IN THE MATTER OF

# CHARLES P. LAWRENCE

*File No. 3-609. Promulgated December 19, 1967*

Securities Exchange Act of 1934—Section 15(b)

## BROKER-DEALER PROCEEDINGS

### Grounds for Bar from Association with Broker-Dealer Fraud in Offer and Sale of Securities

Where branch manager of registered broker-dealer, in offer and sale of securities, made false and misleading representations concerning impending public offering, future market value, his prospective acquisition of stock to be issued, and possibility of construction of motel on site leased by issuer, *held*, in public interest to bar branch manager from association with any broker or dealer with proviso that after expiration of 6 months he may be reemployed in securities business in nonsupervisory capacity upon appropriate showing that he will be adequately supervised.

APPEARANCES:

*Willis H. Riccio* and *Edward P. Delaney*, of the Boston Regional Office of the Commission, for the Division of Trading and Markets.

*Sumner H. Woodrow*, for Charles P. Lawrence.

## FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these proceedings under Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that Charles P. Lawrence, who was branch office manager of a registered broker-dealer, should be excluded from association with any broker or dealer with the proviso that he may return to the securities business after 6 months upon an appropriate showing that he will be adequately supervised. We granted Lawrence's petition for review and he and our Division of Trading and Markets filed briefs and presented oral argument. Our findings are based upon an independent review of the record.

In November 1964, the president of Sea Stores, Inc. ("Sea Stores"), who owned all of the 100 outstanding shares of its stock, entered into an agreement with Lawrence which authorized him to act as agent in the sale of all or part of her shares, and provided that should the "property be sold outright" he would receive a certain commission. The agreement further provided that in the event of a "reorganization" including the sale of shares, his compensation would be 1,000 shares. The latter alternative contemplated that Sea Stores be recapitalized by increasing the authorized common stock from 100 to 10,000 shares and that a portion of the shares be sold to finance an expansion program.

Beginning in early 1965, Lawrence, in the offer of all or part of the president's stock in Sea Stores to a certain customer in person and over the telephone, made materially false or misleading representations. These representations included statements that Sea Stores, which operated a marina and marine supply store on a leased site, was "going public," that he "thought" it would be a "very good" or "great" investment opportunity, and that a nation-wide motel chain was interested in building a motel on the Sea Stores site. Thereafter, Lawrence showed the customer a 1½-page financial statement covering the preceding 3 years which, according to the customer's recollection at the hearings, indicated that although Sea Stores had sustained losses its condition was improving.[1] The customer, because of other commitments, did not accept any of the offers to sell a portion or all of the president's holdings of Sea Stores stock.

Lawrence had also solicited a loan of $10,000 from the customer without success, but the customer finally agreed to lend him $5,000, repayable in 90 days without interest. In soliciting the $5,000 loan Lawrence represented that he needed that amount to complete his commitment to the president of Sea Stores of $20,000 or $25,000 for the purchase of a boat hoist machine by the company, that upon such payment he would receive 1,000 shares of which he would give 500 shares to the customer, that an underwriting of Sea Stores stock was due by the end of the summer and would be handled by his employer, and that the 500 shares would then be worth $12,500 although he could not guarantee it. The customer testified that although he ascertained from our staff that no application for a public offering of Sea Stores stock had been filed and despite his reservations concerning the merits of Sea Stores, he determined to accept the proposition because even if the shares proved worthless he would still have a claim for $5,000.

[1] The 3-year financial statement shown to the customer is not in evidence. His recollection is that it showed a loss of $5,000 the first year, $2,000 the second year, and a profit or loss of $500 the third year.

The customer's check for $5,000, dated March 5, 1965, was delivered personally to Lawrence who, pursuant to the customer's request for a receipt and letter of agreement, prepared a two-page letter, dated March 7, 1965, which stated that the $5,000 loan was repayable in 90 days, and that "for the favor" he was willing to give the lender "½ of the shares which I will receive." The letter added, "I estimate *but cannot guarantee* that these shares (*500*) should have a value of $12,500. However, these shares probably will not be salable until this summer."

Lawrence subsequently reported to the customer that the boat hoist had been purchased by Sea Stores and that his employer was "very enthusiastic" about the company and would "definitely handle the underwriting." When the loan became due, Lawrence was unable to make payment. He requested and received a 90-day extension and paid the lender interest in the amount of $100 to cover the extended period. Upon the expiration of the extended due date, Lawrence again failed to make payment, and he never delivered any Sea Stores stock to the lender.[2]

On the basis of the foregoing, we are satisfied that Lawrence willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b–5 thereunder in the offer and sale of Sea Stores stock.

The optimistic statements made by Lawrence with respect to Sea Stores had no reasonable basis and were fraudulent. Sea Stores, which was organized in 1959, had sustained substantial operating losses in the 3 years preceding the transaction in question. For 1962 its operating loss amounted to over $8,000, and as of the end of that year, it had an accumulated deficit of over $25,000. In 1963, a net loss of about $8,400 increased the deficit to about $33,500. In 1964, it had a net loss of $729. Although as previously noted the customer was shown a summary financial statement covering the 3-year period, the misleading nature of Lawrence's representations and predictions was not cured by it. The statements with respect to Sea Stores "going public," the plans of a motel chain to build a motel on the site when in fact such a proposal had never been discussed with the chain, and the investment quality of Sea Stores, were such as to counteract the adverse information in the financial statement. Moreover, Lawrence, who had previously handled a number of securities transactions for Sea Stores' president, was aware of but did not disclose her financial difficulties in the management of the marina which

[2] The lender subsequently instituted suit against Lawrence for $17,500, which was settled for $6,300.

led to her engaging him to seek a buyer for her stock or recapitalize the company.

Lawrence's representation that he needed the $5,000 to complete a commitment to Sea Stores' president was false. Not only had he made no investment in Sea Stores, but he had in fact borrowed $4,000 from the president. Nor was there any reasonable basis for his representations concerning an impending public offering of Sea Stores stock or his employer's enthusiasm for handling it. Although Lawrence had discussed a proposed underwriting with a principal of the firm which employed him, the proposal never reached any advanced stage nor were any actual figures considered, and the principal testified that he had not been impressed with Sea Stores' potential upon a previous visit to the property. No disclosure was made of the inchoate state of Sea Stores' recapitalization plan and the consequent uncertainty as to whether Lawrence would ever receive 1,000 shares in the company. Thus, Lawrence's statement in the March 7 agreement that he "will receive" such shares was not justified. Moreover, the statement in the agreement that these shares "probably will not be salable until this summer" implied that they would then be salable, an implication which was unwarranted under the circumstances.

Lawrence's estimate in the agreement of a value of $12,500 for the 500 shares was clearly misleading. We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent.[3] Lawrence based his valuation of $25 per share on what he considered to be the book value, taking into account his estimated value of $120,000 for an option held by Sea Stores to purchase for $125,000 the land which it leased, and the proposed cancellation by the president of the company's indebtedness to her of about $62,000. His valuation of the option was entirely speculative, not being supported by an independent appraisal nor noted in the company's financial statements.

The hearing examiner, noting that the 500 Sea Stores shares Lawrence promised to deliver were not "physically in existence," considered that it was unnecessary to determine whether those shares constituted a security because in his opinion the loan agreement, being an evidence of indebtedness, itself constituted a security within the meaning of Section 2(1) of the Securities Act. Aside from the fact that such a finding with respect to the loan agreement does not appear to be within the scope of the allegations in the order for proceedings, it is immaterial that the 500 shares were not in existence. The sale of such shares was in effect

[3] See, *e.g.*, *Hamilton Waters & Co., Inc.*, 42 S.E.C. 784, 787 (1965), and cases there cited.

a sale of securities "when, as and if issued," which we have considered to be within the ambit of Section 5 of the Securities Act and the anti-fraud provisions of that Act and the Exchange Act.[4] And there is no merit in Lawrence's suggestion that no "sale" was involved because he merely promised to "give" the shares to the customer out of gratitude. We find that such promise constituted a "sale" of securities within the meaning of Section 2(3) of the Securities Act and Section 3(a)(14) of the Exchange Act since the shares were an integral part of the loan transaction.[5]

Lawrence also contends, in connection with the loan transaction, that no violations of the anti-fraud provisions can be found because he did not use the mails or interstate facilities for the purpose of executing the alleged fraud, and that such use is the "gist" of such violations. He notes that interstate facilities were used by his local bank to clear the $5,000 check only after he had deposited the check and his account had been credited with the amount of the check. He relies on *Kann* v. *U.S.*,[6] which reversed a conviction of mail fraud involving the use of the mails by a clearing bank after the defendant had cashed checks of associates (not of the victims) and obtained the fruits of the fraud. Whatever the legal principles applicable to the use of the mails may be under the mail fraud statute, however, it is well settled that the gist of the offense under the anti-fraud provisions of the securities acts is the fraud rather than the use of the mails or interstate facilities, and that proof of such use is required merely to establish Federal jurisdiction.[7] The mails need not be used to induce the purchase of or to deliver the security.[8] "It is sufficient if the use of the mails is merely incidental to the fraudulent conduct which the Congress intended to reach . . . by the provisions of the Securities Act of

[4] Since 1954 Section 5(c) of the Securities Act has expressly prohibited any offers of a security before the filing of a registration statement as to it under that Act. Even prior to the adoption of that amendatory provision, we treated the sale of securities on a when-issued basis —*i.e.*, the sale during the waiting period between the filing and the effective date of a registration statement—as unlawful under Section 5 of that Act. See Securities Act Release Nos. 2613 (July 9, 1941), 3011 (August 28, 1944). When-issued securities were the subject of fraud findings in *Batkin & Co.*, 38 S.E.C. 436, 438–46 (1958). Cf. *Seeman* v. *U.S.*, 90 F.2d 88, 89 (C.A. 5, 1937), 96 F.2d 732 (C.A. 5, 1938), *cert. denied*, 305 U.S. 620, which rejected a contention that the anti-fraud provisions of the Securities Act are not applicable to forged securities.

[5] Section 2(3) of the Securities Act provides in pertinent part: "Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been offered and sold for value." See *S.E.C.* v. *Addison*, 194 F. Supp. 709, 722 (N.D. Tex., 1961). The same principal would apply to a "sale" under the Exchange Act. See Loss, *Securities Regulation* (2d ed., 1961), p. 516.

[6] 323 U.S. 88 (1944).

[7] *Little* v. *U.S.*, 331 F.2d 287, 293 (C.A. 8, 1964), *cert. denied* 379 U.S. 834; *U.S.* v. *Cashin* 281 F.2d 669, 673–4 (C.A. 2, 1960).

[8] See *U.S.* v. *Moniar*, 147 F.2d 916, 920 (C.A. 3, 1944), *cert. denied* 325 U.S. 859 (letters and telegrams sent by defendant to co-defendant); *Little* v. *U.S.*, *supra*, (clearance of victims' checks involved use of mails and interstate facility).

1933." [9] It is clear that the use by Lawrence's bank of interstate facilities to clear the $5,000 check was a direct or indirect use of such facilities in execution of his scheme to defraud, irrespective of the fact that the bank may have immediately credited his account.[10]

In urging that any violations by him were not willful, Lawrence argues that the standard employed in *Hughes* v. *S.E.C.*,[11] that the respondent need only be aware of what he was doing and not of the legal consequences of his acts, is not applicable to fraud violations. He contends that for such violations a higher degree of willfulness is required than for violations of Section 5 of the Securities Act. The *Hughes* case itself, however, applied the standard in finding that fraud violations were willful, and that standard has since been frequently applied by us and approved by the courts in broker-dealer proceedings involving charges of fraud.[12]

OTHER MATTERS

Lawrence objects to the examiner's admission into evidence of assertedly "irrelevant, immaterial, nonresponsive and hearsay testimony" of the customer. Lawrence has not complied with Rule 17 CFR 201.18 of our Rules of Practice which requires that each exception urged before us with respect to the admission or exclusion of evidence set forth the substance of the evidence in question with appropriate references to the transcript. In any event, the customer's testimony concerning Lawrence's representations to him was not adduced to prove the truth of those representations but only to show that they were made. Even at common law, such testimony is not hearsay.[13] We note, moreover, that the generally accepted view favors liberality in the admission of evidence in administrative proceedings, and all evidence which "can conceivably throw any light upon the controversy" should normally be admitted.[14] That such evidence might be excluded in a jury trial does not preclude or militate against its admission in a proceeding

[9] *Little* v. *U.S.*, *supra*, 331 F.2d at 292.

[10] *Ibid*; *U.S.* v. *Robertson*, 181 F. Supp. 158, 163 (S.D.N.Y. 1959) *aff'd in part and rev'd in part on other grounds*, 298 F.2d 739 (C.A. 2, 1962). It has also been held that an intra-state telephone call is a use of a facility of interstate commerce within the meaning of the anti-fraud provisions. *Myzel* v. *Fields*, 36 U.S.L. Week 2242 (C.A. 8, October 12, 1967); *Lennerth* v. *Mendenhall*, 234 F. Supp. 59 (N.D. Ohio, 1964); *Nemitz* v. *Cunny*, 221 F. Supp. 571 (N.D. Ill., 1963); *Clarence Earl Thorton*, 42 S.E.C. 751, 753, n. 4 (1965).

[11] 174 F.2d 969 (C.A.D.C., 1949).

[12] See, *e.g.*, *Gearhart & Otis, Inc.* v. *S.E.C.*, 348 F.2d 798, 802–3 (C.A. D.C., 1965), *aff'g Gearhart, Otis, Inc.*, 42 S.E.C. 1 (1964); *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965), *aff'g Sidney Tager*, 42 S.E.C. 132 (1964).

[13] See McCormick, *Evidence*, Sections 225, 228 (1954); 6 Wigmore, *Evidence* (3d ed., 1940) Section 1766; *Aikins* v. *U.S.*, 282 F.2d 53, 57–58 (C.A. 10, 1960); *U.S.* v. *Sapperstein*, 198 F. Supp. 147, 150 (D. Md., 1961), *aff'd* 312 F.2d 694 (C.A. 4, 1963).

[14] *Samuel H. Moss, Inc.* v. *F.T.C.*, 148 F.2d 378, 380 (C.A. 2, 1945), *cert. denied* 326 U.S. 734. See also *Hyun* v. *Landon*, 219 F.2d 404, 408 (C.A. 9, 1955), *aff'd*, 350 U.S. 990.

where it is not weighed by a jury, which could be unduly influenced, but by a hearing examiner who is legally trained and judicially oriented.[15] Under Section 7(c) (now 5 U.S.C. §556(d)) of the Administrative Procedure Act, hearsay evidence may support findings if "reliable, probative and substantial." [16]

Lawrence also asserts that the examiner improperly excluded testimony offered to show that the customer was an "irrational, litigious, unstable individual." In support, he points to various portions of the record, which however show that on his cross-examination of the customer and on his direct examination of another witness those witnesses were in fact permitted to testify to matters which in Lawrence's view would tend to show that the customer was litigious. At the oral argument before us he also referred to an offer of proof he had made to show, that on one occasion the customer had a highly emotional reaction to disappointing news. The examiner excluded that proffered evidence on the ground that it was not relevant to the question of credibility. In our opinion his ruling was a proper exercise of the examiner's discretion.[17] We further note that the customer on cross-examination denied that he had had the emotional reaction Lawrence had attempted to show.

Lawrence further objects to the admission in evidence of a photostatic copy of the first page of the two-page letter of agreement dated March 7, 1965, which is missing.[18] This objection is not well taken. Lawrence admitted writing the letter and that the first page contained the material portion of the agreement and the missing second page contained little more than his signature.

PUBLIC INTEREST

Lawrence contends that it is not appropriate or necessary in the public interest to impose any sanction upon him. He asserts that only a single transaction which concerned a personal loan has been questioned, that the loan has been paid, and that he has already sustained substantial damage as a result of the adverse publicity.

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[15] See *Clinton Engines Corporation*, 41 S.E.C. 408, 411 (1963), and cases there cited.

[16] See 2 Davis, *Administrative Law Treaties*, pp. 303–4 (1958). Cf. *Ellers* v. *Railroad Retirement Board*, 132 F.2d 636, 639 (C.A. 2, 1943); *Marmon* v. *Railroad Retirement Board*, 218 F.2d 716, 717 (C.A. 3, 1955); *Montana Power Co.* v. *F.P.C.*, 185 F.2d 491, 497–8 (C.A.D.C., 1950), *cert. denied*, 340 U.S. 947.

[17] See McCormick, *Evidence* (1954), Section 42; 3 Wigmore, *Evidence* (3d ed., 1940), Sections 981–87.

[18] According to the testimony of the customer's accountant, who was called as a witness by Lawrence, the accountant received the original letter of agreement, and upon being asked by the customer to return it, made a photocopy of the first page but was unable to make a copy of the second page because his copying machine broke down, and he then returned the original letter to the customer. The customer testified he thereafter discussed his claim against Lawrence with a member of the firm which employed Lawrence and left the letter at the office of the firm to be examined and photocopied, and it subsequently could not be found.

In our opinion, however, the limited sanction imposed by the hearing examiner, after careful review of what he considered to be mitigative factors, is fully warranted. Lawrence, with 10 years' experience in the securities business, engaged in fraudulent conduct in soliciting a customer to make a substantial loan to him and to buy stock of the issuer's president. If the public interest is to be protected, such conduct cannot be condoned merely because only one customer was involved.[19]

An appropriate order will issue.

By the Commission (Chairman COHEN and Commissioners OWENS and WHEAT), Commissioner BUDGE dissenting and Commissioner SMITH not participating.

Commissioner BUDGE, dissenting:

The facts developed in this proceeding do not warrant imposition of a sanction by the Commission.

[19] See *N. Sims Organ & Co., Inc.*, 40 S.E.C. 573 (1961), *aff'd* 293 F.2d 78 (C.A. 2, 1961), *cert. denied* 368 U.S. 968.

The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.