IN THE MATTERS OF

JAFFEE & COMPANY*

File No. 3-570. Promulgated April 20, 1970

Securities Exchange Act of 1934—Sections 15(b), 15A and 19(a)(3)

BROKER-DEALER PROCEEDINGS

Bids and purchases During Distribution

Failure to Deliver Prospectuses

Where registered broker-dealer through its trader purchased from underwriter, with a view to distribution, registered securities offered from time to time by selling stockholders, and trader on behalf of his firm (with knowledge of underwriter) and a selling stockholder who is controlling partner of another broker-dealer firm bid for and purchased such securities during distribution, in willful violation of anti-manipulation provisions of Rule 10b-6 under Section 10(b) of Securities Exchange Act of 1934, and where trader failed to have prospectuses sent to purchasers of registered securities in willful violation of Section 5(b)(2) of Securities Act of 1933, *held*, in public interest to suspend trader and partner from association with any broker-dealer, to suspend broker-dealer registration of firm controlled by partner, and to censure trader's firm and underwriter.

*Wilton L. Jaffee, Jr.; Greene & Company; Irving A Greene; Robert Topal; Bernard Horn; M. L. Lee & Co., Inc.; Martin L. Levy.

APPEARANCES:

Donald N. Malawsky, William H. Joseph, Gerald Gordon, Robert G. Willner, and *Michael Gettelman,* of the New York Regional Office of the Commission, for the Division of Trading and Markets.

Jerome J. Londin, of Carro, Spanbock & Londin, for Jaffee & Company and Wilton L. Jaffee, Jr.

Ira M. Millstein, Donald J. Williamson, and *Peter D. Standish,* of Weil, Gotshal & Manges, and *Melvin Katz,* for Greene & Company, Irving A. Greene, and Robert Topol.

Raphael P. Koenig, of Koenig and Ratner, for Bernard Horn.

Eric M. Javits, David A. Goldstein, William J. Quinlan, and *John C. Moore III,* of Javits & Javits, for M. L. Lee & Co., Inc.

stock from that firm, he should have inquired into the status of the offering so as to determine whether to discontinue bids for the stock and purchases of stock not a part of the offering. Lee's president testified that he examined the sheets every day and knew that G Co. was entering bids as well as offers for Solitron stock throughout the relevant period. Yet Lee continued to sell registered Solitron stock to G Co., and therefore, contrary to the examiner's finding, knew or should have known that G Co. was participating in the distribution. By such sales Lee aided and abetted G Co.'s violations of Rule 10b–6.

Jaffee, although he was one of the selling stockholders under the registration statement, made purchases of Solitron stock for his own account during the relevant period, and admitted that prior to that period but during the course of the Solitron offering he had asked Horn to "go into" the sheets. Thereafter, Horn as indicated above entered bids for the stock.[6]

Jaffee and Lee state that the Solitron registration constituted a "shelf registration" or "delayed offering" and argue that such an offering does not constitute a distribution within the meaning of Rule 10b–6. Jaffee further contends that the one sale of only 3,500 shares of registered Solitron stock on his behalf during the relevant period was not a distribution. G Co. and Horn claim that they simply engaged in normal trading activities, and Jaffee, G Co., and Lee assert that the record shows none of the usual indicia of a manipulation nor any manipulative intent on their part.

There is no merit in these contentions. An offering of stock pursuant to a registration statement by its very nature constitutes a distribution within the meaning of Rule 10b–6.[7] For purposes of the Rule, such distribution must here be deemed to have commenced at least upon commencement of the offering by the exclusive agent following the effective date of the registration statement. Jaffee, having agreed to participate in

[6] The only evidence of Jaffee's arrangement with Horn is contained in a transcript of Jaffee's prior investigative testimony portions of which were received in evidence only against Jaffee and therefore cannot be used against Horn.

[7] See Whitney, *Rule 10b–6: The Special Study's Rediscovered Rule*, 62 Mich. L. Rev. 567, 575 (1964): "There is no question that a 'distribution' [within the meaning of Rule 10b-6] is contemplated in an underwritten offering to the public of previously unregistered securities pursuant to registration under the 1933 Act . . .". The test used in *Bruns, Nordeman & Company* (40 S.E.C. 652, 660 (1961)) in finding there was a "distribution" under the Rule of securities which were neither registered nor subject to registration (*i.e.*, the magnitude of the offering and selling effort), merely extended the application of that term. See *Comment, The SEC's Rule 10b–6: Preserving A Competitive Market During Distributions*, 1967 Duke L. J. 809, 820. in *J. H. Goddard & Co., Inc.*, 42 S.E.C. 638, 640 (1965), we found sales by an underwriter of control shares subject to registration under the Securities Act to be a Rule 10b–6 distribution without regard to the *Bruns, Nordeman* test, whereas we applied that test to sales of blocks of stock which were neither registered nor subject to registration.

such an offering, became a participant in the distribution irrespective of any sales of his own registered shares, and his participation continued for so long as any of such shares remained unsold or until they were withdrawn from registration. Otherwise, the Rule's prophylactic purpose could be circumvented since each selling stockholder in turn could refrain from selling his shares for a certain period while engaging in buying and bidding activities serving to raise the price of the stock, and thereby benefit the other selling stockholders as well as himself when sales were effected at the higher price. Similarly, the Rule could be circumvented by Lee were it permitted, merely if it refrained from making bids or purchases, to sell the stock to other broker-dealers engaged in such activities. Whatever the type of offering involved in this case may be called—a time-to-time offering, or a shelf registration or delayed offering—it is clear that Rule 10b–6 is applicable.[8] The fact that the shareholders could control the timing of their sales in no way obviated the need for the protections of the Rule or gave rise to any exemption from it. G Co. and Horn should have been aware that their purchases for resale of stock that they knew was part of a registered offering did not constitute normal trading activity. Persons, like G Co., engaging in market-making activities in a security which at the same time is being offered in a registered distribution must not participate in such distribution unless they have terminated their bidding and purchasing in the open market as provided in Rule 10b–6. Finally, Rule 10b–6 defines certain conduct as manipulative *per se;* no further showing of manipulative practices or manipulative intent is required in order to establish violations of the Rule.[9]

Lee asserts that it had the right to assume that G Co. was buying registered Solitron stock for investment purposes and thus not participating in a distribution. Jaffee, Lee, and G Co. argue that they did not employ the mails or interstate facilities required for finding violations by them during the relevant period, and Jaffee and Lee assert that any violations by them were not willful. We disagree. Lee had no basis for assuming that a dealer who was placing offers for Solitron stock in the sheets every day was buying the stock for investment. G Co.'s insertion of bids in the sheets, which are dissemi-

[8] See *Hazel Bishop, Inc., supra,* 40 S.E.C. at 735–6; *Lum's Inc.,* 43 S.E.C. 223, 230 (1966); Securities Act Release No. 4936, pp. 5–6 (December 9, 1968).

[9] See *Lum's, Inc., supra.* Respondents' reliance upon cases involving manipulative practices in addition to those found herein is misplaced. The manipulation violations at issue in those cases were based on antifraud provisions including Rule 10b–5, or both Rules 10b–5 and 10b–6.

nated in interstate commerce, is a sufficient jurisdictional basis to support the findings against it and against Jaffee who arranged for such insertion.[10] Lee mailed confirmations of Solitron purchases and prospectuses to G Co., and in addition there were telephone conversations relating to Solitron between the two firms.[11] It is well established that a finding of willfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing.[12] Moreover, Jaffee and Lee were on notice of the applicability of Rule 10b–6 as shown by their agreements with Solitron in which they undertook to abide by the provisions of that Rule.

We conclude that G Co., which, as has been noted, knew that it was purchasing and selling shares that were part of a registered offering, willfully aided and abetted by Horn and Lee, and Jaffee willfully violated Section 10(b) of the Exchange Act and Rule 10b–6 thereunder.[12a]

With respect to J Co., it was not in existence during the relevant period and, as a basis for findings against it, the order for proceedings was amended to add charges of violations by its predecessor firm, Jaffee and Leverton ("J&L"). In view of our disposition of these proceedings with regard to J Co., as set forth below, we deem it unnecessary to determine on the record before us whether J&L, as a result of its transactions in registered Solitron stock, became a participant in the distribution and violated Rule 10b–6, and whether J Co. would be chargeable with any such violation.

As to Greene and Topol, there is no evidence that they were or should have been aware of the registered offering of Solitron stock. Accordingly, we find no violations of Rule 10b–6 by

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[10] See *F. S. Johns & Company, Inc.*, 43 S.E.C. 124, 138n.–16 (1966), *aff'd sub nom. Dlugash* v. *S.E.C.*, 373 F.2d 107 (C.A. 2, 1967) and *Winkler* v. *S.E.C.*, 377 F.2d 517 (C.A. 2, 1967).

[11] See *Myzel* v. *Fields*, 386 F.2d 718, 727–8 (C.A. 8, 1967), *cert. denied* 390 U.S. 951.

[12] *Gearhart & Otis, Inc.* v. *S.E.C.*, 348 F.2d 798, 802–3 (C.A. D.C. 1965); *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965). See also *Dlugash* v. *S.E.C.*, 373 F.2d 107, 109 (C.A. 2, 1967), which held that where the circumstances were such as to put respondents on notice that "something was wrong, . . . they were under a duty to investigate, and their violation of that duty brings them within the term 'willful' in the Exchange Act."

[12a] We cannot agree with the suggestion in the dissent to this portion of our opinion that to hold G Co. in violation of Rule 10b–6 could result "in a form of discrimination" as between the market maker in the over-the-counter market and the specialist registered with an exchange. A specialist, no less than an over-the-counter market maker, is subject to the prohibitions of the Rule if he is a participant in a distribution other than one covered by a plan filed by the exchange as provided under Rule 10b–6*(a)* (10). It is not material to consider whether or not a question would arise in the situation posed by the dissent of a purchase by the specialist of a very small number of shares subject to registration. His obligation, as a specialist, is to maintain a "fair and orderly market" in the particular security, and dealings for his own account are restricted so far as practical to those reasonably necessary to permit him to maintain such market. (Section 11(b) of the Exchange Act; see *Re, Re & Sagarese*, 41 S.E.C. 230, 231 (1962)). A market maker such as G Co. is not under the same obligation to maintain a market, and, in any event, the number of shares purchased by G Co., as previously noted, was substantial.

them, and they were not charged with a failure to supervise Horn with a view to preventing such violations.

FAILURE TO DELIVER PROSPECTUSES

Section 5(b)(2) of the Securities Act of 1933 makes it unlawful to cause to be carried through the mails or in interstate commerce any security, with respect to which a registration statement has been filed, "for the purpose of sale or for delivery after sale" unless accompanied or preceded by a prospectus. We find that, during September and October 1963, G Co. and Horn willfully violated that Section.

The record shows that during that two-month period G Co. caused its clearing agent to deliver 6,100 shares of registered Solitron stock through the mails to 18 broker-dealers but sent no prospectus to them. Horn was the only trader dealing in the stock at G Co. at that time. Contrary to the examiner's finding, it was Horn's responsibility, under the firm's system then in effect, to make a notation on the order ticket when he sold registered stock which would alert the back office to send a prospectus in connection with delivery of the shares. No such notation was made on any of G Co.'s Solitron order tickets, nor does any appear on sale confirmations, as would have been the case if any prospectuses had been sent to customers who purchased registered Solitron stock. In fact, the back office at G Co. received no special instructions concerning transactions in Solitron.

Since there is no evidence that Greene or Topol knew or should have known of Horn's failure to carry out his responsibility to see that prospectuses were delivered, we find no violations by them of Section 5(b)(2), and they are not charged with any failure of supervision. Nor does the record support findings of violations of that Section by Jaffee. For the reason previously indicated, we do not reach the question of J&L's liability in this respect.

G Co. argues that it was not acting as an underwriter with respect to Solitron stock and therefore, under Section 4(1) of the Securities Act, the prospectus-delivery requirements were not applicable to it;[13] that the Division had the burden of proving that the broker-dealers to whom G Co. sold registered shares had not already obtained a prospectus from some other source; that, in fact, these broker-dealers had previously purchased stock from Lee which sent a prospectus to every

[13] Section 4(1) provides that the registration and prospectus requirements of Section 5 shall not apply to transaction by any person other than an issuer, underwriter or dealer.

purchaser and, in any event, were sophisticated dealers who did not need the information in the prospectus; that a negative inference must be drawn from the staff's failure to call G Co.'s cashier instead of its assistant cashier as a witness because the latter "was not in a position to have knowledge of the facts at issue"; and that any violations by it were not willful.

We reject these contentions. It has been judicially established that the Section 4(1) exemption does "not in terms or by fair implication" protect those who, like G Co., "are engaged in steps necessary to the distribution of security issues".[14] G Co., as principal, purchased shares of registered Solitron stock from Lee and resold those shares to other broker-dealers. These purchases made G Co. a participant in the distribution and brought it within the definition of "underwriter" in Section 2(11) of the Securities Act.[15] G Co. does not fall within the exception from the definition of "underwriter" in Section 2(11) for persons whose interest is limited to receipt, from an underwriter or dealer, of usual and customary distributors' or sellers' commissions. It has not shown, in accordance with Rule 141 under the Securities Act, that its "commission" or margin of profit on resales was not in excess of the spread that is usual and customary in such transactions. Since G Co. was an "underwriter" within the meaning of Section 2(11), its transactions in Solitron securities were not exempted from Section 5 of the Act by Section 4(1), which is limited to a person other than an issuer, underwriter or dealer, or by Section 4(3), which is limited to a dealer "no longer acting as an underwriter."[16]

The record does not show that any of the broker-dealer customers who did not receive a prospectus from G Co. had previously purchased registered Solitron stock from Lee or received a prospectus from Lee or any other source. It was G Co.'s burden, not the staff's, to prove that a particular purchaser had already obtained a prospectus elsewhere.[17] The fact that the purchasers may have been "sophisticated" broker-dealers did not relieve G Co. of its statutory obligation.[18] While

[14] *S.E.C.* v. *Chinese Consolidated Benevolent Association*, 120 F.2d 738, 741 (C.A. 2, 1941), cert. denied 314 U.S. 618. See *S.E.C.* v. *Guild Films Company, Inc.*, 279 F.2d 485, 489 (C.A. 2, 1960); *Sutro Bros & Co.*, 41 S.E.C. 470, 477–78 (1963). See also *S.E.C.* v. *Culpepper*, 270 F.2d 241, 246–47 (C.A. 2, 1959), which held that a broker-dealer who purchased, for resale to the public, unregistered shares from other brokers who had acquired such shares from a control group of the issuer, was not entitled to a Section 4(1) exemption since he has "engaged in steps necessary to the consummation of the public distribution."

[15] *S.E.C.* v. *Culpepper*, *supra*, at p. 247.

[16] Even if we view G Co. as having acted solely as a dealer, the exemption provided in Section 4(3) would not be available for its transactions. The registered securities sold by Lee to G Co. were in the nature of "an unsold allotment to or subscription by [a] dealer as a participant in the distribution of such securities . . . by or through an underwriter" within the meaning of Section 4(3) (C).

[17] 1 *Loss, Securities Regulation* 250 (2d ed. 1961).

[18] *Cf. Pennaluna & Company, Inc.*, 43 S.E.C. 298, 307 (1967), and cases there cited.

the then assistant cashier, who is presently the cashier of G Co., testified that he was not familiar at the time with "all aspects of the trading activity being conducted", he had been employed by G Co. in "different phases" of its back office work since 1955 and had served as its assistant cashier since about 1960. Under the circumstances, we consider that he was fully competent to testify with respect to the matters concerning which he was questioned, and, since G Co. was free to call its former cashier as a witness if it considered his testimony superior, there is no basis for assuming that the former cashier would have testified to any different effect. Moreover, G Co. concedes that the "system in effect" required that trading slips be marked "prospectus enclosed" by each trader "to assure that the back office would send out prospectuses". Finally, G Co. and Horn caused registered Solitron stock to be sent through the mails for delivery after sale without sending customers prospectuses, and accordingly, on the basis of our discussion of willfulness in the context of Rule 10b–6, their violations of Section 5(b)(2) of the Securities Act were willful.

OTHER MATTERS

Jaffee attacks various rulings of the examiner. During cross-examination of a staff investigator who had prepared various charts showing trading in Solitron stock,[19] the examiner denied Jaffee's request for production of reports of staff interviews with and statements obtained from customers of J&L whose names appeared on such charts as purchasers of Solitron stock. Neither the Jencks Act[20] nor the case of *Brady* v. *Maryland*[21] cited by Jaffee entitled him to obtain the confidential investigative material sought. The Jencks Act, which in substance is incorporated into our Rules of Practice,[22] provides that prior statements of Government witnesses shall not be the subject of inspection until such witnesses have testified on direct examination, and is obviously inapplicable to Jaffee's request. The *Brady* case held that suppression by the prosecution of material evidence favorable to an accused who has requested it is a denial of due process. It does not authorize a

[19] Jaffee, G Co. and Lee object to the admission of these charts into evidence, and Jaffee, to the admission of a notebook kept by Lee detailing its sales of Solitron stock. Since none of our findings is based on these documents, we deem it unnecessary to consider those objections.

[20] 18 U.S.C. 3500 (1957).

[21] 373 U.S. 83 (1963).

[22] See Rule 11.1

"fishing expedition" into investigative material.[23] In any event, we have made no findings with respect to sales of Solitron stock by J&L.

There is similarly no basis for Jaffee's claim of prejudice resulting from his inability to inspect certain confidential Commission files relating to the Solitron registration statement. At the hearings, the attorney who prepared that statement was called as a witness by Lee and testified to various discussions with our staff concerning the mechanics of the offering. Apparently in an effort to satisfy the examiner's doubts concerning this witness' credibility, Lee requested that the staff produce "anything" in the Commission's Solitron files "reflecting on these conversations that the witness has testified about." Not only did Jaffee fail to join in Lee's request, which the examiner denied, but he has made no showing of the relevance of the evidence sought nor of any adverse effect upon him resulting from its absence.

PUBLIC INTEREST

Jaffee, Horn, and Lee argue that the public interest does not require the imposition of any sanctions upon them, and G Co. contends that any sanction other than censure would be unwarranted.[24]

Jaffee asserts, among other things, that his record is otherwise good, that he cooperated with our staff, and that his violations, if any, were technical in nature. We do not consider that Jaffee's violations of Rule 10b–6 were merely technical. Bids and purchases in the course of a distribution at market price have a manipulative effect on such price to the detriment of investors. We conclude that under all the circumstances it is appropriate in the public interest to suspend Jaffee from association with a broker or dealer for 20 days.

Horn asserts that his only function was as a trader. However, Horn was responsible for all of the violations which occurred at G Co. In view of his violations of Rule 10b–6, as well as of Section 5(b) (2) of which he was exonerated by the examiner, we conclude that the public interest requires that he be suspended for 30 days.

G Co. no longer employs Horn, and its partners, with respect to whom we have found no violations, point to lengthy unblemished records in the securities business. Lee asserts, among

[23] See *Harris Clare & Co. Inc.*, 43 S.E.C. 198, 201 (1966).

[24] Since we have found no violations on the part of Greene or Topol, the proceedings will be dismissed as to them.

other things, that no purchaser suffered a market loss. It points to the recent death of its president and 95 percent stockholder, who was in active control of its business during the relevant period, and states that it is presently in the process of liquidation.[25] Under these circumstances, we conclude that censure of the two firms will adequately serve the public interest.

With respect to J Co., a sanction may be imposed upon it pursuant to Section 15(b) (5) of the Exchange Act upon the basis of willful violations committed by an associated person, including a partner or controlling person, prior to becoming so associated if in the public interest.[26] The record shows that at the time these proceedings were instituted and during the hearings, Jaffee's partnership interest in J Co., which has two partners, exceeded 90 percent. The hearing examiner dismissed the proceedings against J Co. on the ground that the order for proceedings was not notice to that firm that Jaffee's association with it provided a basis for a sanction.

In our opinion, however, the order for proceedings constituted sufficient notice to J Co. that it would be subject to a sanction if findings of violations were made against Jaffee. J Co. was named a respondent and was served with a copy of that order. The order alleged violations of the securities acts by Jaffee, identified him as a partner of J Co., and recited that "in view of the allegations made . . ., the Commission deems it necessary that private proceedings be instituted to determine . . . what, if any, remedial action is appropriate in the public interest pursuant to Section 15(b) . . . of the Exchange Act." Accordingly, we reverse the examiner's order dismissing the proceedings against J Co.[27] And since Jaffee is the controlling partner of J Co., we conclude that the firm's broker-dealer registration should be suspended for 20 days, the same period as Jaffee's suspension.[28]

J Co., Jaffee, G Co., and Horn have filed motions requesting further oral argument before us and stays of any sanctions imposed pending determination of petitions for review to be filed by them in the Court of Appeals.[29] The Division filed a

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[25] Dissolution of the respondent broken-dealer firm is no bar to the imposition of a sanction in the public interest. See *W.T. Anderson Company, Inc.*, 39 S.E.C. 630, 633 (1960).

[26] See *Richard N. Cea*, 44 S.E.C. (1969), and cases there cited. *Cf. Securities National Corporation*, 35 S.E.C. 163 (1953).

[27] See *Advanced Research Associates, Inc.* 41 S.E.C. 579, 613, n. 77 (1963).

[28] 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.

[29] Greene and Topol also joined in the motions, but since the proceedings will be dismissed as to them, their requests are moot.

memorandum in opposition. No basis for further oral argument has been shown, and that request is denied. With respect to the request for stays, the specified effective date of the sanctions in our order will provide movants with time to file petitions for review before the sanctions go into effect. The sanction with respect to any respondent who files such a petition prior to the effective date shall be stayed pending final determination of the petition.

An appropriate order will issue.

By the Commission (Chairman BUDGE and Commissioner OWENS), Commissioner SMITH concurring in part and dissenting in part, and Commissioners NEEDHAM and HERLONG not participating.

Commissioner SMITH, concurring in part and dissenting in part:

I concur with the majority in all aspects of the case except its findings of violations of Rule 10b–6 by G Co., its trader Horn, and Lee. I do not believe the test used, that the registration of an offering *per se* makes that Rule applicable, comports with the intended coverage of the Rule, and, using a stricter test, I do not believe the evidence supports findings of violations. Consequently, I would reduce the sanction against Horn to censure and would dismiss as to Lee.

The majority reasons first that G Co. was an "underwriter" in a "distribution" within the meaning of those terms in Section 2(11) of the 1933 Act and thereby is required by Section 5 of that Act to deliver prospectuses. With that reasoning I agree. From that the majority deduces that a "particular distribution" was also occurring and G Co. was, if not an "underwriter," at least "participating" in that distribution within the meaning of those terms as used in Rule 10b–6 under the 1934 Act, thereby prohibiting any bids or purchases by G Co. in the course of market-making. While the symmetry is appealing, I do not think the result necessarily follows. I cannot agree with the majority's premise that a public offering of securities requiring registration under the 1933 Act "by its very nature" constitutes a distribution for purposes of Rule 10b–6 under the 1934 Act.[1] Nor can I agree with the asserted

[1]The majority cites former Commissioner Whitney's excellent article for this proposition, Whitney, *Rule 10b–6: The Special Study's Rediscovered Rule*, 62 Mich. L. Rev. 567, 573 (1964). I do not read the article to say that. The sentence quoted by the majority appears to me to contemplate the usual "underwritten offering" through a syndicate of securities firms, at which the group of 10b–6, 10b–7 and 10–8 rules simultaneously adopted in 1955 were mainly aimed. See Foshay, *Market Activities of*

consequence, that a person who is a statutory underwriter for purposes of the 1933 Act is automatically a participant in a distribution subject to Rule 10b–6. The term "distribution" is defined in neither the 1933 Act nor the 1934 Act, and its meaning and applicability to particular persons in each context should be strictly derived from the differing purposes for which it is used.

The purpose of the 1933 Act is to provide adequate disclosure about the issuer and the offering to the ultimate purchaser, and so one participating in the distribution of the new issue is required to see to it that a prospectus reaches the ultimate purchaser. With that purpose in mind, it behooves us to bring within the distribution process someone purchasing for resale who is in a position to effectuate prospectus deliveries (such as a professional like G Co.) and who cannot avail himself of any of the specific statutory exemptions. This we did.

On the other hand, the purpose of Section 10(b) of the 1934 Act is to prevent manipulation in the trading markets. Here we are called on by Rule 10b–6 to keep someone who chooses to be on the sell side of the market out of the market on the buy side where the particular distribution by that person is of such a nature as to raise a sufficient temptation to manipulate (because the financial rewards are high enough) to cause a threat to the integrity of the market processes. Thus, selling shareholders—such as Jaffee—are prohibitied by Rule 10b–6 from buying when they are selling or poised to sell, and Lee, the exclusive agent for the selling shareholders, is similarly prohibited. Jaffee, who purchased with shares unsold, violated 10b–6 [2] and in my view Lee, who made no purchases, did not. G Co., a market-maker, and Horn, its trader, stand on a different footing.

It is not difficult to conceive that in certain situations where 1933 Act registration serves a purpose, to apply Rule 10b–6 would serve no purpose because the dangers of manipulation at which the Rule is aimed do not exist.[3] For example, if an

Participants in Securities Distributions, 45 Univ. of Va. L. Rev. 407 (1959). In his article Mr. Whitney said (footnote 3), "the prudent 'rule of thumb' assumes that a registered 1933 Act 'distribution' normally will be subject to Rule 10b–6." That phrasing is a long way from a *per se* application. Moreover, when he defines distribution for 10b–6 purposes, he does so (footnotes 31 and 37) in terms of the *Bruns, Nordeman* test I describe below, and indicates (footnotes 3 and 26) that the term is used for different purposes in the two statutes so that interpretations of one do not necessarily control the other.

[2] It is material to me in finding violation of Rule 10b 6 by Jaffee that he held unsold registered shares when he purchased in the market and had taken no steps to deregister or otherwise disassociate himself from the selling group.

[3] There are, of course, situations where the converse is true: distributions that do not require registration under the 1933 Act but should be subject to Rule 10b–6 or comparable antimanipulative requirements, e.g. "unregistered secondaries" or sales of substantial blocks acquired privately and held for the requisite investment periods. See Whitney, *supra* note 1 at 579 and 581.

individual acquires a small number of shares, say 200, directly from a listed issuer in an actively traded stock and promptly sells them on the floor of the exchange, it is clear he would be a statutory underwriter for purposes of Section 2(11) of the Securities Act of 1933, and Section 5 would require him to register those shares. However, there would be no warrant in applying the prohibitions of Rule 10b–6 to a specialist who purchases those shares in the course of his functioning as a specialist, even though he obviously purchases them for resale. Sales of these shares would be simply normal trading transactions to which, I submit, Rule 10b–6 is not intended to apply. The specialist would not be required to exert any special efforts to sell these shares, since the amount involved does not approach a quantity the market is unable to absorb through normal action and no countervailing sales effort is therefore needed to stimulate demand. Rule 10b–6 has never been applied to this situation, probably because it is recognized that to require the specialist to give up the book and withdraw his bid until he sold out his position in the registered stock would unduly and unnecessarily disrupt the operation of the exchange market. Yet Rule 153 under the 1933 Act recognizes the applicability of the prospectus delivery requirement for such exchange transactions.

Unnecessary disruption of trading markets is as undesirable over-the-counter as on the exchanges. Nevertheless, the majority here would *per se* require any market-maker who buys shares covered by a registration statement to withdraw from the sheets. Such an automatic application of 10b–6 to a market-maker who is independent of the seller can result in a form of discrimination between the over-the-counter and exchange markets. There has not been persuasive demonstration in this case that the market-maker participated in the kind of activity which would raise the spectre of manipulative dangers at which Rule 10b–6 is aimed.

The Commission has had occasion to determine the circumstances which constitute a distribution for purposes of 10b–6 in several prior cases. In *Gob Shopes*[4] the Commission, while not finding a Rule 10b–6 violation, indicated that a distribution for 10b–6 purposes hinges on the presence of a major selling effort by the broker-dealer. Later, in *Bruns, Nordeman*,[5] a case based on the same facts as *Gob Shops*, the Commission found a Rule

[4] 39 S.E.C. 92, 103 at fn. 25 (1959).

[5] 40 S.E.C. 652, (1961).

10b–6 violation by the broker-dealer and enunciated the test which must be met to reach that conclusion:

> "Rule 10b–6 is applicable to all distributions whether or not subject to registration under the Securities Act and whether or not the conventional procedure of utilizing an underwriter or selling group is employed. The term 'distribution' as used in Rule 10b–6 is to be interpreted in the light of the rule's purposes as covering offerings of such a nature or magnitude as to require restrictions upon open market purchases by participants in order to prevent manipulative practices. For these purposes a distribution is to be distinguished from ordinary trading transactions and other normal conduct of a securities business upon the basis of the magnitude of the offering and particularly upon the basis of the selling efforts and selling methods utilized." [6]

In subsequent cases the Commission reaffirmed its position that a concerted selling effort of an unusually large amount of securities constitutes the hallmark of a distribution for 10b–6 purposes.[7] None of the cases cited by the majority, save possibly one, reflects a departure from the *Bruns, Nordeman* test.

In *Hazel Bishop*,[8] for instance, the Commission issued a stop order for false and misleading statements in a pending registration statement covering a large secondary distribution at the market. The Commission there warned that any broker or person "acting for" any selling stockholder would be subject to the provisions of Rule 10b–6. There is no indication in *Hazel Bishop* that mere awareness or knowledge of a 1933 Act distribution, without more, is sufficient to make a market-maker purchasing and selling that stock for his own account a participant violating Rule 10b–6. There is no proof in this case that Horn or G Co. was "acting for" Lee or any of the selling stockholders.

In *Lum's*[9] the issue before the Commission was whether or not a temporary suspension of the Regulation A exemption from 1933 Act registration should be made permanent. The Regulation A offering included shares which a broker-dealer (Aetna, which was also a market-maker in Lum's stock) had acquired privately and certain shares owned by two principal officers of the company. After it had sold all its shares as principal, Aetna reentered the sheets with bid and asked quotations, while selling stock for and purchasing from the two

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[6] *Id.*, at 660.

[7] See *Sutro Bros. & Co.*, 41 S.E.C. 470 (1963); *Batten & Co., Inc.*, 41 S.E.C. 538 (1963); *A.T. Brod & Co.*, 41 S.E.C. 643 (1963); *Woods & Company, Inc.*, 41 S.E.C. 725 (1963).

[8] 40 S.E.C. 718, 736 (1961).

[9] 43 S.E.C. 223 (1966).

officers, first as agent and later as principal. Aetna distributed all the selling stockholders' shares; 82 percent of the total shares it purchased during the relevant period were from the selling stockholders. The Commission determined in that case, correctly I believe, that Aetna was participating in a distribution for or on behalf of the two officers and Rule 10b–6 was applicable to its market activities. In the instant case, however, there is insufficient proof that G Co. was intimately involved with the selling stockholders or their exclusive agent, or was in any way acting for them, or was behaving other than as an independent market-maker.

The decision of the Commission in *Goddard*[10] need not compel a different result. In that case the broker-dealer/maker dominated and controlled the market in the unregistered stock being distributed, and its market activities in that stock would not be found to be ordinary trading transactions. The Commission pinpointed two particular such distributions of control stock to which it said Rule 10b–6 was applicable, as well as two particular distributions of non-control stock specifically meeting the *Bruns, Nordeman* test. The cases relied upon[11] to support the statement in *Goddard* that public sales of control stock subject to 1933 Act registration fall within the meaning of the term "distribution" in Rule 10b–6, all involved aggressive sales effort, as in *Goddard,* to induce purchases of the respective securities. There is no evidence that G Co. engaged in that type of conduct in this case.[12]

Having discussed policy and precedent, I turn to proof in this case. A review of G Co.'s trading activities over the whole of the relevant period, from June 1963 to March 1964, does not reveal anything unusual. It purchased a total of 25,610 shares from Lee, less than 24 percent of the total shares registered. Its purchases were from time to time and not in large units disproportionate to the units it sold in trading. Its total purchases from Lee amounted to only about 26 percent of its

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[10] 42 S.E.C. 638 (1965).

[11] Cases cited in note 7 *supra.*

[12] The majority also cited, mistakenly I believe, *Oklahoma-Texas Trust,* 2 S.E.C. 764 (1937), and *Shearson, Hammill & Co.,* 42 S.E.C. 811 (1965), as authority for finding G Co. and Horn participants in a distribution for purposes of Rule 10b–6 (majority opinion at footnote 5). The portions of the decisions cited relate only to determinations that a 1933 Act public offering had not ceased, one for the purpose of deciding whether a stop order should issue, the other for the purpose of deciding whether the Regulation A $300,000 limitation had been exceeded. Application of Section 10(b) of the 1934 Act was not involved in any way in *Oklahoma-Texas.* It is true that in another portion of the *Shearson, Hammill* decision, a Rule 10b–6 violation was found. It was determined in that case, however, that partners and employees of the broker-dealer made extensive solitations of subscribers for the issue and purchased and resold shares of the issue as individuals, all at the time the firm was entering bids in the sheets and was the principal market-maker.

total purchases from all sources. G Co. was neither high nor even tied for high on over 65 percent of the days it submitted bids in the sheets. A total of 25 other firms were in the sheets, at least two for more than one-half the total trading days. G Co.'s largest long position was only 1,239 shares, while its largest short position totalled 6,632 shares. It engaged in no retail sales or in any retail sales effort, and there is no indication that its activities in the wholesale market were in any way out of the ordinary. Its trading mark-ups did not appear to be unreasonable and as the hearing examiner stated, "no pattern of manipulation by raising prices was found in the sales transactions." [13]

A closer examination of the record indicates that in one month, September 1963, G Co. purchased 20,160 shares from Lee, or 71 percent of its total purchases from Lee during the entire period. Those purchases represented about 48 percent of the shares sold by the selling stockholders during the entire period. In that month this represented 52 percent of G Co.'s total purchases from all broker-dealers. Of the 20,160 shares, 6,600 were purchased from Lee in three trades on September 12 and 9,500 were purchased in eight trades on September 18. G Co. was high bidder in the sheets on two days, by 1/8 on September 11 and by 1/4 on September 18, and tied for high on ten days out of the total of 20 trading days that month. Another firm was high bidder for five days in the month, and on six of the ten days when G Co. was tied for high, there were as many as three or more firms tied. The high bids that month moved between 9 5/8 and 13 3/4, beginning the month at 9 5/8 and ending at 12 1/2. There is no persuasive evidence on which to find that G Co. was even the principal market-maker that month or that it dominated the market in volume or price. G Co.'s sales about equalled its purchases in September and its inventory position remained throughout relatively low.

Even though this activity in September 1963 indicates a number of the registered shares were being traded by G Co., I can find no basis for finding that the stock was being absorbed by anything other than normal market action or that G Co. was acting in any way other than as an independent market maker responding to supply and demand in an unmanipulated market.[14] Certainly there is no evidence that a sales effort was

[13] Initial Decision, at p. 22.

[14] As the majority points out, the only evidence in the case of a possible arrangement between Horn and Jaffee relating to trading in Solitron stock, was admitted only as against Jaffee, and cannot be used against Horn or G Co. The existance of a direct wire between G Co. and J Co. is not sufficiently probative.

undertaken or participated in by G Co. to convey these shares to purchasers. Thus, on this record, I am unable to conclude that a sufficient showing has been made that G Co. and Horn engaged in the kind of activity which would support a finding they were participants in a distribution for purposes of Rule 10b–6. Since that proof is insufficient, I cannot find violations of Rule 10b–6 in this case by Lee.