

IN THE MATTER OF
L. A. FRANCES, LTD.
A. FRANK SIDOTI
LAWRENCE MARTIRE
LOUIS BENJAMIN MEADOWS

File No. 3-1987. Promulgated June 22, 1971

Securities Exchange Act of 1934—Section 15(b)

BROKER-DEALER PROCEEDINGS

Sale of Unregistered Securities

Inadequate Supervision

Where two registered broker-dealers and manager of one effected sales of unregistered stock of issuer's controlling persons as to which by exercise of reasonable diligence they should have known no exemption from registration provisions of Securities Act of 1933 was available, *held*, their conduct constituted willful violations of registration provisions and in public interest to impose suspensions on them and on president and sole stockholder of broker-dealer who failed reasonably to supervise manager.

APPEARANCES:

Kevin Thomas Duffy, Paul Chernis, Dennis J. Block, and David M. Greenberg, of the New York Regional Office of the Commission, for the Division of Trading and Markets.

Irwin L. Germaise, of Germaise and Quinn, for L. A. Frances, Ltd., A. Frank Sidoti and Lawrence Martire.

Efrem A. Gordon, for Louis Benjamin Meadows.

FINDINGS, OPINION AND ORDER

Following hearings in these proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934, the hearing examiner filed an initial decision concluding that the registration as a broker and dealer of L. A. Frances, Ltd. should be suspended for 20 days, that A. Frank Sidoti, the manager of Frances, should be suspended from association with any bro-

ker or dealer for one year, and that Lawrence Martire, Frances' president and sole stockholder, and Louis Benjamin Meadows should each be suspended from such association for a period of 2 months.¹ We granted petitions for review filed by the respondents and in addition determined to review the initial decision on our own initiative with respect to all issues which were before the examiner. Briefs were filed by respondents and by our Division of Trading and Markets. 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.

As found by the examiner, during the period December 1966–February 1967, Frances, Sidoti, and Meadows willfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 in the offer and sale of common stock of Vista Industries Corporation when no registration statement had been filed or was in effect with respect to such securities, and Martire failed reasonably to supervise Sidoti in the operations of Frances with a view to preventing such violations. The transactions in question involved the distribution of a total of 60,000 shares of Vista stock owned by a controlling group comprised of Harry Vogel, his brother Eugene Vogel and Philip Levy, who during the above period were Vista's officers and together owned about 32 percent of its approximately 2 million outstanding shares. Of the total, 5,000 shares were sold by H. Vogel and 10,000 shares by Levy directly to Frances, in the names of nominees, while the remaining 45,000 shares were sold by the three insiders in their own names through Meadows to Frances. All 60,000 shares were resold by Frances to its customers; during the period of such sales, its prices ranged from about 65c to about \$1.12 per share.

It is evident that respondents' transactions in unregistered Vista stock violated Section 5, unless an exemption from the registration requirements of that Section was available.² The burden of proving the availability of an exemption from the general policy of the Securities Act requiring registration rests with those claiming the exemption.³ Here it is not clear that an

¹ During the period relevant to these proceedings, Meadows was engaged in the securities business as sole proprietor of Louis B. Meadows & Co., a registered broker-dealer. That registration was withdrawn in December 1967 and Louis B. Meadows & Co., Inc., of which Meadows is president and principal stockholder, succeeded to its business. The corporate successor was not named as a respondent in these proceedings.

² See, e.g., *Gilligan, Will & Co.*, 38 S.E.C. 388, 391 (1958), *aff'd* 267 F.2d 461 (C.A. 2, 1959), *cert. denied* 361 U.S. 896.

³ See *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119 (1953); *S.E.C. v. Culpepper*, 270 F.2d 241, 246 (C.A. 2, 1959).

exemption is even being claimed, although the Frances respondents seem to suggest that an exemption was available under Section 4(4) of the Securities Act and Rule 154 thereunder.⁴ The record shows, however, that no such exemption was available. It is clear that the three closely related sellers effected a distribution of 60,000 shares, or approximately 3 percent of the shares outstanding, substantially exceeding the 1 percent limitation of Rule 154.⁵ Moreover, Frances executed the transactions in a manner which did not comply with the conditions for an exemption. Its sales were not "brokers' transactions," within the meaning of Section 4(4), since it purchased and resold the shares as principal, and in addition it solicited purchasers.

Respondents' principal contentions are that Sidoti and Meadows acted with due diligence to satisfy themselves that the transactions were legal, that they were misled by the sellers, and that any violations by them were not willful. The record does not support their position. It is well established that a broker-dealer offered or asked to sell a substantial amount of securities has a responsibility to take reasonable steps to determine that the proposed sales by him would not constitute participation in transactions by an issuer or controlling person which require registration under the Securities Act.⁶ Here the proposed transactions were rife with "red flags" which called for a searching inquiry on the part of Sidoti and Meadows before lending the facilities of their firms to a substantial distribution without the investor protections provided by Section 5.

With respect to the first 15,000 shares, the orders, as noted, were placed directly with Sidoti by H. Vogel and Levy. The nominee sellers were relatives of Vogel and Levy, but that fact was not disclosed to Sidoti. However, Sidoti, who had dealt in Vista stock for some time on behalf of Frances, was personally acquainted with the Vogels and Levy and knew of their official position in and control relationship with Vista. Despite the fact that the orders which were placed by them involved substantial blocks of stock, he admittedly did not inquire into the

⁴ Section 4(4) exempts from the provisions of Section 5 "brokers' transactions executed upon customers' orders . . . but not the solicitation of such orders." Rule 154 was adopted by this Commission to interpret and define various terms used in Section 4(4) and to indicate more clearly the scope of the exemption for a broker offering or selling securities on behalf of a person in a control relationship to the issuer. See Securities Act Release No. 4818 (January 21, 1966).

⁵ Rule 154 defines "distribution" as not including sales of not more than 1 percent of the shares outstanding.

⁶ See *Sutro Bros. & Co.*, 41 S.E.C. 470, 479 (1964).

manner in which the purported sellers had acquired the shares⁷ and made no effort to contact them.

As indicated above, the remaining 45,000 shares, which were comprised of 15,000 shares owned by H. Vogel, 20,000 by E. Vogel and 10,000 by Levy, travelled a more circuitous route. H. Vogel initiated the sales by contacting S, a trader with a New York securities firm which had been making a market in Vista stock. He identified himself as an officer of Vista, advised S of the identity of the proposed sellers, and stated that they wanted to avoid paying New York stock transfer taxes on the transactions, and that he had an "opinion letter" covering the stock. S in turn asked K, whom he believed to be associated with Meadows, a Massachusetts firm, whether Meadows could handle the transaction. S specified the amount of commission to be charged, which was less than would normally be payable, and designated Frances as the firm to which Meadows would resell the stock, having obtained Sidoti's agreement to purchase the stock. K, who was actually employed by a New York firm which had a direct wire to Meadows' office and made a market in New York for Meadows, called Meadows who, upon being advised by K that he could see nothing wrong with the proposed transaction, agreed to handle it. According to Meadows, he was not informed by K that the sellers were affiliated with Vista. Meadows communicated with the sellers, who represented orally or on customer cards which two of them filled out, that they were associated with Vogel's Dairy. That company was a subsidiary of Vista; however, the sellers did not advise Meadows of that fact or of any connection between them and Vista.

With respect to the role of the Frances respondents in the sale of this block, Sidoti knew that the sellers were controlling persons of Vista. He saw an opinion letter, which each of the Vista principals had obtained from an attorney, stating that the sales of Vista stock by such principal could be made without registration provided that, among other things, the sales were made through a broker who did not solicit any buy orders.⁸ As noted, however, Sidoti caused Frances to purchase the shares for its own account, and he admitted that purchasers were solicited. Moreover, even aside from counsel's

⁷ Sidoti testified that he asked Levy whether the 10,000 shares were "good stock, because it was a large piece" and that he consummated the transaction after Levy assured him that the stock was "good."

⁸ The three opinion letters of the attorney, which bore the same date, stated that the opinion that an exemption was available under Section 4(4) of the Securities Act and Rule 154 thereunder was based on the understanding that the proposed sale by the principal together with all sales by him and his immediate family within the preceding 6 months would not exceed 1 percent of Vista's outstanding shares.

letter, which failed to give consideration to the aggregate size of the sales being made by the three Vista principals, Sidoti and Frances had a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act.⁹

Meadows asserts that he did not know of any connection between the selling stockholders and Vista, that he was assured by H. Vogel that the sales were proper, and that he relied on the advice of K, who was more experienced than he was, as well as on the fact that, as reflected by published quotations, Vista stock was being actively traded. However, the circumstances surrounding the transaction were such as to put Meadows on notice of possible irregularities and called for more diligent investigation than he undertook. The transaction itself was unusual in nature and it involved a substantial amount of stock being sold by persons previously unknown to him and who he knew were all associated with the same company, and an issuer with which he was not familiar. According to Meadows, he was advised by K that the firm which employed S could not handle the transaction because it was not a retail house.¹⁰ This was not a plausible reason, however, in light of the fact that the purchase of the whole block by Frances had already been arranged and no retail effort was required for that transaction. Moreover, although Meadows inquired of the sellers regarding their business or occupation, he did not specifically inquire of them or of K whether they were connected with Vista.

Respondents suggest that in view of the deception practiced by the sellers on them, and the fact that Vista was its own transfer agent, further inquiry would have been fruitless. However, we need not speculate as to what reasonable inquiry would have disclosed where no such inquiry is made.¹¹ Nor are respondents aided by the fact that the Vista certificates involved in the transactions did not contain restrictive legends.¹² In such a context as that presented here, it is not sufficient for a broker-dealer merely to accept self-serving statements of his sellers without reasonably exploring the possibility of contrary facts.¹³ It is clear that in light of their failure to do so, the violations by Frances, Sidoti and Meadows were willful.¹⁴

⁹ See, e.g., *Strathmore Securities, Inc.*, 43 S.E.C. 575, 582 (1967), *aff'd* 407 F.2d 722 (C.A.D.C., 1969).

¹⁰ The confirmations sent by Meadows to two of the sellers were marked "through courtesy of 'S' firm."

¹¹ See *Strathmore Securities, Inc.*, *supra*, p. 584.

¹² See *Quinn and Company, Inc.*, 44 S.E.C. 461 (1971), app. pending (C.A. 10, No. 71-1090).

¹³ *Cf. S.E.C. v. Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959).

¹⁴ See *Strathmore Securities, Inc.*, *supra*, p. 585.

On the issue of Martire's supervision, the record shows that during the period in question he delegated complete authority over the day-to-day operations and decisions to Sidoti.¹⁵ Although Sidoti testified that Martire was in daily communication with him and discussed such matters as profits and losses and problems of the firm, Sidoti was not required to check with Martire before taking positions in securities and Martire did not review the firm's records. As president and chief executive officer Martire "necessarily assumed the duties of keeping himself informed of registrant's activities, of providing adequate supervision, and of taking whatever steps might be necessary to secure compliance with the law."¹⁶ His reliance on Sidoti did not constitute compliance with those duties and we agree with the examiner's conclusion that he failed reasonably to supervise Sidoti with a view to preventing the Section 5 violations.

PUBLIC INTEREST

Respondents contend that the public interest does not require the imposition of any sanctions.¹⁷ Aside from the arguments regarding their asserted diligence which we have discussed, respondents argue that no detriment to public investors appears to have resulted from their transactions. That argument overlooks the fact that their conduct deprived public investors of the protection afforded by the registration and prospectus provisions of the Securities Act which are designed to permit prospective purchasers to make an informed investment judgment. Indeed, in light of the cardinal role occupied by broker-dealers in the securities distribution process, we cannot overemphasize the importance of their obligation to take all reasonable steps to avoid participation in distributions violative of those provisions. Respondents' conduct fell far short of meeting that obligation.

In reaching his conclusions regarding sanctions, the examiner took into consideration disciplinary action taken against Sidoti and Meadows by the National Association of Securities Dealers, Inc. ("NASD"). In 1963, Sidoti's registration as a registered representative was suspended for one year and he

¹⁵ Martire was president, director and sole stockholder of a company engaged in the automobile repair business.

¹⁶ *Albion Securities Company, Inc.*, 42 S.E.C. 544, 547 (1965). See also *Aldrich, Scott & Co., Inc.*, 40 S.E.C. 775, 778 (1961).

¹⁷ The Frances respondents also claim that due process required a separate hearing on the sanctions issue after the examiner had determined that violations had occurred. They have not, however, presented any supporting reasons for this contention, and we find it to be without merit.

was fined and severely censured, based on findings of violations of certain NASD and Commission rules by a broker-dealer of which he was then president. Those violations included improper hypothecation of customers' securities, improper extension of credit, failure to make proper disclosure in dual agency transactions, failure to register a representative with the NASD and non-compliance with net capital requirements. In 1969, the NASD suspended Meadows' registration for 30 days and fined and censured him. That action was based on violations by a broker-dealer of which he was a principal prior to May 1966, including violations of net capital requirements and failure to maintain written supervisory procedures, to make appropriate disclosure to customers with free credit balances, and to maintain required information regarding customer accounts.¹⁸

We have concluded that under all the circumstances the two-month suspension imposed by the examiner with respect to Meadows and Martire and the one-year suspension of Sidoti are appropriate in the public interest. However, as to Sidoti, we consider that his conduct demonstrates that he should not be entrusted in the future with supervisory responsibilities, and we will therefore additionally provide in our order that, following his one-year suspension he may not be associated with any broker or dealer in a managerial or supervisory capacity without our approval. We further consider that the public interest requires a two-month suspension of Frances' registration.¹⁹

Accordingly, IT IS ORDERED that the registration as a broker and dealer of L. A. Frances, Ltd. be, and it hereby is, suspended for a period of two months; that A. Frank Sidoti be, and he hereby is, suspended from association with any broker or dealer for a period of one year and thereafter barred from such association in a managerial or supervisory capacity except with the prior approval of the Commission; and that Lawrence Martire and Louis B. Meadows be, and they hereby are, suspended from association with any broker or dealer for a

¹⁸ Contrary to Meadows' assertion that he was no longer associated with that firm at the time of the net capital violations, the NASD decisions show that he was a principal of the firm during most of the period for which such violations were found. There is no basis for his assertion that he was not given an opportunity to offer any evidence concerning the NASD action; moreover, such action was not open to collateral challenge in the instant proceedings. See *Richard C. Spangler, Inc.*, 43 S.E.C. 1093 (1969).

¹⁹ The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.

period of two months. The above suspensions are to take effect at the opening of business on June 28, 1971.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG), Chairman CASEY not participating.