

IN THE MATTER OF
BOETTCHER AND COMPANY

DAVID F. LAWRENCE

ALFRED A. WIESNER

BRUCE C. NEWMAN

File No. 3-544. Promulgated August 30, 1968

Securities Exchange Act of 1934—Sections 15(b), 15A and 19(a) (3)

BROKER-DEALER PROCEEDINGS

Grounds for Censure

Failure to Exercise Supervision

Where due to failure of adequate supervision by registered broker-dealer, price charged customer for securities included markup contrary to agreement between registrant and customer, *held*, under circumstances including facts that markup was charged through oversight and registrant made restitution, sanction limited to censure of registrant is appropriate in public interest.

APPEARANCES:

Joseph F. Kryz and Robert F. Watson for the Division of Trading and Markets.

Arthur K. Underwood, Jr. and Jon K. Mulford, of Dawson, Nagel, Sherman & Howard, and *Josiah G. Holland and Robert H. Durham, Jr.*, of Holland and Hart, for respondents.

FINDINGS, OPINION AND ORDER

In these proceedings pursuant to Sections 15(b), 15A and 19(a) (3) of the Securities Exchange Act of 1934 ("Exchange Act"), we granted petitions for review of the hearing examiner's initial decision in which he concluded that Boettcher and Company ("registrant"), a registered broker and dealer, should be censured, and that David F. Lawrence and Alfred A. Wiesner, general partners of registrant, and Bruce C. Newman, an employee of reg-

istrant, should each be suspended from association with any broker or dealer for 15 days. Briefs were filed, and we heard oral argument. On the basis of our review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

MARKUPS ON GOVERNMENT BONDS IN CONNECTION WITH "ADVANCE REFUNDING" TRANSACTIONS

Registrant acted as manager of an underwriting syndicate in connection with the "advance refunding" in 1963 of bonds of two Colorado school districts, Jefferson County District No. R-1 ("Jeffco") and Adams County District No. 50 ("Adams"). The "advance refunding" technique entails the issuance by a school district of new bonds for the purpose of "refunding" existing bonds which may not be due or callable. Under such technique, as here relevant, the proceeds of the new bonds issued by the school district are invested in United States Government obligations ("Governments"), maturing at such times and in such amounts as to insure prompt payments of the "refunded" bonds. The Governments are then placed in escrow, and the "refunded" bonds are no longer deemed outstanding. The objective of these steps is to secure savings to the school district by enabling it to issue its "refunding" bonds at a lower interest rate than it receives on the Governments; and it may also be able to reduce the principal amount of its debt by purchasing Governments at a discount. In negotiated sales of refunding bonds, as here, the form of the underwriter's compensation may include a markup on the new bonds issued by, or on the Governments sold to, the school district, or cash paid by the district. In this case the syndicate purchased the refunding bonds from and sold the Governments to Jeffco and Adams, charging Jeffco a markup on the Governments over the syndicate's cost. The Governments involved in both transactions were acquired by the syndicate from registrant's wholly-owned subsidiary which, pursuant to syndicate authorization, had purchased such securities and charged the syndicate a markup of \$1.25 per bond. The hearing examiner found that registrant failed to make adequate disclosure to Jeffco and Adams of the markups taken on the Governments, and respondents controvert this finding.

1. *Jeffco Transaction*

Registrant reached an agreement with Jeffco on July 30, 1963, giving it the right to form a selling group to buy Jeffco refunding bonds for resale to the general public, the proceeds of which Jeffco

would use to buy Governments from the underwriters at the prices paid by the latter, who undertook to acquire the Governments at the "best possible" price. The objective by Jeffco was to achieve net savings estimated at approximately \$2,500,000. The option given registrant was not exercised by its extended expiration date of September 30, but negotiations with Jeffco continued. Registrant concluded that because of changed market conditions the gross profit it had anticipated could not be realized under the terms of the July 30 proposal, and determined to make up the deficiency in part by taking a markup on the Governments. It entered into a new agreement with Jeffco as of October 10, under which the syndicate formed by registrant would purchase \$38,873,000 of Jeffco refunding bonds in exchange for which the underwriters would supply Jeffco with specified Governments sufficient to refund \$39,757,000 of outstanding Jeffco bonds. The transaction was consummated on November 1, 1963. The prices paid the syndicate by Jeffco for the Governments, however, included a markup of \$394,469 over the prices paid for such securities by registrant's subsidiary. Following a 1964 audit Jeffco instituted legal action against registrant to recover that amount, and the case was thereafter settled by the parties by a payment to Jeffco of \$200,000.

At the outset we note that no finding was made by the hearing examiner that registrant's underwriting compensation was in fact excessive or improper *per se*, and that Jeffco attained substantially the estimated savings of about \$2,500,000. Our inquiry here relates solely to the question of the disclosure of the underwriting compensation. Respondents assert that in 1963 Jeffco was concerned only with the over-all compensation involved, and that in any event Jeffco was informed by registrant, but unreasonably failed to understand, that part of such compensation under the October 10 contract consisted of a markup on the Governments. It is certainly incumbent upon an underwriter to exercise care to make full and clear disclosure to issuers, both public and private, with respect to the nature and amount of the underwriting expense and profit involved. We are unable to find, however, that registrant failed in this duty in the Jeffco situation.

Jeffco was experienced and knowledgeable in financial matters and was advised by counsel in connection with the transaction in question. The October 10 agreement, pursuant to which the transaction was consummated, repeated provisions of the July 30 proposal but did not include the earlier provision barring a markup on the Governments. In addition, an exhibit attached to the Octo-

ber 10 agreement prepared by registrant, which summarized the estimated underwriting costs and expenses per \$100 bond issued, listed "U.S. Government Bond underwriting" at \$.893 (on which basis the markup on Governments would aggregate around \$350,000) as well as "refunding bond underwriting" at \$1.376. Moreover, a letter signed by Wiesner addressed to bond counsel, dated November 1, stated that the costs of the Governments included at least \$394,469 for "underwriting, obtaining and maintaining physical availability" of such securities. Not only are these items inconsistent with an intent on registrant's part to conceal the markup on the Governments but at least the exhibit should have alerted Jeffco to the possibility of such a markup. In view of the integrated nature of a refunding transaction, it would have been reasonable to evaluate its fairness on the basis of overall results. The markup on the Governments of \$394,469 was one aspect of a transaction involving the issuance of \$38,873,000 of refunding bonds in which Jeffco achieved its estimated savings of around \$2,500,000. The record as a whole indicates, as recognized by the parties in settling the civil action based on the issues now before us, a "mutual misunderstanding" with respect to registrant's compensation engendered by the "complicated nature" of the negotiations and transactions.

2. Adams Transaction

Registrant entered into an agreement in August 1963 with Adams for an advance refunding of \$7,735,000 of Adams bonds. That agreement, which was modelled after the July 30 Jeffco proposal, provided that registrant and its associates would purchase the necessary Governments at the "best possible" price and resell them to Adams at their purchase price. The transaction was consummated on September 30, 1963, around which time registrant's subsidiary acquired the Governments. The syndicate purchased the Governments from the subsidiary for \$7,760,100, and sold them to Adams for the same price. However, unknown to Adams that price included a markup of \$1.25 per \$1,000 bond or a total of \$9,031 taken by the subsidiary in the sale of the Governments to the syndicate.

Newman, registrant's employee who prepared the Adams contract, contemplated that the markup would not be passed on to Adams but would be absorbed by the syndicate. However, he turned over the transaction to another employee without advising him of that intention, and the latter interpreted the contract to mean that Adams would purchase the Governments at the syndi-

cate's cost (which included the markup charged by registrant's subsidiary). Upon discovering the markup after the closing date Adams claimed it was an improper charge, and around April 1966 registrant repaid the full amount.

Respondents assert, and we find, that the markup was charged Adams through inadvertence. However, neither the inadvertence of the undisclosed markup nor the restitution following complaint can absolve registrant of the failure to carry out its responsibility to review transactions, particularly of the size here involved, and make certain that no unauthorized or undisclosed charges are imposed. It cannot by its own carelessness shift such burden to its customer. Under the circumstances we conclude that registrant failed to exercise reasonable supervision to prevent overcharging its customer in violation of the securities acts.¹

PUBLIC INTEREST

In determining what remedial action is appropriate in the public interest, we have taken into account the facts that registrant has been in business for over 50 years without any prior disciplinary action; that it has settled the claims of both Jeffco and Adams; and that it has made changes in its operations and forms designed to prevent a repetition of the problems respecting refundings that arose in this case. Nevertheless we consider that registrant should be censured for the failure to exercise proper supervision in the Adams situation.

Since we have made no adverse findings with respect to the individual respondents, we shall enter an order dismissing the proceedings as to them.

Accordingly, IT IS ORDERED that Boettcher and Company be, and it hereby is, censured;

¹ During 1966 registrant used certain newspaper and radio advertisements containing statements which conveyed the impression that in every over-the-counter transaction registrant's traders try to get for the customer "the best possible price." Although they also indicated that registrant maintained an inventory of some securities, nothing was said specifically about pricing in sales from inventory. Prior to the use of the advertisements registrant in accordance with the requirements of the New York Stock Exchange, of which it is a member, had submitted them to that Exchange for approval of their manner and form of presentation and the Exchange had raised no questions as to their use.

Registrant effected some of its over-the-counter transactions with customers on a principal basis, disclosing its principal capacity but not always disclosing the markups included in the prices. The hearing examiner held that under the circumstances registrant should have made clear what procedures and pricing policies it followed when it filled orders from inventory, and that the failure to do so made the advertisements false and misleading. The record does not show that the prices charged in the principal transactions referred to were not in fact the best possible prices, it being stipulated merely that the undisclosed markups in some instances exceeded the minimum commissions that would have been charged on transactions executed on the New York Stock Exchange. On the record before us we are unable to find that registrant violated the anti-fraud provisions. We also note that registrant discontinued the use of the advertisements after being alerted to the problems they created.

IT IS FURTHER ORDERED that the proceedings herein as to David F. Lawrence, Alfred A. Wiesner and Bruce C. Newman be, and they hereby are, dismissed.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT and SMITH).