IN THE MATTER OF

ARMSTRONG, JONES AND COMPANY, et al.*

File No. 3-336. Promulgated October 3, 1968

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

BROKER-DEALER PROCEEDINGS

Offer, Sale and Delivery of Unrequistered Securities

Fraudulent Representations in Offer and Sale of Securities

Failure to Disclose Common Control

Confirmations of Unauthorized Transactions

False and Fictitious Records

Where registered broker-dealer offered, sold and delivered unregistered securities, made fraudulent price predictions to customers, failed to disclose to customers that registrant and issuer of securities were under common control, sent confirmations of sales to persons who had indicated interest in but had not offered to buy securities, and made false and fictitious records and entries, *held*, willful violations of registration provisions of Securities Act of 1933, anti-fraud provisions of that Act and Securities Exchange Act of 1934, and record-keeping provisions of latter Act, and in public interest to revoke broker-dealer's registration and expel it from membership in registered securities association and national securities exchange.

Where residents of same state as issuer, which offered and sold unregistered securities pursuant to claimed intrastate exemption under Section 3(a)(11) of Securities Act of 1933, variously acted as nominees of or alleged trustee for nonresidents or resold securities to non-residents under circumstances indicating that offering had not come to rest exclusively in hands of residents, *held*, exemption unavailable for entire offering, including portion sold to residents.

Practice and Procedure

Contentions by respondents that Commission's staff had induced customers to give biased statements during investigation, that such statements were used to refresh their recollection before taking stand without giving respondents opportunity to examine statements until conclusion of direct examination, that respondents' request for list of staff's proposed witnesses was improperly denied, and that staff improperly failed to interview various employees and former officer of registrant, or to name officer as respondent or call him as a witness, *rejected*.

* Thomas W. Itin, George A. Reuter, Rene F. Compeau, E. Keith Owens, Charles H. Bruce and Robert O. Safford.

APPEARANCES:

William D. Goldsberry and *Mark A. Loush,* of the Detroit Branch Office of the Commission, and *Donald W. McKenzie,* of the Chicago Regional Office of the Commission, for the Division of Trading and Markets.

James C. Sargent and *Michael Heitner,* of Lowenstein, Pitcher, Hotchkiss & Parr, for Armstrong, Jones and Company and Thomas W. Itin.

James F. Littell and *David Robb,* of Poole, Warren & Littell, for George A. Reuter.

Harry A. Carson and *Thomas A. Roach,* of McClintock, Fulton, Donovan & Waterman, for Rene F. Campeau.

W. McNeil Kennedy, Herbert S. Wander, and *Michael Warner,* of Pope, Ballard, Uriell, Kennedy, Shepard and Fowle, and *John L. Vanker,* of Butzel, Eaman, Long, Gust & Kennedy, for E. Keith Owens, Charles H. Bruce, and Robert O. Safford.

FINDINGS AND OPINION OF THE COMMISSION

Following extensive hearings in these proceedings pursuant to Sections 15(b), 15A and 19(a) (3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that the registration as a broker and dealer of Armstrong, Jones and Company ("registrant") should be revoked and that it should be expelled from membership in the National Association of Securities Dealers, Inc. ("NASD") and the Detroit Stock Exchange, and that certain sanctions should be imposed upon Thomas W. Itin, registrant's president, Rene F. Campeau, executive vice-president and sales manager, George A. Reuter, vice-president in charge of trading, E. Keith Owens, one of registrant's principal stockholders, and Charles H. Bruce and Robert O. Safford, directors of registrant. We granted petitions of respondents for review of the initial decision as to certain issues and on our own motion ordered review of the initial decision with respect to all issues involved in the proceedings. Briefs were filed by respondents and our Division of Trading and Markets ("Division"), and we heard oral argument. Our findings are based upon an independent review of the record.

I.

Alexander Hamilton Life Insurance Company ("Hamilton Life"), which was incorporated in Michigan in October 1963, com-

menced a public offering about November 15, 1963, of 1,500,000 shares of Class A common stock at $4 per share pursuant to a claimed intrastate exemption under Section 3(a)(11) of the Securities Act of 1933 from the registration provisions of that Act.[1]

The underwriter was a firm organized by Owens for the purpose of underwriting the offering and was wholly owned by him, and the selling group consisted of registrant and another securities firm. The offering was terminated on March 23, 1964.[2] Registrant commenced trading in Hamilton Life stock in the over-the-counter market on April 27, 1964.

VIOLATION OF REGISTRATION PROVISIONS

The prospectus used in the offering of Hamilton Life stock stated that the offering was limited to residents of Michigan, and each purchaser was required to sign a subscription agreement certifying that he was such a resident and was purchasing the stock for his own account for investment. However, two persons who signed such agreements were in fact nominees for non-resident purchasers of a total of 1,550 shares, and Owens subscribed to 375 shares allegedly as trustee for a non-resident.

In one instance, three non-residents, including an acquaintance of Itin, arranged for a resident-nominee, the uncle of one of the non-residents, to purchase 1,000 shares in their behalf. About March 15, 1964, the nominee sent to registrant a subscription agreement together with a $4,000 treasurer's check payable to registrant, which had been purchased by the non-resident nephew from a savings and loan association in his state. Itin at first testified that the nominee told him he had purchased the check from "his" savings association, but later admitted that he knew the check came from the nominee's nephew. Itin also knew the nephew was a non-resident. Itin advised the nominee that the check should have been made payable to the escrow agent, and on March 17, he endorsed the treasurer's check in registrant's behalf and returned it together with the subscription agreement to the nominee who in turn sent them to his nephew. On March 23, the last day of the offering, Itin informed the nominee that payment was due that day if he still wished to purchase the stock. The

[1] Section 3(a)(11) of the Securities Act exempts from registration "any security which is part of an issue offered and sold only to persons resident within a single State. . ., where the issuer of such security. . ., if a corporation, [is] incorporated by and doing business within, such State. . . ."

[2] The offering was initially oversubscribed by 682,000 shares. Pursuant to a plan formulated with the state securities authorities to avoid violations of state law, subscribers for the original 1,500,000 shares were allowed to rescind and the remaining subscribers were told that their subscriptions had been rejected but that they could resubscribe. After rescissions and resubscriptions approximately 24,000 shares remained unsold and such shares were purchased by registrant and associated persons of Hamilton Life between April 3 and 15, 1964.

nominee stated that he did not have sufficient funds in his checking account but would ask his nephew to send the money directly to Itin. The nephew called Itin later that day and Itin told him that since payment could not possibly be received that day, he would advance the money, and on the following day the nephew sent to Itin a new check and a second subscription agreement purporting to be signed by the nominee.[3] We agree with the examiner's finding that the circumstances surrounding this sale were sufficient to put Itin on notice that the purported purchaser was acting on behalf of a non-resident. Particularly suspect were the facts that the treasurer's check, as Itin knew, was sent by a non-resident, and that the second subscription form and check also came from him.

The second instance involved a non-resident from an adjoining state whom Owens had known for many years, having lived in the same town. Following a call from and apparently at the suggestion of that non-resident, Owens, acting on behalf of the underwriter, sent a prospectus and subscription form to a resident who had indicated to the non-resident an interest in Hamilton Life. Shortly thereafter the resident requested and received four additional subscription forms from Owens. The resident signed and returned each of the forms for varying amounts of stock totalling 750 shares and indicated that the certificates were to be issued in his name. Accompanying the executed forms were five checks in payment for the varying amounts of stock. Four of the checks were drawn on the same bank, dated the same day, and consecutively numbered. These subscriptions in fact represented the purchase of 200 shares by the resident and of the remaining 550 shares by four non-residents, including the acquaintance of Owens.[4] We think that the facts that this transaction was initiated by a non-resident, that an individual, who was supposedly buying stock for his own account, submitted five subscription forms for varying amounts of stock with a separate check covering each amount, and that four of the checks were drawn on one bank should have alerted Owens to inquire into the transaction with a view to determining whether the resident was purchasing stock either for non-residents or for other residents who were not buying for investment.[5]

[3] The nephew testified that his uncle, the nominee, had signed the second subscription agreement and given it to him on March 21, whereas the nominee testified that the signature was not his.

[4] A certificate for 750 shares was subsequently sent to the resident who then arranged to have new certificates issued in the names of the five purchasers.

[5] See *Strathmore Securities, Inc.*, 43 S.E.C. 575, 578 (1967), for a discussion of the responsibility of securities salesmen to make certain basic inquiries when circumstances raise questions as to the legality of proposed transactions with customers.

The third out-of-state sale occurred when Owens, allegedly acting as a trustee for a non-resident, subscribed to 375 shares for which he paid with funds which had been sent to him by the non-resident to invest at his discretion. At Owens' direction, a certificate for 250 shares was issued to him and the non-resident as tenants in common, and a certificate for the remaining shares was issued to them as joint tenants.[6] Whether or not Owens was a trustee, we are of the opinion that he was acting primarily as an agent or broker and did not intend to do anything more than select investments for his principal. There is a substantial question whether he was a trustee in the sense urged. The checks sent to Owens by the non-resident were payable to Owens in his individual capacity, and not as "trustee." Owens did not subscribe to the shares as "trustee" but rather certified that he was purchasing for investment for his own account, and he subsequently directed that the certificates be issued in both his own name and that of the non-resident. He testified that he had the certificates placed in both names so that if anything happened to him there would be "some indication" that the stock "belonged" to the non-resident. There is no evidence that the non-resident and Owens intended to establish a trust estate which could be considered a source of local funds and contribute to the "local financing" contemplated by the intrastate exemption.[7]

The record further establishes, contrary to the hearing examiner's conclusion, that an out-of-state distribution occurred when a part of the original offering was resold by resident subscribers shortly after registrant's commencement of trading in the stock on April 27, 1964. Although, except for the three instances described above, precautions were taken to confine the offering to residents who certified that their purchases were for investment, and interested non-residents were informed prior to the commencement of trading that they could not buy the stock at that time, Itin contributed to or even encouraged the resale of stock held by residents to non-residents shortly after trading began. Between February and April 1964, during the period of the offering and prior to the commencement of trading, Itin recommended to or solicited the purchase of such stock by two non-residents, and advised three others to place orders or indications of interest as soon as possible to assure the best execution upon the commencement of trading. Altogether, registrant received orders or

[6] In May 1965, the shares were transferred to the non-resident alone.

[7] See Securities Act Release No. 4434 (December 6, 1961).

indications of interest from about 35 to 40 non-residents for about 20,000 shares before April 27, 1964.[8]

Registrant's opening bid on that date was 7, which tended to induce residents, who had presumably purchased for investment, to sell their stock for a quick and substantial profit and enable registrant to resell the stock to non-residents who had given it orders or indications of interest. Registrant sold at least 11,500 shares between April 27 and May 1, 1964 to 29 non-residents, including 2 broker-dealers, at prices ranging from 7¾ to 9½, at least 10,000 shares between May 4 and 30 to 36 non-residents, including 2 broker-dealers, at from 8¼ to 14, and at least 13,400 shares between June 2 and August 31, 1964, to 71 non-residents, including 15 broker-dealers, at from 11½ to 19¾.[9]

It is clear that a securities issue has not come to rest with residents where orders and indications of interest have been solicited from non-residents during the offering of the securities, and trading begins at a substantial increase over the offering price.[10] "It is incumbent upon the. . .underwriter, dealers and other persons connected with the offering to make sure that it does not become an interstate distribution through resales."[11] We find that registrant and Itin failed to discharge this responsibility since the record establishes that they intended to sell Hamilton Life stock to non-residents as soon as the market opened.

In view of the offers and sales of Hamilton Life stock to non-residents, no intrastate exemption was available and therefore registrant, Itin, and Owens violated Sections 5(a) and 5(c) of the

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[8] The record discloses as to ten of the non-residents that three placed orders at market, and seven placed limit orders: one at 4½, three at 5, one at 5½ and two at 8.

[9] The record does not indicate the nature or volume of registrant's transactions in Hamilton Life stock after August 31, 1964.

[10] Resales by residents shortly after the commencement of trading are evidence that they did not purchase for investment. *Cf. Skiatron Electronics and Television Corporation*, 40 S.E.C. 236, 249 (1960); Securities Act Release No. 4434 (December 6, 1961). We reject respondents' contention that the facts that all the subscribers to the offering did not rescind their orders or resubscribe and that the remaining shares were purchased by registrant and persons associated with Hamilton Life, demonstrated that the residents had acquired the stock for investment and the offering had come to rest. Refusal of the offer to rescind or resubscribe was not inconsistent with an intention to resell within a short time if a profit could be realized.

[11] Securities Act Release No. 4434 (December 6, 1961). See also *Capital Funds, Inc.*, 42 S.E.C. 245, 247 (1964), *aff'd* 348 F.2d 582 (C.A. 8, 1965).

Securities Act in the offer, sale, and delivery of such stock.[12] Such exemption is not available unless the entire issue is offered and sold to, and comes to rest exclusively in the hands of, residents.[13] "If any part of the issue is offered or sold to a non-resident, the exemption is unavailable not only for the securities so sold, but for all securities forming a part of the issue, including those sold to residents."[14]

We further conclude that such violations were willful. As we have seen, these respondents knew or should have known that no exemption under Section 3(a) (11) was available.[15]

VIOLATIONS OF ANTI-FRAUD PROVISIONS

1. *Fraudulent Representations*

In the offer and sale of Hamilton Life stock, Campeau and various salesmen of registrant made extravagant and unwarranted representations and price predictions to customers. Campeau told a customer, who purchased 500 shares at 7½ and 7¾ on April 27,

[12] We reject respondents' contention that the application of the securities laws in these proceedings is an unlawful intrusion upon the power to regulate "the business of insurance" expressly reserved to the States by Congress in the McCarran Act (15 U.S.C. 1011–15). Their reliance upon *S.E.C.* v. *National Securities, Inc.*, 387 F.2d 25 (C.A. 9, 1967), *cert. granted*, is misplaced. That case held that invalidation of a state-approved merger of life insurance companies, on the ground that the proxy soliciting material used to secure shareholder approval violated anti-fraud provisions of the Exchange Act, would "impair" the state statutory procedures for such mergers. The offer and sale of insurance company stock, however, cannot be equated to the insurance business and is not covered by the McCarran Act. See *U.S.* v. *Meade*, 179 F. Supp. 868 (S.D. Ind., 1960); *S.E.C.* v. *American Founders Life Insurance Company of Denver, Colorado*, Civ. Action No. 6021 (D. Colo., May 7, 1958), where the order stated: "The offer for sale, sale and delivery of capital stock of insurance companies is not the business of insurance' within the contemplation of . . . [the McCarran ct.], and thus . . . is not exempt from the operation of the Securities Act . . . ."

[13] A distribution of securities comprises "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hand of the investing public." *Lewisohn Copper Company*, 38 S.E.C. 226, 234 (1958).

[14] Securities Act Release No. 4434 (December 6, 1961). See also *Capital Funds, Inc.* v. *S.E.C.*, 348 F.2d 582, 586 (C.A. 8, 1965), *aff'g Capital Funds, Inc.*, 42 S.E.C. 245 (1964); *S.E.C.* v. *Hillsborough Investment Corp.*, 276 F. 2d 665 (C.A. 1, 1960); *Ned J. Bowman Company*, 39 S.E.C. 879, 881 (1960).

Respondents assert that our staff advised registrant, in so-called "no-action" letters, that an intrastate exemption would be available for the proposed offering, and did not warn registrant that any sale to a non-resident would defeat such exemption nor mention resales to non-residents. However, those letters were based on the representation that the shares were proposed to be offered to residents, stated that the offering "may be" exempt if "limited to bona fide residents" who "acquire their shares for investment and not for resale to non-residents," and enclosed a copy of Securities Act Release No. 4434 which, as previously indicated, expressly states that if any part of the issue is offered or sold "directly to non-residents or indirectly through residents who as part of the distribution thereafter sell to non-residents," the exemption for the whole is defeated.

[15] *Cf. Aircraft Dynamics International Corp.*, 41 S.E.C. 566, 573 (1963); *Morris J. Reiter*, 41 *S.E.C.* 137,141 (1962).

The record further shows, as charged in the order for proceedings, that registrant bid for and purchased Hamilton stock during the distribution of the offering. Such bids and purchases are proscribed by Rule 10b–6 under Section 10(b) of the Exchange Act. However, the hearing examiner dismissed the charge of violation of these provisions because the Division failed to pursue it and we have determined not to consider such violation in assessing the sanctions to be imposed.

1964, before the company had sold any insurance, that he thought the stock had "extreme growth possibilities" and "could possibly hit 30" in four or five years, and advised another customer, who purchased 400 shares at 16½ on June 9 and 100 shares at 13⅝ on July 1, that the price would be 50 in 18 months. Two salesmen respectively represented to two customers who purchased a total of 310 shares in June 1964 at 12, 16¼ and 19, that the price could rise to "around" 30 within a year or two, and that the stock was "terrific" and he thought it would be selling at 23 or 25 in a short time. Another salesman told a customer, who purchased 100 shares at 19¼ on June 28, that there were "bets in the office" that the price would go to 27 by July 4. From May to July 1964, five other salesmen, in connection with sales of a total of 829 shares to five customers at prices which in one instance was 9¼ and otherwise ranged from 13 to 20, variously predicted price increases to 30, 40 or 100 within a year, or 30 or 40 by the end of the year.

Respondents assert that the testimony of the customers with respect to the above representations was vague and was contradicted by the testimony of Campeau and five of the salesmen, was adduced through leading questions, and was influenced in some cases by the fact that the customers had lost money on their investment. Respondents contend that the alleged price predictions were not fraudulent because they were couched in terms of opinion and customers were informed that the stock was speculative, and because Hamilton Life assertedly was organized after extensive studies and planning, had skilled personnel, and sold an exceptional amount of insurance during its first few weeks of operation beginning in May 1964. Respondents further assert that registrant's salesmen did not use high-pressure sales techniques, that registrant was not a boiler-room since most of the customer-witnesses had previous business or social relationships with registrant's salesmen, and that there is no evidence of other type of typical boiler-room misrepresentations or that the price predictions induced the purchases or were relied upon by the customer-witnesses, most of whom initiated the transactions.

The hearing examiner, who heard the witnesses and observed their demeanor, credited the customers' testimony, and we find no adequate basis in the record for disagreeing with his conclusions in that respect. Merely because a customer may have lost money is no reasons for rejecting his testimony, especially where the representations attributed to the salesmen by a number of customers are similar.[16] Nor do we think that the examiner abused his dis-

[16] See *Irving Friedman*, 43 S.E.C. 314, 321 (1967); *R. Baruch and Company*, 43 S.E.C. 13, 19, (1966); *A. J. Caradean & Co., Inc.*, 41 S.E.C. 234, 238 (1962).

cretion in permitting some leading questions by Division counsel.[17] The predictions of specific and substantial increases in the price of this speculative security were inherently fraudulent,[18] and it is irrelevant that such predictions were couched in terms of opinion and the customer was advised that the security was speculative,[19] or that the purchaser was a friend or former customer of the salesman[20] or initiated the transaction.

It is not necessary to establish that registrant's salesmen engaged in boiler-room or high-pressure tactics,[21] that the issuer had an adverse financial condition, that the price predictions induced the purchases and were relied upon by the customers,[22] or that other types of fraudulent representations were made.[23] Moreover, apart from the inherently fraudulent nature of the price predictions, Campeau and the salesmen had no reasonable basis for making them.[24] Although insurance sales by the company may have been above average in its first month or two of business in May and June 1964, in view of the fact that as noted in Hamilton Life's prospectus the sale of life insurance is highly competitive, it was uncertain whether such sales would continue or whether or when sales volume would be translated into an operating profit.[25]

We conclude that registrant, together with or willfully aided and abetted by Campeau, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b–5 and 15c1–2 thereunder.

2. *Failure to Disclose Common Control*

The hearing examiner found that between November 1963 and August 1964, registrant, Itin, and various of registrant's salesmen

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[17] See McCormick *Evidence* (1954), Section 6; II Wigmore, *Evidence* (3d ed. 1940), Section 770; *Robertson* v. *U. S.*, 249 F.2d 737, 742 (C.A. 5, 1957), *cert. denied*, 356 U. S. 919; *Mitchell* v. *U. S.*, F.2d 951, 956 (C.A. 9, 1954), *cert. denied*, 348 U.S. 912.

[18] See *A. T. Brod & Company*, 43 S.E.C. 289, 290, n.3 (1967); *R. Baruch and Company*, *supra*, at p. 18.

[19] *James De Mammos*, 43 S.E.C. 333, 336 (1967), *aff'd* C.A. 2, Docket No. 31469 (October 3, 1967); *R. Baruch and Company*, *supra*; *Alfred Miller*, 43 S.E.C. 235, 238 (1966), *aff'd* C.A. 2, Docket No. 31270 (January 4, 1968).

[20] See *Alfred Miller*, *supra*; *James De Mammos*, *supra*; *Arnold Securities Corp.* 42 S.E.C. 898, 901 (1966).

[21] See *Charles P. Lawrence*, 43 S.E.C. 607, 609 (1967), *aff'd* 398 F.2d 276 (C.A. 1, 1968).

[22] See *e.g.*, *A. T. Brod & Company*, 43 S.E.C. 289, 292 (1967); *Hamilton Waters & Co., Inc.*, 42 S.E.C. 784, 790 (1965).

[23] See *Arnold Securities Corp.*, 42 S.E.C. 898, 901 (1966).

[24] See *Aircraft Dynamics International Corp.*, 41 S.E.C. 566, 570 (1963): "A salesman who expresses an opinion about future market prices . . . impliedly represents that he has an adequate basis for such opinion. Absent such basis he violated his duty to deal fairly with customers and his implied representation is fraudulent."

[25] During its first month of operations beginning about May 5, 1964, Hamilton Life wrote nearly $15,400,000 worth of insurance, and by the end of the year it had $60,331,500 of insurance in force. It sustained an operating loss of $81,531 in 1964.

sold Hamilton Life stock to customers without disclosing, as required by Rule 15c1–5 under the Exchange Act, that registrant and Hamilton Life were under "common control." We find that Owens, Bruce, and Safford, who concededly controlled Hamilton Life, also controlled registrant, at least until early 1964.

Owens, Bruce, Safford, and another individual were the promoters of Hamilton Life, and Owens became chairman of the board, Bruce became president and a director, and Safford became vice-president and a director. Itin, about July 1962, had agreed to become a regional sales agent for the company. Because of the delay in securing state authorization for the public stock offering by the company and for conducting business, the substantial expenditures by the promoters, and the office lease and maintenance obligations incurred by Itin for his contemplated sales agency, Owens, Bruce and Safford agreed to join Itin in purchasing a majority of registrant's outstanding stock and thereby provide him with a source of current income from registrant to induce him to remain with Hamilton Life. They were also interested in supplementing their own income through their interest in registrant and ultimately selling such interest and realizing a capital gain. Between 75 percent and 80 percent of registrant's outstanding stock was acquired in August or September 1963, with Owens contributing $16,679, Bruce $6,885, Safford about $8,400, and Itin, according to his testimony, between $10,000 and $25,000. Itin became president and a director of registrant, and Bruce and Safford became directors on the seven-member board, which was reduced to five members on October 16, 1963, with Itin serving as chairman and he, Bruce, and Safford constituting a majority of the board. Owens had intended to become a director of registrant, but did not do so because of certain business or legal problems. However, he attended one or two of registrant's board meetings and he, as well as Bruce and Safford, received a confidential "Weekly Management Report" on registrant's operations, prepared by Itin, from January through at least July 1964.

Following Hamilton Life's incorporation in October 1963, Owens, Bruce, Safford, and Itin sought a replacement for Itin as president of registrant without success. In March 1964, Itin decided to give up the sales agency and remain with registrant, and Owens, Bruce, and Safford sold their stock interests in registrant to him. Itin gave each of them a personal 6 percent promissory note for the amount of his investment in registrant's stock, and it was agreed that registrant would pay monthly to each of them,

including Itin, a sum equal to $100 plus 1 percent of their respective investments in registrant. Pursuant to this arrangment, a total of $5,950 was paid by registrant between March and September 1964 to a company whose stock was owned equally by the four individuals and which had been formed as a means of pooling consulting and finders' fees. Owens, Bruce, and Itin testified that these payments were, in part, compensation for consulting services.

We do not agree with respondents that Itin, who was not a member of the control group of Hamilton Life, alone controlled registrant. The record establishes that Owens, Bruce, and Safford, in company with Itin and Reuter, who was also a member of registrant's board, controlled registrant, at least until they conveyed their stock interests in registrant to Itin in March 1964. In reaching this conclusion we have taken into account their business association with each other and with Itin before and after Hamilton Life was incorporated; their acquisition of the majority of registrant's outstanding stock; their participation in management decisions relating to Itin's compensation as president and to a possible replacement for him in that position, and in plans and activities affecting registrant; and the memberships of Bruce and Safford on the board of directors of registrant. Under the circumstances, it is unnecessary to decide whether common control continued after Itin's acquisition of the stock interests of Owens, Bruce, and Safford in registrant.

Respondents contend that, in any event, appropriate disclosure of control was made in that the confirmations of sales to customers stated that an officer of registrant was a director of Hamilton Life. The confirmations in the record which were used prior to April 27, 1964, when the trading began, did not contain any such disclosure, although that disclosure appears in subsequent confirmations. Even assuming, however, that such confirmations were used during the period when we have found there was common control, the disclosure was inaccurate since the fact was that two officers of Hamilton Life were directors of registrant, and it did not satisfy the requirement of Rule 15c1–5 that disclosure be made prior to the sale.[26]

We conclude that registrant, willfully aided and abetted by Itin,

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[26] See *Pennaluna & Company, Inc.*, 43 S.E.C. 298, 312, n. 23 (1967).

willfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-5 thereunder.[27]

II.

CONFIRMATION OF UNAUTHORIZED TRANSACTIONS
FALSE AND FICTITIOUS RECORDS

Between October 23, 1964, when a registration statement with respect to an offering of stock by Windsor Raceway Holdings Limited ("Windsor") was filed with us, and December 21, 1964, when the registration statement became effective, registrant, which was named as the underwriter, solicited indications of interest and offers to buy from customers.[28] Some of the persons solicited indicated their interest in purchasing stock and other made offers to buy. Upon the effective date, Itin instructed the salesmen to telephone all persons who had given "indications of interest" in order to "firm up" those indications. On that day and the next, registrant sent confirmations of sales to all persons who had given indications of interest or made offers to buy in alphabetical order, except those who the salesmen advised registrant did

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[27] We do not agree with the hearing examiner's conclusion that all the respondents are chargeable with the violations we have found of the anti-fraud provisions and, except for Reuter, of the registration provisions, on the grounds that they acted in concert in carrying out a plan to launch Hamilton Life in the insurance business and to provide a market for its stock, and that the unwarranted price predictions, the failure to disclose the existence of common control over Hamilton Life and registrant, and the offer and sale of unregistered stock to finance Hamilton Life were an integral part of such plan. The record does not establish concerted action by all respondents to engage in the fraudulent activities we have found, or to distribute the offering to non-residents.

Nor are any of the respondents whom we have not found to have committed certain of the violations chargeable with such violations, as urged by the Division, on the ground they failed to exercise adequate supervision. Inadequate supervision was not alleged in the order for proceedings, and, in view of Section 15(h)(5)(E) of the Exchange Act added by the 1964 amendments, which made inadequate supervision and independent ground for the imposition of a sanction, a failure of supervision cannot be held to constitute violations of other provisions which are charged as grounds for remedial action. Cases holding otherwise, *e.g.*, *Reynolds & Co.*, 39 S.E.C. 902, 917 (1960), preceded the 1964 amendments.

The hearing examiner also found manipulation of the market in Hamilton Life stock. Registrant dominated the wholesale and retail markets in the stock, which imposed a special obligation on it to avoid any market-making activities which would affect the market artificially within the meaning of the anti-fraud and the anti-manipulation sections of the Act and implementing rules. While registrant's market-making activities raise questions whether it fulfilled this obligation and whether its activities were not colored by a desire to stimulate retail demand by moving market prices upward, in view of our disposition of the other issues in this case, we do not find it necessary to deal further with this issue.

[28] Section 5 of the Securities Act permits offers to sell but not sales of a security during the pre-effective waiting period. Section 2(3) of that Act defines "offer to sell" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security." The solicitation of an "indication of interest" is in effect an "offer to sell" within the meaning of Section 2(3), but not in the common law sense, and a mere indication of interest does not amount to an offer to buy. Such indications must be "firmed up" after the registration statement becomes effective, which is commonly done by making a common law offer to sell and securing the customer's acceptance. See 1 Loss, *Securities Regulation* (1961 ed.) p. 224.

not wish to purchase.[29] Accordingly confirmations were sent to a number of persons who had given indications of interest buy had not been reached by the salesmen.[30] When payments were not forthcoming from persons who had received confirmations registrant, on January 19, 1965, sent telegrams to many of them, including persons who had not agreed to purchase, stating that unless payment was received by the following day the stock would sold for the customer's account and the customer would be liable for any resulting loss to registrant.[31]

Registrant and Itin contend that the testimony of the customer-witnesses in these respects should not be accepted because it was inconsistent, and in many cases influenced by the customers' irritation at receiving the telegrams mentioned above. However, we find no adequate basis in the record for disagreeing with the hearing examiner's decision to credit that testimony; moreover, such testimony was in part corroborated by a saleswoman.[32]

Itin should not have caused registrant to send confirmations in alphabetical order to all persons other than those who had told the salesmen they did not wish to purchase. He must have realized that the salesmen could not possibly reach all persons who had submitted indications of interest before the confirmations were sent to them, especially since some of the salesmen had more than 100 persons to call.

Those confirmations and telegrams that were sent to persons who had not agreed to purchase the stock were false in representing that a sale had taken place. In that respect, registrant, together with or willfully aided and abetted by Itin, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b–5 and 15c1–2 thereunder.[33] The use of such confirmations and telegrams and the entering of "sales" and cancellations of such "sales" for nonpayment upon the records of registrant also constituted the making of false and fictitious records and entries. In those respects, registrant, willfully aided and abetted by Itin,

[29] Two persons who had informed their salesman that they did not wish to purchase the stock testified that they nevertheless received confirmations.

[30] One of the persons had not affirmatively indicated any interest and another had stated he had no interest. Both merely had acquiesced in the salesman's suggestion that he "set aside" stock for them with "no obligation."

[31] Registrant had accepted cancellations through January 8, 1965, from persons who received confirmations.

[32] A saleswoman for registrant testified that she had obtained "indications of interest" from about 150 customers, but realizing that she would be unable to reach all of them in a single day, made no attempt to reach those who she believed "would not cancel." Altogether, she spoke to 25 or 30 customers on December 21 and to about 85 customers thereafter.

[33] See *R. A. Holman & Co., Inc.* v. *S.E.C.*, 366 F.2d 446, 451 (C.A. 2, 1966), *aff'g R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 876 (1965); *Shelley, Roberts & Company of California*, 38 S.E.C. 744, 751 (1958).

willfully violated the record-keeping provisions of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder.[31]

III.

OTHER MATTERS

Respondents contend that the conduct of the investigation and hearings deprived them of due process. They assert that the Division induced customers to give biased statements during the investigation which were used to refresh the customers' recollection before they were called to testify and respondents were denied an opportunity to examine the statements until after the Division's direct examination of the customers. Respondents further complain because their requests for a list of Division witnesses before the commencement of hearings were denied. In addition, registrant and Itin contend that the Division investigators improperly failed to interview salesmen of registrant with respect to statements obtained from their customers, and "turned their backs on witnesses and material" which might be favorable to these respondents or to name as a respondent, interview or call as a witness a former senior vice president of registrant who had been syndicate manager of the Windsor offering and was assertedly the "only" person in the firm with first-hand knowledge of all the facts relating to such offering.

There is no substance to these contentions, and in any event, no prejudice was shown. The record does not indicate any impropriety by the Division in obtaining statements from customers, and those statements were properly used to refresh their recollection.[35] Production of such statements for use in impeaching the witnesses was not required until after direct examination.[36] Nor was the Division required to furnish respondents with a list of its proposed witnesses.[37] In fact, the Division offered to furnish to counsel for each of the respondents the names of its witnesses scheduled to be called the following day, as well as the pre-hearing statements made by them, on condition that the contents of such statements and the names of the witnesses not be disclosed to counsel for the other respondents or discussed with the witnesses before they testified. Only counsel for Campeau agreed to this condition. Moreover, it does not appear that upon

[34] See *P. J. Gruber & Co., Inc.*, 38 S.E.C. 171, 173 (1958); *Shelley, Roberts & Company of California, supra.*

[35] See III Wigmore, *Evidence* (3rd ed. 1940), Sections 758–62; McCormick, *Evidence* (1954), Section 9; *David T. Fleischman*, 43 S.E.C. 371, 384 (1967).

[36] *Ibid.* See Rule 11.1 or our Rules of Practice.

[37] *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967), *aff'g F. S. Johns & Co., Inc.*, 43 S.E.C. 124, 141 (1966).

the production of prior statements, counsel for respondents were denied sufficient time to review the statements before commencing cross-examination.

The Division in collecting and presenting evidence and recommending the institution of proceedings has considerable discretion in determining which persons to interview and call as witnesses and which in its opinion should be named as parties, and registrant and Itin were of course free to call any person as a witness if they wished to do so. We see no basis for assuming that the Windsor syndicate manager, because of alleged personal differences with Itin, would not have responded to questions by registrant's counsel with the same candor as he would have to questions by Division counsel. And if, as registrant and Itin assert, his testimony were essential to their defense but they could not afford the expense of bringing him from the city of his employment to testify, they could have applied pursuant to Rule 15 of our Rules of Practice to take his deposition, but they did not do so. Moreover, it is apparent from the lengthy testimony of Itin and other personnel of registrant regarding the Windsor offering that the syndicate manager was not the only person with knowledge of the pertinent facts.

PUBLIC INTEREST

In view of the willful violations we have found on the part of registrant, Itin, Campeau, and Owens, we must determine whether it is necessary or appropriate in the public interest or for the protection of investors to impose sanctions upon them.

Various factors have been urged in mitigation as warranting the imposition of no sanction or a lesser sanction than was imposed by the hearing examiner. Itin asserts that he was inexperienced, that he frequently sought the advice of our staff and relied upon counsel, that he cooperated with our staff during the investigation, and that he and registrant have suffered expense, a loss of business, and damage to their reputations as a result of these proceedings. Campeau also cites the expense of these proceedings and the damage to his reputation and states that he has not been in the securities business since January 1965. Owens asserts that the Section 5 charges are "technical," that he was not aware he was committing any violation, that there is no evidence that any of the purchasers in the original offering were damaged, that he cooperated in our staff's investigation, and that he has suffered financial injury and damage to his reputation.

After careful consideration of these factors, we have determined that they are not sufficient to overcome the misconduct we

have found. The extensive violations by registrant and Itin demonstrate gross indifference to the requirements of the securities laws and are inconsistent with their continued engagement in the securities business. Campeau, despite his responsibilities as registrant's executive vice-president and sales manager, personally made extravagant and unwarranted price predictions to customers. Owens failed to use due care to confine the sales of the Hamilton Life stock offering to residents, and we cannot agree with his characterization of the registration requirements of Section 5.

Moreover, these are not the only disciplinary proceedings against registrant, Itin and Campeau. In 1966, we upheld the action of the NASD censuring them and fining registrant $1,700 for failure to comply with our net capital and bookkeeping requirements and to disclose to customers that registrant was acting for both the buyer and seller, and for unlawfully extending credit to customers.[38] We note that most of these violations of the NASD's Rules of Fair Practice occurred during the period involved in the instant proceedings. In addition, in October 1964, Campeau's license as a salesman was suspended for 60 days by the Michigan securities commission, following a hearing before it, because he caused unissued stock of a broker-dealer firm of which he was president to be sold to persons other than those listed in his filing with that commission.[39]

Under all the circumstances, we agree with the hearing examiner that registrant's broker-dealer registration should be revoked and that it should be expelled from membership in the NASD and the Detroit Stock Exchange. We also conclude that Itin should be barred from association with a broker-dealer with the understanding that, upon an appropriate showing, he may become associated with a broker-dealer in a non-supervisory capacity after one year, subject to adequate training and supervision. However, we do not agree with the examiner that Campeau should be accorded leni-

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[38] 43 S.E.C. 73 Campeau asserts that the findings against him in those proceedings should not be considered since he was not represented by separate counsel. However, we cannot attribute any mitigative effect to the fact that his counsel also represented the other respondents. He further asserts that since our decision was not introduced in evidence (it was issued after the hearings in the instant case), he had no opportunity to "explain or defend." But any defense should have been presented to the NASD and to us. See *Kaye, Real & Company, Inc.*, 36 S.E.C. 373, 375 (1955). In *R. H. Johnson & Company*, 36 S.E.C. 467, 487 (1955), *aff'd per curiam* 231 F.2d 523 (C.A.D.C., 1956), *cert. denied*, 352 U.S. 844, we took official notice of other disciplinary action against the respondent, and on appeal, respondent unsuccessfully contended that in doing so we had improperly considered matter outside the record. See also *R. H. Johnson & Company*, 33 S.E.C. 180, 187 (1952), *aff'd* 198 F.2d 690 (C.A. 2, 1952), *cert. denied*, 344 U.S. 855.

[39] Campeau asserts that the violation resulted from the state commission's advice to his attorney, and that a court action by him to enjoin enforcement of the suspension order was settled with the action being dismissed and the suspension being deemed to have run during a period when he was not engaged in the securities business.

ency, and we conclude that he should be barred. Although Owens' transactions with respect to the Hamilton Life stock offering were sufficient to defeat the intrastate exemption, he was not shown to have engaged in any fraudulent activity, and these are the first disciplinary proceedings against him. We conclude that he should be censured. In view of our disposition of the issues in the case, the proceedings as to Reuter, Bruce and Safford will be discontinued.[40]

An appropriate order will issue.

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

[40] The exceptions to the initial decision of the hearing examiner by the parties are overruled or sustained to the extent they are inconsistent or in accord with our decision.