ADMINISTRATIVE PROCEEDING
FILE NO. 3-1510

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

ABBETT, SOMMER & CO., INC.
CHARLES W. SOMMER, III
KYLE M. DROLLINGER, JR.
ABBETT, SOMMER & COMPANY
MORTGAGE CORPORATION

(8-7035)

INITIAL DECISION

David J. Markun
Hearing Examiner

Washington, D. C.
February 5, 1969

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APPEARANCES: Joan H. Saxer and Thomas W. McIlheran, for the Division of Trading and Markets.

Carl L. Shipley, of Shipley, Ackerman & Pickett, Washington, D. C. for respondents other than respondent Drollinger.

Sam Rosen, of Shannon, Gracey, Ratliff & Miller, Fort Worth, Texas, for respondent Drollinger.

BEFORE: David J. Markun, Hearing Examiner

THE PROCEEDING

This public proceeding was instituted by an order of the Commission dated March 19, 1968, pursuant to Section 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether, singly and in concert, the respondents willfully violated, or willfully aided and abetted violations of, the Securities Act of 1933 ("Securities Act") and the Exchange Act and rules thereunder as alleged by the Division of Trading and Markets ("Division") and the remedial action, if any, that might be appropriate in the public interest.

Under the order the Division alleges violations of the registration requirements of section 5(a) and 5(c) of the Securities Act and of the anti-fraud provisions of section 17(a) of the Securities Act and sections 10(b) and 15(c) of the Exchange Act and Rules 10b-5 and 15c1-2(a), (b) thereunder in connection with the sale and distribution of certain mortgage notes coupled with an agreement for servicing, etc. that are alleged to be investment contracts. In addition, violations of the record-keeping provisions of section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder are charged.

The evidentiary hearing was held in Fort Worth, Texas, from June 17 through June 25, 1968. All respondents appeared through counsel who participated throughout the hearing. The parties filed proposed findings, conclusions and supporting briefs. The findings and conclusions herein are based upon the record and upon observation of the various witnesses.

FINDINGS OF FACT AND LAW

The Respondents

Respondent Abbett, Sommer & Co., Inc. (generally hereafter referred to as "registrant") has been registered as a broker-dealer with the Commission since December 4, 1958. It was incorporated under Texas law on November 20, 1968. Before being registered in its corporate form the firm had been registered with the Commission as a sole-proprietorship broker-dealer since December 9, 1953. Registrant is a relatively small firm having its offices in Fort Worth, Texas. It is a member of the National Association of Securities Dealers, Inc.

Charles W. Sommer III (hereafter generally referred to as "Sommer") is in full control of registrant. He organized it and its predecessor and owns 100% of the stock of registrant. He has been a director of registrant from the time of its incorporation and was its President until January 10, 1968.

Respondent Kyle M. Drollinger, Jr. (hereafter generally referred to as "Drollinger") has been a registered representative of the registrant since April 1964, having been employed in January of that year to do general office work. In May of 1964 Drollinger was named corporate secretary and on January 10, 1968 the "acting president," but in neither capacity did he have or exercise any actual responsibility or authority. He became the firm's sales manager in January 1966, for which he received additional compensation.

Respondent Abbett, Sommer & Company Mortgage Corporation (hereafter generally referred to as "Sommer Mortgage Corp.") is a Texas corporation that respondent Sommer incorporated on July 1, 1963. Sommer Mortgage Corp. was then owned 80% by registrant, 10% by respondent Sommer, and 10% by Sommer's father, Charles W. Sommer II. Currently Sommer owns 90% and his father 10% of the stock.

Sommer formed Sommer Mortgage Corp. to sell certain first-lien mortgage notes that registrant had theretofore sold.

Where "respondents" are mentioned herein in the plural the reference is to all respondents other than respondent Drollinger, unless the reference is to "all respondents" or Drollinger is expressly included.

Sale of unregistered securities

The order for proceeding alleges that all respondents violated the registration requirements of Sections 5(a) and 5(c) of the Securities Act by selling and offering for sale to the public Century mortgage notes for which there was no registration statement in effect. These securities, for convenience referred to herein as "Century mortgage notes," were mortgage notes executed by various persons (generally individual homeowners for home improvements) which were purchased by Century Trust Company ("Century") of Dallas, Texas, at a discount (generally from building contractors and developers) and were thereafter resold to the public "with recourse" against Century

in the event of default by the note maker.

It is conceded that the Century mortgage notes were not registered and that respondents sold them. From late in 1960 until April 14, 1965, 1/ respondents sold to some 150 of their customers over 600 Century mortgage notes totalling $1,364,469.06. 2/ Prior to July 1, 1963, when Sommer Mortgage Corp. was formed to take over this aspect of the business, the sale of Century mortgage notes was handled by the registrant. After July, 1963, the sales of Century mortgage notes were made by Sommer Mortgage Corp., but insofar as the public customers were aware, they were still dealing with the registrant. This was so because Sommer Mortgage Corp. lacked a palpable identity distinct from that of the registrant. Its officers and employees were the same as registrant's; communications and contact with the public relating to mortgage notes were under registrant's letterhead and on its forms (e.g. confirmations) or handled by registered representatives of the registrant, and there was never any effort to advise the public customers that they were dealing with the Sommer Mortgage Corp. rather than with their broker-dealer (registrant). Century, while aware

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1/ As of April 16, 1965 Century stopped honoring its "with recourse" obligations under the notes because of financial difficulties that ultimately culminated in bankruptcy proceedings.

2/ Exh. 314. (numbered exhibits were introduced by Division; lettered exhibits by respondents; and double-lettered exhibits by respondent Drollinger).

that there was a separate Sommer Mortgage Corp., considered that it was dealing with Sommer personally; communications with it were on registrant's letterhead. The reality was that Sommer controlled fully both corporate entities and used both in the sale of the Century mortgage notes, assigning to each functions as best suited his purposes. Funds were transferred freely between the two entities.

Accordingly, if there have been violations of the registration provisions, as alleged, registrant will bear responsibility as an aider and abettor of violations by Sommer Mortgage Corp. during the period following July 1, 1963, since registrant very actively assisted in the transactions in Century mortgage notes. 3/

Respondents assert that the Century mortgage notes were exempt from the registration requirements of Section 5 of the Securities Act under the Commission's Rule 234, 4/ issued pursuant to that Act, which exempts certain first lien notes. Whether this defense is available depends upon whether the Century mortgage notes are "investment contracts" as the Division contends. Paragraph (e) of Rule 234 provides that no exemption shall be available thereunder "for any investment contract or other security the offering of which is involved in the offering

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3/ Sommer acknowledges his control of and responsibility for the conduct of both corporate entities.

4/ 17 CFR 230.234.

of the notes directly secured by a first lien upon real estate."

Whether the Century mortgage notes were "investment contracts" within the rule depends in turn upon whether the terms, conditions, and circumstances under which they were offered to the public by respondents bring them within the definition of an investment contract under the Commission's Litigation Release No. 1876 of January 9, 1961. 5/

Under the mentioned criteria it is clear that the Century mortgage notes sold and offered by respondents were investment contracts.

Century provided the investigation service to determine the value of the property as security, the credit standing of the notemaker, the absence of prior liens, etc. While respondents' customers were free to personally inspect the mortgaged premises prior to purchase, this was rarely done for a variety of reasons: the properties were often/a considerable distance away; 6/ customers relied on Century's appraisal; customers lacked time, interest, or capacity to make individual appraisals, etc.

Century also maintained a complete collection and payment service. Thus, Century would collect monthly payments from the notemakers and remit them to the public purchasers of the Century notes, either directly or through the registrant. In

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5/ This release re-emphasized eleven (11) criteria set forth in an earlier release issued by the Commission on January 31, 1958, as Release No. 3892 under the Securities Act and Release No. 5633 under the Exchange Act.

6/ A number were located outside Texas, and others were at relatively distant points within Texas.

the event of delinquency in payments, the purchaser could avoid the necessity of foreclosing personally by calling upon Century to buy back the mortgage note under its undertaking to buy back a note whenever it became delinquent for 90 days.

Century's buy-back obligation was in effect a guarantee against loss of principal. In addition, in a few instances, respondents assured their customers that even apart from Century's buy-back undertaking, they would be able to liquidate their holdings in mortgage notes if they so desired because registrant had a "waiting list" of persons interested in buying such notes.

Century also made advances of funds, thus assuring continuity of payments to the public customers, in a number of cases where notemakers were delinquent in their payments.

And finally, respondents' customers made no real "selection" of the particular mortgages they purchased because ordinarily only one or two mortgages were available in the range of funds they had to invest and besides, from the limited data presented to them respecting the mortgage notes, 7/ they really had no sound basis for selecting one mortgage note over another. Because of Century's buy-back undertaking and its investigation, collection, and other services, it is clear that customers regarded these mortgage notes pretty much as fungible securities.

7/ Century prepared for each note a 4" x 6" card setting forth the name of the owner and the location of the premises, their estimated value, the number of payments and amount of each and the balance due, and 2 or 3 lines briefly describing the premises. These cards were made available to respondents when they purchased a Century note and the information thereon was in turn made available to their customers.

Although the customers were aware that the mortgaged premises furnished them a second line of security for their investments, it is clear that most of them relied primarily on the ability and willingness of Century to buy back the mortgage notes in case of delinquency or default.

Thus, the Century mortgage notes meet a substantial number of the specified criteria, which requires a conclusion that they were investment contracts. 8/

Respondents contend as an alternative defense that even if it is concluded (as has here been done) that the Century mortgage notes were investment contracts and therefore not exempt from registration, the action of respondents in selling them should not be regarded as willfull, or in any event should not be the basis for the imposition against them of any sanction, because they relied in good faith on the opinion of counsel and of the Fort Worth Regional Office of the Commission that the notes were exempt from registration. 8a/

By letters dated October 21, 1964, the then Regional Administrator of the Fort Worth Regional Office of the Commission advised Century and respondent Sommer 9/ that although the question whether Century mortgage notes are "investment contracts" within the meaning of Rule 234 is not free from doubt, ". . . it appears that the exemption from registration provided by

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8/ As the Commission noted in the cited releases (footnote 5 above), "The wider the range of services offered and the more the investor must rely on the promoter or third party, the clearer it becomes that there is an investment contract."

9/ Exh. 89, 90.

8a/ Reliance upon advice of counsel would not preclude a finding of willfulness. G. J. Mitchell, Jr., Co., 40 S.E.C. 409, 415 (1960).

Rule 234 under the Act would be available to the offering of first lien notes by Century if they are offered within the limitations specified by the Rule."

This expression of view as to availability of an exemption was based upon a factual situation assumed to have been as represented in a letter of July 20, 1964, to the Commission staff from Century's attorney. 10/ The evidence in this proceeding establishes that such representations were false in a number of material respects.

Before sending the July 20 letter Century's lawyer furnished Sommer a copy of the proposed letter, requesting notification of approval 11/ but Sommer made no response. Sommer later sent his own response 11a/ to the inquiries of the Commission staff, in which he expressed the view that the Century mortgage notes clearly were not investment contracts because, of the 11 criteria set out in Litigation Release No. 1876, only parts of two of them -- investigation and service -- were applicable.

It is clear that under the circumstances presented Sommer had a duty to speak up if he knew of any facts that differed materially from what was being represented to the Commission in the letter from Century's attorney. 12/ Both Sommer and Century

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10 / Exh. 84

11 / Exh. 53

11a/ Exh. 54

12 / See Brennan v. Midwestern United Life Insurance Co., 259 F. Supp. 673, 681-2 (U.S.D.C., June 1966); 286 F. Supp. 702 (1968).

had been requested by the Commission staff to indicate the basis for any claimed exemption for the sale of the Century mortgage notes by the registrant. 13/ In any event, whether or not respondents had an affirmative duty to disclose material facts known to them to be at variance with the representations made in the letter from Century's attorney, they could hardly now claim good faith reliance upon an opinion as to exemption predicated upon facts known to respondents to have been untrue. 14/

The evidence establishes that respondents knew and failed to disclose to the Commission staff a number of material facts that were substantially different from what the letter from Century's lawyer represented to the Commission staff.

First, it was represented that all of the properties securing the mortgage were in Texas, whereas some were in Louisiana and Arkansas. This is a significant factor since remoteness of the property and its being subject to distinct laws in terms of foreclosure etc. would increase the mortgage-note buyer's reliance upon Century.

Second, it was represented that Century never advanced funds to protect the security of the investment, whereas in

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13/ Exh. 48, 83. Moreover, corporate respondents were statutory underwriters under sec. 2(11) of the Securities Act.

14/ The same rationale would apply to facts later discovered by respondents to be at variance with what Century had represented. One cannot in good faith rely upon an opinion as to exemption when he knows the underlying assumed facts are no longer so.

fact Century did "carry" various notemakers who were delinquent in their payments by advancing Century's funds so that payments to respondents' customers could be made on their regular due dates. Here, again, is a factor that increases the note holder's dependence upon Century. 14a/

Third, the representation that the purchaser "selects" the specific note and mortgage was misleading because the actual circumstances under which respondents were selling the mortgage notes were such that ordinarily only one or two notes were available in the range of the amount available for investment and, of perhaps even greater importance, there were no sufficient data made available to the purchaser (e.g. the credit record of the mortgagor) upon which a selection could meaningfully be made. The buyer could only hope that Century had acquired good paper to begin with.

Yet another misleading representation was the statement that Century never offered to buy the mortgage notes back except under its "with recourse" endorsement after payments became delinquent for 90 days. In fact the evidence discloses a very informal working arrangement under which Century would occasionally take back a note that was defective for one reason or another (e.g. when a purported first lien turned out to be a second lien) 15/ and, in addition, it is clear that at least to

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14a/ Century did this without knowledge of the customers, but Sommer was aware of it.

15/ These accommodations were necessary in the interest of good will since respondents accounted for a substantial part of Century's overall sales.

a few customers, the respondents gave assurances that their mortgage holdings could be liquidated at any time apart from Century's buy-back obligation because registrant had a "waiting list" of people ready to buy the mortgages.

While the record reflects still other misrepresentations (though they are less relevant and less clearly established) it would seem unnecessary to here treat them since the elements of misrepresentation discussed above, all of which respondents were aware of, serve sufficiently to defeat respondents' claim of good-faith reliance upon the Regional Administrator's opinion of October 21, 1964.

Respondents also claim good-faith reliance upon the advice of counsel. The two legal opinions referred to in respondents' brief were both rendered by Century's lawyer. 16/ The first opinion was on September 30, 1960, and the latter one, dated July 20, 1964, was the letter, already discussed above, which purported to represent to the Commission how Century mortgage notes were being sold by the respondents to their customers. Since the facts were materially at variance from what they were there represented and assumed to be, and respondents knew so, as discussed above, they could hardly have relied upon the legal conclusion expressed in that 1964 letter. 17/

16/ Exh. 81, 84.

17/ Actually, respondents rely primarily on the opinion of the Regional Administrator and not that of Century's lawyer.

As respects the legal opinion of Century's attorney in 1960, this could certainly not have been relied upon in good faith after the September 1964 inquiry, already discussed, was made. Even before that date the reliance could not have been in good faith, for the record shows that respondent Sommer was earlier aware both of the criteria set forth in Litigation Release No. 1876 (January 9, 1961) and its predecessors and of the facts and circumstances which served to make investment contracts of the Century mortgage notes.

Violation of anti-fraud provisions

It is alleged that all respondents violated the anti-fraud provisions of the securities laws [18/] in selling and offering for sale the Century mortgage notes.

In selling the notes, respondents utilized prepared offering sheets, which were generally transmitted by a one or two page letter; the mortgage-note description cards that had been prepared by Century; Century financial statements; and oral presentations by phone or in person.

The prepared offering sheets for a time used somewhat ambiguous language that could have been construed as guaranteeing a 10% return on investment, rather than merely reflecting the undertaking of Century to buy back the note in event of a delinquency in note payment extending to 90 days. However, the offering

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18/ Section 17(a) of the Securities Act and sections 10(b) and 15(c) of the Exchange Act and Rules 10b-5 and 15c1-2(a)(b) thereunder.

sheets did state the terms of Century's buy-back provision. In view of this it is concluded that the offering sheets would not mislead a reasonable person into believing that the rate of return was guaranteed. The record shows that the customers who testified were not so misled.

A number of the offering sheets represented that the "mortgage is never more than 75% of the value of the property"[19/] but the evidence disclosed that at times the actual value of the property proved to be less than the amount of the mortgage.

Some of the offering sheets were further misleading in stating that the "purchaser is usually able to participate in the contractor's profit" when no such participation was in fact involved and in stating that purchasers "several times" had received "windfall" profits through mortgages being paid off ahead of time or through the mortgage being paid off at face amount from the proceeds of insurance, without stating that this had in fact happened only once or twice and was unlikely to recur.

Respondent's letters to their customers were false or misleading in a number of respects, e.g. representations: that the notes were "guaranteed in such a manner that you can only gain by investing in this way"; that the notes were guaranteed in such a way that the "only risk is from inflation";[20/] that

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19/ Other offering sheets represented the value of the property as 2 to 6 times the amount of the mortgage.

20/ This representation was eliminated after being used for a time.

note payments were something that could be "depended on for income"; that the notes were "safe"; that the notes produce a good return "with safety"; and the like.[20a/]

In oral representations, too, respondents or their registered representatives made various false or misleading statements, e.g. the representations: that there was no risk involved in buying Century mortgage notes; that the notes were as safe as deposits in savings accounts; that the notes were "as good as gold"; that the notes were insured and absolutely safe; and that Century mortgage notes were "something real sweet."[20b/]

The foregoing representations were all known to respondents to be false or misleading. Although reliance on fraudulent representations need not be shown to establish violations of the anti-fraud provisions,[20c/] the record establishes that a number of the customers who testified were in fact persuaded to buy Century mortgage notes partly by the false or misleading statements. Likewise, although proof of customer's losses is not necessary to establish violation of the anti-fraud provisions,[20d/] the record shows that actually a number of customers have sustained financial

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20a/ Representing an investment as "safe" or "without risk" has been recognized as fraud. G.J.Mitchell, Jr. Co., 40 S.E.C.409,413 (1960).

20b/ Charges in paragraphs II C 3a,b,c of the order for proceeding that respondents made false and misleading statements respecting Century's financial condition and its ability to buy back notes and as to the financial ability of the makers of Century notes, are not established by a preponderance of the evidence.

20c/ N. Sims Organ & Co., Inc., 40 S.E.C. 573 (1961), aff'd/F.2d 78 (C.A.2, 1961); B. Fennekohl & Co., et al., 41 S.E.C. 210, 216 (1962).

20d/ Wm. J. Stelmack Corporation, 11 S.E.C. 601, 621 (1942).

loss. Lastly, although certain of the customers who testified were relatively sophisticated investors the majority of them were far from it, and, in any event, the sophistication of investors does not excuse fraudulent representations. 20e/

Accordingly, respondents' defenses of customer sophistication and asserted lack of reliance or of customer losses are found to be without merit both on the facts and on the law.

Violation of record-keeping provisions

It is alleged that from January 1, 1960, to the date of the order for proceeding all respondents violated, or aided and abetted violations of, Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder, in that they failed to make, keep current, and preserve for the required time, records reflecting registrant's transactions in various securities, including Century mortgage notes.

The record establishes a number of record-keeping violations of a more or less routine character.

As of April 13, 1960, the registrant had not posted the general ledger since February 29, 1960; had not posted the customers' individual accounts since February 29, 1960; had not maintained the securities position record as required by the rules; and had not posted to customers' individual accounts

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20e/ A. T. Brod & Co., Securities Exchange Act Release No. 8060, April 26, 1967. The lack of suitability of the Century mortgage notes as an investment vehicle for a number of the customers became quite evident when, after Century's failure, they were thrown upon their own resources for collections, foreclosures, etc.

the date of delivery or receipt of securities.

As of April 2, 1962, registrant had not maintained the required securities position record and the receipts and deliveries of securities in and out of accounts with other brokers and dealers had not been noted.

As of July 27, 1965 registrant had not posted the daily blotter, customer accounts, dealer accounts and position records during the month of July; the position record cards did not have the longs and shorts totalled, and in come cases the totals did not balance; the investment and inventory accounts were not recorded in the position records; one trade was found not posted on the position records; and there were no ledgers or other records reflecting securities borrowed and securities loaned and moneys borrowed and moneys loaned, together with a record of the collateral therefor and any substitutions in any collateral.

As of September 20, 1965, the registrant's ledger for security demand notes receivable did not show the date of the loan, the date of the collateral received and the identity of the specific loan collateralized, and there was an error in the position records.

As of November 14, 1966, there were a number of inaccuracies in registrant's books and records and the memoranda of the brokerage orders showed only one time of day.

Since November, 1953, respondent Sommer has been repeatedly advised by personnel of the Commission of the requirements of

bookkeeping Rules 17a-3 and 17a-4 and was repeatedly reminded of the necessity of keeping the registrant's records properly.[21] In these circumstances the violations that occurred during the charging period since April, 1960, must be regarded as willful.

A second type of record-keeping violation alleged by the Division concerns transactions involving savings and loan deposits and mutual funds. After the Sommer Mortgage Corp. was formed on July 1, 1963, and through November, 1967, the respondents no longer handled through the registrant the placement for customers of deposits in savings and loan companies and the liquidation and sale of shares in various mutual funds. They handled these transactions instead through Sommer Mortgage Corp.,[22] based on Sommer's claim that these were not securities transactions. There is no support for this contention. Sommer knew that mutual funds are securities and that the placing of deposits in savings and loan companies was engaging in securities transactions. Nevertheless, since these were transactions of the Sommer Mortgage Corp. and not of the registrant, it is concluded that registrant had no record-keeping obligation respecting them.

21/ Ex. 78, 11-16-53; Ex. 5, 1-21-54; Ex. 17, 5-18-54; Ex. 4, 3-28-57; Ex. 18, 3-29-57; Ex. 20, 4-3-57; Ex. 21, 5-31-57; Ex. 21, 6-4-57; Ex. 21, 6-6-57; Ex. 23, 6-13-57; Ex. 24, 2-25-58; Ex. 26, 10-25-58; Ex. 8, 4-13-60; Ex. 27, 4-29-60; Ex. 29, 5-9-60; Ex. 32, 4-11-62; Ex. 32, 4-12-62; Ex. 48, 6-9-64; Ex. 85, 7-21-64; Ex. 58, 8-4-65; Ex. 60, 61, circa 8-15-65; Ex. 60, 8-31-65; Ex. 63, 9-10-65; Ex. 68, 1-5-67; Ex. 70, 2-21-67; Ex. 71, 3-23-67.

22/ Since Sommer destroyed or discarded many of the records of Sommer Mortgage Corp. during 1965 and 1966, a complete record regarding these transactions was not available.

The third type of record-keeping violation alleged by the Division concerns the sale of Century mortgage notes after July 1, 1963. Since they were investment contracts they could not be handled without registering as a broker-dealer under the Exchange Act since the exemption available under Section 15(a)(1) of that Act and Rule 15a-1 thereunder as respects certain "evidences of indebtedness secured by mortgage" does not apply to investment contracts. Thus, since Sommer Mortgage Corp. was not registered as a broker-dealer under the Exchange Act, all transactions in Century mortgage notes should properly have been handled entirely by registrant and fully recorded and reflected on its books. However, since legally these transactions were those of Sommer Mortgage Corp. and not of the registrant, it is concluded that registrant had no obligation to record them on its books and records.

Parenthetically it is noted that the fact that transactions in the Century mortgage notes were handled by Sommer Mortgage Corp. rather than registrant has had greater practical impact than it might otherwise have had due to the deliberate 23-24/ destruction or

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23-24/ It is concluded that Sommer deliberately disposed of these records to preclude their being used in any way against him after Century experienced financial trouble culminating in proceedings in bankruptcy. Sommer testified that he personally discarded the records and that he had no regular procedures for the disposition of "surplus" records. His motivation is highly suspect because over the years he had had a running argument with personnel of the Commission as to whether he was obliged to permit inspection of his records relating to sale of Century Mortgage notes. Of even greater significance is the fact that after Centrury ceased honoring its "with recourse"

(Continued next page)

disposition of a considerable volume of the records of Sommer Mortgage Corp. in 1965 and 1966. These absent records are thus not available to cast whatever light they might have been able to shed on the issues raised in this proceeding.

Respondent Drollinger

The Division's briefs do not contend that respondent Drollinger was involved in the record-keeping violations of the registrant. Nor would the record support a conclusion that he was.

As respects the sale of unregistered Centrury mortgage notes it is clear that Drollinger did sell them and that he was aware at the time that they were unregistered. However, although these facts alone are sufficient to make Drollinger's violations technically

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23-24/ (Continued from previous page)

commitments it must have been obvious to Sommer that any records he had relating to Century mortgage notes would be very important to his customers in terms of helping to establish claims in bankruptcy, etc. Sommer was chairman of a creditors' committee and himself brought suit against Century's auditors and was thus well aware of the importance of records in establishing claims. During this time he purported to his mortgage-note customers to be bending every effort in their behalf. In these circumstances it made no sense for Sommer to dispose of any records relating to Century mortgage notes.

willful,[25/] nevertheless the nature and extent of his culpability are far different from Sommer's. When Drollinger took up his employment with registrant respondents had already been handling Century mortgage notes for some time and it is understandable that Drollinger would have relied upon Sommer's statement that the mortgage notes had been determined to be exempt from the registration requirement. Then again, during the inquiry the Commission personnel made into the status of the Century mortgage notes in the latter half of 1964, it does not appear that Drollinger was made aware of the representations made by Century's attorney to the Commission, nor that he was involved in any way in the representations made by Sommer to the Commission at that time.

Although Drollinger was named corporate secretary of the firm in May of 1964 the record establishes that this did not in fact give him any powers as an officer of the corporation. Given his status as a fledgling employee of the firm and Sommer's tight one-man ownership and control, it would be unrealistic to expect Drollinger to have attempted to exercise control as an officer in such a way as to have forestalled the violations.

Turning to the anti-fraud violations, the record shows that Drollinger was one of several registered representatives

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25/ Under section 15(b) of the Exchange Act it is held that willfulness means "'no more than that the person charged with the duty knows what he is doing. It does not mean that in addition, he must suppose that he is breaking the law'". Hughes v. S.E.C., 174 F. 2d 969, 977 (1949).

of the registrant (including Sommer) who sold the Century mortgage notes. Drollinger had 22 transactions in the mortgage notes, for a total of $48,913.30. In the period during which these sales occurred (April 1964 to April 1965) he had a total of 155 transactions and the sale of mortgage notes accounted for about 13% of his total transactions by dollar volume.

The sales of the Century mortgage notes by Drollinger occurred during his first year as a registered representative.

The methods employed by Drollinger in the sale of the mortgage notes were essentially the same as those employed by other salesmen in the firm [25a/] and were such as violated in certain respects the anti-fraud provisions of the securities laws, as discussed above. Drollinger now recognizes that some of the language he employed was improper, but seeks to excuse his actions on the grounds of inexperience and reliance upon Sommer's supervision. He is a college graduate but had no experience in the securities field before coming to registrant. While these factors are for consideration in determining sanctions, they do not serve to make Drollinger's violations of the anti-fraud provisions non-willful.

Conclusions

In general summary of the foregoing, the following conclusions of law are reached:

(1) All respondents willfully violated, or willfully aided and abetted violations of, Sections 5(a) and 5(c) of the Securities Act

25a/ He utilized the prepared offering sheets of the registrant, transmittal letters signed by him, the description cards, and made oral presentations, by phone or in person. Among the false or misleading representations made by him were statements that the only risk was from inflation, that the notes were insured and absolutely safe, and that you can "only gain by investing in this way."

from December 1960 [25a/] through April 1965 by utilizing the mails and telephones to sell and to offer to sell Century mortgage notes, for which no registration statement was in effect and as to which no exemption from registration was available. The sales were not exempted transactions under Section 4 of the Securities Act inasmuch as both corporate respondents were statutory underwriters under Section 2(11) of that Act.

(2) All respondents willfully violated, or willfully aided and abetted violations of, section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 10b-5 and 15c1-2(a)(b) thereunder from December 1960 [25a/] through April 1965 in that, while utilizing the mails and telephones in selling or offering for sale Century mortgage notes, they made various untrue statements of material fact or failed to state material facts necessary to make statements that were made not misleading.

(3) From January 1, 1960, to the date of the order for proceeding registrant willfully violated, and Sommer willfully aided and abetted violations of, Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder in that registrant failed to keep certain required records and failed to keep certain required records current and accurate.

25a/ Drollinger's violations occurred between April, 1964 and April, 1965.

PUBLIC INTEREST

The violations by Sommer and the corporate respondents as disclosed by the record are varied in kind, serious in character, and occurred over an extended period of time.

Respondents urge that no sanctions may be imposed against them because they were not given "opportunity to demonstrate or achieve compliance with all lawful requirements" as required by 5 U.S.C. 558(c)(2). The short answer to this contention is that by its terms the statute excepts cases where the conduct is willful.[26/]

Respondents further claim that no sanctions may be imposed in this proceeding because to do so would improperly subject Sommer to a "penalty or forfeiture" within the meaning of that term as used in section 21(d) of the Exchange Act (15 U.S.C. 78u(d)). This is so, respondents contend, because of the alleged failure of Commission personnel to advise Sommer in the course of investigative proceedings preceding the present administrative proceeding that he could under the section "claim a right not to produce records and testify." Some of the statements made by Sommer at those earlier investigative proceedings have been admitted in the instant proceedings as "admissions" or "false exculpatory statements" and some of the documents then produced were later introduced in evidence at the hearing

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26/ The Commission has held that the willfullness provision as used in Section 15(b) of the Exchange Act has the same meaning as the willfullness provision in 5 U.S.C. 558(c)(2) [formerly sec. 9(b) of the A.P.A.]: Universal Service Corporation, Inc., 36 S.E.C. 595 (1955); Sterling Securities Co., 37 S.E.C. 837 (1957).

in the instant proceeding. To now use such testimony and documents, it is argued, violates Section 21(d).

Respondents' argument misapprehends the thrust, purpose, and effect of Section 21. To begin with, the section does not confer on an individual the right not to produce documents or testify at an S.E.C. investigation. To the contrary, it compels him to testify and to produce evidence. But if he is compelled to testify or produce evidence, after having claimed his privilege against self-incrimination, the individual thereby gains immunity from criminal prosecution. Thus the most that Sommer could have obtained under Section 21, if he had been compelled to testify or produce evidence, would be immunity from criminal prosecution. He could not possibly get immunity to the imposition of sanctions in the instant proceeding, the very kind of proceeding that Section 21 was designed to aid. To apply the section as respondents urge would be to render it meaningless.[27/]

The record discloses a number of factors that militate against applying any lesser sanctions than the nature and severity of respondents' violations would normally warrant.

27/ While the issue of immunity from criminal prosecution is not here involved, it is noted that at no time was Sommer compelled to testify or produce evidence against his will in the course of the investigative procedures, and at no time did he claim his privilege against self-incrimination. And, of course, he testified voluntarily at the hearing in this proceeding.

As a witness Sommer was evasive and argumentative, rather than responsive and candid. At the hearing in this proceeding and at earlier investigative proceedings he was very slow and reluctant in producing records pursuant to subpoena.[27a/]

Sommer's actions in personally discarding records of Sommer Mortgage Corp., discussed above, raise questions both of credibility and motive.

In view of the nature and extent of the violations and the lack of any mitigating factors, it is concluded that the public interest requires that the registration of Abbett, Sommer & Co., Inc. be revoked and Abbett Sommer & Company Mortgage Corporation declared a cause thereof, and that respondent Sommer be barred from association with a broker-dealer.

As regards respondent Drollinger, it is significant that the violations he committed occurred during the first year after he qualified as a registered representative and that they were of a kind that can properly be attributed to ignorance and inexperience. He has terminated his employment with registrant. On the other side of the coin it must be said that Drollinger's testimony was at times less than completely candid.

It is concluded that the public interest would appropriately be served by suspending respondent Drollinger from association with a broker-dealer for a period of sixty (60) days.

27a/ Sommer attempted to impede the Commission's investigation of respondents by instructing customers not to complete questionnaires mailed them by Commission personnel.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer of Abbett, Sommer & Co., Inc. is revoked and the company is expelled from membership in the National Association of Securities Dealers, Inc.; that Abbett, Sommer & Company Mortgage Corporation is declared a cause of such revocation of registration; that Charles W. Sommer III is barred from association with a broker-dealer; and that Kyle M. Drollinger, Jr. is suspended from association with a broker-dealer for sixty (60) days.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), 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. 28/

David J. Markun

Washington, D.C.
February 5, 1969

David J. Markun
Hearing Examiner

28/ To the extent that the proposed findings and conclusions submitted by the parties are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the issues presented.