ADMINISTRATIVE PROCEEDING
FILE NO. 3-503

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
LANGLEY-HOWARD, INC. (8-3349) JOHN A. HOWARD MARK E. O'LEARY THEODORE BARNETT RICHARD A. SORENSON WILLIAM R. STEIGERWALD	

INITIAL DECISION

Washington, D.C.
May 1, 1967

Sidney Ullman
Hearing Examiner

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APPEARANCES: For the Division of Trading and Markets:

Alexander J. Brown, Jr., Administrator, Washington Regional Office, William R. Schief and Burton H. Finkelstein, Attorneys, Washington Regional Office, Thomas N. Holloway, Division of Trading and Markets.

For the Respondents:

James E. McLaughlin and William R. Caroselli, of McArdle, Harrington, Feeney & McLaughlin Frick Building, Pittsburgh, Pennsylvania

BEFORE: Sidney Ullman, Hearing Examiner

I. NATURE OF THE PROCEEDINGS

These are public proceedings instituted by the Commission by an order and notice of hearing ("Order") issued pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the respondents violated certain provisions of the securities laws and rules thereunder, and if so, what,if any, remedial action is appropriate in the public interest.

The Order asserts that as a result of an investigation, the Division of Trading and Markets ("Division") has obtained information which tends to show such violations by the registrant, Langley-Howard, Inc., by John A. Howard, its president, and Mark E. O'Leary, a director of registrant, as well as by registrant's salesmen, Theodore Barnett, Richard A. Sorenson, and William R. Steigerwald. The violations are alleged to have occurred in connection with the offer and sale of the common stock of two corporations, viz.,The Onego Corporation ("Onego") and Bahamas Hotel Corporation ("Bahamas").

As to the Onego stock,the Order alleges that in connection with its offer and sale the respondents singly and in concert wilfully violated and wilfully aided and abetted violations of the provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder, commonly known as

the anti-fraud provisions,[1/] in offering and selling shares of Onego over-the-counter at prices which were excessive and unreasonable, and in making false and misleading statements of material facts and omitting to state necessary material facts concerning the Onego shares to customers and prospective customers. This charges, in essence, that respondents sold Onego to investors at excessive mark-ups over the prices prevailing in the over-the-counter market,during the period from January 3, 1962 to approximately June 30, 1964, without disclosing the mark-ups to their customers.

With respect to the Bahamas stock, the Order alleges that from approximately May 1, 1964 to approximately December 31, 1965, the respondents wilfully violated and wilfully aided and abetted violations of the anti-fraud provisions singly and in concert with each other in offering and selling this stock by means of an offering circular, an addendum thereto, financial statements, sales literature, and other representations which contained false and misleading statements of material facts and omitted to state material facts concerning that stock. The Order also charges that the Bahamas stock was offered, sold and delivered in violation of Sections 5(a) and 5(c) of the

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1/ The composite effect of the anti-fraud provisions, as applicable to this proceeding is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device to defraud, an untrue or misleading statement of a material fact, or any act, practice or course of business which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

Securities Act, inasmuch as no registration statement had been filed with the Securities and Exchange Commission or was in effect with respect to these securities. 2/

Respondents denied the alleged violations in their answer filed in response to the Order. Following a pre-hearing conference in Washington, D.C., a hearing was held before the undersigned in Pittsburgh, Pennsylvania, during which extensive testimony and voluminous exhibits were introduced into evidence in support of the positions of the respective parties. Thereafter, the parties submitted proposed findings of fact, conclusions of law, and briefs in support thereof, and in accordance with a request by counsel for the respondents, oral argument subsequently was had before the undersigned.

The findings of fact and conclusions of law herein are based upon the record in the proceedings, including the exhibits, on the post-hearing documents filed on behalf of the parties and the oral argument, and on my observation of the individual respondents and of the many witnesses who testified during the hearing.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

Registrant

Registrant is a Pennsylvania corporation which became registered with the Commission as a broker-dealer in 1953 and remains so

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2/ Section 5(a) and 5(c) of the Securities Act, in pertinent part, make it unlawful to use the mails or facilities of interstate commerce to sell or deliver after sale any security unless a registration statement is in effect as to such security, or to offer to sell a security unless a registration statement has been filed as to such security.

registered, although the firm ceased doing business on or about December 31, 1965. It is a member of the National Association of Securities Dealers ("NASD"), a national securities association registered pursuant to Section 15A of the Exchange Act.[3/] During the period covering the charges in this proceeding, registrant's offices were located at 2 Gateway Center and at 3 Parkway Center in Pittsburgh.

Since December 1956, Howard has been the president and secretary of registrant as well as a director and owner of more than 10% of its common stock. At all times during the period involved in the charges, Howard dominated and controlled the business affairs of registrant.

O'Leary was employed by registrant as a registered representative or salesmen from 1955 to the termination of business at the end of 1965. He has also served as a director of the firm since January 1961.

3/ One of the issues in this proceeding is whether, under the provisions of Section 15A of the Exchange Act, registrant should be suspended or expelled from NASD membership for the violations alleged. In an earlier proceeding before the NASD it was found that respondents sold securities at unfair prices in violation of NASD Rules of Fair Practice, and on November 10, 1965, the Board of Governors of that Association expelled registrant from membership, revoked Howard's registration, and suspended the registration of the other respondents.

On application to the Commission for review, the Commission on October 26, 1966, affirmed the sanctions against registrant and Howard but set aside the sanctions against all other respondents. In the Matter of the Application of Langley-Howard, Inc., Securities Exchange Act Release No. 7986.

The Commission's decision with respect to the sanctions against registrant and Howard is the subject of an appeal now pending before the Court of Appeals of the District of Columbia. Accordingly, the matter of sanctions against registrant under Section 15A is not at this time a moot issue in this proceeding.

Steigerwald acted as registrant's "trader" for several years prior to the cessation of the business, and he and Barnett and Sorenson were for several years registered representatives of the firm.

Onego Transactions and Mark-Ups

Onego stock was marketed by registrant over a long period of time and in very substantial quantities. Mr. Howard testified that registrant underwrote a Regulation A offering of the stock in 1954, and another offering in 1955 which was registered with the Commission under the Securities Act. Following the initial underwriting registrant made and continued to make a market in Onego, and during the pertinent period during which Onego violations are asserted, January 3, 1962 through June 30, 1964, registrant entered "bid" and "asked" quotations almost daily in the National Daily Quotation Sheets ("pink sheets"). Howard also testified that other brokers quoted the stock in the pink sheets, and that those others who quoted it consistently were "trading brokers" who, unlike registrant, generally did not sell the stock to retail customers. During the pertinent period registrant's bid generally was the highest in the pink sheets, with the bid of the "trading brokers" usually 1/8 of a point under registrant's bid, according to Howard's testimony.

The parties stipulated that respondents used the mails during the pertinent period in connection with the offers, sales and delivery of Onego stock to customers. Counsel for respondents

conceded during the hearing that neither the mark-ups nor the profits of registrant were discussed with any customer, and it was stipulated that those investor-witnesses who testified at the hearing had not been advised of these matters. It was further stipulated that at all times Howard was in full charge and control of registrant's pricing policies and practices, and that he fixed the prices the firm paid and received for the stock.

To support its contention that registrant's sales activity almost consistently reflected excessive and unreasonable mark-ups, the Division introduced into evidence schedules of registrant's transactions in Onego stock during the pertinent period. It predicates its position on substantial differences between the "contemporaneous costs" of the stock to registrant and the sale prices.

In computing mark-up percentages alleged to be excessive and unreasonable, the Division used as registrant's contemporaneous costs of Onego stock on a particular day, the highest price paid by registrant on that day, regardless of any purchases on that day at lower prices. Where no purchases were made on the particular day, purchases on the preceding business day (or the day or two preceding that, if necessary) were analyzed, and the highest price of any purchase on such day was used. In the large majority of transactions with respect to which alleged excessive mark-ups were charged, the Division was able to use "same day" purchases

as the contemporaneous cost.[4/]

The schedules show that during this 30-month period registrant bought approximately 800,000 shares of Onego, generally from brokers but on occasion from customers, and usually at registrant's bid quotation in the pink sheets. The prices paid by registrant sometimes remained constant for days at a time. During this period, registrant had only 11 transactions involving sales to other broker-dealers of 63,000 shares of Onego, but it had 904 transactions involving sales of approximately 754,670 shares to retail customers. It is the bulk of these retail sale transactions which constitute the basis for the charges asserted against respondents.

Of the 904 sale transactions, registrant's mark-up over contemporaneous cost was at least 9.09% in 873 transactions involving 730,120 shares, and these mark-ups ranged from 9.09% to 100% over contemporaneous cost. The Division's summary schedules show that proceeds from these 873 sales approximated $606,000, and that based upon contemporaneous costs the transactions produced total dollar mark-ups of $128,797.67. Following is a chart reflecting further on the 873 sale transactions, disclosing

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4/ Division's accountant-investigator prepared the schedules from registrant's original order tickets and from its copies of confirmations to purchasers and its trading accounts.

both the percentage mark-ups and the dollar mark-ups based on contemporaneous costs:

Percentage of Mark-Up	Number of Sales	Dollar Mark-Up
9.09 - 19.99	85	$ 10,164.06
20.0 - 29.99	394	52,600.39
30.0 - 39.99	164	24,926.44
40.0 - 49.99	138	23,272.40
50.0 - 100.0	92	17,834.38
	873	$ 128,797.67

The testimony also indicated that 40 of the sales involved dollar mark-ups of $500 or more, ranging from $500 to $1,250, and that these 40 transactions covered 118,000 of Onego, for an average of approximately 2,950 shares per transaction, and having an average percentage mark-up of 35.278% and an average dollar mark-up of approximately $633 per transaction.

Registrant does not dispute the mathematical computations of the Division in reflecting mark-ups over contemporaneous costs. However, it does dispute the Division's contention that registrant's contemporaneous costs of Onego stock reflected the fair market price of the security, and it urges, further, that the Division's concept of reasonable mark-ups is not in consonance with practice in the broker-dealer industry.

The theory that contemporaneous costs of a dealer may serve as an appropriate base upon which to compute the reasonableness of mark-ups has been followed by the Commission and endorsed by the courts in a host of proceedings, some of which were based on the NASD Rules of Fair Practice, which prohibit a securities transaction with a customer at a price not reasonably related to the current market price,[5/] while others were based on the anti-fraud provisions of the securities laws.[6/] In both types of proceedings the use of contemporaneous costs as an appropriate base has been held by the Commission to reflect recognition of the fact that absent countervailing evidence, the prices paid by a broker-dealer for a security in actual transactions closely related in time to his sales are normally a highly reliable indication of the prevailing market price, and this position has been affirmed by the courts.[7/]

5/ e.g., Naftalin & Co., Inc., Securities Exchange Act Release No. 7220 (January 10, 1964); J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7334 (June 5, 1964); Gateway Stock and Bond, Inc., Securities Exchange Act Release No. 8003 (December 8, 1966); Thill Securities Corporation, Securities Exchange Act Release No. 7342 (June 11, 1964).

6/ e.g., J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964); Powell & McGowan, Inc., Securities Exchange Act Release No. 7302 (April 24, 1964); Advanced Research Associates, Inc., Securities Exchange Act Release No. 7117 (August 16, 1963); Manthos Moss & Co., Inc., 40 S.E.C. 542 (1961); Lawrence Rappee, 40 S.E.C. 607 (1961).

7/ Samuel B. Franklin & Co. v. S.E.C., 290 F.2d 719 (C.A. 9, 1961), cert. denied 368 U.S. 889; Associated Securities Corporation, 40 S.E.C. 10 (1960), aff'd 283 F.2d 773 (C.A. 2, 1960); Charles Hughes & Co., Inc., 13 S.E.C. 676 (1943), aff'd 139 F.2d 434 (C.A. 2, 1943), cert. denied 321 U.S. 786; Merritt Vickers, Inc. v. S.E.C., 353 F.2d 293 (C.A. 2, 1965).

The Commission has so often and so recently stated this theory that respondents do not at this stage of the proceeding urge its rejection. On the contrary, their brief states, referring to the recent decision of the Commission affirming NASD sanctions imposed against both registrant and Howard for excessive mark-ups charged by registrant, (see n. 3, supra):

> "In view of the most recent decision on this question in a case involving this registrant and these respondents it would be an exercise in futility to make another frontal attack on the Commission's consistent application of the theory of contemporaneous cost to over the counter mark up cases. This in no way implies an abdication of our position on the point, but is merely a recognition that at this juncture, in this proceeding, it does not admit of much fruitful debate. Accordingly, our discussion of this point will be directed to areas more susceptible of debate at the trial level."

The effort, then, is directed against the Division's case because of: (1) the asserted inability of the Division's accountant-investigator to explain, on cross-examination, certain "fundamental principles upon which the schedules were prepared, (2) the failure of the schedules to include, and of the Division to indicate, the hour and minute at which the purchase and sale transactions were executed as well as the inventory positions of registrant at the times of execution, and (3) the asserted lack of any sufficiently clear standards on mark-ups to support the Division's contention. Conversely, registrant contends that its mark-ups in Onego were consistent with industry practice.

These arguments must be and they are rejected. Firstly, the accountant-investigator, although employed in that capacity for many years by the Commission and thoroughly experienced in his work, was not engaged or expected to fashion the Division's theory of its case, nor was it necessary that he comprehend the legal implications of the theory. Secondly, the absence, from the schedules and testimony, of indications of the time of execution of the purchase and sale transactions and of the inventory positions of registrant in Onego in no way militates against the appropriateness of using the contemporaneous costs of registrant as the proper basis on which to compute its mark-ups or indicates that these costs (the highest paid on any day) did not fairly reflect prevailing market prices. 8/

Thirdly, the efforts made by registrant to prove a lack of adequate standards and to prove that its mark-ups in Onego were consistent with industry practice in over-the-counter purchases and sales were unsuccessful. Evidence was introduced to show purchase and sale transactions engaged in by and on behalf of registrant with various broker-dealers in Pittsburgh and Philadelphia who were unaware of the purpose of the transactions. These purchase and sale transactions had been engaged in by O'Leary and others in connection with registrant's preparation of a defense against the charges

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8/ In fact, the schedules contain substantial information on the inventory positions of registrant at various times, and Howard's testimony also reflects on its positions in Onego and on the basic practices registrant followed in marketing the stock. Consideration has been given to this evidence, but it does not persuade against the Division's contentions or the use of the schedules.

in the NASD proceedings (see n. 3) and they obviously were designed by registrant to produce for the several participating brokers excessive mark-ups over their contemporaneous costs. Evidence of the transactions was not received in the NASD proceedings: however, it was received in the instant proceedings, over objections of the Division predicated on lack of relevance and materiality, despite the fact that the transactions were in low-priced speculative securities other than Onego. It was principally under the theory that if registrant's activity in Onego was found to be consistent with industry practice, this could be material with respect to sanctions, in the event respondents were found to have violated the law in selling Onego.

It is unnecessary to discuss in detail these various "staged" transactions, or to analyze at this time either the similarities urged by respondents between the transactions of the Pittsburgh and Philadelphia broker-dealers, on the one hand, and those of registrant in Onego, on the other, or, conversely, to discuss such dissimilarities as are urged by the Division, including the isolated or sporadic trading activity in the stocks involved in "staged" transactions, or the asserted propriety of several of the mark-ups under the particular circumstances of those "staged" transactions. Even disregarding the conditions under which these transactions took place, initiated as they were by registrant's agents and lacking entirely the element

of negotiation which normally inheres in trading operations between broker-dealers, the evidence reflected no industry practice with respect to mark-ups which can be equated to the practice of registrant in its transactions in Onego. The evidence not only fails factually to support registrant's position that its Onego mark-ups were consonant with industry practice, but it also fails factually to indicate an absence or lack of standards sufficiently clear to support fraud violations predicated upon the selling methods which registrant followed. 9/

9/ Moreover, in affirming the sanctions imposed against registrant and Howard in the NASD proceedings, the Commission referred to registrant's contention that the NASD had thwarted its attempt to demonstrate that the NASD's so-called 5% mark-up policy is not followed by the industry, saying:

> "We are also of the opinion that, even if introduced the information sought would have no bearing upon the mark-up violations charged. There are many NASD and Commission precedents in mark-up cases, and the material requested would merely show that other dealers were or were not engaged in charging unfair prices."

In support, the Commission cited Amsbary, Allen & Morton, Inc., Securities Exchange Act Release No. 7834 (March 7, 1966), where it had said:

> "Applicants, however, cannot in our opinion justify the mark-ups taken here by pointing to mark-ups of other firms which, if charged in circumstances comparable to those present here, would be excessive under established standards."

Cf. C.A. Benson & Co., Inc., Securities Exchange Act Release No. 7346 (June 15, 1964), at page 6, where the Commission said, regarding a contention that other broker-dealers had used the same false literature as respondent:

> "It is immaterial that others may also have violated the NASD's rules and have not yet been reached by the enforcement machinery."

The evidence does seem to show that some of the broker-dealers were not selling low-priced securities in fair relation to market prices and at least two witnesses engaged in over-the-counter trading did not understand the mark-up policy of the NASD, although their firms are members of that Association.[10/] But there is no credible evidence that each and every one of the "staged" transactions in which registrant engaged was the subject of testimony in this proceeding, and in any event the evidence which was introduced fails to reflect any sufficiently widespread or uniform pattern of trading or any industry practice which could constitute a basis even for the mitigation of sanctions against registrant for flagrant and persistent violations of law in its selling practices.

The contention of registrant,obdurately followed in its business operations, that it was proper and in consonance with established industry practice for registrant, as an integrated broker-dealer and a dominant market-maker in Onego, to sell the stock to retail customers at its inside wholesale offer or its "asked" quotation in the pink sheets is rejected.[11/] In summary, under all of the circumstances, the evidence and the arguments of respondents fall short of constituting

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10/ The lack of uniform understanding of certain aspects of the NASD's mark-up policy among broker-dealers and even among officials of that Association was discussed in the Commission's Report of Special Study of the Securities Markets, H. Doc. 95, 88th Cong., 1st Sess., Pt. 2,Ch. VII, pp. 654-655 (1963). Obviously, the education of broker-dealers in these areas is yet far from complete. The evidence also indicated that there is no uniform understanding in the industry of the meaning of the term "mark-up".

11/ See General Investing Corporation, Securities Exchange Act Release No. 7316 (May 15, 1964); Costello, Russotto & Co. Securities Exchange Act Release No. 7729 (October 22, 1965).

countervailing evidence or proof that registrant's contemporaneous costs as disclosed in the Division's exhibits did not in fact reflect the prevailing market prices of Onego, and they fail to indicate that any industry practice exists which would dictate or suggest a departure from the principles so frequently enunciated and followed by the Commission and the courts in computing mark-ups.

That the mark-ups of registrant, ranging from a percentage of 9.09% to 100% were excessive, absent countervailing evidence or unusual circumstances, is not expressly disputed by respondents. The Commission has found in broker-dealer revocation proceedings that mark-ups over the prevailing market of lesser percentages than the 9.09% here involved were fraudulent.[12/] The Division has presented and argued its mark-up case on the accepted theory that fraud lies in the failure of the broker-dealer to adhere to an implied representation which he makes to his customers that they will be dealt with fairly. On this, the court said in Charles Hughes & Co. v. Securities and Exchange Commission, supra at n. 7, that the broker has

> "a special duty, in view of its expert knowledge and proffered advice, not to take advantage of its customers' ignorance of market conditions."

And in Duker & Duker, 6 S.E.C. 386 (1939) the Commission said:

> "It is neither fair dealing, nor in accordance with such standards, to exploit trust and ignorance for profits far higher than might be realized from an informed customer. It is fraud to exact such profits through the purchase or sale of securities while the representation on which the relationship is based is knowingly false. This fraud

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12/ 5% in Linder, Bilotti & Co., Inc., Securities Exchange Act Release No. 7738 (November 5, 1965); 5.2% in J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964); 5.4% in Powell & McGowan, Inc., Securities Exchange Act Release No. 7302 (April 24, 1964); 9% in Seaboard Securities Corporation, Securities Exchange Act Release No. 7967 (September 30, 1966).

> is avoided only by charging a price which bears a reasonable relation to the prevailing price or disclosing such information as will permit the customer to make an informed judgment upon whether or not he will complete the transaction."

Registrant argues that the confirmations sent to customers purchasing Onego during and after September 1963 contained not only the purchase price but also registrant's bid price as indicated in the pink sheets,[13/] urging that no fraud could occur where the customers were so informed. The Division asserts that this practice did not begin "until after approximately 700 of the 873 sales involving excessive mark-ups had already taken place." Examination of the exhibits indicates that 656 of the transactions occurred prior to September 1963. In any event, I do not believe that the insertion in a confirmation of a cryptic notation such as "1/2 Bid", without more, is sufficiently meaningful to a retail customer to constitute notice or advice that 1/2 is the currently prevailing market price of the stock and that the broker-dealer's mark-up is the difference between such bid and the price being charged. And this is certainly not the disclosure which would permit the customer to make an informed judgment with respect to the transaction.[14/] Accordingly, I conclude that

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13/ Howard so testified. Also, registrant introduced into evidence its office copies of confirmations for Onego sales sent to purchasers during the period beginning September 3, 1963 and ending October 31, 1963, on the large majority of which was a notation with regard to a bid, such as, for example, "1/2 Bid."

14/ The layman's inability to comprehend the complex and esoteric aspects of reasonable mark-ups in over-the-counter transactions is evident from the Commission's Report of Special Study of Securities Markets, n. 10, supra, at 645.

Cf. William J. Stelmack Corporation, 11 S.E.C. 601 (1942).

the 873 sales of Onego to retail customers were at excessive and unreasonable mark-ups and violated the anti-fraud provisions of the securities acts and the rules thereunder.

Registrant's mark-up violations were clearly the responsibility of Howard, who controlled the business and determined its pricing practices. The Division also urges that respondents O'Leary, Steigerwald, Barnett and Sorenson acted in concert with registrant in selling Onego stock in fraud of its customers, contending that each of these respondents knew of the contemporaneous costs of the stock and the selling prices, and accordingly is chargeable with the fraudulent sales. In support of the argument that these men knew the mark-ups, the Division points out that Steigerwald was the firm's trader, that O'Leary, Barnett, Sorenson and Steigerwald were responsible for a total of 699 of the transactions involving excessive mark-ups in Onego during the pertinent period, and that their respective commissions were 50% of the difference between the price registrant paid for Onego stock and the price charged customers.

In the NASD proceeding it was undoubtedly evident that these salesmen had transacted the large majority of the improper sales there considered, and the Commission, in its review, evidently weighed evidence similar to that which was presented here with regard to the commissions received by the salesmen, for it stated in this regard:

> "On the basis of this record, however, it is not clear whether the compensation received by the member's salesmen should have put them on notice that the mark-ups were or might be unfair. As a rule, the salesmen

> did not receive fixed commissions on their sales. Instead, at the end of the month, they were paid a percentage of the member's monthly gross profit on the stock or stocks in question which figure included profit or loss on the inventory positions in such stocks held by the member at the end of the month." 15/

Perhaps even more significantly and more meaningfully, the Commission then said, on the issue of a salesman's responsibility for excessive mark-ups charged by his employer in selling at its "offer" in the pink sheets, as was done by registrant in Onego:

> ". . . But irrespective of the amount of compensation they received, there is no evidence in the record that they knew or should have known that generally no interdealer sales were effected by the member or other dealers at or about the offers quoted in the sheets and therefore that those offers were not fairly representative of the current market.
>
> "Nor do we think that O'Leary should bear responsibility for unfair prices merely because of the position he occupied. O'Leary was a nominal director and had no proprietary interest in the member, and the record shows that Howard alone was responsible for fixing the member's mark-ups and making all policy decisions."

I find no sufficient variance in the evidence in this proceeding from that which seems to have been presented in the NASD proceeding to warrant a conclusion with respect to the liability of the salesmen for the improper mark-ups in Onego contrary to that reached by the Commission in the NASD proceeding. 16/

15/ Some of the mark-ups in the NASD proceeding involved sales of Onego stock which occurred during a ten-month portion of the thirty-month pertinent period involved in the Onego aspect of this proceeding.

16/ As pointed out in respondents' brief, the NASD moved before the Commission that there be no stay of the disciplinary action imposed by the NASD, pending appeal to the Commission. In denying the motion the Commission pointed out that ". . . neither the NASD nor this Commission has generally held salesmen responsible for unfair prices charged by their firm." Langley-Howard, Inc., et al., Commission Opinion of January 10, 1966, Administrative Proceeding No. 3-426.

Conversely, I find that absent control and evidence of knowledge of violations by the salesmen, including O'Leary, their participation in the mark-up violations of registrant should not be deemed wilful. Cf. Shiels Securities, Inc., Securities Exchange Act Release No. 7339 (June 11, 1964); Lloyd, Miller and Company, Securities Exchange Act Release No. 7440, (June 11, 1964).

Bahamas

Early in 1964, in discussions with George Murdock and Harry Siegel, Howard learned of a hotel on Bimini Island under lease to and operated by Bimini Hotel, Ltd. ("Bimini"), a Bahamian corporation. Bimini also had an option to purchase the hotel and clubhouse property for $165,000 until July 30, 1964 and for $150,000 during the remainder of the leasehold, which ran to January 30, 1969. Howard knew that the hotel was being operated unsuccessfully and on a minimal basis by Bimini, and that it was in need of extensive rehabilitation, but he believed that the property could be acquired at a bargain price by exercising the option to purchase.

At some time prior to May 15, 1964, Murdock, Siegel, and Howard on behalf of registrant, acquired rights to the twenty shares of Bimini's outstanding common stock, and registrant thus acquired ten of those shares by payment of the sum of $28.00. Registrant then made a loan of approximately $40,000 to Bimini, and with a view to either operating the hotel or acquiring the physical property and subsequently reselling it, Howard initiated the organization of Bahamas on May 15, 1964, as a Pennsylvania corporation with an authorized capitalization of 200,000 shares. He became president of Bahamas, O'Leary became its treasurer, and Phyllis Bevilacqua, a long-time clerical employee of registrant, became its secretary. All three were also directors of Bahamas. On July 7, 1964, under an "Agreement and Plan of

Reorganization", 80,000 shares of Bahamas were exchanged for the twenty outstanding shares of Bimini, and registrant thus received 40,000 shares of Bahamas in exchange for its ten shares of Bimini.

As indicated above, with respect to Bahamas there are two primary questions which remain for determination in this proceeding, i.e., whether registrant violated those provisions of the Securities Act which make it unlawful to offer, sell, or deliver unregistered stock, absent exemption, and whether the stock of Bahamas was sold by respondents in violation of the anti-fraud provisions of the securities acts, as alleged by the Division.

Alleged Section 5 Violations

At all times Bahamas was dominated and controlled by Howard as the president and the controlling person of Langley-Howard. Bahamas had no offices of its own, but was operated by Howard out of registrant's offices, and its books and records were located there. During the pertinent period with respect to the charges relating to Bahamas, i.e., May 1964 through December 1965, the sole business of Bahamas was the operation and the control of the hotel on Bimini Island through its ownership of the Bimini shares. Bimini's expenses were paid by Bahamas, sometimes by checks sent directly to the Island from registrant's offices in Pittsburgh and sometimes indirectly by loans made to Bimini.

The hotel operation continued unsuccessfully and on only a nominal basis throughout the pertinent period: the operation was beset by various problems including hurricane damage, and the repair and rehabilitation of the physical plant required the expenditure of large sums. From May 1964 to October 1965, Bahamas disbursed approximately $343,000, partly as a loan to Orange Sun Lines, Inc. ("Orange Sun"), (a subsidiary of Onego, discussed in some detail infra, in connection with the anti-fraud charges), partly in repayment of loans, and for the most part as payments made on behalf of and loans made to Bimini. Since Bahamas had no earnings, the funds for these disbursements came entirely from the sale of Bahamas stock under claimed exemptions from the registration requirements of Section 5 of the Securities Act.

Between May 15, 1964 and December 31, 1965, Bahamas issued 150,875 unregistered shares of its common stock, including the above-mentioned 40,000 shares registrant received for the ten shares of Bimini stock. And during the period from May 1964 through August 1965, registrant, through respondent salesmen, sold 84,775 unregistered shares of Bahamas in 376 transactions at prices ranging from $3.00 to $6.50 per share. 17/ These sales were made in a series of six offerings during the 15-month period, each of which registrant contends

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17/ It was stipulated at the pre-hearing conference that the mails were used in connection with offers and sales of the Bahamas stock, that the offers to sell, the sales and the delivery after sale were made at a time when no registration statement had been filed with the Securities and Exchange Commission or was in effect, and that no investor-witness was told that the sale of Bahamas stock was being made or would be made in violation of Section 5 of the Securities Act.

was exempt from the registration requirements of the Securities Act. Conversely, the Division contends that the several unregistered offerings violated the Act, and also that they constituted an "integrated" offering not within the exemption provisions of the Act. The total proceeds of the several offerings were $401,325. They were made by registrant in at least substantial conformity with advice received from Joseph S. Schuchert, Jr., who then acted as registrant's attorney. Following is a list of the six offerings and a brief description of each for the purpose of discussing the alleged Section 5 violations. The selling activities and individual sale transactions under these offerings are discussed in greater detail infra, in connection with the charges of anti-fraud violations.

1. The first offering was made during May and June 1964, when Bahamas, with registrant as underwriter, sold 15,000 shares at $3.00 per share under a purported "private offering" exemption to ten investors. Schuchert testified that this offering was made following the issuance of a certificate of exemption by the Pennsylvania Securities Commission under Section 2(f)(10) of the Pennsylvania Securities Act. 18/

18/ It is interesting to note that there is no requirement for the registration of securities as such under the Pennsylvania Securities Act, and that Section 2(f)(10) relates to the definition of "dealer", and provides that the following transaction shall not constitute the person engaging therein a "dealer":

> "The original issuance and sale by any corporation organized under the laws of this State of its securities in good faith and not for the purpose of avoiding the provisions of this act for the sole account of the issuer, so long as the number of stockholders of said corporation does not exceed twenty-five (25) and the securities are issued and disposed of without the use of advertisements, circulars, agents, salesmen, solicitors or any form of public solicitation."

Each of the ten purchasers was approached by one of registrant's salesmen and each executed an investment letter in connection with his purchase: all had been customers of registrant and understood that the stock was being "purchased for the purpose of investment and not with the view to resale or public distribution", and that it could not be disposed of merely at the wish of the purchaser.

2. On August 25, 1964, a second allegedly exempt offering was made pursuant to an offering circular dated August 15, 1964, naming registrant as underwriter on a "best efforts" basis. Here 50,000 shares of Bahamas were offered at $5.00 per share to residents of Pennsylvania, and between the commencement of the offering on August 25 and its conclusion on December 8, 1964, 39,975 shares were sold to such residents. The offering circular was prepared by Schuchert.

3. On December 24, 1964, registrant sold 8,300 shares of its Bahamas stock to nine investors at $4.00 per share in an allegedly private sale, again under investment letter, the proceeds to inure to the benefit of registrant. Schuchert provided Howard with a written opinion that the sales would be exempt from registration requirements and he prepared a suggested form of investment letter to be signed by the purchasers.

4. On March 10, 1965, again under investment letters in a purportedly private sale, registrant sold 5,000 of its shares of Bahamas to seven investors at $5.00 per share. These sales followed an oral opinion from Schuchert to Howard with respect to the legality of the offering, thereafter confirmed by Schuchert's opinion letter dated March 16, 1965.

5. Between April 6 and April 20, 1965, registrant again sold to approximately 90 residents of Pennsylvania 10,500 shares of Bahamas at $6.50 per share. In connection with these sales, the investors received the above-mentioned offering circular dated August 15, 1964, together with an addendum thereto prepared by Mr. Schuchert. The proceeds from 7,500 of these shares were to go to Bahamas and the proceeds from 3,500 shares to registrant.

6. Between July 29, 1965 and August 19, 1965, registrant sold 6,000 shares of Bahamas stock at $5.00 per share to eight investors, again in an allegedly private placement, with the proceeds to go to Bahamas. Prior thereto, Howard received from Schuchert an opinion letter dated July 1, 1965, in which the attorney advised that the proposed sales would be exempt.

Apart from the contention of the Division that the offerings were each in violation of the registration requirements of the Securities Act on an individual basis and that they also must be regarded as a single integrated offering which violated the law, the Division also contends, as indicated above, that individual sale transactions violated the anti-fraud provisions because of misstatements in and omissions from the offering circular and its addendum, misrepresentations in brochures and other material furnished registrant's customers, and oral misrepresentations and omissions of the respondent salesmen in transactions with the purchasers. The matter for immediate discussion, however, involves the contentions of the parties regarding the provisions of the Securities Act relating to exempted transactions under two categories, i.e., "private offering"

exemptions and "intrastate" exemptions, and in this connection and at this time only tangential reference is made to selling activities and anti-fraud violations.

The "Private Offering" Exemption

Section 4(2) of the Securities Act exempts from the registration requirements of Section 5, "transactions by an issuer not involving any public offering." Registrant contends that four of the above offerings fall within this exemption, urging that the shares were offered to and purchased by a limited number of investors who had previously bought shares of speculative securities from registrant, who assertedly knew the import of the investment letters they executed with their purchases, and who constituted a class of knowledgeable and sophisticated investors capable of assuming the financial risks involved in buying a speculative stock such as Bahamas.

The Supreme Court in S.E.C. v. Ralston Purina Company, 346 U.S. 119 (1953), after discussing the purpose of the private offering exemption, stated that the focus of inquiry as to its applicability should be "on the need of the offerees for the protections afforded by registration," and the Court held that the exemption was not applicable to an offering of stock to employees of the Ralston Purina Company, inasmuch as some of the offeree-employees were not shown to have had access to the same kind of information concerning their employer company as would be available in a registration statement filed with the Securities and Exchange Commission. The Court pointed out that the

determinative issue was not the number of persons to whom the stock was offered, but rather the knowledge which the offerees had or could obtain with respect to the issuer and its operations. At page 124, it stated:

> "The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. * The natural way to interpret the private offering exemption is in light of the statutory purpose. Since exempt transactions are those as to which 'there is no practical need for [the bill's] application,' the applicability [of the provision] should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" *(footnote omitted).

The Court noted that some employee offerings may come within the exemption:

> ". . . e.g., one made to executive personnel who because of their position have access to the same kind of information that the Act would make available in the form of a registration statement.* Absent such a showing of special circumstances, employees are just as much members of the investing 'public' as any of their neighbors in the community." *(footnote omitted).

Ralston Purina has been cited and followed time and again in decisions of the courts and in opinions and releases of the Commission.[19/] In Securities Act Release No. 4552, November 6, 1962, captioned "Non-Public Offering Exemption," the Commission discussed the case and expressed the view that

> ". . . the number of persons to whom the offering is extended is relevant only to the question whether

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19/ e.g., Gilligan, Will & Co. v. S.E.C., 267 F.2d 461 (C.A. 2, 1959), cert. denied 361 U.S. 896 (1959); S.E.C. v. Culpepper, 270 F.2d 241 (C.A. 2, 1959); Hayden Lynch & Co., Inc., Securities Exchange Act Release No. 7935 (August 10, 1966); Dempsey & Co., 38 S.E.C. 371 (1958).

> they have the requisite association with and knowledge of the issuer which makes the exemption available."

From the testimony of the investor witnesses who purchased in the purported private offerings, it is clear that they had neither the requisite close association with the issuer nor the kind of information, nor access to it, that would be included within a registration statement filed with the Commission on an offering of Bahamas stock.[20/] The investors were given general information on the nature and purpose of the hotel operation proposed to be conducted by Bahamas (if the property was not sold), but the information furnished was almost totally lacking in detail concerning the history, financial condition and business of the issuer company and its problems, including those which arose or became aggravated during the course of the several offerings, the use of the proceeds of the offerings, and other significant and material areas necessary to an informed judgment, all of which would be discussed in a registration statement filed with the Commission.[21/]

Nor do the investment letters signed by purchasers in accordance with Schuchert's advice to registrant provide an exemption.

20/ Cf. Schimer, et al. v. Webster, District of Columbia Court of Appeals, No. 3988 (January 19, 1967), reported in CCH Fed. Sec. L. Rep. at ¶91,875.

21/ In addition, the "misinformation" given in written material to registrant's customers and the oral misrepresentations and omissions discussed infra, in connection with the anti-fraud charges, detract from and emphasize the total inadequacy of such information as was furnished.

A comparable situation was discussed in United States v. Custer Channel Wing Corporation, 247 F. Supp. 481 (1965), (aff'd April 3, 1967 (C.A. 4) Case No. 10,399), where the District Court said at page 487:

> "Although they signed investment letters acknowledging that they had unlimited access to all the books, records, files, plant and personnel of Channel Wing to obtain all the information about its affairs which they desired, and that they had made inquiry and had obtained all information that they regarded necessary for their decision to purchase shares of stock, their testimony was clear that they were not furnished, nor did they have anything more than the vaguest information about the financial affairs of Channel Wing."

And in affirming, the Court of Appeals added that the measures restricting sales by persons purchasing for investment "are only precautions [to prevent illegal distributions] and are not to be regarded as a basis for exemption from registration."

In S.E.C. v. Sunbeam Gold Mining Co., 95 F.2d 699 (C.A. 9, 1938), the court, following Ralston Purina said, with regard to the exemption, that ". . . anyone claiming to be within its terms has the burden of proof that he belongs to the excepted class--that is, that his offer is not to the public."[22/] The court then added: "Furthermore, the terms of such an exception to the 'general policy' of the act must be 'strictly construed' against the claimant of its benefit."[23/] And much in point, in response to registrant's contention that the exemption is available because the offerees of

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22/ Respondents' brief concedes that the burden of proof as to the availability of both exemptions resides with them.

23/ See also Gilligan, Will & Co. v. S.E.C., supra, n. 18; S.E.C. v. Culpepper, supra, n. 18.

Bahamas stock were prior purchasers of other speculative securities from registrant, is the court's conclusion:

> "We therefore hold that an offering of securities under the Securities Act of 1933 may be a public offering though confined to stockholders of an offering company, a fortiori where the offerees include the stockholders of another company, though seeking to become stockholders of the offeror."

I find that the sales of Bahamas stock were made to a diverse group of inadequately informed persons whose strongest common thread was perhaps the fact that many or perhaps most of them previously had bought Onego stock from registrant under investment letters. The authorities on this subject and the limitations on the private offering exemption so frequently and clearly expressed by the courts and by the Commission compel the conclusion that the purported private offerings do not qualify as such.

I conclude, also, that the offerings constituted an integrated plan of financing and that the private offering exemption is additionally inapplicable for that reason. In the release on the "Non-Public Offering Exemption" supra at page 26, the Commission stated:

> "A determination whether an offering is public or private would also include a consideration of the question whether it should be regarded as a part of a larger offering made or to be made. The following

> factors are relevant to such question of integration: whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the same general purpose.
>
> "What may appear to be a separate offering to a properly limited group will not be so considered if it is one of a related series of offerings. A person may not separate parts of a series of related transactions, the sum total of which is really one offering, and claim that a particular part is a non-public transaction. Thus, in the case of offerings of fractional undivided interests in separate oil or gas properties where the promoters must constantly find new participants for each new venture, it would appear to be appropriate to consider the entire series of offerings to determine the scope of this solicitation."

The evidence indicates that at the time the first private offering was planned, registrant knew that more extensive and additional financing would be required and was even then contemplating an intrastate offering for the further financing of the hotel operation. I recognize that it was not possible for Mr. Howard to know, during the earliest stages of financing, the amount of capital required to assure the successful operation of the hotel. But it seems clear that when problems such as those discussed below in connection with the fraud charges had developed, Howard must have recognized that additional financing would be required even as the several purportedly private or intrastate offerings were being made, and he knew, of course, that such future offerings would be unregistered. In my view, the several offerings must be regarded as an

integrated offering, as urged by the Division. A contrary conclusion would authorize and support a relatively simple device for frustrating the registration requirements of the Securities Act and would be without basis either in logic or in precedent. Unity Gold Corporation, 3 S.E.C. 618, 625 (1938); Peoples Security Company, 38 S.E.C. 641, 651 (1960). Registrants' argument against integration of the offerings, based on the fact that some of the stock was owned by registrant and that proceeds from the sale of that stock went to registrant rather than to Bahamas, is a de minimus consideration and in no way changes this conclusion. Cf. Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965). See also, for a discussion of the Commission's criteria on integrated offerings, Sosin, The Intrastate Exemption: Public Offerings and the Issue Concept, 16 W. Res. L. Rev. 110, at 122-126 (1964).

The Intrastate Exemption

An intrastate exemption from registration is provided by Section 3(a)(11) of the Securities Act, which exempts

> "Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

In Securities Act Release No. 4434, December 6, 1961, captioned "Section 3(a)(11) Exemption for Local Offerings," the Commission said, with respect to the intrastate exemption:

> "In view of the local character of the Section 3(a)(11) exemption, the requirement that the issuer be doing business in the state can only be satisfied by the performance of substantial operational activities in the state of incorporation. The doing business requirement is not met by functions in the particular state such as bookkeeping, stock record and similar activities or by offering securities in the state."

This limitation on the applicability of the intrastate exemption was affirmed in S.E.C. v. Truckee Showboat, Inc., 157 F. Supp. 824 (1957), where, as in the instant proceedings, the proceeds of a purported intrastate exemption were to be used to finance the operation of a hotel business outside the state in which the issuer was incorporated. The court held the exemption to be inapplicable.[24/] Here also, the evidence discloses no business activity engaged in by Bahamas in the Commonwealth of Pennsylvania which would constitute "substantial operational activities" and I conclude that there is no basis for a finding that Bahamas was doing business in Pennsylvania within the meaning of Section 3(a)(11). The raising of funds, the maintenance of the books and records of Bahamas and Bimini at registrant's office, and the control and direction of Bahamas by Howard do not satisfy the requirement of "doing business" within the Commonwealth of Pennsylvania.

Moreover, in Securities Act Release No. 4386, July 12, 1961, the Commission stated:

> "The legislative history of Section 3(a)(11) clearly shows that this exemption was designed to apply only to local financing of such a nature that it may practicably be consummated in its entirety within the single state in which the issuer is both incorporated and doing business."

24/ Respondents' brief seeks to distinguish the Truckee Showboat decision on the grounds that Truckee was a California corporation which sought to remodel and operate a hotel in another state, namely Nevada, whereas Bahamas, a Pennsylvania corporation, does no business in any other state or territory of the United States, the Island of Bimini being "in the complex of the British West Indies". I find this distinction meaningless in light of the language of the statute.

And in Securities Act Release No. 4434, December 6, 1961, the Commission said, with respect to the integration issue:

> "Thus, the exemption should not be relied upon in combination with another exemption for the different parts of a single issue where a part is offered or sold to non-residents."

It is clear that registrant has not sustained its burden with respect to the 3(a)(11) exemption and it follows that the registration requirements of Section 5 were violated not only by the purported private offerings but also by the purported intrastate offerings.

Any reliance on the advice of registrant's counsel, Joseph S. Schuchert, Jr., would not negative the wilfulness of the Section 5 violations by registrant, aided and abetted by Howard. In The Whitehall Corporation, 38 S.E.C. 259 (1958), the Commission said, at page 270:

> "The evidence relating to reliance on counsel's advice and efforts made in good faith to restrict the offering to residents of Arkansas is relevant to and will be considered by us in connection with the question of whether denial of the application [for registration as a broker-dealer] is required in the public interest. However, the factors presented to not negative a finding that the violations were willful within the meaning of Section 15(b) of the Exchange Act. Such a finding does not require that we find an intent to violate the law; it is sufficient that it be shown that applicant knew what it was doing." [Citing Thompson Ross Securities Co., 6 S.E.C. 1111, 1122-23 (1940); Hughes v. S.E.C., 174 F.2d 969, 977 (C.A.D.C., 1949).]

Although the selling transactions engaged in by each of the respondent salesmen aided and abetted registrant's violations of Section 5, nevertheless, inasmuch as the salesmen were not in positions of control within registrant's organization and were not shown to have engaged in the sale transactions with knowledge or reason to know that registration was required, I conclude that they did not wilfully violate the pertinent securities laws, and in the further

light of the opinions from Schuchert to registrant and registrant's decisions and directions, in turn, to the salesmen with regard to the sales activity, that sanctions against the salesmen for such a violation would in any event be inappropriate. Cf. Lloyd, Miller and Company, supra, p. 19; Shiels Securities, Inc., supra, p. 19. Nor do I believe that the directorship held by O'Leary in registrant's firm compels a contrary result. Cf. Schmidt, Sharp, McCabe & Company, Inc., Securities Exchange Act Release No. 7416 (September 8, 1964); Powell & McGowan, Inc., Securities Exchange Act Release No. 7302 (April 24, 1964).

Anti-fraud Violations in the Sale of Bahamas Stock

The charges of fraud against all respondents in the sale of Bahamas stock are predicated on misrepresentations and omissions both in written material and in the oral representations of the four salesmen. Basically, the charges with respect to written material involve misrepresentations and omissions in regard to the financial status and requirements of the hotel operation, the improper glamorizing of the physical plant in a travel brochure sent to purchasers and prospective purchasers of stock, and the failure to apprise such purchasers of current problems which should have been regarded as important negative aspects of an investment in Bahamas stock. The salesmen are charged with fraud in the use of these written materials, with improper oral representations, including in some cases expected price rises in the stock, and with the failure to advise their customers of negative aspects, some of which inhered originally in the investment and some of which arose during

the course of the six offerings discussed above.

(a) The Redac Report

Howard had inspected the physical plant at Bimini prior to the incorporation of Bahamas. In July or August 1964, he engaged the Redac Corporation of New York City to examine and evaluate the physical condition of the hotel property on behalf of Bahamas, and to make recommendations for its renovation and improvement. James G. Trautman, president of Redac, a civil engineer with considerable experience in real estate development and familiarity with construction problems in the Bahamas, examined the hotel property from August 22 through August 25, together with an architect employed by Redac.

On September 11, 1964, Trautman sent to Howard a report with findings and recommendations. The report advised that the property was in a general state of disrepair from bad maintenance and was getting progressively worse. It stated, among other things, that the plumbing, heating, painting, roofing, and electrical wiring had deteriorated badly; that many of the unit room air conditioners were undersized, not in operating order, and had not been maintained over a period of several years; it described "a general profusion of missing doors, broken windows, unworkable hardware," and decried the absence of cleanliness in the hotel and grounds. It reported that the swimming pool was not operable because it needed water-proofing, repair of cracks, new plumbing and chlorination systems and pumps; that a tennis court

which appeared not to have been used for many years had no back-stop and was unusable; that much equipment was rusted or broken; that the ocean side of the beach was rough coral and that the property included no area satisfactory for a bathing beach.

The report also indicated that there were large, modern, well-run hotels on the Island, in competition with Bimini, and that unless very substantial work was done to improve the physical plant, and competent management hired, the hotel would not attract repeat business. The evidence disclosed that two recently constructed hotels appeared to be well operated as first-class facilities, and that hotel facilities of lesser quality also were competitive with Bimini. The report estimated that an expenditure of approximately $220,000 was required for a clean-up program costing from $60,000 to $70,000 and for the renovation and replacement of facilities estimated to cost approximately $150,000.

Trautman testified with respect to the above findings in the report. He also stated that Mr. Siegel, the president of Bimini, was optimistic that a gambling license could be obtained, but that Trautman's relatively cursory inquiry had produced both affirmative and negative reactions on this possibility.

Shortly after the receipt of the Redac report, Howard discussed it with the salesmen and it was thereafter available at registrant's office for their examination.

(b) The Travel Brochure

Prior management of the hotel had used a colored travel brochure containing photographs which glamorized the facilities. They displayed a lovely swimming pool filled with clear water and graced, of course, by a good-looking, swim-suited female, a tennis court in apparently excellent condition, and an attractive room and pertinent facilities. In August 1964, registrant arranged for a reprinting of the brochure, deleting the former name of the hotel and inserting its current name, Bimini Hotel. Although the photographs and the text[25/] were a grossly inaccurate representation and description of the existing facilities of the hotel, the brochures were available at registrant's office for distribution to and for viewing by visitors, and they were mailed to customers by registrant. The position taken at the hearing by registrant and by the salesmen, generally, was that the brochures were not mailed by registrant but were mailed, rather, by Bahamas, (a distinction which I reject), and that they were sent only to persons who were already stockholders of Bahamas. For example, Sorenson testified that they were not sent to induce purchases but were sent only

> ". . . because this showed what this hotel looked like a few years ago and it now can show what kind of condition we intend to end up with in a way of operating the hotel."

25/ The brochure described the hotel as "THE BAHAMAS' CLOSEST, SMARTEST RESORT" and read in part: "Enjoy Bimini's most complete recreational facilities at the Bimini Hotel Olympic-size pool . . . tennis, badminton, shuffle board. . . ." Also, "No other Bimini resort offers facilities so modern, spacious, luxurious! No other Bimini resort offers such beautiful rooms and lavish apartments. The Bimini Hotel is unquestionably Bimini's largest, finest, smartest resort."

He also testified that he described the hotel to clients in accordance with the description Howard gave to him, but that the brochure was sent to give stockholders

> ". . . an idea of what we had and what we could end up with with the proper management, and with a little bit of money spent in the right places."

However, no caveat or explanation accompanied the brochure mailed and delivered to registrant's clients, and some of the witnesses testified that they received brochures before their first purchases of Bahamas stock. Other witnesses received the brochures subsequent to their initial purchases of Bahamas but before they had made further purchases of the stock.

The evidence compels my rejection of the contention that the discriminating and selective use of the brochure suggested in the above testimony and in similar testimony by other respondents was either intended or accomplished. On the contrary, the fair intendment and foreseeable consequence of the brochure and its use was to influence the purchase of Bahamas not only by persons who owned the stock but also by those in whom the brochure might generate and develop initial interest in the company. I find that the use of the brochure constituted a significant affirmative misrepresentation with regard to investment in Bahamas, and that the failure of registrant and the salesmen to distinguish between the facilities represented and those actually available at the hotel constituted an omission of material facts necessary to an informed judgment on an investment in the company.

(c) Bahamas' Loan to Orange Sun Lines and the Offering Circular

Orange Sun Lines, Inc. ("Orange Sun"), a subsidiary of the Onego Corporation discussed above, operated a motor vessel which made a round-trip daily between Miami and Bimini Island. Howard believed this vessel could be a valuable asset in attracting guests from Miami to the hotel, and on May 25, 1964 he arranged for Bahamas to make an unsecured loan of approximately $55,000 to Orange Sun for a period of 180 days with interest at 8% per annum. In consideration of this loan of much-needed funds, Orange Sun agreed to transport on its motor vessel, called "M/V Orange Sun", Bahamas' patrons to and from the hotel without charge during the year 1964 and at 40% of the regular established fare beginning in 1965. Apparently, the agreement was viewed by Howard as one which might substantially assist in the effort to achieve success in the hotel venture.

On August 27, 1964, Orange Sun and other subsidiaries of Onego filed under Chapter X of the Bankruptcy Act in the United States District Court for the Western District of Pennsylvania a "Petition for Reorganization". Orange Sun's liabilities exceeded its assets by approximately $120,000. Loyal H. Gregg, an attorney, was appointed Trustee by the court, and Sanford M. Lampl was engaged to act as his attorney. The Chapter X proceeding was initiated primarily to avoid foreclosure by Walter Heller & Co. ("Heller") of a mortgage on the M/V Orange Sun and to prevent the filing of libels against the ship, as had been done previously by other creditors.

Howard had been aware of the claims of creditors, including Heller, against the M/V Orange Sun: he had, of course, a substantial familiarity with the financial structure and problems of Onego, as well

as those of Orange Sun, as one of its subsidiaries. He had discussed these difficulties with Onego's officers and with Schuchert, and following one of these discussions Schuchert filed the above-mentioned Chapter X petition.

Despite the filing, on September 2, 1964 the M/V Orange Sun was seized by the United States Marshal for the Southern District of Florida under a libel to foreclose on a mortgage held by Heller. The seizure and other problems were discussed by Messrs. Gregg, Lampl, Howard and others at meetings which took place on September 17 and 23. The attorneys agreed that the seizure of the vessel was illegal, and Howard was so advised. At that time, especially as a result of discussions with Schuchert, he was optimistic about the prospects that the motor vessel would soon be released to the Trustee and that it could be used as planned.

Howard's optimism in September could not reasonably or realistically persist very long,and it was contra-indicated by the many problems which arose and became magnified throughout the course of the Chapter X proceedings. With two United States District Courts involved, jurisdictional problems arose and conflicting orders were issued by judges of the two Districts. Heller assailed the good faith of Orange Sun's officers, claiming that the filing of the petition was unfair because Heller had "carried" the Orange Sun Company rather than foreclose its mortgage. Moreover, debtors were refusing to pay to the Trustee obligations due Onego and its subsidiaries, and the Trustee

was without funds. On November 5, 1964, the Marshal of the Southern District of Florida was directed to release the vessel to the Trustee on payment of costs for storage, but on November 30 the order was amended to require that the Trustee also pay insurance charges incurred by Heller. Without funds, the Trustee could not obtain the release.[26/] During this period and for months thereafter, various negotiations were conducted by the Trustee and by his attorney with a view to entering into charter agreements or making other arrangements under which operating funds would be advanced to the Trustee. But for many reasons, including the fact that the vessel deteriorated while in storage and eventually was determined in a Coast Guard inspection to be no longer "in class", all negotiations fell through and in September or October 1965, when it became apparent that the Trustee had no equity in the vessel, it was released to Heller.

At a meeting of February 27, 1965, attended by Howard, the Trustee had expressed pessimistic views on the prospects of avoiding straight bankruptcy for Onego and its subsidiaries unless the bleak picture changed quickly and dramatically. On March 1, 1965, a notice was mailed to stockholders and creditors of Onego and the subsidiaries,

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26/ On February 2, 1965, Howard provided $2,500 for the release of the vessel and the Trustee paid charges of $2,200 to the Marshal. However, because of other debts and libels filed against the vessel and further problems mentioned in the text, it never became available to transport passengers as planned.

calling a meeting on April 5, 1965. Many of registrant's customers who owned Bahamas stock received this notice because they also were stockholders or debenture holders of Onego. Some of them related the notice and the Chapter X proceedings to their Bahamas investments, while others did not.

As stated above in connection with the first intrastate offering of Bahamas made between August 25 and December 8, 1964, Schuchert had prepared an offering circular dated August 15, 1964. This offering circular recited in part that Bahamas had loaned to Orange Sun the sum of $55,353.34, and that as part consideration for the loan, Orange Sun had agreed to transport customers of Bahamas to Bimini free of charge during 1964 and for 40% of the regular published fare during 1965. The offering circular then stated:

> "The Company is of the opinion that such arrangement will inure to the best interests of the Company by stimulating the business of the hotel and club facilities owned by the Company's subsidiary, Bimini. However, the Company does not represent and makes no assurance of any such increase due to this arrangement."

The Division contends that on the filing of the petition under Chapter X, registrant and the salesmen had the duty to apprise prospective purchasers of Bahamas stock of the danger that Bahamas might not be repaid the loan made to Orange Sun, which constituted approximately 20% of the assets of Bahamas at that time, and also that it might never have the advantage of the transportation aspects of the loan contract.

Apparently, registrant agrees that at some point it became advisable to modify the offering circular and inform customers of the possible uncollectibility of the loan. Although the selling of shares continued under the original offering circular from August 25 to December 8, 1964, and although the so-called private offerings of December 24, 1964 and March 10, 1965 were made pursuant to Schuchert's opinions, eventually, in connection with the intrastate sale of April 6 through April 20, 1965, an undated addendum to the offering circular was prepared by Schuchert

> ". . . in order to make full disclosure of recent transactions and occurences in Bahamas Hotel Corporation, including transactions by Langley-Howard, Inc. in shares of Bahamas Hotel Corporation acquired by it as set forth on page 4 of the Offering Circular dated August 15, 1964, and to outline the terms of a proposed offering of 10,500 shares to bona fide residents of the Commonwealth of Pennsylvania."

In pertinent part, the addendum also recited that since August 15, 1964, repairs and alterations to the hotel properties had been made but that active operations had not yet commenced, and that the company had operated at a loss during the interval. The addendum continued:

> "Since August 15, 1964, the date of the offering circular, the Orange Sun Lines, Inc. has filed a Petition under Chapter X of the Bankruptcy Act, and the affairs of that company are presently subject to the jurisdiction of the United States District Court for the Western District of Pennsylvania. Accordingly, there is no assurance as to the collectibility of all or any part of the note receivable from Orange Sun Lines, Inc. in the sum of $55.383.24."

Attached to the addendum was a financial statement of Bahamas as of December 31, 1964.

It is my view that the collectibility of the loan was of sufficient importance to Bahamas and was sufficiently doubtful when

the Chapter X petition was filed that despite the optimistic assurances by Schuchert, fair treatment of customers of registrant thereafter required disclosure of those proceedings and the doubtful collectibility. I recognize that Howard and others might have continued to be not only hopeful but optimistic about the prospects of achieving in the Chapter X proceedings the measure of success contemplated on behalf of Onego, i.e., a delay in payment of debts for which it was being pressed. But a fair and realistic appraisal of the situation demanded disclosure, and I find that Howard was reckless in withholding from prospective investors in Bahamas a caveat regarding the possible uncollectibility of an obligation in a relatively significant amount. Howard could not reasonably have regarded the decision to file and the filing as a panacea for the serious problems which compelled the decision to file. It was his responsibility rather than Schuchert's to decide when the caveat to purchasers was required, and in this he failed.

I conclude, also, that the failure to disclose to customers the probability that the vessel would not be available to perform as promised constituted fraud after the filing of the Chapter X petition. And this fraud continued, of course, even after the issuance of the addendum in April 1965, inasmuch as that addendum made no mention of the incapacity of the M/V Orange Sun. While respondents' argument in their brief that the success or failure of Bahamas "did not depend upon the operation of the Orange Sun" is undoubtedly correct, it does not follow that the operation of the vessel was not an important aspect of the venture under all the circumstances, and it is my view that disclosure should have been made.

Respondent's further contention that "there is no testimony in the record that the investor witness [sic] considered the operation of the Orange Sun as an important or material factor in their investments" is not entirely accurate or meaningful, as indicated below. In any event, the fact that the salesmen in their oral representations to customers, and indeed the fact that the offering circular itself, recited the agreement for transportation of passengers, is of more significance than the testimony of some investor witnesses that in their individual views this aspect of the loan agreement was not an important or material factor to the success of the venture. An operating ship would develop needed revenue for Orange Sun and passengers for Bimini. The inability to operate was material in regard to both the repayment of the loan and the hotel business and should have been disclosed in any subsequent offers of stock.

Further, the offering circular prepared by Schuchert gave no description or indication of the state of disrepair of the physical facilities of the hotel. The language came no closer to disclosing the need for a large expenditure to put the hotel into operating condition than to state that one of the principal purposes of the intrastate offering was to finance "the modernization and operation of the hotel and club house properties" of Bimini, and that part of the proceeds of the offering would be used for "a loan in the approximate sum of $44,470.00 to Bimini for the purpose of modernization and improvement of its hotel and club house". This was a far cry from the full disclosure required, and yet the offering circular was used by registrant and the salesmen throughout the several offerings, even after they had knowledge of the contents of the Redac report. The use of the offering circular without further explanation of the condition of the hotel facilities and the need for extensive financing greatly in excess of $44,470.00 was fraudulent.

In addition, the financial statement of Bahamas as of December 31, 1964, which was attached to the addendum prepared by Schuchert, was also materially false. It was prepared by a certified public accountant at the request of Mr. Howard, but at the time of preparation the accountant knew nothing about the filing of the Chapter X petition. The accountant testified that the loan from Orange Sun constituted approximately 25% of the assets of Bahamas as of the date of the financial statement, that this loan was a material item in expressing the financial picture of the corporation, and he indicated that had he known of the filing of the Chapter X petition the financial statement would have reflected that fact.[27/]

(d) Sales Activity of Respondent Salesmen

During the pertinent period, May 1964 to August 1965, the mails were used in connection with six offerings which took place in which respondent salesmen sold Bahamas stock in the following amounts:

Steigerwald	7,925 shares in	36 transactions
Sorenson	18,110 shares in	77 transactions
Barnett	24,090 shares in	105 transactions
O'Leary	34,650 shares in	158 transactions

In support of its fraud charges, the Division called several witnesses to testify with respect to transactions in which they bought Bahamas from the four salesmen. The common aspects which run throughout the sales activity and constitute the fraud charged by the Division reflect unwarranted optimism as to the potential of the hotel operation, and a failure to advise the investors of the negative aspects of the investment and of the problems which arose and became magnified as the several offerings were being made. Not only did the salesmen fail to indicate to their offerees the serious state of disrepair

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27/ The accountant also testified that a financial statement as of April 30, 1965, used in connection with a subsequent private offering, was false in reflecting 99,875 shares of Bahamas outstanding instead of 179,875 shares. This, too, was a material misrepresentation.

of the hotel property and the sizeable amount of money which would be required to put it into operating condition, but even more seriously, they advised some purchasers, as indicated below, of prospective rises which could be expected in the price of the stock.

Steigerwald

Steigerwald made 36 sales of Bahamas to 20 customers, one of whom purchased the stock in a private offering. 28/

R.J.G. testified that he bought 100 shares of Bahamas at $5.00 per share on October 22, 1964, following several telephone conversations with Steigerwald. A second purchase of 60 shares at $5.00 per share was made on December 7, 1964, following the receipt of the August 15, 1964 offering circular. The witness testified that he also received a copy of the color travel brochure, but could not say whether this was prior or subsequent to the second purchase. He was not informed of the Chapter X proceedings or of the seizure of the M/V Orange Sun, although by December 7, 1964 these occurences reflected seriously on the worth of the loan contract described in the offering circular. The testimony of the witness also indicated that at some time following the second purchase, Steigerwald assured him that he had no cause for concern about the investment, for the reason that if the hotel could not be operated profitably, the liquidating value of

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28/ The evidence indicated that C.M., of New Jersey, bought 1,500 shares at $3.00 per share in the first private offering of May-June 1964. He did not testify at the hearing, but Steigerwald's testimony indicates that the purchaser was not an informed person with the kind of knowledge which would obviate the need for the protection intended by the registration provisions of Section 5.

the corporation was about $8 to $10 per share. The witness sold both blocks of his Bahamas shares,at $6.00 per share in February 1965 and at $6.50 per share in February 1966, the latter sale through Mr. O'Leary at his current place of employment, Strathmore Securities, Inc.

C.J.W., the second and last witness to testify with respect to transactions with Steigerwald, received telephone calls from him over a period of several months prior to November 5, 1964, and on that date he bought 500 shares at $5.00 per share. Although Steigerwald described the hotel as "run-down", he also had mentioned the M/V Orange Sun and boxing bouts to be held on it as a "further inducement" for people to visit Bimini Island, and he described the stock to the customer as "a seven and one-half to ten dollar stock, something like that." C.J.W. received a copy of the offering circular of August 15, 1964 and a copy of the travel brochure. However, he was never told about the seizure of the M/V Orange Sun or the possible uncollectibility of the debt. On April 6, 1965, the witness made a further purchase of 500 shares of Bahamas at $6.50 per share. He had previously visited registrant's offices and was impressed by color slides similar to those in the travel brochure, shown to him by Mr. Steigerwald. (In March 1966, this witness bought an additional 100 shares of Bahamas at $7.00 per share thru Mr. O'Leary, at his current place of employment at Strathmore Securities, Inc.).

Barnett

Barnett made three sales totaling 5,000 shares of Bahamas in the purported private offering of May-June 1964 to persons

with whom he had done business for several years and whom he regarded as knowledgeable investors, capable of taking the risks involved in the purchase of a speculative security such as Bahamas. But his testimony in a pre-hearing investigation[29/] indicated that he was unable to and, indeed, did not attempt to furnish the purchasers with the type of information concerning the issuer and its business that could support a contention that the offering was exempt. Barnett made further sales of 3,000 shares of Bahamas to three customers in the purported private offering of December 1964, 2,000 shares to three customers in the purported private offering of March 10, 1965, and in August 1965 he sold 700 shares to one customer in the private offering. His testimony indicates that he was well compensated for the sales he made in December 1964 and March 1965, the proceeds of which were for the benefit of Langley-Howard.

C.M., a resident of Pennsylvania, testified that he made the following purchases of Bahamas at $5.00 per share through Mr. Barnett in the intrastate offering which took place between August and December 1964:

September 4, 1964	200 shares
September 18, 1964	500 shares
September 25, 1964	300 shares
November 12, 1964	600 shares

29/ Portions of transcripts of testimony taken during the pre-hearing investigation of this matter were received in evidence as admissions against interest of the respective respondent-salesmen.

On December 24, 1964, the witness bought 1,000 shares of investment stock in the purported private offering. Thereafter, he sold 700 shares of his stock at prices ranging from $5-3/4 to $6-1/2 per share, and he subsequently purchased 500 shares at $5.00 per share in the purported private offering of March 1965. C.M.'s testimony indicated (although he sold 700 shares at a profit) that he was obviously not a person with sufficient knowledge and information concerning Bahamas and its business to place him outside the intended coverage of the registration requirements of Section 5.

Counsel for respondents, on cross-examination of the witness, adduced evidence of a later purchase of 50 shares at $7.00 per share, through Strathmore Securities, Inc. in 1966, when the witness had knowledge of the Orange Sun Lines problems.

P.M.P. was telephoned by Barnett concerning Bahamas stock and on August 25, 1964, he bought 100 shares at $5.00 per share. The witness testified that prior to November 9, 1964,Barnett advised him that the M/V Orange Sun would transport passengers from Miami to Bimini Island and the witness concluded that these passengers probably would stay at the Bimini Hotel. He was advised by Barnett that the hotel was "getting prepared to be put into operation." On November 9, 1964, he bought 300 shares at $5.00 per share, and on August 2, 1965, he bought 500 shares at $5.00 per share in the private offering. His knowledge and information concerning the operations and financial status of Bahamas and of Bimini were entirely inadequate to qualify

him as one who did not need the benefits of Section 5. He signed the investment letter and made this purchase because he "figured it was a good speculation at $5.00 previously and it would be a good speculation on August 2, 1965."

The witness was not advised of the possible uncollectibility of the Orange Sun debt to Bahamas although he had received and read a copy of the offering circular; and although he knew of the seizure of the M/V Orange Sun, he testified that he "didn't give a thought" to the possible uncollectibility of the debt due to Bahamas.

On cross-examination, counsel for respondents adduced evidence of a further purchase by the witness of 50 shares of Bahamas from Strathmore Securities, Inc. at $7.00 per share through Mr. Barnett on March 8, 1966. His purpose in adducing this evidence (and similar evidence from other witnesses) was to reflect the fact that as of the time of the hearing such investor-witnesses remained satisfied with the treatment they received from the respondent-salesmen. Of greater significance, however, was the complete disclosure in the testimony of this witness concerning the additional purchase, of his lack of sophistication and knowledge concerning the affairs of the issuer. For example, when he was asked whether he knew of "a second public offering of Bahamas Hotel Corporation stock" he responded:

> "Second--well, perhaps so. It is probably the last 50 shares I bought."

And concerning this purchase of 50 shares he said, further,

> "I don't know if it was the first, second or third offering, but I would judge from what Mr. McLaughlin just said that I

> bought 50 shares in the first part of this year, so that must have been the second offering, which I didn't know at the time I bought it was the second offering."

And even more significant, the additional purchase from Mr. Barnett in March 1966 reflects the extent of the trust and confidence which the witness reposed in his salesman, demonstrating the importance of honest, accurate and full disclosure of facts to such investors by a securities salesman.

R.H.S. received a telephone call from Barnett prior to November 10, 1964, in which he was advised that the potential price of the stock might be about twice the offering price of $5.00. He was also told that the M/V Orange Sun would carry tourists to the Island and that this would be a further attraction for the hotel operation. Prior to his purchase, he received copies of the travel brochure and offering circular, and based upon his conversation and this material he bought 170 shares of Bahamas at $5.00 per share. At that time he believed the M/V Orange Sun to be operating: he was not advised concerning the Chapter X proceedings and the possible uncollectibility of the loan to Orange Sun until, as a stockholder of Onego, he received the Trustee's notice of meeting in March 1965.

R.H. learned of Bahamas stock from Barnett prior to December 7, 1964, at which time he bought 100 shares at $5.00 per share. On December 24, 1964,he bought 1,000 shares at $4.00 per share in the purported private offering, and on April 6, 1965,he bought 1,000 shares at $6.50 per share. He had received an offering circular

at the time of his initial purchase, but he learned of the Chapter X proceeding only in March 1965, on receipt of a notice from the Trustee as a debenture holder of Orange Sun and a shareholder of Onego.

Although his memory did not appear to serve him well at the time of the hearing, his testimony indicated that he probably did not know, when he made purchases in 1964, that Bimini had been losing money. It is clear, in any event, that he was not at all knowledgeable concerning the affairs of Bahamas when he purchased investment stock on December 24, 1964.

Sorenson

In May 1964, Sorenson sold to G.F.R. 1,200 of the 15,000 shares of Bahamas which were sold in that private offering. Sorenson advised that the hotel had good potential and that he believed that the hotel had "more prospects of becoming one of the top spots on Bimini than any of the other hotels on the Island." G.F.R. made the following purchases of Bahamas through Mr. Sorenson, all at $5.00 per share:

October 6, 1964, 100 shares
October 26, 1964, 100 shares
November 18, 1964, 400 shares
December 1, 1964, 100 shares
March 10, 1965, 500 shares
August 13, 1965, 500 shares

G.F.R. was not at any time sufficiently knowledgeable with regard to Bahamas and its operations to make an informed judgment of his own with respect to the purported private offerings in which he participated.

This witness also made a purchase of Bahamas stock in November 1965 at $7.00 per share, subsequent to his having learned of the receivership of Orange Sun and the disability of the motor vessel. Counsel for the respondents made the point that the stock was not bought in reliance upon an agreement between Orange Sun and Bahamas, although the witness testified, "It would have been nice if it worked out".

R.B.C. bought 1,300 of the 15,000 unregistered shares from Sorenson on June 22, 1964 in the private offering. He had received no financial information concerning the issuer corporation and knew nothing of its capital structure. The purchase was made because Sorenson represented that the hotel and the stock had growth possibilities and that the customer was buying the shares at a discount. The witness did not believe there was any oral discussion of future proposed offerings of stock.

Prior to a second purchase of 100 shares on January 25, 1965, the witness received a copy of the color travel brochure. He had no discussion of the brochure with Sorenson. On August 27, 1965, the customer purchased 800 shares at $5.00 per share in the private offering then in progress. On November 10, 1965, he bought 300 shares at $7.00 per share and two days later he bought 250 shares at the same price, after Sorenson called and advised that the hotel was being improved and that the stock was a good buy.

This witness also learned of the Chapter X proceedings by reason of his ownership of Onego stock. He was not informed by Mr. Sorenson of the possible uncollectibility of the debt due to Bahamas from Orange Sun: conversely, he testified that it was Mr. Sorenson's opinion that the "debt is still collectible", although the testimony reflected no date on which such opinion was expressed.

H.E.R., Jr. was another witness who purchased stock from Sorenson in the initial private offering. He bought 1,000 shares on May 24, 1964. Thereafter, he bought 300 shares at $5.00 per share on September 18, 1964, and 1,000 shares at $4.00 per share on December 24, 1964, in the purported private offering. The witness lacked the information which under any circumstances could obviate the need for registration. He bought the stock because he considered that Bimini Island had growth potential and because he relied heavily on Mr. Sorenson's representations concerning the stock.

H.N.N. was telephoned by Sorenson and made the following purchases as a result of conversations and material he received:

December 4, 1964, 300 shares at $5.00 per share
February 19, 1965, 200 shares at $6-5/8 per share
April 6, 1965, 400 shares at $6-1/2 per share
June 1, 1965, 200 shares at $7.00 per share

Prior to the first purchase, Sorenson advised the witness that with proper management and renovation of the hotel, the investment would be a very good one, and during the course of the transactions he advised that the stock had very good potential for growth in price.

The witness testified that Sorenson also spoke of the potential of the cruise ship, which should bring large numbers of passengers as opposed to the relatively small capacity of airplanes currently flying to the Island. Several months after the first purchase, Sorenson advised of the unavailability of the M/V Orange Sun.

Although the witness testified that he had seen slides disclosing the need for renovating the hotel before it could be put into operation, he also testified that he was not informed of and did not realize its true condition until he learned from a friend who had visited the Island within the six-month period prior to the hearing, and who informed him that the hotel was in poor condition and that only two guest rooms were then occupied. He also testified that at no time was he informed of the Chapter X proceeding in connection with any of his purchases of stock. He was told by Sorenson that the stock was a good investment and that he would definitely make money on it.

Dr. G.N.B. was telephoned by Sorenson prior to September 10, 1964, and was advised that Bahamas was renovating the hotel and expected it "to be running very shortly." He testified that Sorenson represented the stock as a "good buy" with good growth potential, and that it was "expected to go up in price." The witness received copies of the offering circular and travel

brochure. On September 10, 1964, he bought 600 shares and on November 27, 1964, he bought an additional 400 shares, both purchases at the price of $5.00 per share. On December 24, 1964, Sorenson sold the witness 500 shares of investment stock at $4.00 per share. It was apparent from the testimony of the witness that he was not knowledgeable with respect to the Bahamas Corporation or its affairs and financial condition at that time. On April 20, 1965, the witness bought 150 shares at $6.50 per share. He was informed of the bankruptcy petition when he received a copy of the Trustee's letter in March 1965, as a stockholder of Onego, but he testified that he did not relate these proceedings to his purchases of Bahamas stock. He also testified that some time prior to June 16, 1965 he was told by Sorenson that the hotel was operating at a profit.

F.G.H. made the following four purchases of Bahamas from Sorenson, as follows:

November 20, 1964, 100 shares at $5.00
December 7, 1964, 100 shares at $5.00
February 8, 1965, 150 shares at $6-1/4
April 6, 1965, 50 shares at $6-1/2

With respect to some of his purchases, he said, he relied on the appearance of the hotel as shown in the color travel brochure sent by registrant, and said "That is why I would buy". He also testified: "I looked at the pictures here. They said it would be a good investment and I bought it."

O'Leary

As indicated above, O'Leary has been a director of Langley-Howard since 1961 and is an officer and director of Bahamas. He has held a position of more responsibility in registrant's organization than the other salesmen. He participated in meetings with Mr. Gregg, the Trustee in bankruptcy, and his attorney, and in meetings between Mr. Howard and Mr. Schuchert with regard to the Chapter X proceedings and their implications. He also took an active part in the efforts to prepare a defense for registrant in connection with the NASD mark-up charges discussed above, making some stock purchases and arranging for others to be made from the Pittsburgh and Philadelphia brokers. In other respects as well, he was a part of the management of registrant. In addition, as indicated by the figures set forth, he sold more Bahamas stock than any of the other salesmen, and he was relatively active in selling in the private offerings made by registrant. In the initial private offering of 15,000 shares, O'Leary sold 5,000 shares to three investors. In the second private offering he sold 3,800 shares to four investors out of the 8,300 shares sold, and in the private sale of March 1965, he sold 2,500 shares for registrant out of the total of 5,000 shares. In the last private offering, which took place between July 29 and August 19, 1965, O'Leary sold 4,000 shares of Bahamas to five investors out of the total sales of 6,000 shares to eight investors.

L.F. was called by the Division as an investor witness and indicated that he had a great amount of faith in O'Leary as his salesman, testifying that his purchases of Bahamas stock and other securities were made on the basis of O'Leary's recommendations rather than on any personal effort to evaluate the stock. He testified that he considered offering circulars "junk mail" which he threw into the waste basket. L.F. made two purchases of Bahamas stock, the first on November 19, 1964, when he bought 250 shares at $5.00 per share, and the second on April 6, 1965, when he bought 150 shares at $6-1/2 per share. In response to the question,

> "And what did [O'Leary] tell you at that time about Bahamas Hotel Corporation"?

L.F. responded,

> "He said, 'I got a deal coming up. It looks like we are going to make some money. What do you say?'
>
> I said, 'go ahead and buy some.'"

With respect to the second purchase, also made during a telephone call from O'Leary, L.F. testified,

> "He called me on this 150. He said, 'I have 150 shares. Do you want it?'
>
> I said, 'I got 250 now; let's go ahead.'"

L.F. testified that with respect to neither of these transactions was he told anything further about Bahamas Hotel Corporation, indicating, of course, that his reliance on O'Leary with respect to his purchases of the stock was rather complete. At another point, he testified,

"I dealt with Mark so often that he would call me up and say, 'I got a hot number. Let's go,' or 'I got a stock; let's go.'

I said, 'ok.'"

From his testimony, it is clear that L.F. was not told of the Chapter X proceedings, nor of any of the negative aspects of the investment in Bahamas stock, but he relied solely on O'Leary's recommendations.

F.H.K. made the following purchases of Bahamas stock through Mr. O'Leary, all at $5.00 per share:

October 12, 1964	50 shares
November 13, 1964	50 shares
December 7, 1964	50 shares
April 6, 1965	50 shares

The witness testified that during the course of these purchases he received copies of the color travel brochure and of the offering circular, but that he was never advised by registrant of the seizure of the M/V Orange Sun or of the bankruptcy proceedings and the possible uncollectibility of the debt due from Bahamas. Although F.H.K. "leafed through" the offering circular, he also stated that he more or less relied upon O'Leary's decision with respect to the purchase of the stock. The witness also testified that he assumed from his conversations with O'Leary that gambling would be permitted at the Bimini Hotel, inasmuch as the salesman advised that there was no restriction on gambling on the Island. The customer indicated that he learned of the seizure of the M/V Orange Sun when he received the letter from the Trustee in March 1965, as a stockholder of Onego.

G.S. testified that he made the following purchases of Bahamas stock through O'Leary:

October 28, 1964, 300 shares at $5.00 per share
November 9, 1964, 700 shares at $5.00 per share
April 6, 1965, 200 shares at $6-1/2 per share

The witness testified that he was told by O'Leary in the first telephone conversation concerning Bahamas that the price of the stock "could appreciate many fold" or that "It would rise in value many fold". He also testified that prior to his first purchase he received a copy of the offering circular and that he received a copy of the travel brochure following the first purchase, but that he was never advised of the seizure of the M/V Orange Sun or of the bankruptcy proceedings and the possible uncollectibility of the debt due from Orange Sun.

Violations of Law in the Selling Activity

As indicated in the above discussion of the sales activity, each respondent wilfully violated and aided and abetted violations of the anti-fraud provisions in the sale of Bahamas stock during the period from May 1964 to December 1965, as charged.[30/]

The evidence discloses that some of the purchasers reposed complete trust and confidence in the respective salesmen. Under such circumstances, registrant, Howard, and the salesmen assumed a fiduciary obligation to deal with such people "with an eye single to the best interests of the customers." Reynolds & Co., et al., 39 S.E.C. 902 (1960). But the frequent and almost continuous selling

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30/ All of the violations were wilful within the meaning of the securities acts, inasmuch as the acts and omissions were consciously and intentionally performed or omitted to be performed. Gearhart & Otis, Inc. v. S.E.C., 348 F.2d 798 (C.A.D.C., 1965); Crow, Brourman & Chatkin, Inc., Securities Exchange Act Release No. 7839, March 15, 1966.

of Bahamas stock in the several offerings, with recurring sales of substantial amounts to some customers during a period when serious problems rather than progress and good fortune attended the hotel venture, compels the conclusion that the eye focused more sharply on the interests of registrant and the salesmen than on the interests of the customer. The selling activity is subject to severe criticism because it was carried out in an atmosphere of recklessness created by the following factors, among others: the selling activity included the very profitable and remunerative disposal of thousands of shares of Bahamas stock acquired by registrant at nominal cost when the issuer corporation was formed; the obviously misleading nature of the travel brochure, known by all salesmen to be in use; the unwarranted expressions of optimism by the salesmen to their customers and the concomitant failure to disclose the negative aspects and developments, including in some instances the representations of prospective price rises in the stock, totally unwarranted under the uncertain circumstances in which this hotel venture was launched and subsequently became bogged. 31/

Of course, apart from the fact that some customers reposed complete trust and confidence in the respective salesmen, the law is well-established that basic to the relationship between a broker or dealer and his customers is the representation that the latter will be

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31/ The Commission has frequently held that an unwarranted representation of a price rise in a speculative, low-priced security is fraudulent. Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962); Barnett & Co., Inc., 40 S.E.C. 1 (1960); Leonard Burton Corporation, 39 S.E.C. 211 (1959). In the last-cited case the Commission stated that a prediction by a securities salesman or dealer to an investor that a stock is likely to go up implies that there is adequate foundation for such prediction and that there are no known facts which make such a prediction dangerous and unreliable."

dealt with fairly and in accordance with the standards of the profession.[32/] This obligation is applicable also to securities salesmen.[33/] It was violated by Steigerwald's representation of the value of the stock on liquidation, by unwarranted representations of prospective price rises in the stock by each salesman, by Sorenson's representation as to the hotel's chances for becoming a "top spot" on the Island and the unwarranted assurance that a customer would make money on the stock, by the use of the offering circular, addendum, and travel brochure and false financial statements, and by the omission to state material facts, the disclosure of which was necessary to render statements made not misleading, all of which selling activity was reckless and inconsistent with the required standard of fair dealing. The activity extended over a period of many months and included the several offerings of Bahamas. The anti-fraud provisions apply to all representations, whether oral or in written material such as the offering circular and the travel brochure, made both during and after the distribution of the securities in these several offerings.[34/]

Respondents point out that the customers, in general, were satisfied with their investments and felt kindly disposed toward registrant and the respective salesmen at the time of the hearing. But the views of these customers with respect to their investments, as expressed to registrant and its employees and as evidenced in their testimony, are to no small extent the consequence of the confidence reposed in the respective salesmen and of reassurances that their investments currently were

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32/ Mac Robbins & Co., Inc., 41 S.E.C. 116 (1962), aff'd sub. nom. Berko v. S.E.C., 316 F.2d 137 (C.A. 2, 1963); Duker v. Duker, cited supra at p. 15.

33/ A.J. Caradean & Co., 41 S.E.C. 234 (1962); Lawrence Securities, Inc., 41 S.E.C. 652 (1963).

34/ Ross Securities, Inc., 41 S.E.C. 509 (1963).

safe and would be profitable, if, indeed, they had not already yielded a profit. However, the issue for determination is what was told and what was omitted to be told the customer, rather than the profit or loss which the customer might sustain. The Raymer Kelly Corporation, 39 S.E.C. 756 (1960).

The purchasers and prospective purchasers were entitled to be told the material facts concerning the physical condition of the hotel and the need for the expenditure of substantial amounts of money to put it into operating condition (including the probability of future securities issues to raise such funds and the consequent dilution of any stock purchased). The failure to convey such information by making false affirmative statements and by omissions to state material facts in the selling activity, as discussed above, also constituted fraud in which each respondent participated, regardless of whether or not the customers would have relied on the accurate information, if furnished, and regardless of whether any or all customers sustained losses in purchasing Bahamas stock. Hughes v. S.E.C., 174 F.2d 969, 974 (C.A.D.C. 1949); Mac Robbins & Co., Inc. (Supplemental Opinion and Order), 40 S.E.C. 586 (1961).

The Public Interest and Sanctions

Registrant has filed a request for withdrawal of its registration as a broker-dealer, and, as stated, has not been functioning as such since December 1965. Its counsel urges that the public interest will be served if the Commission authorizes the withdrawal of the registration. I cannot agree.

Howard has had many years of experience in the securities industry and is a knowledgeable and intelligent person. In running

the business of Langley-Howard during the past several years, he took a considered risk in charging mark-ups which he regarded as justified, and he stubbornly and consistently refused to yield his position or change registrant's pattern of selling in any meaningful way. Whether his defiance had its roots in a desire for monetary gain or in the establishment of the position for which he contended, or in both, it is clear that he had adequate warning, prior to the time of the mark-up charges here involved, that the consequences of not justifying his action were serious. In December 1961, pricing violations were found by the District Business Conduct Committee of the NASD. 35/ That the NASD may have predicated that proceeding on a theory of improper mark-up which differed from the basis for the mark-up charges asserted in the instant proceedings is not, as Howard suggests, justification for registrant's sales of Onego stock. The Commission had expressed its views on mark-up policy on many occasions prior to and during the pertinent period here involved in Onego sales. In addition, as discussed above, registrant and Howard have been found by the Board of Governors of the NASD and the Commission to have violated the NASD mark-up policy in the proceeding now pending before the Court of Appeals.

Based on the wilful violations of the anti-fraud provisions in connection with sales of Onego and Bahamas, and on the violations

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35/ Registrant testified that this decision was not appealed because it was almost concomitant with an indictment in a criminal case which required full time and concentration to achieve the vindication which eventually was gained in the trial of the case.

of the provisions of Section 5 of the Securities Act in selling Bahamas, all of which were serious, flagrant and financially remunerative, I have no hesitance in finding that the public interest requires that Langley-Howard's registration should be revoked, that it should be expelled from membership in the NASD, and that Howard should be barred from being associated with any broker or dealer. I have considered Howard's reliance on Schuchert's opinion letters and advice, but lesser sanctions would not be appropriate.

The Division contends that each of the salesmen also should be barred from being associated with a broker or dealer. However, this position is predicated on proposed findings and conclusions that each man violated the securities laws as charged in the Order. The violations in the selling of Bahamas are serious, but I believe that none of these salesmen had an intention to defraud the public. The selling activity reveals a recklessness in each man and an indifference to the need for full and accurate disclosure, and it supports and requires the imposition of sanctions in the public interest. But in the absence of more flagrant types of high-pressure sales operations found in some other cases,[36/] and in light of the fact that the salesmen were guided by Howard, in whose judgment they had faith, the fact that money was being expended for the improvement of the hotel property, and the further fact that they thought that the hotel might be a profitable venture, I believe that their suspension from being associated with persons in the securities business, rather than

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36/ See, e.g. M.J. Meritt & Co., Inc., Securities Exchange Act Release No. 7878, p. 3 (May 2, 1966); Crow, Brourman & Chatkin, Inc., supra, n. 30.

permanent bar, would be appropriate in the public interest. Cf. Floyd, Earl O'Gorman and Joseph Baron (Costello Russotto & Co.), Securities Exchange Act Release No. 7959, September 22, 1966. I conclude that Barnett, Sorenson and Steigerwald should be suspended from being associated with any broker or dealer for four months and that O'Leary should be suspended from being so associated for a period of six months.[37/]

Accordingly, IT IS ORDERED that the registration as a broker-dealer of Langley-Howard, Inc. is revoked and the company is expelled from membership in the NASD; that John A. Howard is barred from being associated with any broker or dealer; that Theodore Barnett, Richard A. Sorenson, and William R. Steigerwald are each suspended from being associated with any broker or dealer for a period of four months from the effective date of this order; and that Mark E. O'Leary is suspended from being associated with any broker or dealer for a period of six months from the effective date of this order.

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

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review. If any party timely

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37/ To the extent that the proposed findings and conclusions submitted by the parties are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are rejected.

files a petition for review or if the Commission takes action to review as to a party, this initial decision shall not become final with respect to such party.

Sidney Ullman
Hearing Examiner

Washington, D.C.
May 1, 1967