to August 8, 1968, CSC maintained a "security ledger" which did not reflect separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by CSC for its account or for the accounts of its customers, nor did it show the location of all securities long and the offsetting position to all securities short and the name or designation of the account in which each position was carried. (Div. Ex. 5-A through 5-L).

The ledger did not contain a daily running indication by individuals of long and short positions (Tr. 3749), nor did it contain a record of stock in transfer (Tr. 2343, 3745), nor the number of shares in safekeeping for customers (Tr. 2344, 3733-4).

Collins had arranged with National Cash Register personnel to set up its securities record system. Similar systems apparently had been set up for other broker-dealer firms in the Denver area. Unfortunately, the system did not contain in a single record in proper form the information necessary to an understanding of the firm's positions with respect to securities. Following an examination by the American Stock Exchange, CSC in August created a stock position record system which reflected the required information. (Div. Ex. 13).

That the information prior to that time was available to an investigator who, with effort and perhaps some measure of luck, might search and make comparisons is not an answer to the charge.

The Commission has expressed the opinion, as indicated in the Division's brief, that compliance with bookkeeping rules is not within the province of a broker-dealer's discretion.

> "The requirements that books be kept current . . . and in proper form (emphasis supplied) are important and are a keystone of the surveillance of registrants and NASD members with which we and the NASD are charged in the interest of affording protection to investors. It is obvious that full compliance with those requirements must be enforced, and registrants cannot be permitted to decide for themselves that in their own particular circumstances compliance with some or all is not necessary." In the Matter of Olds & Co., 37 SEC 23 (1956).

These deficiencies were in violation of Rule 17a-3. They were corrected by CSC following an examination by a representative of the American Stock Exchange in August 1968, in connection with CSC's application for membership in the Exchange. (Div. Ex. 13; Tr. 2342-2352).

Cash Receipts and Disbursements Ledgers

The entries to CSC's ledger for cash receipts and disbursements for July 19,1968, reflect disbursements to the warrant holders rather than joint checks to warrant holders and Big Horn. Accordingly, as urged by the Division, the ledger sheet is inaccurate. (Div. Ex. 117).

Order Memoranda

As discussed above, the order memoranda prepared in connection with the warrant transaction were inaccurate because of the fiction involved therein. Other order memoranda, unrelated to that transaction, have been found inaccurate on inspections by the Denver Regional Office, and there had been notice to Collins of inadequacies prior to the relevant period.

A letter of March 23, 1965 from that Office to Collins, Eatherton, the predecessor firm, warned that during a recent inspection it was observed that certain of the "memoranda of orders did not reflect the date and time of entry and time of execution . . ." (Div. Ex. 25A). Collins replied, as president, on April 1, 1965, that a policy had been adopted so that checking order memoranda would be accomplished by three people " to assure that each order is dated and time stamped". (Div. Ex. 25). A letter from the Denver Regional Office dated May 10, 1966 again advised that "certain of the order memoranda did not reflect the time of entry or time of execution or cancellation." (Div. Ex. 26A). Again, Collins responded, as president, that checking order memoranda had been made "part of the responsibility of the officer who approves the order memoranda." (Div. Ex. 26). However, during the 1967 inspection of CSC, three order memoranda were found to bear no time stamps. And during the 1968 inspection seven such inadequate memoranda were found. These were of course, violations of the Rule.

Forms BD and ADV

The Order charges violations of Section 15(b) of the Exchange Act and Rule 15b-3 thereunder in that Collins and Smith allegedly failed to file amendments to CSC's broker-dealer application "promptly" upon the application becoming inaccurate. Similarly, the Order charges that such amendments were not promptly filed with respect to the CSC application for investment adviser status as required by

Section 203(c) and Rule 204-1 thereunder.

In September 1966, Douglass became a vice president and director of CSC. This was not reflected by amendments to the BD and ADV forms until November 6, 1967.

On August 22, 1968, according to minutes of the board of directors, Smith was approved as vice president. The action was not noted by amendments to the BD and ADV forms until December 4, 1968, although on October 15, 1968, Commission investigators had called to the attention of CSC's treasurer the failure to amend promptly after the August 22 date.

Similarly, on or about September 22, 1968, Schneider was made vice president, but no amendment was filed to the BD and ADV forms to reflect this until December 4, 1968.

On February 28, 1970, CSC closed its Denver offices and opened its new office in New York City. The record indicates no filing of a BD form amendment to reflect the change of address until June 11, 1970. No amendment to the ADV form was filed as of August 4, 1970, the date of the Order.

I find no violation of the requirement for prompt filing of amendments to the BD and ADV forms in the failure to reflect, prior to November 6, 1967, the election of Smith as Secretary of CSC which occurred on October 18, 1967. The failures indicated above, however, are violations of the Acts and Rules mentioned.

Safekeeping Records

As of November 8, 1967, CSC held in safekeeping for customers

the following securities in a vault at the Western Federal Savings Building, in Denver:

(1) a $1,000,000 tax anticipation treasury bill owned by Condor Petroleum;

(2) $100,000 in Estero Municipal Improvement District bonds, owned by Ringsby Pacific Limited.

The investigator from the Denver Regional Office, testified that he examined the securities in the vault, but that CSC maintained no safekeeping record of the securities. Although testimony was adduced by respondents to the effect that the record was in existence it could not be found and produced at the hearing.[39/]

I credit the testimony of Ann Kennedy, formerly cashier at CSC, to the effect that the record was in existence on November 8, 1967, and the investigator "had to have something to tell him to . . . look at [the securities] in the vault". (Tr. 4465). These were the only securities in the vault, and I conclude from the evidence that the investigator may have been mistaken and that in any event the burden of proof has not been sustained.

Regulation T Violations

CSC is charged with wilful violations, and Collins and Smith with aiding and abetting such violations, of Section 7(c) of the

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39/ Whether the record may have been lost in the move of CSC to New York City, as suggested, is problematical. Certain other records were unavailable at the hearing and appear to have been lost, perhaps in the move, perhaps in a warehouse. In either event the loss would have been subsequent to the relevant period.

Exchange Act and Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System, in that from September 1, 1966 to October 31, 1968, registrant failed promptly to cancel or otherwise liquidate transactions of customers who purchased securities and did not pay therefor within the required time periods.

Ordinarily, purchases made for customers having "special cash accounts" must be paid for or cancelled within seven business days from purchase. On the next page is a list of Regulation T alleged violations found by investigators of the Denver Regional Office, based upon a 5% to 10% test check in the 1967 and 1968 inspections. Except as noted below in the discussion of these "seven day rule accounts", either payment, cancellation of the trade, or an extension of time granted by the N.A.S.D. is required by the seventh day following the purchase. The list of alleged violations is taken from Division's Exhibit 93. Contest or asserted mitigation of the alleged violations are included in the discussion which follows the list.

It seems appropriate to note at this point that although Smith is charged with aiding and abetting, there is insufficient evidence of his involvement in these violations. Nor is there evidence of his inability to rely on the persons to whom Collins (albeit improperly) had delegated responsibility for avoiding such violations.

Alleged Seven Day Violations

Customer	Trade Date	Total Price	Security	No. of Days Past Date Due* Paymt Rec'd or Trade Cancelled
Austin	9/14/66	155.00	Investors Preferred Life Insurance	3
Boveroux	8/10/67	202.50	Big Indian Uran.	30
Bromwell	4/4/67	562.50	Texas Amer. Oil	4
Edwards	8/3/67	437.50	Amer. Nuclear	28
Rollert	6/9/67	10,050.00	Susquehanna Corp.	79
Heintz	5/18/67	513.50	Enterprise Corp.	100
Adams	7/22/68	1,287.50	Minerals Engr.	1**
Alcock	6/18/68	1,900.00	Reserve Oil & Min.	18
Calhoun	5/1/68	625.00	Automated Mgmt.	4
Cann	6/13/68	105.00	Western Oil Flds.	56
Clark	8/2/68	400.08	Susquehanna Corp.	47
Loew	6/21/68	1,000.00	Liberty Gem	38
Sibla	9/9/68	2,687.50	Minerals Engr.	3**

*Due date is seven business days beyond trade date or an extended date granted by the NASD.

**Denotes the two instances of extended dates.

Respondents contend that payment for the first item on the list - a purchase by Austin, was due on Friday, September 23, and that the trade was cancelled on that date although cancellation was not posted until the following Monday. The evidence on this is weak, at best, but because of the de minimus aspect of the alleged violation, I accept the explanation and find no violation.

Respondents contend that the Rollert transaction, involving an alleged 79 day violation, was a 35 day C.O.D. account, in which event the number of days of the violation is reduced by 28 days. The evidence supports this contention. (Tr. 4802). (C.O.D. accounts are discussed below.)

They contend that the funds for the Heintz purchase were not posted when received and that the violation was for less than 100 days; that no violation occurred in the Adams transaction because the Division failed to consider that the markets were closed on Wednesday, July 24 and July 31. The respondents are correct: payment was received on August 2, the seventh business day, and no violation occurred with Adams.

With respect to two transactions, Cann and Sibla, they suggest, in mitigation, that because the payments were "due" on non-business days, "there is a reasonable likelihood that this fact caused overlooking the 'tickler' for the transaction." They also point out, in mitigation, that some of the listed amounts are not greatly in excess of the $100 figure which, at the option of the creditor, may be disregarded by him in applying Regulation T. (Section 220.4(c)(7)).

Section 220.4(c)(5) of Regulation T provides that under certain circumstances where a security is delivered by the broker under an understanding that payment is to be made against delivery, the broker may treat the transaction as one in which payment must be made not within 7 business days but within 35 calendar days after the trade date. These are referred to as C.O.D. accounts.

The Division contends that in the following nine transactions found during the 1968 inspection the Regulation was violated in such accounts by the number of days indicated.

Customer	Trade Date	Total Price	Security	No. of Days Past Due Date Pymt Rec'd or Trade Cancelled
Belmont	1/3/68	$ 5,100.00	Pioneer Nat'l Gas	51
Gardener	2/7/68	750.00	Energy Resources	7
Lamy Assoc.	7/3/68	2,350.00	Comptron Computer	15
Lamy Assoc.	7/23/68	7,687.50	Big Horn Nat'l Life	13
Value Line Special Situation Fund	5/1/68	56,250.00	Mineral Engr.	16
" "	5/23/68	205,875.00	Bokum Corp. units	21
" "	7/1/68	36,250.00	" "	4
" "	7/2/68	28,750.00	" "	3
" "	8/1/68	160,000.00	" "	25

Respondents point out with respect to several transactions that payment was made within relatively short periods following delivery of the securities. Nevertheless, as charged by the Division, the Regulation was violated inasmuch as the payments were not made within the respective 35 day periods following the transactions.

They also assert that payment of the $5,100 debit in the Belmont transaction was made on January 12, 1968 (seven business days after the purchase), but fail to recognize that the draft "bounced" twice before payment was ultimately made on March 29, 1968.

Similarly, the fact that credit was given CSC by the bank on May 23, 1968 for the transaction of Value Line on May 1, 1968 is unavailing, inasmuch as the bank returned the draft and settlement was not made until June 21. The four Value Line transactions in Bokum Corporation Units also involved violations as charged, despite the fact that, as asserted in respondents' brief, "CSC experienced difficulty in receiving such securities for delivery".

In the previously mentioned correspondence between the Denver Regional Office and Collins, Eatherton, notice of a large number of Regulation T violations had been given (Div. Exs. 25A and 26A), and Collins had replied with representations that CSC had revised its system of supervising cash account payments (Div. Ex. 25) and he explained that the firm's cashier had not been diligent in preventing violations of the Regulation. The evidence discloses that the Regional Office personnel notified CSC personnel of Regulation T violations during inspections, but that no adequate controls had been devised to prevent recurrence. Much of the problem resulted from the fact that Mrs. Kennedy, the cashier, and Schneider, the treasurer, had no adequate training before being assigned responsibility for preventing Regulation T violations. Both were competent, intelligent and diligent employees. Unfortunately, the responsibility of learning while on the job and without adequate training or supervision was an unfair challenge.

Private Placements

The Division sought to prove that five "private placements" listed on Division's Exhibit 101 should have been treated as broker-dealer transactions and recorded as such on purchase and sale blotters, confirmations, order memoranda, customers ledgers and security ledgers.

The list was put into evidence through the testimony of CSC treasurer Schneider, as a Division witness. He testified that the transactions in issue were accomplished as a finder rather than as a broker-dealer purchasing and selling shares. Further evidence was received on behalf of respondents to support the contention that with respect to these transactions CSC acted as a finder who brought together the seller (issuer company) and the purchasers, and that compensation in the form of cash or cash and securities was given to CSC by the seller-issuers as a finder's fee.

The Division appears to be relying substantially on the exhibit in support of its contention. That document reveals that with respect to some of the transactions the buyers consisted of as many as 17 persons, sometimes including officers and employees of CSC, often including names recognizable as purchasers from CSC of other securities. The suspicion therefore is strong that CSC was in fact acting in the capacity of a seller of the securities to its customers, even though its compensation was paid by the seller-issuers. But the Division did not produce evidence of such fact and relied on the listing of the purchasers in the exhibit, which

was prepared and produced by respondents at the Division's request.

The testimony of respondents also indicated that it was on the advice of counsel and of a C.P.A. that no recording of the transactions was made on blotters, memoranda or other records which would record purchases by CSC and sales to customers.

I conclude that the Division has not sustained the burden of proving that these "private placements" 40/ were purchases and sales required to be recorded as such on CSC's books.

Failure to Supervise

The Order charges that registrant and Collins "failed reasonably to supervise Smith and Kornelsen, persons subject to their supervision, with a view to preventing violations" of the antifraud provisions by these subordinates. There is no question that the violations by Smith and Kornelsen were ascribable not only to a lack of adequate supervision, but more significantly, they resulted from activity in carrying out the instructions and directions from their superior. For whatever value it may have in adding another violation, it is clear that registrant and Collins had a duty to supervise these men with a view to preventing their antifraud violations, and that they failed to do so, as charged. Bohn-Williams Securities Corporation, Securities Exchange Act Release No. 9327, September 8, 1971, p. 7. Proper supervision of Kornelsen required more than a blind assumption that all problems had been resolved and that limitations of activity by CSC did not inhere in any clearance that might have been given by counsel: supervision of Smith required a complete change in selling practices.

40/ The Division refers to the transactions as such, as do respondents.

Advice of Counsel: The Warrant Transaction

The Collins respondents contend that Kornelsen received and acted in accordance with legal advice. They refer, primarily, to a meeting of June 12, 1968 at Hopper's office. As stated earlier, the meeting was attended by Cole and Kornelsen, both of whom participated with Hopper in a telephone conversation with Owen, who was representing CSC. The meeting involved discussion of the prospective holding company and also the warrant transaction, particularly the problem of non-assignability of the warrants.[41/]

Kornelsen testified that he avoided stating at the meeting that CSC intended to acquire from 10 to 20 thousand shares, because he did not want Cole to relax his efforts to have the warrants exercised by the holders. No one knew, at that time, how many warrants might be exercised. Although trades in the stock were being made at $4.50, Collins' goal of $5.00 was not yet reached, and the canvassing of warrant holders had not begun. Hopper, representing Big Horn, seems to have approved the original mechanics of the plan, although he testified that it was his understanding that Kornelsen was to confer on the mechanics with Owen, and such conference never took place. But clearly, neither Hopper nor Owen knew (1) that CSC would supply funds in an amount approaching $400,000, and certainly they did not know that CSC would take all shares not subscribed for by

41/ Big Horn's former "S.E.C. counsel", Hal Bloomenthal, had advised earlier of the non-transferability problem. When he became unavailable, Hopper was requested to and did become legal adviser to Big Horn on securities problems.

warrant holders; (2) that CSC would sell at a mark-up the shares it might acquire.[42] Neither Hopper nor Owen knew other facts and could not anticipate other events essential to informed judgment on the status of the transaction, including those relating to the domination, control and manipulation of the market in Big Horn shares. These are among the several reasons why the respondents cannot argue successfully that good faith reliance on the advice of counsel supported their activity in the transaction.

Kornelsen, of course, knew that counsel were not fully informed on CSC's plans on July 12, and by July 19 he must have recognized the total change in the posture of the transaction. Collins knew and did not care that any legal advice given Kornelsen would be inadequate after a change in plans. Without checking with counsel or anyone else, he made and carried out his decision to acquire and sell the

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42/ Hopper understood that CSC "was merely purchasing some shares for itself and a few persons with whom it was closely associated", but testified that he did not want the sticker to the prospectus to indicate that CSC was willing to pay $5.00 per share because of the potentially bullish effect. In a letter of July 12, 1971, in which he reported his recollection of the meeting with Cole and Kornelsen held three years earlier he stated: "If there had been any firm agreement with Collins to buy shares . . . it would have been . . . necessary disclosure. The fact is that insofar as I know there was no such agreement. I actually thought there was a good chance Collins would not buy any significant number of shares . . ." (Collins Ex. 44).

Even with inadequate and incomplete understanding of the facts as they developed, both counsel indicated great concern on July 12 that CSC might be deemed an underwriter. Hopper testified that he had advised there should be no mark-up by anyone who might sell the warrant shares, as ~~they~~ that might be regarded as underwriter compensation, and that he did not know until shortly before the hearing that CSC had sold shares at 5 1/8. (Tr. 4254, 5). Owen was much concerned that there be no "rinkey-dink" in the transaction.

available shares. Good faith reliance on counsel is nowhere within these proceedings. The violations by Collins and Kornelsen were wilfull, and I find no substantial mitigative factors in the nature or extent of Kornelsen's consultation with counsel.[43/]

It also appears that neither Hopper nor Owen knew that CSC was trading Big Horn or quoting it in the sheets, and I find that the violation of Rule 10b-6 is in no way mitigated by Kornelsen's consultation with counsel. Having engaged actively in underwritings and other broker-dealer functions over a period of many years, Collins knew Rule 10b-6 and its prohibitions in July 1968. (Tr. 4963). His effort to remain on the periphery of the warrant transaction by delegating to Kornelsen, who was a C.P.A. but not an experienced broker-dealer, the total responsibility for resolving the non-transferability problem and the mechanics of acquiring warrant stock, was a clear abnegation of responsibility which is aggravated by Kornelsen's lack of experience as a broker-dealer, even though he would confer with counsel.[44/]

43/ Abbett, Sommer & Co. Inc., Securities Exchange Act Release No. 8741, November 10, 1969; Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329, June 2, 1964, p. 8, aff'd 348 F.2d 798 (C.A.D.C., 1965). As the Commission explained a number of years ago,

> "an attorney's opinion based on hypothetical facts is worthless if the facts are not as specified, or if unspecified but vital facts are not considered."

44/ Collins was asked at the hearing whether he had ever thought about the 10b-6 question during July. He responded negatively, because he had "instructed Kornelsen to talk to our attorneys. . . He was very reliable. . . So there would be no reason for me to even think about it." (Tr. 4963). Even assuming that he gave the problem no thought prior to his decision to take and to distribute all additional stock that became available, it is much more incredible that he gave it no thought in connection with that decision.

His lack of experience, however, does not excuse Kornelsen's violations. Whether or not he knew the restrictions imposed by Rule 10b-6 prior to July 19 would be significant on the matter of sanctions, but not on his wilfulness in violating and in aiding and abetting the violations of the Rule by activity which he intended to perform.[45/] The possibility of a violation was recognized and raised by Douglass on July 23. Kornelsen had assumed the responsibility of architect of the transaction, but took no steps to insure that further violations did not occur. The proposed finding by the Collins respondents that "Both Hopper and Owen had determined on July 12, 1968 that Rule 10b-6 did not apply to the acquisition of warrant stock by CSC" is also out of tune with the facts.

The argument on reliance as a defense also must be rejected insofar as it proclaims that "good faith reliance on the advice of counsel is based upon knowledge of all pertinent facts known to the violators." Apart from the unacceptable factual premise, there is no legal support for the proposition. The cases cited in its support are criminal cases which are inapposite to the issues in these administrative proceedings.[46/] Similarly unacceptable is the argument that a preponderance of the evidence is not a sufficient

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45/ A finding of wilful violation does not require that there be an intention to violate the law, but only that there be an intent to perform the prohibited act. Dunhill Securities Corporation, Securities Exchange Act Release No. 9066 (January 26, 1971); Cady, Roberts & Co., 40 S.E.C. 907, 917 (1961).

46/ Cf. Telescript - CSP Inc., supra; Abbett, Sommer & Co., Inc., supra.

quantum on which to predicate findings of wilfull violations as charged. The Commission has held to the contrary and has been sustained in court.[47/]

Public Interest and Sanctions

The Order instituted these proceedings to determine whether the allegations of the Division are true, to afford respondents an opportunity to establish defenses thereto, and to determine what remedial action, if any, is appropriate in the public interest. The many serious violations of the several securities acts and rules require severe sanctions, even without regard to consideration of other violations on which evidence was received in the public interest. Smith, for example, was censured (along with CSC) by NASD District Business Conduct Committee for District No. 3 on December 4, 1970 for violation of the NASD's Rules of Fair Practice. Each was individually fined $250 and one-half of the cost of the proceeding, after a finding that they had maintained a discretionary account from April 26, 1968 to April 12, 1969 without prior written authorization from Barbara Popp, a customer.[48/]

Previously, on July 22, 1970, Smith (and CSC) had been found by the Division of Securities of the Colorado Department of Regulatory Agencies to have violated Colorado statutes and rules of the Division

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47/ Norman Pollisky, Securities Exchange Act Release No. 8381, pp. 9-10, August 13, 1968; Sidney Leavitt, Securities Exchange Act Release No. 10013, February 22, 1973, where the Commission said at p. 5, footnote 9: "Administrative allegations of willful violations need be proven only by a preponderance of the evidence and not beyond a reasonable doubt as in a criminal proceeding . . ." citing Pollisky; Cf. James De Mammos, Securities Exchange Act Release No. 8090 (June 2, 1967), aff'd without opinion, C.A. 2, October 13, 1967.

48/ In connection with its application to become an associate member of the American Stock Exchange in January 1969, CSC was advised that its oral discretionary or managed account arrangements did not accord with Exchange rules. Letters were sent by CSC to these clients with written authorization forms, most of which were returned signed by the clients. (Div. Exs. 24, A, B, C).

in transactions for the same customer. It was found that Smith had placed in her account speculative securities not suitable to her financial condition. His license as a securities salesman had been withheld for six months and a sanction was imposed requiring his securities activity to be adequately supervised by his employer for an additional period of six months.

Smith failed to pay the fine assesed by the NASD, as a result of which he was barred by that body from further association with any of its members. Although he did not participate in defense of his activities in the instant proceedings, he stated, in response to a direct question, that he did not want to be barred from association with a broker-dealer. I find that his fraudulent activity was due substantially to improper supervision and to his exposure to an atmosphere pervaded by an excess of optimism for the potential for quick profits in speculative securities. But his fraud in the Big Horn transaction was flagrant and excessive. He became a major actor in CSC's fraudulent scheme when he joined it on or about July 19 and furthered its purpose at the request of Collins. Whether his primary motive in putting Big Horn shares into managed accounts was to assist his employer or whether it was to earn commissions on the sales is neither clear nor of great importance: what he did with the managed accounts was reckless, irresponsible and fraudulent. His failure to respect the warning from Douglass of potential 10b-6 violations was especially egregious. I conclude that the public interest requires that he be barred from association with a broker or dealer.

Smith is not engaged in the securities industry and, as noted above, he has stated that he does not intend to return to it. In the event of a change of mind on his part, I note for the record that he was cooperative during the proceeding insofar as he participated, that his testimony was forthright and appeared to be truthful, and that it is my view that under proper supervision he could serve adequately as a registered representative at some future time.

Kornelsen, of course, was an important part of the scheme as it ultimately developed, but I do not believe that he intended to participate in a fraudulent activity. His inexperience with the securities laws and rules should have deterred him from accepting the responsibility involved in the assignment from Collins in the warrant transaction, particularly since he did not propose to disclose fully to counsel the plans of CSC. His covert activity in arranging with Cole for the acquisition of shares without disclosure to Smith or Douglass is unexplained and at best strange. I have no doubt that he wilfully violated and wilfully aided and abetted violations by the other respondents of the anti-fraud provisions, including Rule 10b-6, as discussed above in connection with the defense of the Collins respondents based on "advice of counsel". Kornelsen's ignorance of the law, if it existed, and his lack of intention to violate the anti-fraud provisions are considered only as mitigating factors. 49/

49/ Cases cited at page 73, supra, fn.45 .

Granted that he was not sophisticated in broker-dealer activities, he was shrewd in his plan to accomplish the warrant transaction and avoid the nontransferability of the warrants, and careless in not conferring with a more knowledgeable person such as Collins during the implementation of the plan. He followed the price of Big Horn by checking with Douglass prior to July 23 but without disclosing the plan, and he knew that the price rise was essential to its success. I can concede only that the evidence does not prove he knew that manipulation of the market was taking place.

The favorable testimony of Kornelsen's character witnesses has been considered and careful evaluation has been given to his good reputation as a C.P.A. I have also considered the fact that he has not been the subject of disciplinary proceedings. I conclude nevertheless, that because of the nature and extent of his participation in the violations it is appropriate in the public interest that he be barred from association with any broker-dealer, provided that after a period of three months, if he should want to enter the industry he may apply to do so upon a showing to the Commission staff that he will be adequately supervised.

Severe sanctions must be imposed in the public interest on the registrant and Collins for the many serious violations found above. As chief executive officer, president, and virtually sole owner, Collins was in complete control of the registrant's corporate activities, was aware of earlier problems, and is responsible for

the violations found.[50/] His subordinates were hired to carry out his wishes, and except as to the record violations they did so implicitly in the matters involved in these proceedings. He did make an effort to correct the many deficiencies in bookkeeping and recording when he engaged Kornelsen initially to preclude defalcations and another CPA subsequently to devise procedures for avoiding violations. But his delegation of responsibility for implementation of the procedures and for avoiding record and bookkeeping violations to inexperienced persons who were learning while "on the job" without adequate supervision and direction was cavalier and careless. He was ambitious and confident to the point of being somewhat arrogant, and the many repetitive violations of bookkeeping requirements are among other indicia of the low esteem in which he held securities laws and regulations.

Especially cavalier was his delegation to Kornelsen of responsibility for the warrant transaction and his intentional disassociation from the mechanics. To remain on the periphery and assume that Kornelsen, even with the opportunity to consult with counsel, would avoid all pitfalls and violations was reckless. More so was his decision to take all stock that became available without seriously considering (as he suggests) the potential effect or dangers that might result from such decision.

Mentioned above collaterally in the discussion of prior findings of violations by Smith were the NASD decision of December 4, 1970

50/ Aldrich, Scott & Co., Inc., 40 S.E.C. 775 (1961); Luckhurst & Company, Inc. 40 S.E.C. 539 (1961).

and the penalty imposed on CSC, as well as the decision of July 22, 1970 of the Colorado Department of Regulatory Agencies. (Div. Ex. 116). In this decision it was found that CSC had fallen short of its obligations to the customer (Barbara Popp) with respect to the handling of her discretionary account and had violated the Colorado statutes and rules of the Division of Securities. The firm was suspended from doing business as a dealer for 15 days.

Previously, Collins, Eatherton and Collins individually were found by the NASD's District Business Conduct Committee for District No. 3 to have incurred the following violations: (1) 24 instances of unfair mark-ups in violation of NASD's Rules of Fair Practice; (2) three instances of the use of sales literature contrary to NASD's Statement of Policy concerning use of sales literature and its Rules of Fair Practice; (3) failure to exercise adequate supervision of the firm's business, in violation of the Rules of Fair Practice. (Div. Ex. 114). Collins and the firm were fined $200 each and were required to pay the costs of the proceeding.

The letters of the Division to CSC pointing out certain records deficiencies and the responses of Collins were mentioned above. (Div. Exs. 25A, 26A, 25, 26). In addition to those deficiencies, the correspondence referred to net capital violations, failures to maintain adequate records under Rule 17a-3, failure to maintain extension requests under Regulation T, and failure to comply with Rule 15c3-2 regarding statements to customers reflecting free credit

balances in their accounts. Collins' responses mentioned procedures which would preclude further violations, but of course they were not prevented.

I have considered as a mitigating factor that Collins was overly optimistic concerning the value and prospects of Big Horn as a conglomerate as against any intentional fraud in selling shares known to have no potential; I have considered, among other factors suggested by counsel, the expense in time and money in defending in these proceedings, the suggestion that the present business operation does not involve retail sales, and the fact that quotations in pink sheets have not previously been held to be a prospectus. I have also considered that the violations occurred during a time when many speculative stocks were considered good risks by large segments of the securities industry and when that industry was plagued by back-office problems; that competent legal counsel was available to CSC's employees for consultation; and that the reputations of Collins and of CSC have been damaged by the activities here under consideration. Nevertheless, after careful review and consideration of these factors among others urged in mitigation, including the testimony of character witnesses, I conclude that because of the serious nature of the many violations, particularly of the antifraud provisions of the securities laws, it is appropriate in the public interest that registrant's broker-dealer and investment adviser registrations be revoked, that registrant be expelled from the NASD, and that Collins be barred from association with a broker or dealer.

A bar order does not preclude the person barred from successful application to the Commission for the right to future association at a time when the granting thereof is supported by existing facts and circumstances. 51/ I should think that an indication of respect for the securities laws would be a pre-requisite to a successful application by Collins: that with such indication it might well be granted.

Accordingly, IT IS ORDERED that Garry Smith is barred from association with a broker or dealer;

that Vern Kornelsen is barred from association with any broker or dealer, provided that after three months from the effective date of this order he may become associated with a registered broker-dealer in a non-supervisory capacity upon a showing to the staff of the Commission that he will be adequately supervised;

that the registrations of Collins Security Corporation as a broker-dealer and as investment adviser are revoked and that it is expelled from the NASD; and that Timothy Collins is barred from association with any broker-dealer.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant

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51/ Fink v. S.E.C., 417 F.2d 1058, 1060 (2d Cir., 1969); Vanasco v. S.E.C., 395 F.2d 349, 353 (2d Cir., 1968).

to Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 52/

Sidney Ullman
Administrative Law Judge

Washington, D.C.
April 6, 1973

52/ To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the issues presented. To the extent that the testimony of the Respondents is not in accord with the findings herein it is not credited.