IN THE MATTER OF

LUM'S INC.

AETNA SECURITIES CORPORATION

STUART PERLMAN

CLIFFORD PERLMAN

File No. 3–3. Promulgated December 21, 1966

Securities Act of 1933—Section 3(b) and Regulation A

EXEMPTION FROM REGISTRATION

Vacating Order of Suspension

Failure to File Sales Literature

Bids and Purchases During Distribution

Public Interest—Mitigative Factors Warranting Vacation of Suspension

Where selling shareholders did not file sales literature used in connection with Regulation A offering, and selling shareholder bid for and purchased issuer's stock while participating in distribution without disclosing such bids and purchases in connection with offering, but where sales literature consisted of reprint of unsolicited newspaper article, and offering shareholder had withdrawn from market for month before distribution began and its bids and purchases were made upon advice of counsel and after it had sold its part of offering, *held*, appropriate in public interest to vacate order suspending exemption.

APPEARANCES:

J. Cecil Penland and *Leslie Bruce McDaniel*, of the Atlanta Regional Office of the Commission, for the Division of Corporation Finance.

Richard H. Wels, of Moss, Wels & Marcus, for Lum's Inc., Stuart Perlman and Clifford Perlman.

William J. Schifino, of Whitehead and Schifino, for Aetna Securities Corporation.

FINDINGS, OPINION AND ORDER

On September 30, 1964, Lum's, Inc. ("Lum's" or "issuer"), Stuart and Clifford Perlman, its two principal officers, and Aetna Securities Corporation ("Aetna"), a registered broker-dealer, filed with us a notification and an offering circular for the purpose of obtaining an exemption from the registration requirements of the Securities Act of 1933 ("Securities Act") pursuant to Section 3(b) thereof and Regulation A thereunder (Rules 17 CFR 230.251 *et seq.*) with respect to a public offering of 35,900 shares of Lum's Class A common stock. The filing covered 25,200 shares offered in equal amounts by the Perlmans and 10,700 shares offered by Aetna, and it was stated that the shares would be offered and sold from time to time at the prevailing market prices, with a maximum aggregate offering price of $200,000. The offering began on November 4, 1964, and the issuer and the offering stockholders reported that it was discontinued on December 7, 1964, with the sale of a total of 31,985 shares, including all the 10,700 shares offered by Aetna, and 21,285 shares sold by the Perlmans for an aggregate price of slightly less than $100,000.

On January 19, 1965, we issued an order pursuant to Rule 261 of Regulation A temporarily suspending the exemption from registration, and at the request of the issuer and the selling stockholders, hearings were held to determine whether to suspend permanently the exemption or to vacate the temporary order. The hearing examiner submitted an initial decision in which he found, as alleged in the order for hearings, as amended, that there had been a failure to file copies of sales material as required by Rule 258 of Regulation A, that certain of such material contained incorrect or misleading information in violation of section 17(a) of the Securities Act, that the offerors had engaged in manipulative activities and violated Rule 17 CFR 240.10b–6 under Section 10(b) of the Securities Exchange Act of 1934 in connection with the offering, and that the offering circular failed to disclose such activities. The hearing examiner concluded that a permanent suspension order should be issued, but that there were certain factors which should be considered in mitigation of the 5 year bar from the use of Regulation A that would result from a permanent suspension.

We granted petitions by the issuer and the selling stockholders for review of the initial decision. On the basis of our review of the record, we make the following findings.

The issuer was incorporated in Florida in 1958 and at the time of the Regulation A filing operated a chain of 16 specialty restaurants in the Miami area. It had outstanding 200,100 shares of Class

A common stock, of which the Perlmans owned 65,900 shares.[1] In August 1964, one Joseph Weill, representing a group which had acquired a block of Lum's stock in satisfaction of claims against the underwriter of a public offering of that stock in 1961, advised the Perlmans that he wished to sell 10,700 Class A shares. The Perlmans asked Aetna, which had been trading in the stock and entering quotations in the daily sheet published by the National Quotation Bureau, Inc. since about April 1964 and had handled Lum's purchases of shares under its employees' purchase plan, to purchase this block. Aetna agreed to do so with the understanding that the shares would be the subject of a subsequent public offering under Regulation A together with about 20,000 shares of the Perlmans' stock, and on September 4, 1964, it purchased the 10,700 shares at 1¾, which was approximately the market price at the time of the agreement. Thereafter Weill indicated he wished to sell an additional 10,675 shares, and the Perlmans arranged for the purchase on September 29, 1964, of 9,400 shares by relatives and 1,275 shares by Aetna, all at 2½.

Aetna continued to publish quotations in the sheets, and its bids increased progressively from 1⅞ on August 27, when the offering had been agreed upon, to 2⅞ on September 24. From September 25 through November 5, Aetna made no bids. The offering began on November 4 and by November 6, Aetna had sold its 10,700 shares at an average price of about 3. Aetna thereupon reappeared in the sheets with bids which increased from 3⅞ to 7¼ on December 7, 1964, when the offering was discontinued. During this period Aetna from time to time, first as agent for the Perlmans, and then as principal buying from the Perlmans and reselling, disposed of 21,285 shares offered by the Perlmans.

Alleged Manipulative Activities During The Pre-Offering Period

The principal issue here presented with respect to respondents' activities in the pre-offering period is whether they were designed to create actual or apparent activity in or to raise the price of the issuer's stock, for the purpose of inducing the purchase of such security by others at rising prices. Respondents concede that Aetna entered bids for and purchased stock at progressively increasing prices during that period, and that they acquired shares from Weill as described above, but deny that their activity was improper or manipulative.

To find a manipulation, we must find that respondents' actions did in fact create trading activity or cause a price increase, and in

[1] The issuer also had outstanding 144,900 shares of Class B common stock all owned by the Perlmans, which are convertible into Class A shares and differ from the Class A shares only in that they are not entitled to dividends.

addition that such activity and price raising were designed to induce others to buy. We have held that the insertion of increasingly higher bids is the most universally employed device to create a false appearance of activity in the over-the-counter market;[2] that it is necessary in the usual case that a finding of manipulative purpose be based on inferences drawn from circumstantial evidence; and that a prima facie case of manipulative purpose exists when it is shown that a person who has a substantial interest in the success of a proposed offering takes active steps to effect a rise in price.[3]

The hearing examiner's conclusion that there was a manipulation in the instant case was based mainly upon his finding that Aetna had abnormally increased its bidding activities in the sheets in the period August 27—September 24, for the purpose of raising the market price in anticipation of the intended offering.[4] The record does not show, however, any acceleration of Aetna's listings in the sheets in that period. Although the record contains a schedule listing quotations entered in the sheets by Aetna and other dealers for the period April through December 1964, which contains quotations for only 4 or 5 days in each month until August 27 and daily for the month thereafter, it appears that the quotations prior to August 27 are merely presented on a weekly basis. An examination of the sheets themselves, of which we take official notice, discloses that in fact Aetna (as well as the other dealers listed in the schedule) was submitting quotations on a daily basis prior to August 27 as well as after that date. The sheets show that in the period of approximately 3 months from May 26 through August 26, Aetna entered bids in the sheets on 64 of 65 trading dates, ranging from 1¼ on May 26 to 1⅞ on August 26, and that its activity during this period, as well as in the period after August 27, was not inconsistent with that of other dealers. Aetna's activity in the sheets was thus basically the same both before and after August 27.

Moreover, there are other factors which militate against a finding that Aetna's conduct "created" trading activity and was designed to cause or caused the price increases. There is absent here the evidence usually present in a manipulation showing that the

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[2] *Gob Shops of America, Inc.*, 39 S.E.C. 92, 101 (1959), and cases cited there.

[3] The *Federal Corporation*, 25 S.E.C. 227, 230 (1947); see also *Masland, Fernon & Anderson*, 9 S.E.C. 338, 345 (1941); *Halsey Stuart & Co., Inc.*, 30 S.E.C. 106, 124 (1949); *Bruns, Nordeman & Company*, 40 S.E.C. 652, 659 (1961).

[4] A sudden and otherwise unexplained increase in the number and levels of bids and purchases as compared with prior periods is a significant factor in determining whether a respondent's activity was undertaken for the purpose of raising prices. Cf. *R. L. Emacio & Co., Inc.*, 35 S.E.C. 191, 194 (1953); see also *Charles C. Wright*, 3 S.E.C. 190, 195 (1938); *Russell Maguire & Company, Inc.*, 10 S.E.C. 332, 336 (1941).

alleged manipulator exercised price leadership or dominated and controlled the market or that he played a dominate role in the determination of the price and the price rises. Aetna was not the principal bidder in the sheets nor were its bids generally the highest.[5] Four other dealers appeared regularly in the sheets during the period August 27—September 24, and Aetna's bids did not exceed those of the other dealers.[6] And no evidence has been presented of Aetna's volume of purchases in relation to that of other dealers, so it cannot be found that it was the most active buyer or accounted for a substantial portion of all shares traded.[7]

We further note that Aetna discontinued its quotations in the sheets on September 25, 1964, or 29 trading days before the Regulation A offering began on November 4, 1964, and that it made no purchases as principal after September 29. During this period of about 6 weeks, nine other dealers appeared in the sheets, four of them regularly, and their bids increased from 2⅞ on September 25 to 3⅞ on November 5. Aetna's absence from the market for this extended period just prior to the offering and the continued activity and price increases by other dealers in Aetna's absence tend to refute the contention that Aetna was responsible for the increased price in the market when the offering was made.[8]

Under all the circumstances we cannot find that the record establishes that in the pre-offering period Aetna created apparent or actual activity in or raised the price of the issuer's stock for the purpose of inducing others to purchase such stock at artificially inflated prices.[9]

Moreover, while under some circumstances purchasing or arranging for the purchase of blocks of stock may constitute a de-

[5] Cf. *Floyd A. Allen & Company, Inc.*, 35 S.E.C. 176, 182 (1953); *Daniel & Co., Ltd.*, 38 S.E.C. 9, 11–12 (1957); *Bruns, Nordeman & Company*, 40 S.E.C. 652, 655 (1961); *Advanced Research Associates, Inc.*, 41 S.E.C. 579, 603–4 (1963).

[6] Aetna's bid was never higher than that of all other dealers. It was as high as that of any dealer on 14 days; as low as the lowest on 2 days; in between the high and the low on 3 days; and the lowest on 1 day. Nor is there any evidence of any association or relationship between Aetna and any of the other dealers, or that Aetna instructed or arranged for any other dealer to appear in the sheets to create a false appearance of activity.

[7] Cf. *Russell Maguire & Company, Inc.*, 10 S.E.C. 332, 336 (1941); The *Federal Corporation*, 25 S.E.C. 227, 229 (1947); *Halsey, Stuart & Co., Inc.*, 30 S.E.C. 106, 115 (1949); *R. L. Emacio & Co., Inc.*, 35 S.E.C. 191, 194 (1953); *S. T. Jackson & Company, Inc.*, 36 S.E.C. 631, 651 (1950); *Advanced Research Associates, Inc.*, 41 S.E.C. 579, 605 (1963).

[8] Cf. *M. S. Wien & Co.*, 23 S.E.C. 735, 744 (1946), where it was pointed out that the respondent there did not wait until the effect of its advancing quotations and related activities had been dissipated by the lapse of time but immediately liquidated its position in the securities involved. *Cf.* also Rule 10b–6(a) (11), which indicates that the market effect of a prospective underwriter's normal trading may be dissipated if he discontinues his bids and purchases at least 10 trading days before the commencement of a distribution. Also, in other cases we have found it significant as evidence than an alleged manipulator caused a price increase if the bids drop sharply or disappear when he withdraws from the market, a factor absent here. Cf. *Floyd A. Allen & Company, Inc.*, 35 S.E.C. 176, 182 (1953); *Daniel & Co. Ltd.*, 38 S.E.C. 9, 12 (1957); *Gob Shops of America, Inc.*, 39 S.E.C. 92, 101 (1959).

[9] Cf. *Edgerton, Wykoff & Company*, 36 S.E.C. 583, 588–9 (1955).

vice to "dry up" the market in aid of a manipulative scheme,[10] we cannot find that under the facts of this case the purchase of stock from Weill was such a device. When Aetna purchased the 10,700 shares from Weill it was informed that those shares were restricted as to their saleability and it acquired them with the understanding and intention that it would make them the subject of a public offering after qualifying them by a filing with us. It did make such a filing, and in it specific disclosure was made that those shares had been acquired by Aetna in September 1964 at a cost of 1¾ per share. As to the second Weill block, there is likewise insufficient evidence to establish that respondent effected transactions raising the price of the issuer's stock for the purpose of inducing others to purchase at increased prices.

CONDUCT DURING THE OFFERING PERIOD

As noted, the Regulation A offering began on November 4, 1964. On November 4, 5, and 6, Aetna sold all of its 10,700 shares as principal and also sold 5,815 shares as agent for the Perlmans, mostly at prices of 3 and 3¾.[11] On the completion of the sale of its own shares Aetna re-entered the sheets with bid and asked quotations on November 6 and continued such quotations generally on a daily basis thereafter. It continued to make sales of the Perlmans' stock, first as agent and subsequently on a principal basis, until by December 7, 1964, Aetna had purchased from or sold for the Perlmans a total of 21,285 of the Perlman shares included in the Regulation A filing, at which time the offering was discontinued.

During the period of the offering the issuer sent to stockholders a letter dated November 9, 1964, reporting substantial advances in sales and profits for the fiscal quarter ending October 31, 1964. On November 15, 1964, there appeared in a local newspaper an article containing laudatory and favorable statements about the issuer's operations and prospects, which were based on an interview given by Clifford Perlman to a reporter for the newspaper a few days earlier. Aetna furnished copies of the report to stockholders and to another broker-dealer, and furnished copies of the newspaper article to stockholders of the issuer and to some other broker-dealers about a week after its publication. The hearing examiner found that the quarterly report and the newspaper article were "sales material" required by Rule 258 of Regulation A to be filed with the Commission prior to their use, but in fact not so filed.

[10] Cf. *Aurelius F. DeFelice*, 29 S.E.C. 595, 599, 602 (1949); *R. L. Emacio & Co., Inc.*, 35 S.E.C. 191, 195 (1953); *Gob Shops of America, Inc.*, 39 S.E.C. 92, 101 (1959).

[11] Small amounts were sold at 2, 3⅞ and 4.

Respondents urge that neither the letter nor the newspaper article were intended to be sales material. They point out that the letter was a regular quarterly report to stockholders which is not claimed to be misleading in any way, and that the newspaper interview was not solicited by any of the respondents but was only granted reluctantly by the Perlmans, and in any event the article was not published or distributed until the offering was practically completed.[12]

Accepting the argument that respondents did not deliberately attempt to evade Rule 258, and resolving doubts as to the quarterly report in favor of respondents, we nevertheless find that the reprint of the newspaper article was clearly "sales material" within the meaning of that rule and should have been filed with our regional office prior to its use.

Notwithstanding respondents' argument to the contrary, we are inclined to agree with the finding of the hearing examiner that the reprint as supplemental sales literature was materially misleading in violation of Section 17(a) of the Securities Act. The article stated, among other things, that the issuer was currently operating 16 outlets; that it expected to be operating 30 diners with sales estimated at close to $2 million by the end of the fiscal year in July 1965; that in the first 4 years of operation, four stores were in business, a like number was opened in the next year, and that "this past year the chain has been expanding at the rate of one a month" and in another year would be "starting one new store a week;" and that all of the issuer's stores "make money." The hearing examiner found that the statements as to the expansion and profitability of the issuer's outlets were materially misleading, pointing out that in the fiscal year ending July 31, 1964, the issuer had opened a maximum of only six stores, and that four stores had sustained losses in that fiscal year, five stores had sustained losses for the month of October, and three stores had losses for the quarter ending October 31, 1964.

As has been stated, after it had sold all of its 10,700 shares included in the Regulation A offering, Aetna re-entered the sheets and made purchases of the issuer's stock during the remaining period of the offering. From November 6 through December 7, 1964, it acquired 18,285 shares of which 14,960 shares were pur-

[12] The interview took place about November 11, 1964. Prior to that time there had been sold all 10,700 of Aetna's shares and 10,125 of the 21,285 shares sold by the Perlmans. In the period between the interview and the publication of the article, on November 11, 12 and 13, the Perlmans sold another 7,160 shares. Of the total 31,985 shares sold pursuant to the Regulation A offering, 27,985 shares were sold before the article was published and 29,585 shares were sold before copies of the article were distributed by Aetna, with only 2,400 of the 31,985 being sold after such copies were distributed.,

chased from the Perlmans, and only 3,325 shares were purchased from others.

Rule 10b–6 as applicable here prohibits an underwriter, prospective underwriter, or any other person participating in a distribution, from bidding for or purchasing securities of the same kind as those being distributed until after he has completed his participation in such distribution. It is Aetna's position that it was not an underwriter with respect to the Perlmans' stock, that its participation in the offering was completed when it sold its 10,700 shares included in the offering, and that it was therefore free to resume trading activities thereafter. Citing the definition of underwriter in Rule 10b–6 (*c*) (1) as one "who has agreed" with an issuer or other person on whose behalf a distribution is to be made to purchase securities for distribution or to distribute securities for or on behalf of such person or to manage or supervise a distribution for such person, Aetna asserts that it had not entered into any agreement and had no obligation to sell the Perlmans' shares or to manage or supervise a distribution of their stock.[13] In this connection Aetna points out that it received no special underwriter's fees, commissions or compensation in connection with the Perlmans' sales to or through it. Finally, Aetna also points to the fact that it consulted counsel as to when it would be permitted to go back into the market, and was advised that it might do so after it had completed disposition of its 10,700 shares.

For the purposes of Rule 10b–6 the lack of an express arrangement characterized as an underwriting agreement is not controlling. Apart from the fact that every time Aetna undertook to sell stock for, or to buy stock from the Perlmans, an agreement was of necessity involved with respect to each such transaction,[14] it is clear that Aetna's role was participation in a distribution for or on behalf of the Perlmans, and that an agreement for such purpose may be inferred from all the circumstances. The fact is that Aetna did distribute all of the Perlmans' stock sold in connection with the Regulation A offering. In view of Aetna's prior transactions with the issuer and the Perlmans and the substantial sales Aetna made for the Perlmans in the first few days of the offering while Aetna was also disposing of its own shares, it could have reasonably anticipated and we find that it was contemplated that Aetna would continue to sell shares for the Perlmans or buy

[13] Aetna cites the fact that in referring to the original acquisition of the 10,700 shares by another firm which had been the underwriter in connection with a prior offering in 1961, the offering circular specifically stated that Aetna may be deemed to be an underwriter with respect to the re-offering of such shares but made no such statement with respect to the Perlmans' shares.

[14] Cf. *Hazel Bishop Inc.*, 40 S.E.C. 718, 736 (1961), where we stated that a broker or dealer acting for a selling stockholder is subject to the prohibitions of Rule 10b–6.

shares from them for resale.[15] We conclude that Aetna was an underwriter in the distribution of the Perlmans' shares as well as its own shares and so subject to the restrictions of Rule 10b–6 during the entire period of the offering.

Aetna further urges that even if its bids and purchases be deemed a violation of Rule 10b–6, such violation was not intentional or designed to create apparent or actual activity or to raise prices. It states that in this period, like the pre-offering period, it did not control or dominate the market, pointing to the quotations and trading in the stocks at rising prices by other independent dealers.[16] It further emphasizes that its own 10,700 shares were sold quickly in a few days before Aetna re-entered the sheets and points out that it did not accumulate any inventory thereafter, and that it was primarily a wholesale dealer and did business largely with other dealers.

Rule 10b–6 was intended among other things to prevent activity during an offering which would have a tendency to distort or influence the operation of the market. We are of the opinion that the fact that Aetna did engage in bidding and purchases prohibited by Rule 10b–6 was a material one that should have been disclosed in connection with the offering, which was being made at such prices as prevailed in the market.

The Public Interest

The Perlmans and the issuer assert that they acted in good faith and that the public interest and the protection of investors do not require that the temporary order of suspension be made permanent. They urge that such interest would be adversely affected by such action in that it would make it more difficult for the issuer to proceed with a contemplated full registration and public offering of securities through an established underwriting firm to provide funds for expansion of the issuer's operations which it now has under negotiation. They also point out that the price of the stock has risen in the period subsequent to the offering, so that no purchaser has suffered a market loss.[17]

The hearing examiner, while reaching the conclusion that the temporary suspension should be made permanent, noted various mitigating factors which he felt should be considered in connec-

[15] Clifford Perlman testified that Lum's and the Perlmans had dealt with Aetna before, it was convenient to do so as Aetna's office was "right down the street" and "it never occurred to me to do business anywhere else."

[16] After the Perlmans' 21,285 shares were sold and the offering was terminated, other dealers as well as Aetna continued to appear regularly in the sheets, with quotations which continued to rise.

[17] Subsequent to the offering, quotations in the sheets have risen from about 7½ to a high of 14¾—15 bid as of December 19, 1966.

tion with any request which might be made 2 years after the date of the temporary suspension to remove the 5-year bar to the further use of Regulation A. Among other things, he noted that the letter to stockholders of November 9, 1964, involved no misrepresentations, that Weill initiated his transactions with respondents, and that Aetna refrained from bidding for or purchasing stock for more than a month prior to the commencement of the distribution, and went back into the sheets following prompt sale of its shares in the offering only after consulting counsel.

Under all the circumstances, we conclude that it is not necessary to make the suspension permanent.

Accordingly, IT IS ORDERED that the order of January 19, 1965, temporarily suspending the exemption from registration with respect to an offering of stock of Lum's, Inc. be, and it hereby is, vacated.

By the Commission (Chairman COHEN and Commissioners WOODSIDE, OWENS, BUDGE, and WHEAT).