IN THE MATTER OF

BOHN-WILLIAMS SECURITIES CORPORATION

(now known as Don Williams Securities Corporation)

RAY G. BOHN

DONALD J. WILLIAMS

File No. 3-1916. Promulgated Septemeber 8, 1971

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

BROKER/DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Offer and Sale of Unregistered Securities

Bids and Purchases While Engaged in Distribution

Fraud in Sale of Securities

Failure to Disclose Additional Remuneration

Failure to Comply with Record-Keeping Requirements

Improper Extension of Credit

Failure of Supervision

Where registered broker-dealer offered and sold unregistered securities and engaged in fraud in their sale, bid for and purchased stock while engaged in a distribution of such stock, failed to disclose to customers additional remuneration received from issuer's officer in connection with sales of stock, failed to comply with record-keeping requirements, and improperly extended credit to customers, in willful violation of Securities Act of 1933 and Securities Exchange Act of 1934, and failed to exercise reasonable supervision with a view toward preventing such violations, *held*, in public interest to revoke broker-dealer's registration and expel it and associated person from membership in national securities exchange and to bar associated persons from association with any broker-dealer.

APPEARANCES:

J. Donald Sullivan and *Joseph J. Carr*, for Bohn-Williams Securities Corporation (now known as Don Williams Securities Corporation), Ray G. Bohn and Donald J. Williams.

Francis N. Mithoug, for the Division of Trading and Markets of the Commission.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these private proceedings pursuant to Sections 15(b) and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner issued an initial decision in which he concluded that the registration as a broker and dealer of Bohn-Williams Securities Corporation (now known as Don Williams Securities Corporation) ("registrant") should be revoked, that registrant and Donald J. Williams, who was secretary-treasurer of registrant, should be expelled from membership in the Spokane Stock Exchange, and that Williams and Ray G. Bohn, who was president of registrant, should be barred from association with a broker or dealer. We granted a petition for review of the initial decision filed by respondents, briefs were filed by them and our Division of Trading and Markets ("Division"), and we heard oral argument. On the basis of an independent review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

Registrant became registered as a broker-dealer in April 1968, and during the relevant period Bohn and Williams occupied the positions with registrant noted above, and each beneficially owned 50 percent of its common stock and controlled its operations.[1]

OFFER AND SALE OF UNREGISTERED SECURITIES, AND BIDS AND PURCHASES DURING DISTRIBUTION

The record establishes that in August 1968 respondents willfully violated the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933 in the offer and sale of the common stock of Champion Oil and Mining Company ("Champion"), a Nevada corporation, when no registration statement had been filed or was in effect under that Act with respect to such securities.

In July 1968 Allan F. Zalk, David E. Hoover and another person acquired control of Champion, a corporate shell which had been formed in 1924 and had a small number of shareholders and whose stock had no quoted market, through their purchase for $20,000 of over 1/3 of the approximately 1,470,000

[1] Bohn ceased active participation in the operations of registrant about April 1, 1969, shortly after the institution of these proceedings, and was replaced by Williams as president around July or August. As of December 1969 Bohn had no official position with registrant, and negotiations have taken place for the sale of his ownership interest in registrant to Williams and employees of registrant. In January 1970 registrant filed an amendment to its broker-dealer registration application to show its name had been changed to Don Williams Securities Corporation.

outstanding Champion shares. Zalk arranged with Bohn and Williams, whom he told Champion was a corporate shell he had acquired and who knew Zalk and Hoover were its president and treasurer, to make available to registrant 100,000 shares of Champion stock for sale by it for the benefit of Champion through an account in Hoover's name. In addition, Bohn and Williams obtained 10,000 Champion shares from Zalk as a bonus or additional compensation in connection with the sale of Champion stock. Between August 1 and August 23, 1968, registrant sold a total of 69,100 shares for the Hoover account in about 80 transactions.

Respondents assert that they believed the Champion stock could properly be sold because Zalk stated it was exempt from registration under the so-called "grandfather" clause of the Securities Act applicable to securities issued prior to the passage of that Act,[2] Champion's counsel on Williams' inquiry verified the free-trading status of the stock under that clause, and the Secretary of State of Nevada, whom Williams also contacted, advised that Champion had been in good standing since 1925. They further assert that they did not know that Zalk's group were the sellers.

We find that respondents sold shares for an issuer in connection with a distribution and were accordingly underwriters as defined in Section 2(11) of the Securities Act.[3] Where, as here, control persons seek to dispose of a block of shares they have acquired in a shell, a "new offering" is involved which is expressly excluded from the exemption from registration provided by the "grandfather" clause of Section 3(a)(1) of the Securities Act for securities sold or offered to the public prior to or shortly after passage of that Act.[4]

The technique used in this case fits in general the classic pattern of an unlawful distribution of unregistered securities of an essentially assetless corporation of which control has been acquired for a small sum. A company formed prior to the passage of the Securities Act is selected where possible so as to give an appearance of the availability of a "grandfather" clause exemption, and the device has been used to unload

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[2] Section 3(a)(1) of the Securities Act exempts from registration a security which was *prior* to or within sixty days after passage of that Act "sold or disposed of by the issuer or bona fide offered to the public" but does "not apply to any new offering of any such security by an issuer or underwriter subsequent to such sixty days."

[3] Section 2(11) of the Securities Act includes within the definition of an "issuer" a person controlling the issuer.

[4] *Cf. U.S.* v. *Schwenoha*, 383 F.2d 395 (C.A. 2, 1967), *cert. denied* 390 U.S. 904; *S.E.C.* v. *North American Research and Development Corp.*, 424 F.2d 63, 70–71 (C.A. 2, 1970).

essentially worthless stock on public investors without the protections afforded by the registration provisions of the Act. The new owners typically engage in activities designed to quickly increase the market value of the company's stock. Among other things, a program of acquisitions financed by the sale or issuance of securities may be initiated, and frequently it is accompanied by activities violative of the antifraud provisions of the securities acts, including false and misleading statements designed to stimulate investor interest in and artificially raising the market price for such securities.[5] As discussed below, such activities were present in this case.

Where sale of securities of a shell corporation is involved, it is incumbent on a broker-dealer to exercise especial care so as to be reasonably assured that no violation of the securities laws is involved.[6] As stated above, respondents knew that Champion was a shell and that Zalk and Hoover, respectively, were its president and treasurer. We think it clear that under the circumstances they were not entitled to rely on the self-serving statements of Zalk and Champion's counsel that the securities were exempt from registration under Section 3(a)(1).[7] That they may not have known, as they have asserted, of the arrangements relating to the acquisition of stock in and control of Champion by the Zalk group cannot excuse their actions. The facts known to them called for further and more direct inquiry. They did not seek the advice of their counsel prior to the sales and did not consult him until advised to do so by our investigator when on August 22 he questioned the legality of the sales. In view of the fact that respondents knew that they were offering and selling unregistered securities, it is also clear that their violations were willful.[8]

Respondents also willfully violated Section 10(b) of the Exchange Act and Rule 10b–6 thereunder in that registrant bid for and purchased Champion stock during August 1968 while engaged in the distribution of such stock.

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[5] *Cf. S.E.C.* v. *North American Research and Development Corp.*, *supra* at 66–70; *U.S.* v. *Schwenoha*, *supra*. See also Securities Act Release No. 4982 (July 2, 1969) dealing with the application of the securities acts to trading in the securities of shell corporations.

[6] See Securities Act Release No. 4982, *supra*.

[7] See *S.E.C.* v. *Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959); *A. G. Bellin Securities Corp.*, 39 S.E.C. 178, 184 (1959). See also Securities Act Release Nos. 4445 and 4982 (February 2, 1962 and July 2, 1969) relating to the standards of conduct expected of a broker-dealer in connection with the distribution of substantial blocks of unregistered securities, particularly in situations where relatively obscure and unseasoned issuers are involved and where all the circumstance surrounding the proposed distribution are not known to the broker-dealer; and with respect to the sale of securities of a little-known inactive issuer.

[8] It is well established that a finding of willfulness does not requre an intent to violate the law; it is sufficient that the person charged with the duty intentionally commits the act which constitutes the violation. See *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965), and cases there cited.

FRAUD IN SALE OF SECURITIES

The record establishes that in connection with the sale of Champion stock between August and October 1968 respondents willfully violated the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b–5 thereunder in various respects.

1. Fraudulent and Manipulative Trading Activities

Respondents dominated and controlled the market for and artificially raised the price of Champion stock. Zalk arranged to have registrant start selling shares at 80c and attempt to move the price up to $3 as expeditiously as possible because of Champion's agreements to make certain acquisitions on the basis of stock selling for around $3. Starting with a sale at 80c per share on August 1, 1968, registrant effected transactions at generally increasing prices which reached a level of around $1.90 on August 22, generally remained at that level for about one month, and reached a high of $2.10 on October 14 in a sale by registrant for Williams. Between August and October 1968 registrant effected transactions involving 178,725 shares.

The record contains instances in which registrant purchased Champion shares for Bohn and Williams at prices far below those at which it effected contemporaneous purchases as agent for customers. Such transactions not only aided respondents' mainipulative activities by removing from the market stock obtainable at lower prices but also produced substantial profits for Bohn and Williams by giving them the benefit of those prices in preference to customers. For example, on September 24, registrant purchased shares for Bohn at $1.50 and for customers from his account at $1.89 in execution of the customers' purchase orders, two of which had been placed with it prior to Bohn's purchase. Similarly, on September 26, registrant bought shares for Williams at $1.50 and the following day effected the purchase for a customer at $1.90 of shares from his and Bohn's accounts.[9] Again on October 10, despite existing purchase orders of customers, registrant purchased shares for Williams at $1 and for those customers at $1.60. On the same day it also effected a transaction involving a sale for Williams and purchase for a customer at $1.90, without disclosing that the seller was Williams or that he had earlier that day purchased Champion shares at $1. On October 11 registrant purchased Champion shares for Bohn, Williams and an employee

[9] Around the end of September Bohn purchased from Zalk 10,000 shares at $1 per share in a transaction not handled by registrant.

at $1 and for a customer at $1.60 and effected the sale of shares at $1.90 for Williams and the employee to customers for whom it also acted as agent.

Respondents claim that Bohn and Williams were able to purchase stock below the trading price because it was offered in a block at that price. The fact that an entire block had to be purchased to obtain an advantageous price would not, however, afford any justification for the preferential treatment which was accorded Bohn and Williams.[10] In situations in which registrant had on hand customer purchase orders, respondents were required to fill those orders first and, in the case of a block offering which they accepted, to limit any purchases for themselves to any shares of the block that remained after filling such orders. In one of the instances noted above, registrant was in receipt of three customer orders, two of which were each for amounts equal to the number of shares bought for Williams at the preferential price. Respondents did not disclose to customers Bohn's and Williams' personal transactions and the activities described were both manipulative and a fraud on the customers.

2. Dissemination of False and Misleading Sales Literature

Champion provided registrant with a large number of copies of a stockholder letter dated July 24 and signed by Zalk, which registrant made available to customers at its office in Spokane and furnished in response to inquiry concerning Champion. The letter recited that a mining program was being activated by means of acquisitions and projects which were being negotiated and for which certain contracts had been acquired and referred to three specified mining projects. It stated that Champion had contracted to acquire the Curlew Mine for $1,650,000, to be paid through the issuance of convertible preferred shares and that the company intended to market 200 tons or more per day and within six months would install a 200-ton per day mill and a smelter. It also referred to negotiations to purchase the Lost Lode Mine for $220,000, to be paid out of a 10 percent royalty override, and stated that the assay values from 27 assays furnished Champion from that mine's developed ore body showed over $120 per ton average. It further recited that an agreement had been signed to acquire for $1,675,000 the Cavalli-Hughes claims and the operator's 120-ton per day mill which was currently processing at capac-

[10] Bohn testified that "if we get an offer [to buy Champion stock] at a price that is attractive, we purchase it personally."

ity and producing concentrates from ore that was assaying 5.8 percent copper, over 34 ounces of silver and a small amount of free gold. The letter was materially false and misleading.

As has been seen, Champion was a recently acquired corporate shell, and it had no cash or assets immediately after Zalk took control. The stockholder letter, however, made no disclosure of the acquisition and operation problems Champion faced in view of its lack of cash resources. The arrangements to issued preferred stock for the Curlew Mine had been made with the lessees of the mine; its owners required cash. A proposed "250 ton" per day mill for that mine was estimated to cost between $300,000 and $400,000. The Lost Lode Mine was acquired for stock and cash consisting of $20,000 down and minimum payments, with respect to which Champion is presently delinquent, of $5,000 a month. The Lost Lode Mine assays were furnished by the seller, and Champion did not verify them, and no shipments have been made from that mine since July 24, 1968. Champion never acquired the Cavalli-Hughes claims, which were to be paid for with cash and stock, and the mill referred to in the letter was not producing ore from those claims but was engaged in custom milling for other mines.

Respondents cannot excuse their use of the fraudulent literature by their assertions that the investors in Champion stock were principally sophisticated investors and that the record does not show that any purchases were made in reliance upon it. It is sufficient that such literature was used by registrant in connection with the sale of securities.[11] Although respondents were aware that Champion was a recently acquired shell and had no financial information with respect to it, they did not make any adequate inquiry to verify the company's statements in the letter concerning its financial condition and contractual arrangements and the value of the properties acquired or to be acquired by it.

FAILURE TO DISCLOSE ADDITIONAL REMUNERATION

As stated above, Bohn and Williams obtained from Zalk 10,000 shares of Champion stock as additional compensation in connection with the sale of the stock.[12] However, such additional remuneration was not disclosed to customers for whom registrant thereafter effected transactions from August 9 to 23, 1968. Under the circumstances, registrant, willfully aided

[11] *Cf. N. Sims Organ & Co., Inc.*, 40 S.E.C. 573, 575 (1961), *aff'd* 293 F.2d 78 (C.A. 2, 1961), *cert. denied* 368 U.S. 968.

[12] The shares were issued on August 2, 1968 in the name of registrant's bookkeeper.

and abetted by Bohn and Williams, willfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1–4 thereunder.[13]

FAILURE TO COMPLY WITH CREDIT-EXTENSION AND RECORD-KEEPING REQUIREMENTS AND FAILURE OF SUPERVISION

The record shows that between May and October 1968, registrant in about 30 instances failed to promptly cancel or liquidate purchases in cash accounts of customers who did not make payment within seven business days or the extended period of time granted for payment. We find that by such failure, registrant, willfully aided and abetted by Bohn and Williams, willfully violated the credit-extension provisions of Section 7(c) of the Exchange Act and Regulation T promulgated by the Board of Governors of the Federal Reserve System.

In addition, between August and October 1968, many of registrant's memoranda of agency orders did not show the times of entry and execution of the orders, as required by Section 17(a) of the Exchange Act and Rule 17a–3 thereunder. Those omissions constituted willful violations of that Section and Rule by registrant, willfully aided and abetted by Bohn and Williams.

We further find that registrant, and Bohn and Williams, who owned and controlled registrant, failed to exercise reasonable supervision with a view toward preventing the violations found by us.

PUBLIC INTEREST

Respondents urge that lesser sanctions should be imposed than ordered by the hearing examiner. They assert, among other things, that certain violative activities took place shortly after registrant began business and that those violations were unintentional, that they took prompt corrective action and made full disclosure to our staff, that registrant has adopted procedures to prevent future violations, that they were deceived by Zalk, and that Bohn, who had the principal dealings with Zalk and made the Champion stockholders' letter available to customers, is no longer actively associated with registrant. They also claim that no financial losses were suffered by investors.

[13] Rule 15c1–4 requires, among other things, that a broker furnish his customer, at or before the completion of a transaction, written notification disclosing the source and amount of any commission or other remuneration received or to be received by him in connection with the transaction.

In light of the serious and pervasive violations found, the factors presented by respondents do not in our opinion justify reduction of the sanctions the examiner considered appropriate. Those violations demonstrated an inability or unwillingness to engage in the securities business in conformance with applicable requirements. Moreover, even after the legality of the Champion stock sales had been questioned by our investigator on August 22, registrant sold around 9,000 shares for the Hoover account on August 23 and engaged or continued to engage in fraudulent and manipulative conduct.[14] It is also clear that not only Bohn but also Williams, who with Bohn owned and operated registrant, is culpable. Although Zalk's initial contact with registrant was made through Bohn, Williams met Zalk shortly thereafter and participated in the agreement relating to the distribution and market manipulation of the unregistered Champion stock. And the claim that customers suffered no losses is unacceptable. As seen, customers were denied the more favorable prices which should have been available to them but which were given to Bohn and Williams and were made to pay higher manipulated prices. Even assuming customers could on a resale obtain a price equal to or more than they paid, they would, of course, realize less than they would have had they paid the lower proper prices.[15]

Finally, we note that although violations began shortly after registrant had commenced business, Bohn and Williams had previous securities selling experience, assertedly with respect to intra-state issues; and, in any event, the misconduct we have found, particularly with respect to market manipulation and preferential price treatment, is of such a nature that its impropriety was or should have been obvious to respondents irrespective of prior securities experience.

Under all the circumstances we conclude, as did the hearing examiner, that the public interest requires that registrant's registration be revoked, that registrant and Williams be expelled from membership in the Spokane Stock Exchange, and that Bohn and Williams be barred from association with any broker or dealer.[16]

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[14] In February 1969 the United States District Court for the Eastern District of Washington, Northern Division, entered a decree of permanent injunction, on the basis of a complaint filed by us and with the consent of respondents who did not admit the allegations of such complaint, enjoining them from offering, selling or delivering unregistered securities of Champion. Civil Action File No. 3229.

[15] *Cf. Atlantic Equities Company*, 43 S.E.C. 354, 368 (1967).

[16] The exceptions to the initial decision of the hearing examiner are overruled to the extent that they are inconsistent with our decision and sustained to the extent that they are in accord.

An appropriate order will issue.

By the Commission (Chairman CASEY and Commissioners OWENS, NEEDHAM, HERLONG and LOOMIS).