ADMINISTRATIVE PROCEEDING
FILE NO. 3-1596 and 3-1597

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

JOHN HARDY
RICHARD CLARK ANDERSON

FOLGER, NOLAN, FLEMING & CO., INC.
(8-3335)

* * * *

EDWARD SINCLAIR

FILOR, BULLARD & SMYTH
(8-87)

(PRIVATE PROCEEDINGS)

INITIAL DECISION

Washington, D. C.
December 31, 1969

Sidney L. Feiler
Hearing Examiner

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APPEARANCES: Messrs. William D. Moran, Kenneth S. Spirer, Samuel M. Feder and Ralph K. Kessler, for the Division of Trading and Markets.

Lawrence F. Weslock, Esq., 3737 Branch Ave., Suite 408, Hillcrest Heights, Maryland, for Richard Clark Anderson.

John Hardy, 1717 Henry Rd., Rockville, Maryland pro se.

Lawrence Greenapple, Esq., of Otterbourg, Steindler, Houston & Rosen, 230 Park Avenue, New York, New York 10017, for Edward Sinclair.

BEFORE: Sidney L. Feiler, Hearing Examiner

I. THE PROCEEDINGS

These are private proceedings instituted by two orders of the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), to determine whether certain allegations set forth in the respective orders are true and, if so, what, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act. The proceedings were consolidated as to common questions of law and fact.

The order for proceedings in #1597, the Folger, Nolan, Fleming & Co., Inc. proceeding ("Folger"), alleges in substance that during the period from on or about October 1963 to on or about February 1966 Folger, a registered broker-dealer, one of its officers, and John Hardy and Richard Clark Anderson who were employed as order clerks in Folger's Over-the-Counter Securities Department, willfully violated and willfully aided and abetted violations of the anti-fraud provisions of the Securities Acts 1/ in that said respondents, in connection with the

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1/ Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 (17 CFR 240.10b-5 and 15c1-2) thereunder are sometimes referred to as the anti-fraud provisions of the Securities Acts. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities of commerce in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device. Jurisdictional allegations are not in dispute in either proceeding.

execution of customers' agency orders for the purchase and sale of securities in the over-the-counter market, directly and indirectly, made untrue statements of fact and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and engaged in acts, practices and courses of business which would and did operate as a fraud and deceit on Folger customers. It was further alleged that as part of the aforesaid conduct and activities and contrary to Folger's obligation to treat its customers fairly and act in their best interests, the named respondents would and did cause Folger's customers to incur unnecessary costs and charges by interposing another registered broker-dealer, Hoit, Rose & Co. ("Hoit") between Folger and other broker-dealers in the execution of securities transactions in the over-the-counter market; failed to seek and obtain for Folger's customers best execution in the purchase and sale of securities in the over-the-counter market; carried out these activities for the purpose of securing additional compensation for Hardy and Anderson; and failed to disclose these activities by confirmation or otherwise to Folger customers.

Additional allegations contained in the order are that during the relevant period, Folger, willfully aided and abetted by the above-named individual respondents, willfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder in that Folger, in connection with the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis,

failed to give written notification due its customers at or before the completion of each such transaction of the source and amount of all commissions and other remuneration to be received by them in connection with the transaction and, as a result, misrepresented the actual prices at which the said transactions were being effected; that Folger, willfully aided and abetted by Hardy and Anderson, willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Folger in connection with the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis, failed to record on the order tickets prepared for such transactions the time when such orders were transmitted for execution; and that Folger and a named official failed to adequately supervise Hardy and Anderson.

It was also alleged that Hoit and its principals violated the anti-fraud provisions of the Securities Acts during the relevant times mentioned in the order in that they aided and abetted the violations by Folger set forth in the order, induced and caused Folger, in the execution of transactions in the over-the-counter market, to interpose Hoit between Folger and other broker-dealers and thereby caused Folger's customers to incur unnecessary costs and charges; and obtained that business through an arrangement whereby principals of Hoit, on its behalf, paid Hardy and Anderson for the purpose of inducing and rewarding Hardy and Anderson in placing Folger's customers' orders with Hoit.

During the hearing the Commission accepted offers of settlement submitted by Folger and a named official, Paul Rodler. (Securities

Exchange Act Release No. 8489, January 8, 1969). Accordingly, Folger and Rodler are no longer parties to these proceedings and the issues remaining in the Folger proceeding concern the activities of Hardy and Anderson in their positions as order clerks.

The order in #1596, the Filor, Bullard & Smyth proceeding, as amended ("Filor"), alleges that during the period from on or about January 1, 1965 to on or about December 31, 1965 Filor, a registered broker-dealer, and Edward Sinclair, an order clerk in Filor's Over-the-Counter Securities Department, willfully violated and aided and abetted violations of the anti-fraud provisions previously mentioned, by among other things, causing Filor's customers to incur unnecessary costs and charges by interposing Hoit between Filor and other broker-dealers in the execution of securities transactions in the over-the-counter market; failing to seek and obtain for its customers' best execution in the purchase and sale of securities in the over-the-counter market; carrying out these activities for the purpose of securing for Filor reciprocal business and additional compensation; and failing to disclose these arrangements to Filor's customers by confirmation or otherwise.

It is further alleged that during the aforementioned period Filor, aided and abetted by Sinclair, willfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder, in that Filor, in connection with the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis, failed to give written notification to its customers at

or before completion of each such transaction of the source and amount of all commissions and other remuneration received or to be received by Filor in connection with the transaction and as a result misrepresented the actual prices at which the said transactions were being effected. It is also alleged that Filor willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, and Sinclair willfully aided, abetted and participated in and caused such violations in that Sinclair made false entries on certain of Filor's order tickets and caused other employees of Filor to unwittingly make false entries on other books and records of Filor.

With respect to Hoit, it was alleged that Hoit and its principals willfully violated the anti-fraud provisions of the Securities Acts by aiding and abetting Filor in the aforementioned violations and obtaining for Hoit over-the-counter business through an arrangement under which Hoit referred listed business to Filor for the purpose of influencing and rewarding Filor and Sinclair in placing Filor's customers' orders with Hoit.

During the hearing the Commission accepted an offer of settlement submitted by Filor and one of its general partners. (Securities Exchange Act Release No. 8489, January 8, 1969). Hoit, Rose & Co. and its three general partners submitted an offer of settlement which was accepted by the Commission (Securities Exchange Act Release No. 8563, April 7, 1969). The remaining respondents in the consolidated proceedings therefore are two former order clerks of Folger, Hardy and Anderson, and one former order clerk of Filor, Sinclair. Briefs and proposed findings were filed by all the parties except Hardy. While the

two orders which were consolidated for hearing have a common thread through them in that they both allege schemes for extra remuneration between order clerks and the Hoit firm, there are substantial differences in the alleged arrangements involved and how they were carried out which require separate treatment of the occurrences at each firm.

II. FINDINGS OF FACT AND LAW

A. Activities of Anderson and Hardy

Anderson joined Folger in April 1954. He was an order clerk in its Over-the-Counter Trading Department during the period October 1963 to February 1966. Hardy was employed by Folger in September 1956 and worked with Anderson as an order clerk in the Over-the-Counter Department during the relevant period herein. Hardy and Anderson handled the large bulk of all of Folger's over-the-counter transactions during the relevant period. Anderson and Hardy had available to them the Eastern Edition of the National Daily Quotation Service,Inc. ("pink sheets"),[2/] teletype or "wire lines" with a brokerage firm in New York, and direct telephone lines to several other brokers.

On or about April 1962 a broker approached Hardy and Anderson for the purpose of obtaining more over-the-counter business from

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2/ This service consists of a listing of brokers indicating their interest in specific stocks traded over-the-counter, often with specific price quotations. Brokers who regularly list their quotations and are ready to buy and sell a security are referred to as market makers (Exch. Act Rule 17a-9(f)(1).

Folger. He offered them, and they agreed to accept, 25% of the gross profits this broker would realize from over-the-counter business referred to him by them. Thereafter, when doing business with this broker, Hardy or Anderson would check the market condition, would advise their broker contact by phone what the quotation was, the broker would then check the market and if he could execute the order at a price better than the quotation given to him by Hardy or Anderson he would accept the order. Sometimes the transaction was completed while Hardy or Anderson waited on the telephone. As a result of this procedure their contact realized a riskless profit based on the difference in prices quoted by Hardy and Anderson and the price that he was able to obtain in the open market. This broker was not a market maker appearing in the pink sheets in many of the over-the-counter stocks which were the subject of their mutual dealings but used sources that were available to Hardy and Anderson. This arrangement existed for approximately 12 to 14 months, during which time Hardy and Anderson each received about $150 to $200 per month for the business that they had referred. Payment was made by separate money orders to each sent to Anderson's home.

In or about October 1963 their broker contact advised Hardy and Anderson that he was going out of the securities business but that Thomas Brown, a partner, of Hoit would call them. He also spoke to Brown and suggested that Hoit assume his arrangement for Folger business. Brown phoned Anderson and suggested that they work together on over-the-counter business. Anderson and Hardy agreed to continue

the previous arrangement. Monthly payments were made to Hardy and Anderson, each receiving separate checks sent to them at Anderson's home.

The procedure outlined above with respect to obtaining quotations and execution of referred orders was followed in business referred to Hoit. Between October 1963 and February 1966, 1,615 over-the-counter trades were effected between Folger and Hoit. In 1,456 of these transactions Hoit did not appear in the pink sheets as a market maker in the securities involved nor did the firm maintain a position in those securities. In 1,249 (85.7%) of the 1,456 trades where Hoit did not appear in the pink sheets as a market maker in the securities involved it was able to execute the transaction with a market maker appearing in the pink sheets within 20 minutes after receiving the order from Folger and earn a risk-free profit of 1/8 to 1/2 point (Div. Exs. 1, 2, 11 and 12; Tr. 167-70, 181). In 795 (54.6%) of the 1,456 trades above mentioned Hoit was able to simultaneously or reasonably contemporaneously execute the transaction with a market maker appearing in the pink sheets and earn a risk-free profit. Between October 1963 and February 1966 an average of 12 brokers was listed in the pink sheets as interested in each of the securities which were the subject of the 1,456 transactions between Folger and Hoit on the date of those transactions.

The arrangement between Hoit and Hardy and Anderson also encompassed "open orders" received from Folger's customers. These were orders placed by Folger customers for transactions at a

particular price which was not the current price of the stock involved. These orders would be referred by Hardy and Anderson to Hoit as "open orders" which Hoit would execute at a profit to itself with another broker when the price coincided with the order price.

The business with Hoit was a substantial part of Folger's over-the-counter transactions. For instance, in the 1964-65 period, of its total of 6,197 transactions 1,274 or 20.5% were with Hoit. During the period from October 1963 until February 1966, Hoit earned in excess of $100,000 in gross profits as a result of the over-the-counter business which Anderson and Hardy directed to Hoit. Hoit in turn remitted approximately $12,000 each to Hardy and Anderson for their efforts on its behalf. The amount Hardy and Anderson received from Hoit monthly exceeded their maximum monthly earnings from Folger.

On or about February 1966 an internal memorandum was circulated at Folger instructing all personnel to cease transacting business with Hoit. These instructions were carried out. Hardy left Folger in March 1966 and was not in the securities business at the time of the hearing herein. Anderson left Folger in December 1966 and was employed by another brokerage firm at the time of the hearing.

The arrangement between Hoit and Hardy and Anderson as well as that with Hoit's predecessor was kept secret from Folger and its customers. No entries were made on order tickets or confirmations to indicate what was going on. Hardy and Anderson also failed to report on the Folger order tickets prepared for the execution of customers' orders for the purchase and sale of securities in the

over-the-counter market on agency basis, the time when such orders were transmitted for execution.

Contentions of the parties; Conclusions

It is pointed out on Anderson's behalf that he had no previous business experience or specific experience in the securities business when he joined Folger at the age of 19, he received a low salary, was not given any formal training in the execution of over-the-counter orders and had the responsibility of operating the Over-the-Counter Department with little supervision or assistance. It is conceded that he did receive special remuneration from Hoit and did direct orders to it. It is asserted, and Anderson so testified, that while Anderson understood that procedures at Folger required checking of three different market makers or firms to obtain the best price at which to execute a transaction, he was seldom able to take the necessary time in view of his work load but did in fact check the largest number of dealers that he was able to at any given time. It is argued that while there may have been some interpositioning in the instances alleged by the Division it is not clear that this resulted in any higher prices to customers of Folger and that the best available price was obtained in each case. Finally, it is urged that in view of the sanction imposed on Anderson's employer, a suspension of 15 days, the heavy sanction which the Division is requesting, a bar order, would be an abuse of discretion. In support of this contention it is urged that Anderson was in effect a victim of a system under which he was required to work under unreasonable working

conditions and under a minimal compensation standard. With respect to the allegation that the procedure of time stamping orders was not followed, it is contended that such irregularities and departures from the norm was the standard operating procedure in the Folger firm rather than a rarity.

The Division contends that the allegations in the order have been proved and that Hardy and Anderson should be barred from the securities business.

A broker's relationship to his customer is that of a fiduciary. The Commission has pointed out that

> "A corollary of the fiduciary's duty of loyalty to his principal is his duty to obtain or dispose of property for his principal at the best price discoverable in the exercise of reasonable diligence." 3/

A diligent execution of a retail securities order involves a reasonable effort in obtaining the best wholesale dealer quotation and an execution as favorable as may be obtained in light of the kind and amount of securities involved and other pertinent circumstances. Since there is no central market or exchange where orders for unlisted securities may be executed, a broker in those transactions must negotiate with those other brokers who are interested in the particular security. If the public customer is to obtain the benefits of competition and diversity in the wholesale markets, his broker-dealer must make a reasonable effort to check competing markets. 4/ In carrying out their

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3/ Arleen W. Hughes, 27 S.E.C. 629, 636 (1948), aff'd 173 F. 2d 969 (D. C. Cir. 1949).

4/ Report of Special Studies of Securities Markets, 88th Cong., 1st Sess., H. Doc. No. 95, Part 2, Page 616.

fiduciary obligation in over-the-counter transactions, broker-dealers customarily have recourse to the "sheets" published by the National Quotation Bureau, Inc. They are recognized as the primary medium for the dissemination of wholesale or "inside" quotations among professionals and are of crucial importance to the over-the-counter markets. ~~They are recognized as the primary medium for the dissemination of wholesale or "inside" quotations among professionals and are of crucial importance to the over-the-counter markets.~~ They are used to find and communicate buying or selling interest in securities and to judge activity.[5/] Brokers who make markets in particular issues regularly insert quotations in the quotation sheets and other brokers indicate their interest from time to time. There is no special rule requiring a broker in the execution of an order to check only with brokers appearing in the quotation sheets or, if he does, with how many. However, a failure to make such an exploration raises doubts that there has been good execution of an order. This is especially true if a transaction is consummated with a non-market maker or one who is not known to have an inventory of the stock.

Normally where a firm receives an order from a customer in a security in which it is not making a market and in which it has no position it goes directly to a firm making a wholesale market in the security. If this is not done and a third firm is used which actually executes a transaction with a market maker the third firm receives a fee from a retail firm for the transaction whether it acts as agent for the retail firm or sells the security to it as principal. In both

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5/ Special Study, supra, Part 2, pp. 595-610.

cases the charge by the intervening firm becomes a part of the price paid by the customer's firm and is passed on to the customer by computing the "mark-up" or commission on the basis of the retail firm's cost, not the cost of the interpositioning firm.[6/] This practice is known as interpositioning.

The Commission has considered various interpositioning practices in a series of cases:[7/] In the Thomson & McKinnon case, The Commission after stating that it had on numerous occasions stressed the importance of the broker's fiduciary obligation to get the best price for his customers stated:

> "In view of the obligation of a broker to obtain the most favorable price for his customer, where he interposes another broker-dealer between himself and a third broker-dealer, he prima facie has not met that obligation and he has the burden of showing that the customer's total cost or proceeds of the transaction is the most favorable obtainable under the circumstances." (Supra, p. 4).

The factual situation the Commission was considering in this case was that over a four-year period registrant, in connection with its execution of customers' orders for stocks in the over-the-counter market, regularly interposed between itself and the best available market - 7 broker-dealers, none of whom made a market in or was otherwise a

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6/ Special Study, supra, Part 2, pp. 620-624.

7/ Thomson & McKinnon, Sec. Exch. Act Rel. No. 8310 (May 8, 1968); George A. Brown, Sec. Exch. Act Rel. No. 8160 (Sept. 19, 1967); Delaware Management Company, Inc., Sec. Exch. Act Rel. No. 8128 (July 19, 1967); Thomas Brown III, Sec. Exch. Act Rel. No. 8032 (February 8, 1967); H. C. Keister & Company, Sec. Exch. Act. Rel. No. 7988 (November 1, 1966); W. K. Archer & Company, 11 S.E.C. 635 (1942), aff'd 133 F. 2d 795 (C.A.A. 1943).

traditional source of the stock traded. On 8 randomly selected trading days during the period registrant effected 25% of its over-the-counter transactions with the interposed broker-dealers. In substantially all cases these firms effected same-day offset transactions at a profit with broker-dealers who made a market in or were otherwise traditional sources of the security, making profits of some 1/8th to 3/8th per share. These added transaction costs were borne by registrant's customers. The Commission, applying the standard quoted above, found that the respondents involved in making a practice of interpositioning, could not sustain any contention that the customers did receive proper treatment and concluded that the conduct under consideration constituted a fraud upon the registrant's customers.

The Archer case, supra, was the first case in which the Commission specifically considered the practice of interpositioning. It found that a trader for a "listed" house (a broker doing business in securities listed on a stock exchange) effected trades with a broker dealing in over-the-counter securities in which the trader had an interest. They effected trades at prices which deviated from prevailing market prices to the benefit of the over-the-counter dealer and to the detriment of customers of the listed house during a period of over 2-1/2 years. While it found that many of the transactions were consummated at prices deviating only slightly from the prevailing market price, the Commission concluded that this was not due to the trader not being astute but, rather, to his willful violation of his duties to his firm's customers because of evidence that in some

transactions the trader knew of a better market for the security involved than he obtained from the interposed broker and that in one instance he referred the interposed broker to another broker who in turn bought the stock involved at a substantial profit to the interposed broker. It pointed out that the size of deviations must be considered in the context of a particular scheme found and that a greater divergence of a market price might have incited suspicion and facilitated discovery of the scheme.

As previously pointed out, the Special Study of the Securities Markets which was published in 1963 referred in detail to the practice of interpositioning and its consequences to public customers of brokerage concerns.

In the Keister case, supra, the Commission found that a small over-the-counter firm was interposed between a large brokerage firm and the best available market in the execution of the large firm's customer orders. It found that an arrangement existed whereby a trader of the larger firm was receiving payments from an employee of the interposed firm who was sharing in the trading profits of his employer. It was found that in certain sample periods over 3-1/2-year span over 300 transactions took place between the two firms in a wide variety of securities in which the interposed broker's profit was 1/8 to 1/4 point per share or an average of about $40 per transaction and that the great bulk of the dealers with whom the member effected offset transactions in the securities or for whom it acted as agent were market makers in or traditional sources of those securities.

The Commission rejected the defense that the interposed broker, despite its small size and the fact that it was not a market maker,

had available to it as a wholesale dealer a market with respect to all the diverse securities involved which was more favorable than that available to that of the originating broker which was a substantial retail broker of considerable standing. It pointed out that this was not a case involving a few isolated transactions but a course of conduct over a long period of time involving various securities. It noted in passing that no evidence was presented that the originating broker checked market makers for the best price of each security involved before it effected transactions with the interposed broker or that the interposed broker's price was equal to or better than such price. The fact that payments were made to obtain the business, it held, militated against the interposed broker's claim that it had access to a more favorable market.

In the Delaware Management case, supra, the Commission condemned the practice of an investment adviser to certain investment funds of interposing another broker between those funds and other broker-dealers who made markets in the securities sought to be traded. It found that the funds, in substantially all instances, were in a position to deal directly with the same broker-dealers as used by the interposed broker since they had a joint trading department and had direct telephone wires to the broker-dealers who were market makers or specialists in large blocks of securities. The Commission rejected a contention that the investment adviser ~~of the interposed broker~~ believed that best execution was being obtained through the interposed broker because it could obtain better prices than were available to the funds. It

concluded that there was no reasonable basis for this belief when the interposed broker was not a market maker and these were not isolated transactions but involved many transactions in various securities over a long period of time.

Many of the factors which the Commission has found are indicia of improper interpositioning are present in the instant case. Folger, the originating broker, was a firm of substantial size with facilities by telephone and direct wire to enable its order clerks to check the over-the-counter market properly and to obtain the best execution possible for Folger customers. Instead, a practice was developed over the years whereby Hoit was regularly interposed between Folger and the market. Many such transactions took place in a substantial number of issues. In most of the instances analyzed in this proceeding, Hoit was not a market maker in the stock nor did it have any inventory. It had to pursue the same avenues of inquiry open to Folger; namely, check the market as indicated in the quotation sheets and take the best price obtainable. The speed with which Hoit was able to execute many of the interpositioned orders negates any claim that there was any extraordinary difficulty involved. Indeed, a partner of Hoit testified that the techniques Hoit used in filling the interpositioned orders could have been used by Hardy and Anderson. The fact that Hoit paid to get the business referred to it also tends to negate the claim that it brought a special expertise to the execution of orders it received from Anderson and Hardy. Folger customers in effect paid the mark-up or commission of Hoit on a

particular transaction, plus the regular charge of Folger. It is therefore found that the conduct of Anderson and Hardy resulted in the improper interpositioning of the Hoit firm between Folger customers and available market sources.

Concluding Findings

It is concluded that Hardy and Anderson willfully violated and willfully aided and abetted the violations of anti-fraud provisions of the Securities Acts, as alleged, by causing Folger's customers to incur unnecessary costs and charges by interposing Hoit between Folger and other broker-dealers in the execution of securities transactions in the over-the-counter market, thus failing to seek and obtain for Folger's customers best execution in the purchase and sale of securities in the over-the-counter market, enriching themselves in the process, and failing to disclose these activities to Folger customers. It is further concluded that Hardy and Anderson willfully aided and abetted and participated in willful violations of Section 15(c) of the Exchange Act and Rule 15c1-4 thereunder in that Folger, in the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis, failed to give written notification to the customers involved at or before the completion of each such transaction of the source and amount of all remuneration received by Hardy and Anderson in connection with the transaction and, as a result, misrepresented the actual prices at which the said transactions were being effected. 8/ Hardy

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8/ Every broker, pursuant to this rule, is required to furnish a customer with a written notification of any commission or remuneration to be received by him in connection with a transaction.

and Anderson also willfully aided and abetted and participated in willful violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Hardy and Anderson in connection with the purchase and sale of securities in the over-the-counter market on an agency basis, failed to record on the order tickets prepared for such transactions the time when such orders were transmitted for execution. 9/

The violations found were most serious and go to the heart of the regulatory policy underlying the Securities Acts. The activities of Hardy and Anderson serve to point up the importance of employees in brokerage firms in the enforcement of rules and regulations designed to protect investors. When employees engage in secret activities designed to circumvent statutory requirements and the rules of their own employer, the entire regulatory scheme may be defeated for a very long time before the true facts come to light. The arguments offered in extenuation of Anderson, which are also applicable to Hardy, do not detract from the seriousness of the violations.

While much has been made of the alleged heavy work load of Hardy and Anderson, there is nothing in the record to show that they ever made any formal complaint to their superiors in an effort to secure more assistance. The arrangement that they entered into with Hoit was made by them with a clear understanding of what they were

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9/ This is required by the provisions of sub-division (6) of Rule 17a-3. The fact that this omission was a regular practice at Folger, as Anderson testified, does not excuse these violations, but rather emphasizes the serious nature of these many violations.

doing and they accepted secret payments over a period of years. What can be said for them is that they were very young when they entered into the arrangement, had no business experience, and that they received low salaries which may have acted as a temptation to engage in their extra-curricular activities. It is concluded that the public interest requires that these respondents not have an opportunity to again engage in the unlawful activities found here, but that in view of circumstances mentioned above that they not be permanently barred from the securities industry. Accordingly, it will be ordered that these respondents be barred from any association with a broker or dealer providing that after a period of six months application may be made to the Commission for approval of their employment in the securities business after adequate assurance is given both as to their assignments and supervision which will be designed to prevent a recurrence of the violations found herein.

B. Activities of Sinclair

1. Background

Sinclair was first employed by Filor in 1961. Some time in 1962, he was transferred to the Over-the-Counter Department at Filor and worked there until his employment was terminated in December 1965. In 1965, the year when the violations alleged in the order for the proceedings took place, Sinclair was the sole order clerk in the Over-the-Counter Department. The entire Order Room, of which the Over-the-Counter Department was a part, was under the supervision of a partner.

Filor at all times here relevant was, and still is, a New York

partnership, with principal offices in New York City. It has been registered with the Commission as a broker-dealer since 1949. It conducted an essentially institutional type of business until 1949 when it began to more actively solicit individual accounts. By September 1967, Filor had 10 partners and 123 employees and was in the top 25% of those brokerage firms which reported their gross income figures to the New York Stock Exchange. In 1965, it had approximately 20 private wire connections with non-members of the New York Exchange.

As has been previously noted, Hoit was a much smaller concern than Filor having 3 partners and 6 employees. Whereas Filor conducted a business in securities listed on the exchanges as well as in unlisted securities, Hoit was an over-the-counter brokerage house only and in 1965 it made markets in from 60 to 75 securities.

Commencing prior to 1963 and continuing through 1965, Filor granted commission credit to certain employees based upon the amount of listed business these employees could generate to Filor as a result of arrangements effected with certain over-the-counter dealers whereby such firms would refer listed business to Filor. These arrangements were supposed to be entered into and executed in a manner consistent with Filor's fiduciary obligations to its customers. After Sinclair became registered with the New York Stock Exchange and the National Association of Securities Dealers, Inc. in 1963 he became eligible to receive, and did receive, commissions for over-the counter and listed business he was able to generate to Filor in accounts which he had opened for customers or brokers or which were assigned to him. His

compensation was 30% of the commissions realized by Filor for executing these orders. This compensation arrangement encouraged Sinclair to open new accounts at Filor for various brokers and to reactivate previously existing but dormant accounts. His main assignment continued to be that of order clerk effecting over-the-counter transactions for the firm. Sinclair made it a point to direct over-the-counter business to the firms which were listed as his accounts whether or not they were market makers or listed in the pink sheets (Tr. A 276).

One of the firms which became an account of Sinclair as a result of his efforts to reactivate its account at Filor was Hoit. In July 1963 Sinclair had lunch with Charles Clausen, a partner of Hoit, in which they discussed the reactivation of the Hoit account at Filor and they agreed in substance that Hoit would direct listed business to Filor and Sinclair would direct some over-the-counter business to Hoit. (Tr. A 286 - A 289). The informal arrangement was put into effect thereafter and was continued through 1965.

2. Procedures at Filor in the Execution of Over-the-Counter Orders

When an order was received by a Filor representative he entered the order on a so-called yellow order ticket (Div. Ex. 33). The representative would enter the account name, the account number and the details of the order including the number of shares involved, the security and whether it was being purchased or sold, and special instructions as to price and other matters. If the order was for an

unlisted security, it would be delivered to Sinclair. Sinclair would first time-stamp the order on its back.

Before executing an order he was required, by Filor rules, to call at least three market makers in connection with a particular security involved in order to ascertain the prevailing market price and to execute the order with the broker offering the best price. Sinclair was also required, by Filor rules and procedures, to record on the yellow order tickets the names of the brokers he called, the quotations he received from them and the name of the broker with whom the transaction had been effected. Then he would stamp the execution time on the back of the ticket.

Thereafter, Sinclair would copy information from the yellow ticket onto a blue ticket (Div. Ex.34) where, again, the account number and the customer would be listed, the security involved, the quantity, the price, and the registered representative involved. He would then turn over this form to the Purchase and Sales Department ("P & S Department") which would keep one copy of the blue ticket and forward one copy for further processing by Filor's service bureau. Another P & S copy went to the registered representative concerned. The Department, after it received the processed material (blotters, confirmations, and/or comparisons) and after checking that no mistakes had been made, would send out confirmations or comparisons to the brokers involved. After that, the transaction was cleared unless the broker involved sent back a "D.K." (don't know), in which case the P & S Department would have to recheck with Sinclair to determine if a mistake had been made in the

Filor organization and to take appropriate action. The yellow tickets were kept in the Order Room and if Sinclair was not available, clerks from the P & S Department would recheck the yellow tickets for further information. Sinclair, himself, would refer to them, on occasion.

3. Sinclair's Procedures in Transactions with Hoit

K. C. Weimann was appointed supervisor of Filor's Over-the Counter Department on August 10, 1964. On August 21, 1964 he issued a memorandum to Sinclair stating "All over-the-counter orders must be executed with firms that are shown as making markets in the National Quotation Service pink sheets." (Div. Ex. 28).[9/] As supervisor of the Over-the-Counter Department Weimann was empowered to, and did, check the yellow order tickets from time to time against the pink sheets to determine if Sinclair had been executing trades with market makers appearing in the pink sheets. Sinclair knew of this practice. He also intended to, and did, deal with Hoit on occasions when Hoit was not listed in the pink sheets and was not a known market maker. According to Sinclair he attempted to execute orders with Hoit because he was receiving compensation from business coming into the Filor firm from Hoit.

9/ Weimann was referring to quotation sheets for over-the-counter securities issued by the National Daily Quotation Service, Inc. These quotations are published in three sets: the Eastern, Mid-West, and Western editions. Weimann was referring to the pink sheet or Eastern edition to which Filor subscribed and which Sinclair had available.

The procedure he used, according to his testimony, was to survey the over-the-counter market by calling at least 3 brokers, who were listed in the pink sheets and who were known market makers, to obtain current quotations for the security involved. He would then telephone Hoit, where he usually dealt with Clausen, and attempt to execute the order with Hoit. He would frequently tell Clausen quotations he had received and Clausen would make his own survey of the market and would attempt to find a broker quoting a price which would enable Hoit to execute the order at a price profitable to itself. When such a broker was found the transactions were simultaneously or reasonably contemporaneously offset by Hoit with the brokerage firm. If such an offset could not be arranged, Clausen would turn down the order offered by Sinclair. Sometimes an offer by Sinclair would be accepted immediately if Clausen knew that he could offset the transaction at a profit. After Sinclair had executed an order with Hoit, where the latter was not listed in the pink sheets for the security and Sinclair was thus violating written instructions by making the trade with it, he would insert the name of a firm listed in the pink sheets as the one he had traded with in order to escape detection. He testified he would then enter the correct information on the blue ticket and forward it to the P & S Department. Weimann did not check the blue tickets.

Although Sinclair denied ever referring Clausen to another broker-dealer with whom Hoit would profitably offset the transaction after executing the order with Sinclair, in approximately 40 trades involving

Filor and Hoit, the name of the broker which Sinclair entered on the yellow order ticket as the broker with whom he had executed the trade, although the trade had been in fact executed with Hoit, was the actual name of the broker with whom Hoit offset the transaction for a riskless profit (See Analysis of Div. Ex. 3 attached to the Division's Brief as Appendix A). Clausen's memory was hazy on this point. Sinclair testified he might have directed Clausen to a broker whom he could not reach himself.

In 1965, Filor executed a total of 5,850 over-the-counter transactions for a total value of $61,997,000. Of these, 317, 5.4%, were between Filor and Hoit at a total value of $1,174,774 (1.9%).[10/] In 189, or 59.6%, of the 317 transactions between Filor and Hoit, Hoit did not appear in the pink sheets as a market maker or broker interested in the securities involved nor did the firm have or maintain a position in the particular stock on the day before or the day after a particular transaction.[11/] These transactions total 3.2% of Filor's total over-the-counter transactions in 1965. It is these trades which the Division alleges were transactions where Hoit was improperly interpositioned between Filor and market makers with whom the transactions could have

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10/ The above figures are contained in a summary sheet prepared by the Division and received in evidence (Div. Ex. 42). The figures contained thereon are not challenged in their essential details.

11/ In some instances Hoit acquired stock after an inquiry from Filor and then completed a transaction with it.

been directly executed.

The elapsed time between Hoit's receipt of a trade allegedly interpositioned and its execution with an offsetting broker was recorded on its books as follows:

	No. of Transactions	Percent of Total	Time Involved
	132	70	Simultaneous
	37	20	1-10 minutes
	4	2	11-20 minutes
	2	1	21-30 minutes
	11	5	Over 30 minutes
	3	2	Time Not Indicated
Total Interposed	189	100%	

In the above 189 transactions Hoit was able to offset the transactions with another broker-dealer usually appearing as a market maker in the pink sheets both on the trade date and the day before the trade at a profit ranging from 1/8 to 5-1/2 points on each transaction as follows:

Range	Number of Transactions
1/8	70
3/16	2
1/4	74
3/8	7
1/2	26
5/8	1
3/4	3
1	2
1-1/4	1
1-1/2	1
5	1
5-1/2	1
Total	189

Also, in these transactions an average of 9 broker-dealers were listed in the pink sheets as market makers in the particular securities on the trade dates in question and 10.8 on the day before the trade dates

in question. Hoit received a gross profit on these 189 trades of $8,496.25. In 1965, approximately 55% of all the commissions received by Sinclair was derived from transactions with Hoit.

4. Termination of Sinclair's Employment

On or about September 14, 1965 Martin Kiffel was appointed supervisor of the Order Room of Filor which included the Over-the-Counter Trading Department. On or about November 26, 1965 an investigation into Filor's trading in a particular stock was directed by its managing partner. In the course of this investigation some of the practices of Sinclair, including his dealings with non-market makers and his entry of false information on order tickets, came to light. On December 13, 1965 a memorandum was issued by the Managing Partner, R. A. Smith, stating:

> "After several prior warnings and an internal disciplinary action, Mr. E. Sinclair has again violated a partnership directive to refrain from trading over-the-counter securities with NASD members who do not appear in the 'pink sheets' of the National Quotation Bureau."
>
> (Div. Ex. 37).

It was further stated that Sinclair's employment was to be terminated.

5. Interpositioning -- Contentions of the Parties -- Conclusions

Sinclair testified, in substance, that while he did try to trade with Hoit on occasion he never favored it by giving it an order at a price more favorable to Hoit than he could have obtained in the market. His testimony, as supplemented by a stipulation as to what his further testimony would be, was that he always checked an order with market

makers and/or dealers appearing in the pink sheets to obtain quotations, that he telephoned various broker-dealers and noted their names and quotations on the yellow order tickets, and that the prices at which he executed trades with Hoit were at least as good as those he obtained from others. Sinclair further testified that there were instances in which he could not reach a broker who had given him what turned out to be the best quotation or he did not have time to do additional checking. In such instances he would call Clausen at Hoit to see if Clausen could meet the best market quotation Sinclair had learned of in his survey of the market situation.

It is urged on Sinclair's behalf that Hoit was better able to execute trades in the over-the-counter market because it was a specialist in over-the-counter transactions, made a market in approximately 70 securities, and had approximately 50 direct wire connections to other brokerage houses. Sinclair and Clausen both testified, as has been pointed out, that on some occasions Hoit rejected trades offered by Sinclair. It was also pointed out that in many of the 189 transactions where alleged interpositioning occurred Hoit obtained only a small profit and these transactions constituted only 3.2% of the trades handled by Sinclair and less than 1% of the dollar volume of these trades. Reliance also is placed on the fact that in approximately 20 of the 189 trades Sinclair was unable to conclude the purchase or sale of the entire block of stock in which he was dealing by placing it with a single broker. In those instances it was necessary to execute the transaction with more than one broker including Hoit.

In those cases Hoit received no more than the price negotiated with other brokers, except in one instance. (Tr. A 921 et seq.). Other arguments presented were that transactions were executed by Hoit with brokers with whom Filor did not do business or with whom Filor did not have a direct wire while Hoit did. Evidence was presented that the completion of trades is facilitated when the brokers involved have direct wire connections between them rather than having to resort to ordinary telephone communications.

The Division contends that the course of the transactions between Filor and Hoit which it has charted in great detail (Div. Exs. 3, 42) established both that Sinclair favored Hoit when the latter was not a market maker and that Hoit had little difficulty in executing orders with other brokers to meet the offerings from Sinclair quickly and with profit to itself. This, it is contended, constituted interpositioning resulting in excess charges to customers of Filor and violations of the anti-fraud provisions of the Securities Acts.

The general principles in the leading Commission decisions applicable in a case involving alleged interpositioning have previously been summarized. (Supra, pp. 12-18). The common thread linking the cases cited is an effort on the part of one broker to reward another broker for referred business or for other favors. A possible conflict of interest and violation of the fiduciary obligation owed customers arises when a broker-dealer seeks to reciprocate for listed commission business given him by a non-member broker-dealer. Various arrangements are possible. One that may be used is for the broker who is a member

of a stock exchange to provide reciprocal business to the non-member broker either in agreed ratio or by use of some other less specific standard, rather than transacting his business in the best available market.[12/] The result of such a practice is that the listed broker-dealer is not fulfilling his fiduciary obligations to the customer involved and the customer is subsidizing the arrangement by not getting proper execution from his broker and at the very least paying double commission or mark-up charges.

The detailed chart of all the transactions between Hoit and Filor in 1965 (Div. Ex. 3) reveals that there was a continuous and steady relationship between the two firms all during the year and that trades were effected in many different securities. This is true of the 189 transactions on which the Division relies for proof of its contentions. Sinclair did not deny that he sought to place business with Hoit and was influenced in this by his financial interest in the commissions earned in those transactions.

While it is conceded that the chart correctly shows that in 189 transactions Hoit was not listed in the pink sheets nor was it a market maker, it is urged, as Sinclair testified, that customers were not disadvantaged in these trades because Hoit met the market quotations which Sinclair had previously checked. Reliance is not only placed on Sinclair's testimony but on entries on the yellow order tickets which

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12/ See generally, Special Study, supra, Part 2, pp. 302-310.

Sinclair testified reflected the standard operating procedure in quotations he had received. However, Sinclair freely admitted falsifying entries on the yellow tickets when he felt it was necessary in order to deceive his supervisor. In addition, the evidence shows that in 132 of 189 transactions Hoit was able to complete a trade with an offsetting broker simultaneously upon receipt of the trade from Filor and that 169 of those offsetting trades were completed within ten minutes. In the vast majority of cases these trades were completed with brokers listed in the same pink sheets which were available to Sinclair. Then again, the record shows that in finding offsetting brokers Hoit went to many different brokers and did not rely on a small group to whom it had special access by direct wire or otherwise. These factors, in the opinion of the undersigned, negate the contentions of the respondent on this point and indicate that Sinclair did not carefully check the market in the transactions involved here but, instead, gave Hoit an opportunity to make riskless profits in these trades quickly and with very little trouble to itself. Further support for this finding is found in the fact that while Sinclair denied that he ever directed Hoit to a broker with whom he knew Hoit might profitably offset a transaction the record reveals that in 40 cases where Sinclair testified he inserted the name of a market maker as the one with whom a trade had been effected, the name he allegedly selected at random also coincided with the name of the offsetting broker reflected in the Hoit records. (Appendix A to Division's Proposed Findings).

The evidence establishes that Hoit made a profit on each of the interposed transactions from 1/8 of a point upwards. While in most of

these transactions the profit made was 1/2 point or less, the amounts involved all represent sums which were needlessly added to the cost of Filor's customers.

It is urged on behalf of the respondent that the 189 trades covered here constituted 3.2% of the total trades handled by Sinclair in 1965 and less than 1% of the total dollar volume of trades he executed. It is contended that the interpositioning cases previously summarized and cited by the Division concerned cases where the percentages of interpositioned trade to total trades were larger or higher in number. The determination of the question whether there has been improper interpositioning does not rest on some absolute percentage or numerical standard. In every case it must depend on an analysis of the trading relationship between brokers which evidences a steady course of conduct between the brokers involved which is consistently operated to the detriment of the public customers of the originating broker. While the trades involved here are small in percentage in relation to Filor's total trades it constituted almost 2/3 of all the trades between Filor and Hoit. In this connection, it must be observed that Sinclair and Hoit undoubtedly kept some rough proportion between the business directed to each other and had no arrangement for exclusive referral of business.

It is argued that the Division is seeking to establish a rule that when a broker does business with a non-market maker he does so at his peril. The standard applicable is the one which runs through the cases which have been cited and which have been summarized in the Thomson & McKinnon case, supra, at p. 4, namely: that since it is the obligation of a broker to obtain the most favorable price possible for his customer, where he interposes another broker-dealer between himself

and a third broker-dealer, he prima-facie has not met that obligation and that the practice of such interpositioning tends to negate the defense that a customer's total costs were the most favorable obtainable under the circumstances. Sinclair engaged in such a practice in trades with Hoit. It is therefore concluded that Sinclair willfully violated the anti-fraud provisions of the Securities Laws by his practice of interposing Hoit between market makers and the execution of orders for Filor customers in certain transactions in the over-the-counter market, and Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder.

6. Violations of Record-Keeping Requirements

It is alleged in the amended order for these proceedings that during 1965 Filor willfully violated Section 17(a) of the Exchange Act[13/] and Rule 17a-3 thereunder and Sinclair willfully aided, abetted and participated in and caused such violations in that Sinclair made false entries on certain of Filor's order tickets and caused other employees of Filor to willfully make false entries on books and records of Filor.

As has been previously noted, it has been conceded on behalf of respondent that Sinclair made false entries on some yellow order tickets of Filor by noting on them the alleged name of the broker with whom he had executed an over-the-counter transaction. This was done by

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13/ This Section provides, in pertinent part, that every broker or dealer ". . .shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records. . .as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Sinclair in order to conceal from his supervisor that he had made a trade with a firm not appearing in the pink sheets, in violation of Filor's written rules. This occurred in approximately 175 cases - most of them with Hoit (Div. Ex. 8, 8A; Tr. A 835). Other brokers where Sinclair used this practice were M. S. Wien & Company and M. L. Lee & Co., both brokerage firms from whose orders Sinclair obtained commission revenue (Tr. A 830 - A 833). According to Sinclair, his practice was to insert the name of the actual broker with whom he had dealt on the blue order slip which he transmitted to the P & S Department in connection with each transaction. By this method Sinclair protected himself from detection by a supervisor who might check his yellow order tickets while at the same time insuring that the P & S Department had the correct information on the transaction and that clearance procedures would follow their normal course.

While the respondent concedes that Sinclair was responsible for and did prepare the entries on the yellow order tickets, it asserts that Sinclair was not required by applicable rules to place the name of the broker with whom he had dealt on the order tickets and any falsification of the name of the broker involved in the transaction was not violative of Section 17(a) of the Exchange Act and rules thereunder.

Subsection (6) of Rule 17a-3 provides that every broker or dealer shall make and keep current

> "A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order or instruc-

> tions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Orders entered pursuant to the exercise of discretionary power by such member, broker or dealer, or any employee thereof, shall be so designated. The term 'instruction' shall be deemed to include instructions between partners and employees of a member, broker or dealer. The term 'time of entry' shall be deemed to mean the time when such member, broker or dealer transmits the order or instruction for execution or, if it is not so transmitted, the time when it is received."

While respondent concedes that Sinclair was required by Filor's rules and practices to place on the yellow order ticket the name of the broker with whom he had executed a transaction, it contends that this was not specifically required by the rule and therefore Sinclair cannot be held to have violated it by his admitted falsifications. The Division contends that the yellow order tickets constituted memoranda of brokerage orders which were required to be made and kept current, that the requirement that records be kept embodies the obligation that such records must be true and correct[13/] and that the requirement that a broker's books and records be accurate must apply to all data relating to a broker's business recorded on his books and records. It also urges that since the term "instruction," as used in the following language in subsection (6), "any other instruction, given or received for the purchase or sale of securities," is further defined therein to include instruc-

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13/ Lowell Niebuhr & Co., Inc., 18 S.E.C. 471 (1945); Carter Harrison Corbrey, 29 S.E.C. 283 (1949); See Morris Luster, 36 S.E.C. 298 (1955). Weiss, Registration and Regulation of Brokers and Dealers (1965), pp. 43-44, and cases cited in Footnote 19 therein.

tions between partners and employees of a broker, this term should be given a liberal construction and should be held to include instructions such as that given by Filor to Sinclair to record the name of the broker with whom the transaction had been executed.

The yellow order ticket was the initial and basic record of a customer's order at Filor. On it was recorded information required by subsection (6) which was not included on the blue ticket. These items are "any other instruction, given or received for the purchase or sale of securities whether executed or unexecuted. . .the terms and conditions of the order or instructions and of any modification or cancellation thereof. . .the time of entry. . .and the time of execution or cancellation." In order to determine whether Filor was complying with the record-keeping requirements of Section 17(a) of the Exchange Act and applicable rules it would be necessary to examine the yellow order tickets. Also, while the yellow tickets were not forwarded to the P & S Department they were intended to be referred to by employees from that unit when further checking was needed and this was done on occasion.

The statutory language indicates that a main purpose of the record-keeping requirements is to make these records available for examination by representatives of the Commission in the public interest or for the protection of investors. The contention that a vital record such as the yellow order ticket as used by Filor to comply with statutory requirements may contain a combination of truth and falsities would negate the purpose and policy of the record-keeping requirements

of the Exchange Act. The undersigned concludes that the rule that records must be true and correct must apply to all entries on records kept by a broker pursuant to statutory requirements[14/] Moreover, Rule 17a-4 under Section 17(a) of the Exchange Act in part requires that a broker shall keep and preserve

> "(4) Originals of all communications received and copies of all communications sent by such member, broker or dealer (including inter-office memoranda and communications) relating to his business as such." (Emphasis added.)

This requirement includes memoranda such as the yellow order tickets considered here. This provision is directed to the protection of the public interest and investors by making these records available for inspection for a period of years. Certainly, this requirement would be of no value if it did not include the requirement that these records be true and correct. The undersigned therefore concludes that Sinclair willfully aided, abetted and participated in and caused Filor's willful violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Sinclair made false entries on certain of Filor's order tickets.

As has been previously noted, Sinclair testified that when he executed an over-the-counter transaction with a broker who was not listed in the pink sheets, he concealed this violations of his employer's

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14/ The term "instruction" as used in subsection (6) is susceptible of the meaning urged by the Division, but the undersigned has not found it necessary to rule on this contention.

instructions by placing on the yellow order ticket the name of a market maker as the one with whom the transaction had been made. He would then put the name of the actual broker involved on the blue ticket which he forwarded to the P & S Department in connection with each transaction. When this was done Sinclair achieved the double goal of concealing this practice from his supervisors while at the same time arranging matters so that clearance procedures followed their normal course with no problem. However, in some instances Sinclair wrote on the blue ticket the name of the same broker he had written on the yellow ticket. This resulted in incorrect entries being made on the Filor blotters, comparisons and other records which later had to be changed when the true broker's identity became known. Changes had to be made on the blue tickets and all other records used by Filor in processing the transactions. There were 32 such cases: of these, 19 involved Hoit as the true broker and 13, M. S. Wien & Company, another broker from whose orders Sinclair obtained commission revenue.

While the respondent concedes that Sinclair was responsible for and did prepare the entries on both the yellow and blue tickets, it asserts that those blue tickets on which the Division relies in support of its allegation that Sinclair caused false entries to be made on the books and records of Filor were a very small proportion of the total of the blue tickets he prepared during 1965, that these were unintentional errors, that no possible advantage could have occurred to Sinclair by reasons of inserting the incorrect name on the blue tickets, that he always assisted the P & S Department in correcting the records, and

that errors on blue tickets do occur in the regular course of brokerage business.

The Division contends that due to a more efficient supervision of Filor's Over-the-Counter Department and Order Room which were formally merged in 1965, Sinclair found it necessary to make false entries on the blue tickets.[15/] The Division further argues that the falsifications of the blue order tickets were not mere errors as the respondent contends but were motivated by an effort to conceal this practice in case blue tickets should be examined and that Sinclair would have no fear of correcting mistakes on the blue tickets later, since that was a matter that he could work out with the P & S Department.

The arguments of the Division are not supported by the factual record. Of the 19 Hoit transactions involved, at least one instance occurred in every month of the year through November, except one; the highest number, 4, was in March. There was a similar distribution in the case of the Wien transactions referred to above. Therefore, there was no concentration of these blue ticket incidents in the latter part of 1965 when supervision was tightened. A small number of instances each month also leads to the conclusion that Sinclair did not make a practice of falsifying entries on the blue tickets.

However, there is no question that Sinclair did make false entries

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15/ On September 14, 1965 the Over-the-Counter Trading Department and the Order Room were formally merged and a new supervisor was placed in charge with full-time responsibility for the operations of the merged department (Div. Ex. 2).

on Filor's blue order tickets and caused other employees of Filor to make false entries on the books and records of Filor in violation of the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. The fundamental question remaining is whether Sinclair's activity was inadvertent as contended on his behalf or willful within the meaning of the Exchange Act.

It has been stated that

> "the word [willful] often denotes an act which is intentional or knowing, or voluntary, as distinguished from accidental." 16/

The general standard applied by the Commission and approved by the Courts is that "willful"

> "....means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts." 17/

Sinclair did the writing on the blue tickets involved here and to that extent what he did was a conscious act. Most important, in

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16/ United States v. Murdock, 290 U. S. 389, 394-395 (1933).

17/ Tager v. S.E.C., 344 F. 2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord, Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E. W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959). See generally Loss, Securities Regulation, (1961 Ed.), Vol.II, pp. 1309-1312, (1969 Supp.), Vol.V, pp. 3368-3374.

evaluating it, is the fact that the entries on these blue tickets were part of a conscious, deliberate, and willful scheme by Sinclair to mislead his employer and to defraud Filor customers. To carry out his plan, Sinclair had to constantly keep in mind which transactions were legitimate ones within the standards set up by Filor and which were improper ones which required a certain amount of juggling of the yellow and blue order tickets. It was inevitable, and certainly foreseeable, that in the course of executing many transactions Sinclair would fail in certain instances to make the proper record entries and thus cause trouble in the P & S Department. Therefore, these transactions cannot be considered in isolation but must be considered as part of an overall scheme devised by Sinclair which, admittedly, was willful and deliberate. The undersigned therefore concludes that by his conduct in connection with the blue tickets considered here Sinclair made incorrect entries on them, caused other employees of Filor to make false entries on the books and records of Filor, and by his conduct willfully aided, abetted, participated in, and caused Filor's further willful violation of Section 17(a) of the Exchange Act and Rule 17a-3.

7. Concluding Findings

It has been found that Sinclair willfully violated the anti-fraud provisions of the Securities Acts and applicable rules thereunder, as alleged, by causing customers of Filor to incur unnecessary costs and charges by interposing Hoit between Filor and other broker-dealers in the execution of securities transactions in the over-the-counter market, thus failing to seek and obtain for Filor customers best execution in

the purchase and sale of securities in the over-the-counter market and carrying out these activities for the purpose of securing for Filor reciprocal business and additional compensation for himself. It has further been found that Sinclair willfully aided and abetted and participated in willful violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder in that Sinclair, in connection with the execution of customers' orders for the purchase and sale of securities in the over-the-counter market on an agency basis, aided and abetted in the failure to give written notification to Filor's customers at or before the completion of each such transaction of the source and amount of all commissions and other remuneration received or to be received by Sinclair and Filor in connection with the transaction and, as a result, misrepresented the actual prices at which the said transactions were being effected. It has also been found that Sinclair willfully aided and abetted and participated in and caused violations of Section 17(a) of the Exchange Act and applicable rules thereunder and that he made false entries on certain order tickets and caused other employees of Filor to unwittingly make false entries on other books and records of that firm.

This case is another illustration of activities of an employee of a brokerage firm which, for a time, frustrate both statutory rules and regulations and procedures of his own employer designed to protect investors. As a result of Sinclair's activities certain customers of Filor bore the burden of unnecessary charges in their over-the-counter transactions. This activity was covered up by a carefully planned

scheme designed to prevent Sinclair's supervisors from detecting what was going on. The statutory provisions and rules violated were key provisions of the Securities Acts designed to protect investors in the public interest. The only extenuating circumstances that the undersigned can find in the record that might be urged in Sinclair's behalf is that he had a clear record in the securities industry prior to these events; that the number of interpositioned transactions relied on by the Division, while substantial, do not indicate a design to engage in interpositioning in any more than a small percentage of the over-the-counter transactions that Sinclair handled; and that the arrangement that Sinclair's employer established whereby Sinclair shared in commissions for business be obtained from other brokers placed him in a position where he had a monetary interest in diverting business to non-market makers and this undoubtedly acted as a temptation which he did not resist. These arguments do not detract from the seriousness of the violations. The undersigned concludes, with some reluctance, that under all the circumstances the public interest does not demand that Sinclair be completely barred from the securities industry. However, it is necessary in the public interest that this respondent not have an opportunity to again engage in any of the unlawful activities found here. Accordingly, it will be ordered that this respondent be barred from any association with a broker or dealer providing that after a period of six months application may be made to the Commission for approval of his employment in the securities business after adequate assurance is given both as to his assignment and supervision which will be designed to preve a recurrence of the violations found herein.

III. ORDER

It has been found that the respondents have willfully violated provisions of the Securities Acts and applicable rules thereunder and that certain sanctions should be imposed in the public interest and for the protection of investors. Accordingly,

IT IS ORDERED that pursuant to the provisions of Section 15(b)(7) of the Exchange Act the respondents John Hardy, Richard Clark Anderson and Edward Sinclair are barred from association with a broker or dealer, providing that after a period of six months application may be made to the Commission for approval of the employment of any of said respondents in the securities business upon assurance as to his assignment and supervision which will be designed to prevent a recurrence of the violations found herein.

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

decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party. 18/

Sidney L. Feiler
Hearing Examiner

Washington, D. C.
December 31, 1969

18/ All contentions and proposed findings have been carefully considered. This initial decision incorporates those which have been found necessary for incorporation therein.

A motion has been filed on behalf of the respondent, Edward Sinclair, to postpone consideration by the Commission of the findings of fact and conclusions of law in these proceedings until such time as there are sitting on the Commission at least three commissioners who have not participated in the decision of the Commission of January 8, 1969, ruling on an offer of settlement submitted by Filor (Exch. Act Rel. No. 8489). It is further moved that any commissioner who participated in the findings, opinion and order disqualify himself from participating in the decision with respect to the issues in the proceedings.

The basis for this motion is that the findings, opinion and order of January 8, 1969, constitute a prejudgment of the issues in this litigation with respect to Sinclair, and that accordingly a determination by any of the commissioners who participated in that decision of

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18/ Continued
the issues here would deprive Sinclair of his constitutional rights to due process of law and a fair and impartial hearing before an unbiased tribunal.

Reliance is placed on statements in the opinion of January 8, 1969, that an order clerk of Filor in charge of executing over-the-counter orders engaged in interpositioning and circumvented Filor's policies prohibiting interpositioning by falsely listing a market maker as the executing dealer on the tickets relating to orders. Since these are the matters in issue here, it is urged that that decision adjudicates Sinclair guilty of the charges made against him.

While recognizing that the Commission did state in its decision "Those findings, of course, relate only to the named respondents and are not binding on the other respondents" (footnote 2) it is argued that it strains credulity to believe that the Commission, having penalized Filor for failure to supervise and to prevent the misconduct of the order clerk (Sinclair), could now make contrary findings as to Sinclair.

The Commission as a regular matter receives and acts on offers of settlement submitted by one or more parties to a formal administrative proceeding. The record before it is necessarily a limited one consisting of the order for proceedings, the answers thereto, the offers of settlement and stipulations of facts, memoranda submitted in support of the offers, and the recommendations of the staff. This was the record the Commission had before it in reaching its decision of January 8, 1969 (a denial by Sinclair of any violations of the Securities Acts was also on file). None of the evidentiary record developed here was before it.

Parties may stipulate to any matters they wish. The Commission when it issues orders based on such stipulations, is not making a final determination of issues still in litigation. The contention of this respondent, if adopted, would prevent the Commission from expeditiously disposing of much litigation with a minimum of expense and loss of time. There is no merit to the contention that the Commission cannot now give full and impartial consideration to contentions on the law and facts which may be presented to it by this respondent based on a complete record. (For an example of a somewhat similar case, see, Sutro Bros. & Co. (Sec. Exch. Act Rel. No. 7053, April 10, 1963), esp. p. 2, fn. 3 with relation to "W." The hearing was subsequently reopened as to "W" and a full evidentiary hearing was held.)