ADMINISTRATIVE PROCEEDING
FILE NO. 3-4243

U. S. SECURITIES & EXCHANGE COMMISSION
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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

CHARLES PLOHN & CO., et al.

(8-2756)

U. S. SECURITIES & EXCHANGE COMMISSION
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INITIAL DECISION

Washington, D.C.
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Edward B. Wagner
Administrative Law Judge

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CHARLES PLOHN & CO., et al. (8-2756)	INITIAL DECISION

APPEARANCES: Peter B. Schaeffer, Edward Shapiro, Franklin Ormsten, Martin Siegel and Alfred Kruhm of the New York Regional Office for the Division of Enforcement

Edward C. Jaegerman, pro se.

BEFORE: Edward B. Wagner, Administrative Law Judge

THE PROCEEDING

On March 27, 1973 the Commission instituted this public proceeding, pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 (Exchange Act), against respondents Charles Plohn & Co. (Plohn & Co.), Charles Plohn, Sr. (Plohn, Sr.), Steven Gutman (Gutman) and Edward C. Jaegerman (Jaegerman).

Plohn, Sr. and Gutman submitted offers of settlement which neither admitted nor denied allegations contained in the order for proceedings and consented to findings of misconduct and to the imposition of specified sanctions. These offers were accepted.1/

During the course of the pre-hearing conference in this proceeding on May 14, 1974, a question was raised as to who properly was to represent Plohn & Co. A decision on this matter was deferred until June 3, 1974 when on the basis of written briefs and oral argument, I ruled that the Receiver for Plohn & Co., Robert Patterson

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1/ Plohn, Sr. was suspended from association with any broker-dealer for 6 months, precluded from association with any broker-dealer in a supervisory or proprietary capacity at any time and permitted to associate in any other capacity only upon prior Commission approval. SEA Rel. No. 10958 (Aug. 9, 1974).

Gutman was suspended from association with any broker-dealer, investment company or investment adviser for a period of 30 days and thereafter barred from association in a supervisory or proprietary capacity for a period of 1 year. Thereafter, it was provided that Gutman could apply for permission to become associated in a supervisory or proprietary capacity. SEA Rel. 11004 (Sept. 9, 1974).

(Patterson), was the proper party to represent Plohn & Co. 2/ However, because the receiver was contemplating a motion to the District Court for termination of the receivership which would result in a new person or entity becoming the proper party, I granted a motion by Patterson's counsel, joined in by the Division of Enforcement (Division), to sever Plohn & Co. from this hearing.

Thus, Jaegerman is the sole remaining contesting respondent, and this initial decision has application only to him, although the other respondents will necessarily be mentioned. Insofar as pertinent here, the Order for Proceedings charged Jaegerman with having:

(A) wilfully aided and abetted violations by Plohn & Co. of Sections 8(c) and 15(c)(2) 3/ of the Exchange Act and Rules 8c-1 and 15c2-1 4/ thereunder in that the firm employed customers' securities to collateralize loans to the firm in amounts which exceeded the indebtedness to the firm of all customers in respect to securities carried for their accounts;

(B) wilfully violated and wilfully aided and abetted violations by Plohn & Co. of the antifraud provisions of Section 10(b) 5/ of the Exchange Act and Rule 10b-5 6/ thereunder, in six specific counts; 7/

2/ Prior to the institution of this proceeding the Commission had filed a complaint in the United States District Court for the Southern District of New York seeking to enjoin Plohn & Co. from violations of the Exchange Act and praying for the appointment of a receiver. A preliminary injunction had been granted and Patterson appointed as Receiver by District Court Judge Lloyd F. MacMahon. Judge MacMahon's decision was affirmed on appeal. S.E.C. v. Charles Plohn & Co., 433 F. 2d 376 (2d Cir. 1970).

3/ 15 U.S.C. 78h(c) and 78o(c)(2).

4/ 17 C.F.R. 240.8c-1 and 15c2-1.

5/ 15 U.S.C. 78j(b).

6/ 17 C.F.R. 240.10b-5.

7/ This was reduced to four counts during the course of the hearing. Two counts, Subparagraphs (c) and (e) of Paragraph (B) of Section II of the Order, were waived by the Division during the course of the hearing (Tr. 9675).

(C) wilfully violated and wilfully aided and abetted violations by Plohn & Co. of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that a favorable report on Clinton Oil Co. (Clinton) was prepared and distributed to customers of Plohn & Co without disclosing that Jaegerman while Managing Partner of Plohn & Co. had a substantial financial interest in Clinton and in oil and gas programs operated by it; and [8/]

(D) In the alternative with respect to paragraphs (A) and (B), above, failed reasonably to supervise within the meaning of Section 15(b)(5)(E) of the Exchange Act [9/], with a view to preventing the violations, persons subject to his supervision.

Generally, the alleged violations were charged to have taken place between January 1, and August 27, 1970.

The evidentiary hearing commenced on June 3, 1974 and continued thereafter with the exception of limited periods of recess until January 24, 1975. The transcript exceeds 10,700 pages, and the record includes over 200 exhibits, many of which have multiple pages. In view of the voluminous record, an extended schedule was adopted for post-hearing filings. This was further extended as a result of requests for additional time from both the Division and Jaegerman [10/] with the result that the Division's filing of Proposed Findings of Fact, Conclusions of Law and Brief was made on April 16, 1975 and Jaegerman's corresponding filing was made on August 4, 1975. The Division's filing comprises 189 pages of typed material, while Jaegerman's filing, which contains no case citations nor specific record citations, comprises 8 pages.

8/ Division Brief, p. 98.

9/ 15 U.S.C. 78o(b)(5)(E)

10/ The Division was granted an additional 3 weeks' time and Jaegerman 45 additional days.

The Division determined not to file a scheduled Reply Brief which would otherwise have been due September 4, 1975, and the post-hearing procedures were, accordingly, completed.

During the hearing, a motion by Jaegerman that the proceeding be dismissed based upon double jeopardy in that he was acquitted by a jury in a New York State Court in a criminal case of certain of the charges involved here was dismissed by the Commission. 11/

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the witnesses. Preponderance of the evidence is the standard of proof applied.

Background

Plohn & Co., a partnership, became registered with the Commission as a broker-dealer on February 6, 1954. The firm operated its business from executive offices located at 200 Park Avenue, and its sales force and back office were located at 44 Beaver Street in New York City. It also had numerous branch offices in the East. At the height of its operations around 500 persons were employed by Plohn & Co. Although the firm was a member of the New York Stock Exchange (NYSE or Exchange), it specialized in underwriting speculative securities. Its reputation in this area was such that Plohn, Sr., who had a large majority ownership interest in the firm, was known as "two a week Charlie" (Tr. 2629). 12/

11/ Commission Order, dated July 2, 1974.

12/ In his brief at p. 1 Jaegerman states that the firm "completed two underwritings per week for about $5,000,000 per week."

In 1969 Plohn & Co. consented to a finding by the NYSE that it had violated from about the beginning of 1967 through 1968 various rules of the Exchange and provisions of the Exchange Act and agreed to a $100,000 fine. Plohn, Sr. also agreed personally to pay a $50,000 fine. In further settlement of the NYSE proceeding Plohn, Sr. agreed that he would have no operating responsibility.[13/]

Exchange officials in conversations with Jaegerman before he took over as Managing Partner were extremely critical of the Plohn firm, asserting that it had used its NYSE membership to float issues which were relatively worthless and was largely conducting an over-the-counter business. They stated that the Exchange would have to close down the firm unless Jaegerman or someone else took over its operation. He was urged to upgrade the firm's underwritings and the issues in which it traded.

Jaegerman was Managing Partner, Chief Executive Officer and a general partner of Plohn & Co. from October 15, 1968 until his resignation on August 18, 1970.

Jaegerman graduated from Yale College, Phi Beta Kappa, has a Bachelor of Laws degree from the Yale Law School, and is 63 years of age.

13/ Plohn, Sr. agreed that he would "not participate in any supervisory activity relating to the operation and conduct of the business of Charles Plohn & Co." (Resp. Ex. 127-31).

Jaegerman was employed by the Commission from December, 1936 until October 15, 1968, except for 3 or 4 years spent as a naval officer during World War II. While employed by the Commission, Jaegerman was ". . . supervising attorney, litigation and enforcement . . . senior trial attorney . . . chief attorney or principal attorney, Office of Special Investigations and . . . Chief Investigative Counsel for the Division of Trading and Exchanges for the Commission" (Tr. 8485-6). While with the Commission and around 1956 Jaegerman received a Rockefeller Public Service award, as a result of which he spent 14 months in England where he was in close association with government officials and lectured at Oxford and Cambridge Universities and at the London School of Economics.

Jaegerman is an attorney of outstanding and unusual ability, well-versed in the securities laws. However, witnesses in this proceeding in describing him in his role as Managing Partner have characterized him as "dictatorial" (Tr. 7341), "mercurial" (Tr. 7341) and "very assertive" (Tr. 7683).[14/] Persons who were under his supervision have stated that he did not have sufficient knowledge of back office operations to qualify him for supervisory responsibilities. He, of course, had had no previous experience with a brokerage firm. In fact, he acknowledged his deficiency in back office operations in conversations with Exchange officials prior to accepting his position, but was urged to take on the job.

14/ Another witness characterized him as "excitable" (Tr. 8868).

Nevertheless, upon assuming his positions at Plohn & Co., and continuing until his resignation, Jaegerman took charge of and assumed responsibility for the conduct of the firm's business and had complete responsibility for the supervision of the back office. Office managers were told to report directly to Jaegerman with any problems they might encounter, and Jaegerman was charged with the responsibility of overseeing daily operations.

Pursuant to Jaegerman's five-year employment contract, he was given full power, authority and discretion to enable him properly to perform his functions as Managing Partner. His employment contract provided that, if he were, by act of the firm or any partner, impeded or prevented from properly discharging his duties, he could resign at full salary if the impediment were not corrected within three days after written notification. Under the terms of his contract Jaegerman was paid an annual salary of $52,000 and was, in addition, entitled to a 3% interest in the profits of Plohn & Co. and a 25% interest in any warrants, options or bargain purchase shares received by the firm as additional underwriting compensation in underwritings which he brought to the firm.

Jaegerman was required to make no capital contribution and was not responsible for any partnership losses. In view of the fact that he contributed no capital, he insisted in conversations with Exchange officials that his contract be amended to make clear he had "no responsibility or anything to do with the vested capital of the firm." (Tr. 10343).

During Jaegerman's term of office Steven Gutman (Gutman) was the Plohn & Co. Coordinator responsible for net capital compliance and was in other respects subordinate to Jaegerman.

Joseph Pasciucco (Pasciucco) was the firm's Cashier in charge of the cage and bank loans. In 1970 Pasciucco was approved as a Partner in the firm by the NYSE, but balked when he discovered that the firm was in poor financial condition and that partnership status would require a contribution of his life savings of some $28,000.

Richard Stillwell (Stillwell) was the head of the Margin Department at Plohn & Co.

Gutman, Pasciucco and Stillwell all had extensive backgrounds of experience in various brokerage firms.

Jaegerman assumed full charge of the firm in the areas covered by his contract immediately on October 15, 1968. During his term of office, he was in very frequent communication with the NYSE both orally and in writing concerning the firm's problems and restrictions as the number of registered representatives, branch offices and number of trades imposed by the Exchange.

During the period Jaegerman was Managing Partner, Plohn, Sr. withdrew around $1,300,000 in cash from the firm for personal use substituting listed securities or relying upon accretions in value of securities which were already in the capital account (Tr. 10527-30, Jaegerman Brief, p. 1). The majority of the cash was withdrawn in 1969. There was nothing improper in these actions which had no significant effect upon net capital at the time but which reduced working capital.

In early May of 1970 there was a drastic break in the market for listed securities.

The first significant falling out among the principals occurred in early May of 1970 when Gutman and Plohn, Sr., alarmed by the then failing net capital position of the firm, met with Exchange officials in Jaegerman's absence. Jaegerman was at this time in Wichita, Kansas meeting with Realto P. Clinton (Clinton) and attending directors' meetings of Real Petroleum Company.[15/] While in Wichita, he discussed with Clinton the possible infusion of some $2,000,000 into the Plohn firm from Clinton. Jaegerman was asked by Gutman in a telephone call to return to attend the Plohn meeting at the Exchange but did not do so. Jaegerman strongly resented the meeting at the Exchange as an attempt to steal a march upon him and felt that he had "lost control of being the only communicator with the New York Stock Exchange that they would recognize." (Tr. 8688). For a period of a year and a half Jaegerman had been offered the $2,000,000 by Clinton but had previously turned it down consistently. He was dissuaded at the time of the meeting from taking the additional capital for the firm by the above telephone conversation with Gutman and questioned whether at this point it might be better for him to set up his own firm "rather than put $2,000,000 into the Plohn firm." (Tr. 8702).

In June or early July, 1970, after various attempts to obtain funds for the firm in order to remedy a shortage of working capital had failed, Jaegerman came into direct confrontation with Plohn, Sr. by ordering the sale of exchange memberships belonging to firm partners

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15/ Real Petroleum Company was related to Clinton Oil Company. Realto P. Clinton, a principal of Clinton Oil, was a personal friend of Jaegerman. These relationships will be dealt with in more detail later in this initial decision.

and proprietary securities in the firm accounts belonging to Plohn, Sr. and his wife, Faye Plohn. A meeting was called by Plohn, Sr. at which employees of the firm were told to disregard any such orders of Jaegerman.

Further attempts by Jaegerman in July, 1970 to assert his authority to dispose of securities in firm proprietary accounts and Exchange memberships belonging to partners were met with strong opposition from Plohn, Sr. and his son, Charles Plohn, Jr., who contended that matters of capital and liquidation were involved and that these matters were the sole province of Plohn, Sr.[16/] After a conference on August 4, 1970 the Exchange determined that the question of who had authority to sell the above shares was an internal matter in which it would not intervene. The Exchange had earlier advised the firm on July 30, 1970 that it would not disapprove the replacement of Jaegerman as managing partner with Abraham Livingston (Livingston), a general partner, provided the firm would cease doing business as a broker-dealer and cease to be a member of the NYSE. The firm had refused these conditions.

16/ In a memorandum dated July 22, 1970, from Charles Plohn, Jr. to Jaegerman it was stated:

> "Mr. Plohn has all the financial and reputation risks concerned with the firm and ultimately is responsible for any losses that might be sustained by our customers, creditors, subordinated lenders and limited partners. Your capital participation in the firm is zero; your ultimate risks and responsibilities are zero; and therefore your authority and control should also be zero." (Resp. Ex. 134).

Around $1,000,000 in cash was later contributed to the firm's capital through the sale of Faye Plohn's antique silver collection.

After the refusal to follow his instructions as to the sale of firm assets, Jaegerman continued to assert his other management prerogatives and, proceeding according to Exchange direction, a large number of accounts were liquidated and the business substantially wound down.

On or about August 18, 1970 the Exchange suspended Plohn & Co. and on that date Jaegerman resigned as a managing and general partner of the firm, stating as his reason in this proceeding that there was no longer a need for a Managing Partner since the firm was not doing any business.

Thereafter, the Commission obtained the appointment by the Federal District Court in New York of a receiver for Plohn & Co. referred to earlier in this initial decision. On June 17, 1975 District Court Judge MacMahon in a Memorandum Opinion discharged the receiver and directed him to turn the remaining assets over to Charles Plohn, Jr. as liquidator of the partnership under a plan of liquidation approved by the limited partners and subordinated lenders of Plohn & Co.

Jaegerman has asserted during the course of the proceeding without contradiction from the Division that all creditors of the firm with the exception of the subordinated lenders have been paid in full.

On June 10, 1971, the New York Stock Exchange accepted an Offer of Settlement and Consent to Penalty submitted by Jaegerman and imposed a sanction wherein Jaegerman would not, in the future, be approved as a member or allied member or be employed in any capacity with any member or

member organization of the NYSE based on findings that Jaegerman engaged in conduct inconsistent with just and equitable principles of trade and violated various Exchange Rules and Exchange Act provisions.

(A) <u>Pledging of Customer Securities in Violation of Section 8(c) and 15(c) of the Exchange Act (Point I of Division Brief, pp. 2-11)</u>

Rule 8c-1(a)(3) under the above statutory provisions makes it unlawful for any member of a national securities exchange to hypothecate or arrange for or permit the continued hypothecation of any securities carried for the account of a customer under circumstances that permit such securities to be subject to claims of a pledgee in an amount in excess of the indebtedness of all customers to the member in respect of securities carried for their accounts. Rule 15c2-1(a)(3) is identical in substance to Rule 8c-1(a)(3) except that it applies to any broker-dealer regardless of membership in a national securities exchange and describes the violation in terms of a "fraudulent, deceptive, or manipulative act or practice".

As the Division points out, the purpose of these provisions is clear, "When the sum of money borrowed secured by customers' collateral exceeds the amount of customer indebtedness the broker-dealer is no longer using the borrowed money solely for the purpose of financing customer transactions in securities. The excess amount is being used to finance the operations of the broker-dealer with the concomitant danger of exposing customers' securities to the general risk of the business of the firm." (Division Brief, p. 3).

The House Report commenting on these provisions states:

> "A broker is forbidden . . . to pledge customers' securities under circumstances that will subject customers' securities to a lien in excess of the aggregate indebtedness of the customers. This means that a broker cannot risk the securities of his customers to finance his own speculative operations." H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 20 (1934).

The record clearly establishes that wilfull violations of these provisions by Plohn & Co. occurred during the period charged in the order, from about May 1, 1970 to on or about August 27, 1970.

A NYSE Examiner found that as of July 23, 1970, customers owed Plohn & Co. an adjusted amount of $587,424 against which the firm had borrowed from banks $1,275,000 collateralized by customers' collateral and $42,600 as proceeds of customers' securities loaned for a total of money borrowed cf $1,317,600 which was 2.24 times the amount owed by customers of Plohn & Co. The Examiner found that as of July 29, 1970, customers owed Plohn & Co. an adjusted amount of $502,691 against which the firm had borrowed from banks $1,175,000 secured by customers' collateral and $7,600 as proceeds of customers stock loaned for a total amount borrowed of $1,182,600 which was 2.35 times the amount owed by customers to Plohn & Co. On July 30, 1970, the Examiner discussed his findings with Jaegerman. During this discussion, Jaegerman told the examiner that ten days previously Jaegerman had informed Mr. Robert Bishop, a Vice-President of the NYSE, of an apparent excess of money borrowed as opposed to customer indebtedness.

The excess ratio of money borrowed by Plohn & Co. collateralized by customers' securities to the amount customers owed to Plohn & Co. was not corrected during the period July 30, 1970 to August 18, 1970.

For purposes of this hearing, a Commission securities investigator computed the amount of money borrowed by Plohn & Co. collateralized by customers' securities and the amount of money owed by customers to Plohn and Co.

This examination disclosed that commencing on June 10, 1970 and continuing until July 10, 1970 Plohn & Co. was borrowing money collaterialized by customers' securities in an amount in excess of the amount of money owed by customers to the firm.

The amount of the excess was as follows:

Date	Money Borrowed	Amount Owed	Excess
6/10/70	$5,275,000	$5,219,106.51	$ 55,893.49
6/11/70	5,250,000	4,816,317.81	433,682.19
6/12/70	4,950,000	4,458,007.96	491,992.04
6/16/70	4,674,500	3,815,580.95	858,919.05
6/18/70	4,200,000	3,221,037.68	978,962.32
6/19/70	4,150,000	2,786,998.29	1,363,001.71
6/22/70	3,275,000	2,562,907.95	712,092.05
6/25/70	2,925,000	2,382,405.59	542,594.41
6/30/70	2,725,000	2,050,516.23	674,483.77
7/2/70	2,500,000	1,924,672.32	575,327.68
7/9/70	1,900,000	1,398,413.35	501,586.65
7/10/70	1,775,000	1,264,776.69	510,223.31

Jaegerman does not contend that no such violations occurred. Based upon the foregoing it is concluded that Plohn & Co. violated Sections 8(c) and 15(c)(2) of the Exchange Act and Rules 8c-1 15c2-1 thereunder during the period charged in the Order.

The Division charges Jaegerman with wilfully aiding and abetting the firm's violations and, in the alternative, with having failed reasonably to supervise. Jaegerman contends that he could not have aided and abetted a violation of which he was not aware and in which he did not participate, that his supervision was conscientious and thorough and that his later actions were corrective. (Jaegerman Brief, p. 4).

The Division argues that Jaegerman was a wilful aider and abetter based upon (1) his unquestioned responsibility as Managing Partner to see to it that the firm did not violate these provisions, (2) his failure to establish an internal auditing system to monitor this situation, (3) his knowledge in the latter part of July that excess borrowing might exist, and (4) clear "red flags", such as shortage of working capital, net capital violation, and the pledging of customers' fully paid American Telephone and Telegraph debentures as collateral to secure a loan to Plohn & Co. (discussed later in this Initial Decision) and reduction of customer debit balances which should have alerted him that a possibility of excess borrowing existed.

The Division also points to two Commission decisions, Sackville - Pickard, SEA Rel. No. 8433 (October 24, 1968), and Joseph V. Shields, Jr., SEA Rel. No. 8484 (January 1, 1969), which together indicate that officers

who did not "cause" hypothecation violations may be held as aiders and abettors. However, these were not contested cases, and the Commission has stated in a contested case, Fox Securities Company, Inc. SEA Rel. No. 10475, pp. 6-7 (November 1, 1973):

> "In some situations the difference between aiding and abetting and failure of supervision may be somewhat shadowy, with aiding and abetting connoting more of an active participation or awareness of improprieties, and failure to supervise connoting more an inattention to supervisory responsibilities when more diligent attention would have uncovered improprieties."

In my opinion, Jaegerman's activities, or rather lack of activity, in this connection do not constitute wilful aiding and abetting of these violations, and such charges are dismissed.

It is however, concluded that Jaegerman reasonably failed to supervise with respect to these violations within the meaning of clause E of Section 15(b)(5) of the Exchange Act. As the Division points out, the Commission stated in Reynolds & Co., 39 S.E.C. 902, 916 (1960):

> "We have repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and that in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention."

Jaegerman established no adequate system of internal control and the much vaunted procedures manual which he introduced after becoming Managing Partner did not deal with these problems. It was directly his responsibility, and informing the NYSE that such a situation might exist was not sufficient response to gain him exculpation. While later actions, such as his effort to sell proprietary securities to gain cash for working capital which could be used to pay off indebtedness, did tend to be corrective, they may only be considered in mitigation and do not relieve him of responsibility for not having discovered the situation when it first occurred and not having insisted that it be corrected immediately.

(B) General Antifraud Violations

Paragraph B of Section II of the Order for Proceedings charges Jaegerman with wilful violation and wilful aiding and abetting of violations by Plohn & Co. of the antifraud provisions of Section 10(b) and Rule 10b-5 in four specific counts, each contained in a separate subparagraph.

Subparagraph (d) of the Order (Point IV of Division Brief, pp. 53-54)

In subparagraph (d) of Paragraph B it is charged that Plohn & Co. wilfully violated these provisions through failing to "disclose to Registrant's customers that bank loans to Registrant were secured and collateralized by fully paid for and excess margin securities of customers, the value of which was in excess of the aggregate of all

debit balances in the accounts of customers." The Division here points to the violations of Sections 8(c)(1), and 15(c)(2) and Rules 8c-1 and 15c2-1 already dealt with in this initial decision. It contends that a failure to disclose such violations to its customers constitutes an independent violation of the general antifraud provisions of the Exchange Act. The decisions which the Division cites for this proposition 17/ are not contested cases and are not persuasive. The Commission in Fox Securities Company, Inc., SEA Rel. No. 10475, fn. 13 (November 1, 1973), in commenting upon a contention by the Division that doing business in violation of the record-keeping and net capital provisions without disclosure also constituted a violation of the antifraud provisions, stated:

> "Such conduct, by itself, is simply the violation of the specific requirements of the Act and of the rules applicable thereto, and not, in addition, a violation of the antifraud provisions."

A compounding of violations as contended for by the Division serves no useful purpose, and the more cogent Commission authority is to the contrary.

Accordingly, the charges of wilful violation, wilful aiding and abetting by Jaegerman and failure to supervise in respect to subparagraph (d) are dismissed.

17/ Division Brief, p. 53.

Subparagraph (a) of the Order (Point II of Division Brief, pp. 12-24)

In subparagraph (a) the Division alleges as a wilful violation of the above antifraud provisions a failure by Plohn & Co. to disclose its adverse financial condition to customers and other broker-dealers.

The record is clear that Plohn & Co. during the period April 24, 1970 to June 12, 1970 was in violation of the net capital requirements. A certified audit of the firm as of April 24, 1970 disclosed that Plohn & Co. was using $777,887 of customers' fully paid securities to secure loans to it. Plohn & Co. had a shortage of working capital throughout May of 1970. During the period May 15 - May 29, 1970 Plohn & Co. used customers' fully paid and excess margin securities as collateral for bank loans, since it did not have sufficient working capital or properly available securities to satisfy demands for additional collateral. On June 8, 1970, in order to make a required payment of $688,728 to the Stock Clearing Corporation Plohn & Co. obtained a loan by improperly collateralizing customers' fully paid American Telephone & Telegraph Company debentures. Working capital was insufficient to make the required payment which had arisen as part of the ordinary business operations of the firm.

The only general communication which could have been viewed as disclosing the above adverse financial condition was a letter, dated May 7, 1970, from Plohn & Co. This letter was directed to customers

who owed either money or property to Plohn & Co. and demanded that clients place their accounts in a fully paid position by May 15, 1970. In the letter, Plohn & Co. also made an offer to accept a subordination of customer money or property. The letter did not inform the customers of Plohn & Co. that the firm was in net capital violation or that there was a serious shortage of working capital which was impeding Plohn & Co. from removing customers' fully paid securities from bank loan and placing them in segregation. Plohn & Co. did not send any similar communication to customers with credit balances. The contents of the letter which was sent were reviewed by Jaegerman prior to its being mailed to customers and also discussed with the NYSE and firm counsel.

During the period April 30, 1970 until the time in early June, 1970 when customers received their May, 1970 monthly statement which included a summary report by Plohn & Co.'s independent auditors (Arthur Anderson & Co.), Plohn & Co. did not inform its customers about its net capital violation.

Although this summary report disclosed the net capital violation, it did not disclose the other matters affecting the firm's financial condition asserted by the Division.

The Division recognizes that failure to disclose a net capital violation without more will not support a charge of antifraud violation. Fox Securities Company, Inc., SEA Rel. No. 10475, p. 6, fn. 13 (November 1, 1973). However, the Commission has held that engaging in the

securities business while insolvent or financially unable to meet current obligations without disclosure does violate the antifraud provisions. Weston and Company, Inc., SEA Rel. No. 9312 (August 30, 1971).

No evidence has been presented that Plohn & Co was insolvent in the bankruptcy sense during this period, and the issue presented is whether the Division has shown that Plohn & Co. was insolvent in the equity sense, *i.e.*, unable to meet its current obligations in the ordinary course of business. It should be pointed out here that the facts which the Division asserts give rise to that inference, such as the pledging of the American Telephone and Telegraph debentures, are all elsewhere alleged as independent violations of the antifraud provisions.

While it may be true, in fact, that the firm was insolvent in the equity sense, I do not believe that the Division has established this on the record. It does not necessarily follow, as the Division argues, that resort to illegal acts means that nothing else could have been done, and that the firm was therefore "unable" to meet its obligations. It is quite possible that a sale of proprietary assets such as later urged by Jaegerman could have placed the firm in a position where it might have met current obligations. In other words, the mere fact that customer assets were used to pay firm bills when other assets

could have been liquidated for this purpose does not establish equitable insolvency.[18]

For these reasons this charge of wilful violation in subparagraph (a) and the related charges against Jaegerman of aiding and abetting and failure to supervise are dismissed.

Subparagraph (b) of the Order (Point III of Division Brief, pp. 25-52)

In subparagraph (b) of the Order Plohn & Co. was charged, with having appropriated for its own use and benefit customers' fully paid for securities and excess margin securities without the knowledge or consent of such customers and Jaegerman was charged with having wilfully aided and abetted such violations of the antifraud provisions of Section 10(b) and Rule 10b-5.

During the period April 24, 1970 to August 18, 1970 Plohn & Co. did not have the written consent of customers to permit it to use customers' fully paid securities purchased in cash accounts or customers' excess margin securities purchased in margin accounts as collateral to secure a bank loan to Plohn & Co. Excess margin securities are defined by the NYSE as a customer's securities having a market value of more than 140% of the debit balance in the customer's account.[19]

18/ Essentially, the Division is again arguing here that it was an independent and additional violation of the antifraud provisions for Plohn & Co. not to disclose to its customers that it was violating the same antifraud provisions in certain specific respects. As previously stated, the compounding of violations in this fashion serves no useful purpose. The alleged specific violations will be considered separately on their merits in this Initial Decision.

19/ Rule 402(a) of the NYSE and CCH NYSE Constitution and Rules ¶2402.70 (1970).

During the period from on or about May 1, 1970 to August 18, 1970, the margin department of Plohn & Co. used the figure of 140% of the customer's debit balance in computing excess margin securities. Excess margin securities were not available to Plohn & Co. for use as collateral to secure a loan to Plohn & Co.

The margin department of Plohn & Co. under the supervision of Stillwell issued instructions to the cashier's department headed by Pasciucco to segregate excess margin securities. Instructions were issued to segregate a customer's full paid securities purchased in cash accounts when the margin department received payment in full from the customer.

These instructions to segregate appeared in the weekly stock record and the daily "excess/deficit" list of Plohn & Co.

A deficit segregation condition existed at Plohn & Co. when the firm had less securities in segregation locations than had been instructed into segregation by the margin department as either fully paid securities purchased in cash accounts or excess margin securities purchased in margin accounts. If such securities were not properly in segregation locations, they were being employed improperly as collateral for bank loans.

Plohn & Co. utilized a bulk method of segregation in which certificates are grouped according to the issues they represent rather than according to who owns them. Identification of ownership is provided by other firm records allocating each security to specific customers.

Based upon the firm's own records, whose accuracy is not contested, the firm's independent auditors, Arthur Andersen & Co., determined that as of April 24, 1970, Plohn & Co. had pledged as collateral for bank loans $777,987 of customers' fully paid securities.

On June 8, 1970, two examiners from the NYSE selected 15 securities for the purpose of reviewing the firm's segregation procedures. Based upon the firm's records for the business weeks ending Friday 5/1/70, 5/8/70, 5/15/70, 5/22/70 and 5/29/70, the Examiners prepared a schedule which reflected that 13 of the 15 stocks selected for review had a deficit segregation position on each of the Fridays during May, 1970.

With respect to the 2 stocks which the NYSE examiners determined did not show a complete history of deficit segregation, it was only on May 1, 1970 that Plohn & Co. had an excess of segregation and this excess was very slight.

The examiners determined that in at least four instances where Plohn & Co. already had a deficit segregation situation, additional customers' fully paid securities were removed from

physical segregation and used as collateral for bank loans with the effect of increasing the deficit segregation amount.

The examiners also determined that as of May 8, 1970, 1906 shares of fully paid Chrysler common stock and 1077 shares of fully paid R.C.A. common stock which had been purchased by customers in cash accounts were pledged at banks as collateral for loans to Plohn & Co.

May 15, 1970 Pledge of Securities

During the morning of May 15, 1970 Pasciucco as Cashier received requests for additional collateral amounting to almost $1,000,000 from six or seven of the firm's lending banks. On of these requests for additional collateral was received from the European American Bank. In order to meet the request from the latter bank, contrary to specific instructions from the margin department to segregate designated amounts of these fully paid securities and excess margin securities, Pasciucco on May 15, 1970 delivered 2,400 shares of R.C.A. Corp. and 3,000 shares of Chrysler Corp. to the European American Bank as additional collateral for a bank loan and by so doing, increased existing deficit segregation figures with respect to both securities by substantial amounts.

During the period May 15, to May 29, 1970 Plohn & Co. did not eliminate this deficit segregation situation with respect to R.C.A. Corp. and Chrysler Corp. stock. The deficit with respect to Chrysler Corp. had increased at the end of the period.

As of the close of business on May 29, 1970, Plohn & Co. was using $63,115.73 worth of customers' fully paid and excess margin R.C.A. Corp. and $77,763.00 worth of customers' fully paid and excess margin Chrysler Corp. stock as collateral to secure a bank loan or loans to Plohn & Co.

June 8, 1970 Pledge of AT & T Debentures

In April, 1970, Plohn & Co. acting as broker for its customers, purchased in excess of $900,000 of American Telephone & Telegraph Co. debentures on a when-issued basis. Customers who purchased these debentures were required by the firm to maintain a credit balance in their account equal to 25% of the purchase price. The firm received notice from the NYSE that the debentures were to settle on June 8, 1970. On the settlement date the firm did not have the required amount of $688,728 to pay the Stock Clearing Corp. Customers of Plohn had at that time paid a total of $671,059 in connection with the purchase of these debentures. According to the conservative method of analysis[20] of the firm records employed by the Division (which is adopted herein) 378 of the pledged Debentures were fully paid on June 8, 1970.

20/ This method of analysis was that none of the AT & T debentures of a particular customer were considered fully paid until the customer had paid in full for all of his debentures (i.e., if a customer purchased 10 debentures for $9,800 and paid $9,700 on June 8, 1970, none of the debentures was fully paid on June 8, 1970).

In order to make the payment to Stock Clearing Corp. Plohn & Co. through Pasciucco arranged for and obtained on June 8, 1970, a loan of $775,000 entirely collateralized by the debentures. Thereafter, customers made further payments on the debentures, and the amount of fully-paid debentures used as collateral for the firm increased to 729 on June 12, 1970. As of the close of business on June 26, 1970 the firm was using 763 debentures which were fully-paid as collateral to secure a loan to Plohn & Co. in the amount of $650,000. As of July 24, 1970 200 fully-paid debentures were employed to secure a loan to Plohn & Co. in the amount of $150,000.

It was not until November, 1970 that the loan was completely repaid and all of the AT & T debentures were retrieved from firm bank loans. All during this period, customers' fully-paid debentures were being used to collateralize bank loans to Plohn & Co.

No disclosure was made to customers of any of these misappropriations of customers' fully paid and excess margin securities.

Jaegerman in his Proposed Findings, Conclusions and Brief does not dispute that the events set forth above occurred. Applicable cases make clear that an appropriation of customer securities for the firm's use and benefit without the knowledge or consent of the customers constitutes a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Thompson & Sloan, Inc., 40 S.E.C. 451, 454 (1961); See also Donald H. Aldritt, SEA Release No. 9806 (October 11, 1972); The Kentucky Company, SEA Release No. 9455 (January 18, 1972).

It is, accordingly, concluded that Plohn & Co. violated the antifraud provisions in the respects herein charged.

Jaegerman contends that he did not wilfully aid and abet these violations nor did he fail reasonably to supervise. He argues that he was not aware of the violations and did not participate in them. However, this contention is belied by the facts.

As to the pledging of customers' securities on May 15, 1970 -- a Friday -- the testimony of both Pasciucco and Gutman establish that Jaegerman on that date was aware of the following: the severe shortage of working capital being experienced by the firm, that additional collateral was being required by lending banks to secure firm loans, that Pasciucco on that date had asked Stillwell as head of the Margin Department to revalue the margin accounts in an attempt to release certain securities from segregation for use as collateral, that Stillwell had at first refused because of insufficient personnel but had been directed to perform the revaluation over that weekend, and, most importantly, that in order to satisfy the request for additional collateral it was necessary for Pasciucco to use securities which did not appear on the firm's books and records as available for such use. Pasciucco's testimony, which is independently credited in this respect, establishes that on May 19, 1970 Jaegerman was informed that the weekend revaluation had not succeeded and the securities which were improperly pledged could not be retrieved unless additional working capital were provided.

As to the June 8, 1970 pledging of the AT & T debentures, Pasciucco's testimony, which is specifically credited in this respect, establishes that Jaegerman was informed by him before the pledging of the AT & T debentures occurred that there was insufficient working capital for the settlement and that a special loan would have to be effected. The record is clear that on June 9, 1970 the Margin Department of the firm issued instructions to Pasciucco to segregate the debentures which instructions could not be followed because there was insufficient working capital to reduce the bank loan and retrieve the debentures. It is also clear that within 10 to 14 days after June 8, 1970 Stillwell received questions from registered representatives as to why their customers had not received the debentures, and, after being informed by Pasciucco of what had occurred informed Jaegerman that customers' fully paid AT & T debentures were being employed as collateral for a firm bank loan. As the Division properly points out (Brief, p. 45-6) the pledging of the AT & T debentures was a continuing violation and Jaegerman was made specifically aware that customers fully paid securities were involved within two weeks after the pledging occurred. Nothing was done by Jaegerman or by the firm during the pendency of this situation from June 8 to August 18, 1970 to ascertain why this had happened or to inform customers properly as to why they were not receiving their securities.

Under these circumstances, I conclude that there was sufficient awareness and involvement on the part of Jaegerman to constitute him a wilful aider and abetter of the violations described above as commencing on May 15 and June 8, 1970. See Gross v. S.E.C., 418 F. 2d 103, 107 (2d Cir. 1969). I also conclude that Jaegerman failed reasonably to supervise with respect to other improper appropriations above described.

Subparagraph (f) of the Order (Point V of Division Brief, pp. 55-62)

In this subparagraph of the order Jaegerman is charged with having wilfully violated and wilfully aided and abetted violations of the above antifraud provisions in having sold stock dividends not belonging to the firm without the authority or consent of the true owners.

In August 1970, Plohn & Co. was attempting to liquidate assets in order to provide additional capital to the firm. As a result of discussions which began at the NYSE, Plohn & Co. began to look for property which might rightfully belong to the firm.

A firm employee, Renato Dinelli (Dinelli) had the responsibility for maintaining the appropriate records for stock dividends received by Plohn & Co. When stock dividends were actually received by the firm, Dinelli made journal entries which had the effect of placing the dividends into accounts identified by the number of the security which was preceded by the number "11". The stock dividends would then be allocated by journal entries from the dividend accounts to the accounts of Plohn & Co. which were entitled to the dividend. After appropriate allocation of the dividends was accomplished, any stock remaining in the dividend accounts were over-payments, (i.e., the result of Plohn & Co. receiving more dividends from the issuing corporation than Plohn & Co. customers, partners, trading accounts or firm accounts were entitled to, according to firm records).

It was the customary practice on Wall Street, and the practice of Plohn & Co., to leave these "overages" in the dividend accounts until claimed at a later date by the person who was entitled to the stock. If no claims were made within the time period (5 years) provided for by a New York State statute, the stock would then be turned over to the state. If claims were made, their legitimacy would be determined when the claim was made. Prior to the receipt of any claim, Plohn & Co. did not know who was entitled to the stock.

As a result of the decision to look for property which might belong to the firm, a list of stock dividends, about whose ownership there was some question, was prepared and sent to Gutman, who then met with Livingston, a general partner of Plohn & Co., Plohn, Sr. and Jaegerman. Gutman told them that the securities were "long" in dividend accounts and Gutman brought the New York statute, regarding unclaimed property, to their attention. Gutman explained to them that because of the statute, the state would, after 5 years, be entitled to the securities or the proceeds of the sales of the stock which remained unclaimed after the sales.

Jaegerman argued that New York State owed Plohn & Co. over $100,000 as a refund for overpayment of unincorporated business taxes. However, at the time Jaegerman made this argument, Plohn & Co. had only filed a refund claim and no determination had been made as to whether Plohn & Co. was in fact entitled to the refund.[21/]

21/ The refund claim was later determined to be valid, and Plohn & Co. received the $100,000 payment.

It was agreed among Jaegerman, Gutman and Livingston "that if there was a risk in selling the property, it was a business risk which would be offset against what was due us from the state" (Tr. 7034).

Jaegerman, Livingston and Plohn, Sr. (whose approval also was required) authorized the sale of the securities to raise additional capital. Neither Dinelli nor any other firm employee was asked to determine who rightfully owned this stock, and no determination that the stock belonged to the firm was made.

To maintain control over the dividend overages to be sold, it was determined that the overages would be isolated by journalling them from the dividend accounts to a proprietary account of Plohn & Co. The overages were so journalled by Dinelli after Jaegerman directed Gutman to effectuate the transfer entries.

After receiving the above authorization, Gutman provided a list of the overages to be sold to the order department of Plohn & Co. The securities were sold on August 7, 1970 and the monies were collected and used in the liquidation of Plohn & Co. $85,175 was generated by the sale of stock dividends.

At best, it was only "very remotely possible" that the dividend overages sold belonged to Plohn & Co. (Testimony of Dinelli, Tr. 3273). Claims for overages sold were made subsequent to the sales, and at least some of these claims were legitimate and had to be satisfied. All of these claims were paid in full.

The Division contends that the sale of these overages was a misappropriation of securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5, citing Thompson & Sloan, Inc., 40 S.E.C. 451 (1961) and Aldrich Scott & Co., Inc., 40 S.E.C. 775 (1961). The Division charges Jaegerman with having wilfully committed and wilfully aided and abetted these violations. Jaegerman merely contends that he was not aware of these violations and did not participate in them. However, the record shows that he specifically authorized the sale of these securities with full knowledge of the facts. Further, he made no real attempt to find out who the rightful owners were and, obviously, no consent was obtained from them. I conclude that in this respect Jaegerman wilfully aided and abetted violations by Plohn & Co. of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

(C) Violation of the Antifraud Provision Relating to Clinton Oil (Point VI of Division Brief, pp. 63-85)

During 1969 and 1970, Realto P. Clinton (Clinton) was President, Chairman of the Board and a substantial stockholder of Clinton Oil Company (Clinton Oil). Jaegerman and Clinton were close friends as officers in the Navy during Work War II and first met in 1944. During the war Jaegerman was Clinton's immediate superior officer. While Jaegerman was on the Commission's Staff he had no appreciable contact with Clinton. Their relationship was renewed at about the time Jaegerman was hired by Plohn.[22]

22/ In November, 1968, Jaegerman at Clinton's invitation attended a meeting in Oklahoma concerning Clinton Oil.

Jaegerman received a $10,000 retainer fee in 1969 for legal work done in connection with the formation of Real Petroleum Company (Real). He was one of the founding officers and a director of Real which was formed in 1969 for the purpose of making a tax free offer of exchange of Real common stock for certain oil and gas participations of Clinton O...

David Bell (Bell), a supervisory analyst, was director of the research department at Plohn & Co. from August 1, 1966 to July 31, 1970. His duties included the preparation and dissemination of research reports and memoranda concerning issuers of securities. Jaegerman directly supervised Bell's activities and required that written material from the research department be shown to him for his review. Jaegerman initialed all such work before it was disseminated.

In June of 1969 Bell attended a Clinton Oil stockholders' meeting at Jaegerman's suggestion. This stockholders' meeting was the only such meeting Jaegerman ever suggested Bell attend. At Jaegerman's suggestion a memorandum of what had occurred at the meeting was prepared by Bell and distributed to the registered representatives and partners. 23/

Late in 1969, Jaegerman made a recommendation in a very insistent manner that a report be written on Clinton Oil. Bell did not wish to write such a report because of his concern about over-the-counter stocks in

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23/ In September of 1969 Jaegerman suggested to Bell that he prepare a report on Clinton Oil which Bell prepared in draft form.

general, general market conditions and the fact that Clinton Oil had certain bonds in the process of being registered with the Commission. Bell telephoned Plohn, Sr. at his home and was told not to write the report and to get in touch with Robert Arum (Arum), the firm's counsel.[24/] Arum also instructed Bell not to write the report and Bell did not do so. Shortly afterwards, Jaegerman confronted Bell and stated that if anybody ever found out about a report that Bell was writing prior to its being signed by Jaegerman, Bell would be fired.

Early in 1970 Jaegerman asked Bell, who was a member of the New York Society of Security Analysts, to arrange for Clinton to speak before the Society. Bell helped arrange for the speech which was given around that time.

In March of 1970, Jaegerman called Bell into his office and told him that he wanted him to prepare something which would stimulate some interest for Plohn & Co. customers. Clinton Oil and other companies were mentioned by Jaegerman as possible subjects for such a report.[25/] Jaegerman indicated to Bell that it was being left up to Bell to choose the stock he would recommend. Bell then prepared a report on Clinton Oil. The report included a recommendation that "Selling close to the low of the year, Clinton Oil common appears to be an attractive situation." (Div. Ex. 87). After Bell prepared the report, Jaegerman reviewed and initialed it.

24/ Arum was then a partner in the law firm of Phillips, Nizer, Benjamin Krim & Ballon of New York City.

25/ At about this same time Jaegerman called his sales managers requesting that they ask the registered representatives under their supervision to call 10 customers and recommend something for purchase. The only stock he specifically mentioned was Clinton Oil and he made no disclosure to them of his interest therein set forth at pp. 36-37 of this initial decision.

In or around March, 1970, this report was mailed to customers of Plohn & Co. as a part of the "filler" which was customarily included in customers' monthly account statements. The report included the standard disclaimer that was used by Plohn & Co. on all such reports, stating, among other things, that "Charles Plohn & Co. and/or its partners or employees may from time to time own securities mentioned herein in addition to those, if any, specifically herein stated to be owned." (Div. Ex. 87).

Jaegerman had a substantial interest in Clinton at the time of the above mailing. On or about October 1, 1969, Clinton called Jaegerman and told him that he wanted Jaegerman to have a stock position in Clinton Oil and that 10,000 shares were available at $8.50 per share. Clinton indicated that, even though Jaegerman did not have the necessary money, Clinton would arrange financing of the purchase price. On October 2, 1969, Jaegerman purchased 10,000 shares of common stock of Clinton Oil. To pay for his purchase, Jaegerman executed an $85,000 promissory note to Clinton Oil.

On or about December 31, 1969, Jaegerman purchased a $250,000 participation (net $235,000) in the 1969 Clinton Oil and Gas Programs [26/] operated by Clinton Oil. This participation consisted of 25 units costing

26/ Under these programs the participant receives a 50% interest in the properties and Clinton Oil a like interest.

$10,000 per unit. To pay for the participation, Jaegerman signed a $235,000 promissory note payable to Clinton Oil pursuant to which the participation was pledged as collateral.[27/]

No disclosure was made by Jaegerman to Plohn & Co. customers of his business relationship with Clinton Oil, his ownership of Clinton Oil securities nor his indebtedness. Bell knew that Jaegerman was to be a director and officer of Real and that Real was to be affiliated with Clinton Oil, but he knew nothing of the above financial dealings by Jaegerman and was told nothing about them by Jaegerman. It is significant that in other reports and memoranda from the research department, Jaegerman had specifically reminded Bell that Plohn & Co. had positions in the subject security and this information should be disclosed.

The Division contends that Jaegerman, in recommending Clinton Oil common stock in March of 1970 without disclosing his personal

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27/ Jaegerman's testimony in this proceeding that he did not purchase these interests and that he was guaranteed against loss and thus had no indebtedness under the promissory notes is contrary to reports filed with the NYSE by him and by the firm auditors, his earlier investigative testimony, his earlier testimony before the NYSE and the Real Petroleum prospectus and is expressly not credited. As the Division contends in Point VII of its brief (pp. 86-97), certain of Jaegerman's testimony in this proceeding is unworthly of belief. For example, he was unable to identify copies of three letters shown to him by counsel for the Division. Later, as a part of his defensive case he stated that he specifically recalled dictating and sending these same letters and offered them in evidence. He gave no credible explanation.

interest in that company, clearly wilfully violated Section 10(b) and Rule 10b-5.[28/]

Jaegerman argues that there was "no campaign"[29/] to sell Clinton Oil shares, that his interest, if any, was fully covered by the disclaimer language and that no Clinton shares were offered or sold. As to the "campaign" allegation, the Division concedes that insufficient evidence has been adduced to justify such a finding. The caveat language is, as the Division contends, designed to cover random and

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28/ Section 10(b) provides:

"It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78(j)(b).

Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

(1) to employ any device, scheme, or artifice to defraud

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security." 17 CFR 240.10b-5

29/ The Order in Paragraph C speaks of "a campaign to solicit buy orders of Clinton Oil Co. stock from customers . . ."

sporadic future purchases of securities and does not apply to prior substantial purchases, such as those of Jaegerman. It further was totally uninformative with respect to Jaegerman's $320,000 indebtedness to Clinton Oil.

The record does show that there were transactions by the firm in Clinton Oil securities (Tr. 10074-78) and that the stock was very actively traded over-the-counter (Tr. 7552).[30/] While no finding has been proposed that Clinton securities were purchased by a Plohn & Co. customer as a result of the March 1970 report nor even that a purchase by such a customer took place through the firm, in point of time, after the report was issued, applicable law does not require such findings. S.E.C. v. Texas Gulf Sulphur Co., 401 F. 2d 833, 860, 882-3 (explaining majority holding) (2d Cir. 1968) takes the position that it is sufficient to meet the "in connection" requirement of Section 10(b) that the public is purchasing and selling the subject securities in the open market, stating, "We do not believe that Congress intended that the proscriptions of the Act would not be violated unless the makers of a misleading statement also participated in pertinent securities transactions in connection therewith. . ."(p. 860) and, ". . . we hold that Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated

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30/ Jaegerman in his own testimony concedes that one or two registered representatives acquired from another firm effected purchases of Clinton Oil for customers after the March 1970 report but states that he concluded that the customers who made these purchases did so independently of the Plohn recommendation (Tr. 9248-9253).

to influence the investing public, . . . if such assertions are false or misleading or are so incomplete as to mislead . . ." (p. 862).[31] But see Blue Chip Stamps v. Manor Drug Stores, 43 LW 4707 (Supreme Court, June 9, 1975) (particularly concurring opinion of Justice Powell in which Justices Stewart and Marshall join).

I conclude that Jaegerman wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in causing the firm to recommend Clinton Oil common stock without disclosing his very substantial interest in that company. In Chasins v. Smith Barney & Co., 438 F. 2d 1167, 1172 (2d Cir. 1970), the Court stated, "the investor . . . must be permitted to evaluate overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest." See also S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). Quite obviously, a substantial self-interest, such as that involved here on the part of the person who suggested the company as a possible subject and approved the report, is a material fact which should have been disclosed to investors.[32]

31/ While this aspect of the Texas Gulf Sulphur case involved a corporate press release, the distinction is only one of degree. Plohn & Co. had some 20,000 active customers to whom its monthly statements were sent.

32/ During the hearing Jaegerman argued that disclosure of his interest should not have been made because it was too "bullish" (Tr. 9248). However, I do not agree that prospective investors should be protected from the truth. As the Division states in its brief (p. 72):

> "A prospective investor of Clinton Oil, whose interest has been aroused by the recommendation received from Plohn & Co. should have been given the opportunity to make up his own mind as to the possible motives behind the preparation and dissemination of the recommendation."

Public Interest

There is no question that the violations in which Jaegerman was involved are of important provisions of the federal securities laws. The Division contends that "the most severe sanction", presumably a permanent bar from the securities business, should be imposed.

The Division points out that Jaegerman consented in 1971 to a sanction by the NYSE that he not be approved as a member or allied member or be employed in any capacity with any member or member organization of the NYSE. It is also pointed out that under Commission Rule 15b8-2[33/] the NYSE sanction disqualifies, subject to application, Jaegerman from being registered as a SECO member or from being associated with such a member. Further, the Bylaws of the National Association of Securities Dealers (NASD) in Article I, Section 2[34/] have the effect of barring Jaegerman from association with NASD members. Thus, the practical effect of the NYSE sanction is that Jaegerman is presently barred from association in the entire broker-dealer community. The disability, however, depends for its future vitality upon its continuance by the NYSE.

Witnesses testified that Jaegerman did a better job as Managing Partner than his predecessors. He initiated the firm's first procedures manual, which while deficient in the hypothecation area, was

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33/ 17 CFR 240.15b 8-2.

34/ CCH NASD Manual ¶1102.

generally recognized to be a sound and helpful document. The institution of weekly meetings at which managers were encouraged to present their problems was also a favorable development. However, most of these advances are of the type which should be expected from any managing partner worthy of the title. Jaegerman cannot claim special credit therefor.

In extenuation of the hypothecation violations involving Sections 8(c) and 15(c)(2) of the Exchange Act, it should be noted that Jaegerman lacked requisite back office experience, and that in taking action which could have resulted in correcting these problems -- through the sale of proprietary securities and exchange seats to generate working capital -- he suffered from impediments stemming from the nature of his contractual arrangement with the firm. The divorce of control over capital from control over operations proved artificial and unworkable. It was further a source of antagonism among the partners. While Jaegerman himself insisted upon this division of responsibility, and it is easy to conclude now, on the basis of hindsight, that it was unworkable; it would have been more difficult at the time to foresee its flaws. Jaegerman did call the attention of the Exchange to the hypothecation problem in general and did urge Plohn, Sr. to put more cash in the firm.

However, no internal auditing procedure was established which would have permitted Jaegerman to maintain control of and stay on top of this situation.

Less may be said in mitigation in connection with the May 15 and June 8, 1970 hypothecations. There Jaegerman's involvement was much more direct and not indicative of a concern for the interests of investors.

The sale of stock dividends for the benefit of the firm without any effort to find out to whom these dividends belonged was clearly inconsistent with fiduciary obligations.

Finally, in connection with the Clinton Oil mailer Jaegerman evidenced an overriding concern for his own personal benefit as opposed to the interests of the firm's customers. Not only was a direct personal advantage involved in activity which presumably would increase demand for the stock and its price, but also an indirect benefit in that such a result would have the effect of enhancing his standing with Clinton personally. It will be recalled that Clinton had for a period of a year and a half offered him $2,000,000 for investment. In view of his background and experience and his insistence on other occasions on similar disclosures of interest, it is clear that Jaegerman was aware of the requirements of Rule 10b-5.

Jaegerman tends to view himself as the victim of a conspiracy. Thus, the Commission is being used as a "catspaw" for Plohn, Sr. in pursuing the Clinton Oil matter (Tr. 9612); Gutman was trying from the beginning to get his job (Tr. 10571) would stop at nothing to get him

out of the firm (Tr. 8689), and was "Machiavellian" (Tr. 8689); Robert Arum, the firm's counsel, was a "Machiavelli" (Tr. 8587); "Mr. Plohn, Sr., Mr. Plohn, Jr., Mr. Gutman, Mr. Pasciucco and Mr. Arum . . . . All these people wanted to destroy me . . ." (Tr. 9612); and if the NYSE had properly supported him in his effort to sell proprietary securities, the firm would still be in existence (Tr. 9754). Jaegerman's statements in this area are merely accusatory and not probative. They are not credited.

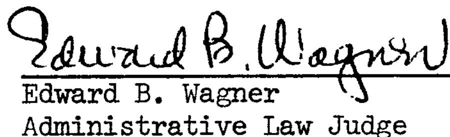
Jaegerman is an attorney of extraordinary ability, but, in view of the violations established herein, his activities in the securities business must be properly motivated and channeled before they will serve the public interest.

Under all the circumstances I conclude that a two-year bar from association with any broker-dealer with a right thereafter to apply for association in a supervised and non-proprietary capacity should accomplish that purpose and thus will best serve the public interest.

Accordingly, IT IS ORDERED that Edward C. Jaegerman is barred from being associated with any broker or dealer, except that after two years from the effective date of this order he may become associated with a registered broker-dealer in a non-supervisory, non-proprietary capacity upon a satisfactory showing to the Commission that he will be adequately supervised.

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.[35/]



Edward B. Wagner
Administrative Law Judge

Washington, D.C.
October 6, 1975

35/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.