ADMINISTRATIVE PROCEEDING
FILE NO. 3-6149

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

A. L. WILLIAMSON & CO. :
GROVER MacCONNELL
:

INITIAL DECISION

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Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: Andrew E. Goldstein, Sandra L. Dolan and David A. Lestch, of the Commission's New York Regional Office, for the Division of Enforcement.

Grover MacConnell, pro se and, as its president, for A. L. Williamson & Co. */

BEFORE: Max O. Regensteiner, Administrative Law Judge

*/ Respondents were represented by counsel during the pre-hearing and hearing stages.

In these proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act"), the Division of Enforcement alleged that A. L. Williamson & Co. ("registrant"), a registered broker-dealer, and Grover MacConnell, one of its principals, willfully violated certain securities law provisions in connection with offers to sell and transactions in the common stock of Lilac, Inc. in early 1980. Both respondents were charged with violating Section 5 of the Securities Act of 1933 by offering and selling about 10,000 shares of Lilac stock when no registration statement had been filed or was in effect. MacConnell was charged additionally with violating anti-fraud provisions of the securities laws (Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 under the latter provision) by creating an artificial trading market with inflated prices in Lilac stock and failing to disclose such activities. The Division further alleged that respondents had been permanently enjoined from violating the above provisions.

Following hearings, the parties filed proposed findings and conclusions and supporting briefs, and the Division filed a reply brief. Thereafter, in another proceeding involving respondents, the Commission, on the basis of their settlement offers, revoked registrant's registration and barred MacConnell from association with any broker-dealer and certain other regulated entities,

provided that after two years he could apply to become so associated in a non-supervisory capacity. (Exchange Act Release No. 19745, May 9, 1983, 27 SEC Docket 1533) As a result, the issue as to the remedial action, if any, to be taken as to registrant has become moot. Findings are made herein concerning the remaining issues. Such findings are based on the preponderance of the evidence as determined from the record and upon observation of the witnesses.

Respondents

MacConnell has been in the securities business approximately 30 years. For several years prior to joining registrant, a New Jersey firm, in 1979, MacConnell had his own broker-dealer firm. In January or February 1980, he became registrant's vice-president, financial principal and a shareholder. Subsequent to the events here under consideration, he became president.

Background

As of the beginning of 1980, Lilac was a "shell" corporation, i.e., it had no assets or liabilities and no business operations. Some years earlier, Lilac, then a non-public corporation with limited business operations, had merged with a publicly-held shell corporation which had previously made an intrastate offering in Minnesota. During the relevant period, Lilac had about 600 shareholders and

about 465,000 outstanding shares of common stock. There was no public trading market in its stock.

Douglas Grobe was a controlling person of Lilac. As of March 1, 1980, he owned 118,000 shares of its stock, representing about 25 percent of the outstanding stock. He had acquired 18,000 shares prior to the above-mentioned merger, apparently for the most part from other shareholders. The remaining 100,000 shares had been issued to him by Lilac in 1978 for services and expenditures in attempting to arrange another merger.

In early 1980, Grobe,who was looking for a merger partner for Lilac, met Robert Duffy, president of Shalako Enterprises, Inc., a privately-held Delaware corporation with offices in California. Shalako, which had land holdings and was engaged in motion picture production, was interested in merging with a publicly-owned shell and thereby "going public." Grobe, on behalf of Lilac, subsequently negotiated a preliminary agreement with Shalako. As reflected in a letter of intent from Shalako to Lilac dated February 15, 1980, Lilac was to acquire all of Shalako's outstanding stock in return for 3.25 million shares of its stock. The Lilac management would then be replaced by Shalako nominees. According to the letter of intent, it was a condition of the transaction that Lilac would be "trading on the over-the-counter market at the time of acquisition" (Div. Ex. 9). The Division contends that what was contemplated by this condition was an active trading market and not

simply a listing for Lilac stock. It argues that the condition lies at the heart of the alleged misconduct, because MacConnell, in attempting to effectuate it, "came to grief" when he participated in the creation of an artificial market and sold a substantial amount of unregistered control stock. Respondents, on the other hand, take the position that the meaning of the condition was only that Lilac stock be listed in the pink sheets, not that it be actually or actively traded.

In any event, at the time of the transactions in question, which covered a three-week period beginning on March 3, 1980, the merger or acquisition was still far from consummation. It appears that shareholders' meetings to vote on the transactions were held in April. The merger did not take place until some months later.

Respondents' involvement is attributable to MacConnell's acquaintance with Grobe, which apparently stemmed from a shared interest in shell corporations. MacConnell attended a meeting in January 1980 with Grobe and Shalako representatives, where Grobe proposed Lilac as a merger partner for Shalako and MacConnell indicated an interest in being a market maker after Shalako had "gone public." MacConnell thereafter was in frequent contact with Grobe. While he did not see the letter of intent with its "trading" condition until after he had already begun making a market in Lilac stock, MacConnell testified that it was

clear from "day one" when he first met Shalako's representatives that Lilac had to be a "public trading company" at the time of the merger (Div. Ex. 5A, p. 52). All concerned understood that MacConnell, and through him registrant, would undertake to satisfy that condition.

In February 1980, MacConnell received from Grobe various information and materials concerning Lilac which he needed in order to get Lilac listed in the "pink sheets." On February 25, 1980, registrant, through MacConnell, filed the appropriate form with the National Quotation Bureau to list Lilac in the sheets. The initial quotations, published on Friday, February 29 were $.05 bid and $.10 asked. Thereafter, registrant inserted no further numerical quotations; it appeared in the sheets on a "name only" basis. Its name was in the sheets, and it was the only dealer listed in the sheets for Lilac, every business day until March 24, 1980. Trading in Lilac stock began on March 3 and prices climbed steadily. On March 24, the Commission suspended trading for a 10-day period commencing March 25.[1/] In its order, the Commission cited an unusual and unexplained price rise and market activity in Lilac stock, when there was no publicly available information to justify such activity, since a recent Lilac financial statement indicated that it had no assets, no liabilities and no ongoing

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1/ Securities Exchange Act Release No. 16692, 19 SEC Docket 993.

business operations. Following termination of the suspension, registrant again appeared in the sheets for Lilac in name only.

The trading in Lilac stock that took place is discussed in some detail below. Registrant occupied a dominant position in the market from March 3 to March 18. Among the shares it purchased and then resold were 10,000 shares emanating from Grobe.

Violation of Registration Provisions

During the first three days of trading in Lilac stock, registrant, through MacConnell, purchased for its own account a total of 10,000 shares in six transactions. In each case the seller was Midwest Discount Securities, a Minneapolis broker-dealer, acting as agent for Grobe. Registrant sold these shares to other broker-dealers. Grobe was concededly a controlling person of Lilac. Section 2(11) of the Securities Act, which defines the term "underwriter" to include any person purchasing securities from an issuer with a view to their distribution, specifies that as used in that Section, the term "issuer" includes a controlling person of the issuer. In consequence, respondents were "statutory underwriters." It makes no difference, in this connection, whether the shares sold by Grobe were those he had obtained from the issuer or shares acquired in transactions which were themselves exempt

from registration.[2/] Since no registration statement had been filed by Lilac, and since the offer, sale and delivery of the shares were effected by use of the mails and the facilities of interstate commerce, it follows that respondents violated Sections 5(a) and 5(c) of the Securities Act. But violations are not a predicate for disciplinary action unless they are "willful." On that issue, the critical question appears to be whether MacConnell knew or should have known that the stock that registrant purchased emanated from Grobe.[3/]

Respondents claim they did not know and had no reason to believe the 10,000 shares belonged to Grobe. They assert that MacConnell knew that Grobe would not sell his 100,000 shares of restricted "investment stock" and was not aware that Grobe had additional shares; that neither Grobe nor Ben Reuben, Midwest's president and trader who handled the Lilac transactions, told MacConnell that the stock came from Grobe; and that the transactions were normal inter-dealer transactions

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2/ See Gearhart & Otis, Inc., 42 S.E.C. 1, 27 (1964), aff'd 348 F.2d 798 (D.C. Cir. 1965): "Neither registration itself nor . . . an exemption therefrom. . . attaches to the security. A subsequent offering of securities that have . . . once been sold pursuant to some valid exemption . . . must stand on its own feet. The sale to the public by a controlling person of a large block of securities previously exempted from registration entails all of the dangers incident to a new offering of securities to the public."

3/ See International Shareholders Services Corporation, 46 S.E.C. 378 (1976); D.H. Blair & Co., 44 S.E.C. 320 (1970).

involving small amounts of stock, with the largest ones involving just 3,000 shares, and did not require respondents to investigate further.

The Division takes a contrary position. It points out that MacConnell called Grobe at least twice for the purpose of having Grobe inject Lilac stock into the newly-created market, and that these calls resulted in Lilac stock coming into the market. The Division argues that in context -- including the facts that Lilac stock had not been traded for years and that there was no "trading float" -- the 10,000 shares did represent a sizeable block and that respondents therefore had a duty to investigate the source of the shares. The Division further stresses that respondents had had prior transactions with Reuben at Midwest, also involving Grobe, and asserts that they were therefore familiar with Reuben's role as broker for Grobe.

The record shows that on March 3, 1980, the first day of trading, MacConnell called Grobe to tell him it was "okay" to trade Lilac stock and that, according to Grobe's testimony, "they'd have to get some stock into the market to make a trade" (Tr. 318, 321). MacConnell himself testified that he told Grobe that "if there was any activity in the stock, he better put some stock into the market" (Tr. 599). Following the conversation, two blocks of 1,000 shares each were offered and sold by Midwest to registrant. On March 4,

MacConnell again called Grobe and said he was "short of stock" and that Grobe would have to find some (Div. Ex. 18). At that point, registrant had a short position of 1,000 shares. Grobe testified that he told MacConnell he would call around and try to find some; that he did so but was unsuccessful; and that he thereupon sold 3,000 shares through Midwest. In three other transactions on March 4 and 5, Midwest, as agent for Grobe, sold an additional 5,000 shares to registrant.

The prompt response which MacConnell obtained following his conversations with Grobe should have indicated to him that Grobe himself was the likely source of the shares which Midwest offered to registrant. Even aside from this circumstance, however, respondents had a duty to undertake a "searching inquiry" into the source of the stock which provided their supply.[4/] Contrary to respondents' suggestion, this was not an ordinary trading situation. The issuer was a shell corporation, and its stock had not previously traded or at least not for several years. MacConnell could not simply assume that Grobe would not sell his stock because it was restricted. And he could not shed his own responsibility by pointing to the failure of Grobe and Reuben to advise him that the stock was Grobe's. As the Commission has said,

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4/ See Distribution by Broker-Dealers of Unregistered Securities, Securities Act Release No. 4445 (February 2, 1962).

> [w]here [the] 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. 5/

Accordingly, I conclude that respondents' violations of Section 5 were willful.

Violation of Antifraud Provisions

The order for proceedings alleges that MacConnell willfully violated the previously-noted antifraud provisions in that (1) alone or with others, he created an artificial trading market in Lilac stock; (2) he established artificially inflated prices bearing no reasonable relationship to the stock's value; (3) he purchased and sold Lilac stock at inflated prices; and (4) he failed to disclose to purchasers from registrant those matters and the fact that a control person (Grobe), who was among persons artificially inducing the market, was himself a significant source of the shares being sold in the market. 6/

The Division's theory of the case is essentially as follows: MacConnell was motivated by the need to create an active trading market in Lilac stock in order to meet the condition precedent to the merger imposed by Shalako. After establishing registrant as market maker for Lilac stock, he began trading

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5/ Bohn-Williams Securities Corporation, 44 S.E.C. 709, 712 (1971).

6/ Registrant was not charged with antifraud violations.

by telling Grobe that he needed to see stock come into the market. Thereafter, he raised his quotations, as well as his purchase and sale prices, with each successive transaction. Sale prices moved from $.10 in the first transaction on March 3 to as high as 2 1/4 on March 18. Both supply and demand were induced and contrived. On the supply side, which MacConnell directly induced during the early days of trading, Grobe's 10,000 shares were the only shares purchased by registrant during the first three days. Other shares later sold into the market came at least in part from associates and acquaintances of Grobe. On the demand side, MacConnell knew that the demand was being induced by leaks of inside information concerning the prospective merger. In this contrived market, MacConnell consistently raised his quotations, with the result that prices bore no relationship to legitimate supply and demand.

I am not persuaded that the Division has made its case. While the events under consideration lend themselves to the suspicion that there may be more here than meets the eye, my findings are of course confined by the terms of the allegations and the four corners of the record (including reasonable inferences to be drawn). The most reasonable inferences that I can draw from the record are that (1) demand for Lilac stock was stimulated by leaks of information concerning the proposed merger, emanating from

persons associated with Lilac; (2) MacConnell's market making conduct was responsive to that demand; and (3) the supply of stock also came, at least for the most part, from persons aware of the prospective merger.

The Division states that the "gravamen" of its case revolves around the "basic requirement" imposed on respondents by Lilac and Shalako, which it characterizes as the creation of "an active trading market in Lilac securities" (Reply brief, p. 15). As previously noted, the letter of intent to which the Division has reference specified that at the time of acquisition Lilac would be "trading on the over-the-counter market." MacConnell, as noted, did not see the letter until trading had already commenced. He was aware, however, that Lilac had to be a "public trading company" as of that time. The intended purpose or meaning of the "trading" requirement is shrouded in ambiguity. It was Shalako which in fact imposed the requirement. The Division did not call Shalako's attorney, who drafted the letter of intent. The testimony of Duffy, Shalako's president, although far from clear, indicates that his concern was that the Lilac stock be legally capable of being publicly traded at the time the Shalako shares were to be exchanged for such stock. 7/ That

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7/ Duffy did not testify at the hearing. His testimony given during the Division's investigation, together with exhibits marked during such testimony, were made part of the record by stipulation, as Division exhibits 114 and 114-A.

Another witness (Brewer), who knew Duffy well, testified that Duffy was not a "detail man" in "those areas" (Div. Ex. 115, p. 38).

this was the intent of the condition seems more likely than the Division's interpretation. Indeed, it appears to me that it was to Shalako's disadvantage to have the market price of Lilac stock rise prior to the final determination of the number of Lilac shares to be issued to the Shalako stockholders, since an increase in the price could result in the issuance of fewer shares. MacConnell's own testimony on this point is to the effect that, as he understood it, the meaning of the condition was that Lilac would have to be in the pink sheets and "just had to be a public company," and that there did not have to be any actual trading (Div. Ex. 5A, p. 58).

Turning now to the actual trading activity, the record does not support the Division's argument that MacConnell initiated such activity by inducing Grobe to provide registrant with a supply of stock. MacConnell testified that he wanted to have little if any trading in Lilac stock prior to public announcement of the prospective merger. He further testified that on March 3, the first day of trading, he had several calls from other dealers, among them ReCom Securities, a Minneapolis firm, to check his market and that Recom actually placed an order to buy 2,000 shares or at least indicated buying interest prior to registrant's first purchase from Midwest. I credit MacConnell's testimony on this point, which is corroborated by the elapsed time of only a few minutes

between the purchase from Midwest and the admittedly unsolicited sale to Recom. ReCom was in fact buying on behalf of an acquaintance of Grobe's who apparently was aware of the prospective merger. Subsequent purchases from registrant by various other broker-dealers were also for the most part either for the accounts of friends or acquaintances of Lilac insiders, or relatives or clients of a California securities salesman who was privy to the merger negotiations. It is evident that these people were ready to buy shares in a shell at price levels reflecting substantial values, in the expectation that the merger would take place and would support such values. 8/ While registrant's quotations and prices moved up sharply once trading began, I cannot find anything in the trading pattern which is not consistent with a not unreasonable desire to avoid being caught in a short position in a stock with very limited supply. The picture that emerges is not one of MacConnell manipulating the market, but of his responding to unsolicited demand. While MacConnell can be faulted for facilitating a market based on trading on inside information, that is not the charge against him.

Based on the above findings, the allegation of violations of the antifraud provisions by MacConnell is dismissed.

8/ The Division's brief states, though without citation to the record, that Shalako had $122 million in assets (p. 2).

Injunctions

On December 10, 1981, respondents were permanently enjoined, with their consent and without admitting or denying the allegations of the Commission's complaint, as follows: both respondents from violating Section 5 of the Securities Act and MacConnell also from violating the previously-noted antifraud provisions. 9/

Public Interest

Having found that respondents willfully violated the Securities Act's registration provisions and are subject to permanent injunctions against violating these and, in MacConnell's case, other securities law provisions, the remaining issue concerns the remedial action that is appropriate in the public interest.

As I noted at the outset, the revocation of registrant's broker-dealer registration in another proceeding has mooted the remedial action issue as to registrant. With

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9/ S.E.C. v. MacConnell, et al., 81 Civil 2575 (D. N.J.). Respondents' arguments concerning the circumstances under which they consented to the injunctions are unsupported by anything in the record. Their request that the injunctions be "rescinded" are addressed to the wrong forum.

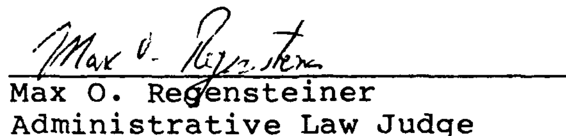
10/ All proposed findings and conclusions and all contentions have been considered. They are accepted to the extent they are consistent with this decision.

respect to MacConnell, the misconduct found here and the injunction do not warrant a sanction to be added onto the two-year exclusion mandated in that proceeding. 10/

Accordingly, IT IS ORDERED that these proceedings are hereby discontinued.

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 that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



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