ADMINISTRATIVE PROCEEDING
FILE NO. 3-6180

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

KEITH E. WENTZ :
RONALD P. BYNUM :

INITIAL DECISION
ON REMAND

Washington, D.C.
May 15, 1984

Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: Bobby C. Lawyer, Steven N. Machtinger, Susan Jacobsen and Julie K. Lutz, of the Commission's San Francisco Branch Office, for the Division of Enforcement.

Vincent O'Gara, of Skjerven, Morrill, MacPherson & Drucker, for Keith E. Wentz.

Kenneth M. Christison, for Ronald P. Bynum.

BEFORE: Max O. Regensteiner, Administrative Law Judge.

On May 25, 1983, I issued an initial decision in this proceeding. In it, I found that Keith E. Wentz and Ronald P. Bynum, who were associated with a registered broker-dealer ("registrant"), willfully violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder by, among other things, purchasing stock of Gulf Energy Corporation ("Gulf") for themselves and others while in possession of material non-public information. According to the decision, Bynum had obtained that information, which concerned favorable test results from a Gulf exploratory oil well, from Emmet Shultz, the company's president, and shared it with Wentz. I also found that Wentz and Bynum committed additional violations of the above and other antifraud provisions.[1/] I concluded that Wentz should be suspended from association with any broker or dealer for 100 days, and that Bynum should be suspended from any such association for 75 days.

Bynum filed a petition for review of the initial decision, together with a motion to adduce additional evidence concerning Shultz's whereabouts on March 21, 1980, the day on which he had been found to have conveyed the inside information to Bynum. Wentz did not seek review of the initial decision. Accordingly, a notice was issued making the decision final as to him.[2/]

1/ Certain other allegations were dismissed.

2/ Securities Exchange Act Release No. 19931 (June 30, 1983), 28 SEC Docket 321.

On July 1, 1983, the day after that notice was issued, the Supreme Court issued its opinion in Dirks v. S.E.C.,[3/] setting forth new standards governing the liability of tippees who trade on the basis of material non-public information received from a corporate insider. Under the circumstances, the Commission deemed it appropriate to grant Bynum's petition for review, to vacate the notice of finality issued with respect to Wentz, and to remand the proceedings to me for further action in light of the Dirks decision. It directed me to conduct whatever additional proceedings I deemed necessary, including the holding of further hearings, with respect to the issue of whether, under the standards announced in Dirks, respondents violated antifraud provisions by purchasing securities on the basis of inside information. The Commission also referred to me Bynum's motion to adduce additional evidence.

The Commission directed that upon completion of the proceedings on remand, I file a supplemental initial decision setting forth my conclusions on the issue remanded, and assessing the effect of my determinations on the sanctions previously imposed.

At Wentz's request, I scheduled further hearings on the remanded issue, and I granted Bynum's request for leave to adduce additional evidence. The parties

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3/ 103 S. Ct. 3255 (1983).

subsequently determined, however, that in lieu of a supplemental hearing, they would enter into a stipulation. They submitted, and I made part of the record, a stipulation setting forth certain very limited testimony which Shultz and other persons would give if called to testify and providing for the admission of a further Division exhibit. The testimony pertained to Shultz's whereabouts on the critical day and to certain telephone numbers; the exhibit consisted essentially of telephone company records showing toll calls billed to Gulf's main office in Salt Lake City for the period including March 21, 1980. 4/ Thereafter the parties filed supplemental proposed findings and/or briefs or memoranda.

In order to simplify matters, this initial decision on remand covers all the issues raised by the order for proceedings, not only those remanded, and thus supersedes the earlier decision. On the issues that were not remanded, there is of course no change from the earlier decision. Thus, the following sections of that decision are carried over into this one unchanged: "Respondents," "Gulf," "Misleading Research Report (Wentz)," "Price Increase Prediction (Bynum)" and "Undisclosed Below-Market Purchases."

As previously indicated, the order for proceedings included several allegations in addition to the insider

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4/ Pursuant to the Division's request, and without objection, I also received in evidence as a further Division exhibit certain additional pages of Wentz's investigative testimony.

trading charge. Thus, the Division of Enforcement alleged that, in violation of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, (1) Wentz prepared and distributed a research report on Gulf which was materially false and misleading; (2) Bynum made specific price increase predictions with respect to Gulf stock; and (3) both respondents bought Gulf stock for their own accounts at below-market prices without disclosing that fact to customers whose orders they solicited and whose market orders were pending. Wentz was also charged with failing reasonably to supervise Bynum with a view to preventing the latter's alleged violation arising out of the below-market purchases. 5/

Following the original hearings, the parties had filed proposed findings and conclusions and briefs. The findings and conclusions herein are based on the preponderance of the evidence as determined from the record, as supplemented, and upon observation of the witnesses.

5/ The allegation pertaining to supervisory failure was not limited to that alleged violation, but the Division sought an adverse finding only in that respect.

Respondents

Wentz, who has a master's degree in economics, entered the securities business in about 1954 following three years as security analyst for a bank. His career has been devoted principally to the security analysis and research areas, and it includes extensive experience in analysis of oil and gas companies. In 1968, he became a chartered financial analyst. In 1970, Wentz became associated with registrant as a senior vice-president, director of research and one of four shareholders. In addition, he was a salesman. He continued in those capacities until after the period here under consideration. During that period, registrant had approximately 30 employees, including about 18 salesmen. Its primary business was the sale of municipal bonds. Only four or five of the salesmen, including Wentz and Bynum, sold equity securities to any substantial extent. And Wentz constituted the firm's research department.

Bynum, who has a total of about 15 to 16 years experience in the securities business, was employed by registrant as a salesman for 2-1/2 to 3 years.

Gulf

Gulf is an oil and gas exploration and coal mining company with headquarters in Salt Lake City. During the relevant period, it financed its operations primarily

through the formation of limited partnerships in which the limited partners contributed the required capital and Gulf retained varying interests. Gulf operated only a few oil or gas wells directly. The operator of the wells here under consideration was Diamond Shamrock Corporation ("Shamrock"). For its fiscal year ended April 30, 1979, Gulf's consolidated revenues, comprising revenues from "turnkey" drilling contracts, fees received for organizing and managing partnerships and earned interest in partnership revenues, were about $2 million. Net earnings were $4,700. Corresponding figures for fiscal year 1980 were $3.1 million and $140,000. Gulf's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of April 30, 1980, there were 26.4 million shares outstanding. At relevant times, Shultz was Gulf's president and board chairman as well as its largest stockholder.

Trading on Inside Information

The Division alleged that on the morning of March 21, 1980, Bynum learned from Gulf of favorable test results just obtained from an exploratory oil well in which Gulf had an interest, and that he knew or reasonably should have known this information was non-public. It further alleged that he promptly passed the information

on to other employees of registrant, including Wentz, who also knew or reasonably should have known it was non-public; that on the same day and the next business day, before Gulf publicly announced the good news, Bynum and Wentz each purchased sizeable blocks of Gulf stock for their own accounts; and that Wentz authorized and caused the purchase of additional Gulf stock for registrant's inventory account. The Division alleged that in connection with these purchases, no public disclosure of the inside information was made by registrant, Wentz or Bynum. Respondents vigorously deny that they received any inside information.

In my original decision, I concluded that while there were some gaps and weaknesses in the record with reference to a chain of information leading from the well-site geologist to Bynum and Wentz by way of Shultz, the combination of circumstances made it probable or more likely than not that Shultz received the information concerning the test results on the morning of March 21 and passed it on to Bynum. Among those circumstances were the facts that on the morning of March 21 a call was made from the telephone number at registrant assigned to Bynum to Gulf's headquarters office in Salt Lake City and that this call was followed by significant buying activity by Bynum and Wentz that day and on March 24, the next business day.

As further discussed below, the supplementary evidence removes the factual underpinning from one of the subsidiary

findings underlying my earlier conclusion, namely, that it was Shultz to whom Bynum spoke in the above-mentioned call. Thus, before even reaching the Dirks issue, it must be determined whether the record as it now stands leads to a different conclusion on the question of whether Bynum and Wentz in fact had non-public information at the time of their transactions in Gulf stock.

1. Did Bynum and Wentz Receive Inside Information?

The well in question, known as the McMillen well, was situated within a large acreage block in Nebraska, in the oil and gas leases on which Gulf, directly and indirectly, had a 25 percent interest. Shamrock was in charge of drilling the well, which was in a geological area known as the Denver Julesberg basin. According to a special shareholders' report issued by Gulf on January 30, 1980 featuring the McMillen well, drilling of that well was about to begin, on an "excellent seismic structure" (Div. Ex. 64). The well was to be drilled to a depth of 8,300 feet. The report stated that this would make it the first well in the area to be drilled below the "D" and "J" sands. 6/ It further noted that, while a few other wells had been drilled to the same depth 20 or more miles away and had encountered oil and gas in less than commercial quantities, this would be the first

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6/ The "D" and "J" sands are in the cretaceous rock area. The deeper, pre-cretaceous rocks are of far older origin.

well drilled to this depth based on seismic evaluation. The report further stated that this test well, if successful, would be very important to Gulf because of the large acreage involved.

It appears that drilling of the McMillen well actually began at the end of February. Kathleen Cox, who was then employed by Shamrock as a senior geologist, [7] had supervisory responsibilities with respect to the McMillen well and other wells. She received written drilling reports in her Denver office on a daily basis, and she communicated orally with the well-site geologists. It was also part of her responsibility to notify "partners" of "any activity" (Tr. Dec. 14, p. 109). [8] In the case of the McMillen well, Shamrock's partner was Gulf, and Cox's only contact person there was Shultz. She spoke to him on a periodic basis, regarding matters of a non-routine nature.

At about 2 or 3 in the morning of March 21, Cox received a call from the geologist at the site of the McMillen well with the news that a "drill stem test" had recovered 550 feet of oil, in one of the deeper formations.

7/ In August 1980, Cox moved to Gulf as vice-president for exploration.

8/ Unfortunately, the transcript pagination begins with page 1 for each of the hearing days, December 14-17, 1982. Hence, transcript references cite date as well as page.

As explained by Cox, a drill stem test is "an attempt to isolate a particular formation or interval down hole and open up a tool and receive what fluids are in that formation" (Tr. Dec. 14, p. 112). Cox testified that she was excited about the test results, because this was the first "real encouragement" they had gotten on this well (Id., p. 116). She further testified that she considered the results significant because until that time there was no production at that depth in this portion of the Denver basin, and the McMillen well recovered "more oil on a drill stem test than any other well up until [that] time" (Id., p. 119).

Although details had faded from her memory by the time of the hearing, it is clear from Cox's testimony, which I credit, that she spoke to Shultz on March 21 and gave him the results of the test, and that he appeared to be pleased. Cox recalled that she had telephoned Shultz at Gulf's headquarters office in Salt Lake City in the morning, but could not recall the time more specifically. She also could not recall whether she had been able to reach Shultz at that time; if she had not reached him, whether she would have tried to call him again or had him call her back; the time of day when she did speak to him; or whether or not he was in Salt Lake City when she spoke to him. Cox could not recall how much information she gave to Shultz, who is not a geologist, or the degree of enthusiasm with which she made her comments.

Shultz was not called as a witness at the original hearings, and there was no direct evidence as to his whereabouts on March 21 or regarding any conversation between him and Bynum that day. The newly admitted evidence establishes that he was not in Salt Lake City on March 21, but in Man, West Virginia, and that during at least portions of that day, he was in Gulf's office there. In addition, newly admitted records of toll calls charged to Gulf's Salt Lake City office, and calls charged to registrant as reflected in a previously admitted exhibit, show the following calls being made on March 21, which could relate to communication between Shultz and respondents:

Time 9/ (Mountain Time)	From	To	Duration (Minutes)
8:49 A.M.	Gulf (SLC)	Gulf (Man)	1
8:55 A.M.	Gulf (SLC)	Registrant (Main #)	1
10:33 A.M.	Registrant (Bynum's #)	Gulf (SLC)	3
11:10 A.M.	Gulf (SLC)	Registrant (Main #)	4
11:20 A.M.	Registrant (Main #)	Gulf (Man)	1
12:39 P.M.	Gulf (SLC)	Gulf (Man)	19
5:04 P.M.	Gulf (SLC)	Registrant (Main #)	2

9/ Mountain Time applies in Salt Lake City. Registrant and respondents were in San Francisco, which is of course on Pacific Time, one hour behind Mountain Time. Man, West Virginia, where Shultz was on March 21, is on Eastern Time, two hours ahead of Mountain Time.

Bynum acknowledged that during the first half of 1980 he was in contact with Shultz from time to time, both by telephone and in person. He generally shared with Wentz and Borzoni, another of registrant's salesmen, whatever information he obtained. In several transactions in February 1980, at prices ranging from 1 to 1-1/2, Bynum had bought a total of 15,000 shares of Gulf stock. Wentz had accumulated 60,000 shares for his account in January and February 1980, at prices ranging from $.64 to $.75 per share. Beginning shortly after 11:30 A.M. Pacific Time on March 21, Bynum bought 10,000 shares of Gulf stock for his own account at 1 3/8, for a total price of $13,803, and two of his customers bought a total of 4,000 shares. During the same period, a Wentz customer bought 2,000 shares, as did a Borzoni customer. Also on March 21, Wentz authorized the purchase by registrant's inventory account of 27,000 shares. 10/

March 21 was a Friday. In the morning of March 24, the next business day, another call was made from Bynum's number to Gulf's office, this one charged for two minutes.

10/ As further described below (see p. 43, infra), the inventory account was used to finance purchases by Wentz and the salesmen of securities which they expected to retail promptly. Registrant shared in the profits; the risk of loss was on the individual employee. Wentz had resposibility for the account with reference to equity securities. The record indicates that it was he who caused 20,000 of the above shares to be purchased by the inventory account, since he bought those shares from that account on March 24. It further indicates that Bynum was responsible for the purchase of the other 7,000 shares, since these were sold to a customer of his on March 24.

Both before and after that call, there was substantial buying activity at registrant's office. Bynum bought 15,000 more shares for his own account at 1-5/8, for a total cost of $24,428. Customers of his bought 18,000 shares. Wentz bought from the inventory account, at 1-7/16 per share, 20,000 of the shares placed in the account on March 21, for a total cost of $28,750. He also authorized 4,000 more shares to be bought for the inventory account. A customer of his bought 6,000 shares. Borzoni bought 1,000 shares for his own account, and his customers bought 4,000 shares. Customers of Bynum, Wentz and Borzoni and the inventory account also bought Gulf stock on March 25. The Division relied on the testimony of one of those customers, Mr. K., in support of its position.

On March 26, 1980, Gulf issued a press release under the heading "Gulf Energy Corporation Announces Potential Discovery" (Div. Ex. 36). The release stated that the McMillen well had encountered "oil shows" in the "J" and "Wolfcamp" formations (the latter being one of the deeper formations); that drill stem tests had recovered significant amounts of oil in the lower Wolfcamp; that drilling was continuing and a thorough evaluation of the well would be made after reaching total depth of about 8,300 feet; and that completion attempts were expected to be made in both the "J" and Wolfcamp formations.

As noted, Shultz was not called as a witness. Bynum

testified that he could not recall whether he spoke to Shultz on March 21. He was not asked about March 24. He denied that Shultz ever told him about the results of the drill stem test and testified that he only became aware of them later, through some written material. Bynum further testified that when he made his purchases on March 21 and 24, he was aware of new information about Gulf that had recently become public, namely, that Gulf had qualified to have its stock listed on the NASDAQ system. He testified that this meant to him that Gulf's "skyrocketing" earnings would be appearing in the Wall Street Journal and the company would be getting more exposure (Tr. Dec. 17, p. 61). 11/ During the Division's investigation, however, Bynum had testified that the reason for his purchases was that he felt this was a good growth opportunity, and that he could not recall any special event causing him to effect those purchases. Wentz testified that during the period March 21-25 he had no telephone calls with Shultz, had no knowledge regarding drill stem test results on the McMillen well and did not learn of such results from Bynum. In his investigative

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11/ On March 17, Gulf had issued a press release captioned "Gulf Energy Has Record Nine Months And Applies For NASDAQ Listing" (Div. Ex. 36). In the body of the release, it was reported, among other things, that net income for the nine months ended January 31 was $171,000, compared to $69,000 for the same period a year earlier, and that revenue for the nine months was a record $2.3 million, as against $1.5 million the year before.

testimony, Wentz stated that he could not recall the reason for his 20,000-share purchase on March 24; that he had heard from Shultz, from the time the McMillen well commenced, that it "looked good," but had not heard or discussed anything about drill stem tests; and that he bought the shares primarily because it was known that the well would be completed in two or three weeks and was "looking good" (Div. Ex. 7, pp. 18-20).

The record includes the testimony of two customers who bought Gulf stock during the March 21-25 period, both through Bynum. 12/ Mr. K. bought 4,000 shares on March 25. He testified that Bynum told him that Gulf was drilling one of the deepest wells in the country and that the stock could go "way up" if the well "hit" (Tr. Dec. 15, p. 148). Mr. K. further testified, in essence, that Bynum said results at the bottom of the well were disappointing but that Gulf was hopeful of hitting oil or gas at higher levels. Mr. K. acknowledged, however, that during the Division's investigation he had signed a "declaration" whose content was essentially correct. According to that declaration, Bynum told him it looked like the well was going to be a wildcat strike; Bynum sounded confident

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12/ Contrary to wentz's contention, the record does not show that Mr. F., another of Bynum's customers, bought Gulf stock during that period. Division Exhibit 80, cited by him for that proposition, was not offered in evidence.

when he said it looked like Gulf had hit a well; Bynum said they had drilled the well too deep and hopefully there would be oil and gas in the higher zones; and Bynum further said that as a result of the wildcat there was a chance the price of the stock would go way up and that Gulf hopefully would hit oil and gas at each zone of the well. On cross-examination, Mr. K. stated that Bynum had not given statistics regarding any test results.

Mr. O. bought 1,000 shares on March 24. But his testimony, other than a few generalities, dealt with conversations with Bynum on unspecified dates between the time of that purchase and a second purchase of Gulf stock in April.

As noted, I commented in my earlier decision that there were certain gaps and weaknesses in the record with reference to the passage of the inside information. Thus, there was no direct evidence that Cox's conversation with Shultz on March 21 took place before 10:33 A.M. Mountain Time, the time of the call from Bynum to Gulf, which on the basis of the original record appeared to be the link between Shultz and Bynum; that, if she did speak to him before that time, Shultz was at Salt Lake City headquarters; that Bynum spoke to Shultz on March 21 or March 24; or that, if he did, Shultz gave him the information concerning the drill stem test. I further stated that I did not discount lightly respondents' explicit denials

that they received and acted upon the drill stem test information.[13] Nevertheless, I concluded that the combination of circumstances made it more likely than not that the scenario posited by the Division reflected the actual events. My reasoning was as follows: Shultz was Bynum's contact person at Gulf. In view of that fact and the apparent length of the calls, it was probable that it was Shultz to whom Bynum spoke on March 21 and 24. It was also probable that Shultz had the drill stem results by the time of the March 21, 10:33 A.M. (MT), conversation,[14] and that he and Bynum discussed the McMillen well, the most significant item in the then current Gulf situation. The most compelling evidence in support of the Division's allegation was the volume of purchases at registrant's office in the course of the three business days between March 21 and 25, for which the record did not provide another reasonable explanation.

13/ However, I could not agree with Bynum that the Division's failure to call Shultz as a witness gave rise to the inference that his testimony would have been unfavorable to its case. Because of his potential culpability as a "tipper" of inside information, Shultz would have had a motive to deny passing such information to Bynum.

14/ It was not at all clear that, as Wentz argued, the time of Shultz's conversation with Cox could have been established by Gulf or Shamrock telephone records. Therefore I could not agree that the Division's failure to produce those records warranted an inference that the conversation did not take place until after the March 21 call from Bynum's number to Gulf.

The Division contends that the fact that Shultz was in West Virginia on March 21, rather than in Salt Lake City, should not alter the earlier conclusion, given the telephone contacts now indicated by the record. Bynum urges that the "key assumption" underlying the earlier decision, namely, that Shultz was in Salt Lake City on March 21 and that Bynum spoke with him prior to the "flurry" of trading activity had been "destroyed" by the supplemental evidence. He asserts that there is nothing in the record to indicate that Shultz, even if he received the information in question on March 21, could have relayed it to Bynum before the trading "flurry." Wentz argues that, to an even greater extent than previously, the Division's scenario rests on "mere conjecture and speculation."

Undoubtedly, the new evidence raises some additional questions regarding the "information chain." Yet the two most critical elements -- the communication of the test result information from Cox to Shultz on March 21 and the extraordinary buying activity in Gulf stock by Bynum and Wentz beginning that day -- are not affected by that evidence. Consequently, the preponderance of the evidence still supports the Division's position. Contrary to

respondents' intimations, the record is clear that, as I found originally, Shultz received the drill stem test information from Cox on March 21. Moreover, while it is now clear that Cox did not reach Shultz in her initial call in the morning, considering the importance of the test to Gulf it is probable either that she reached Shultz in Man soon thereafter or that he promptly got word of her call from his home office and then returned the call. The sequence of telephone calls as set forth above provided ample opportunity for respondents to get the information from Shultz, either directly or through Salt Lake City, before the trading activity commenced. The list does not even include calls which Shultz could have made from the Man office, as to which the record contains no information one way or the other. As before, the most compelling evidence that respondents had the inside information remains the otherwise unexplained volume of purchases of Gulf stock at registrant's office between March 21 and 25. 15/

15/ Respondents have sought to reargue this point, claiming that other explanations for their and their customers' transactions do in fact exist. However, the reason for the purchases was not a matter that was encompassed within the Commission's remand, nor was any additional evidence offered concerning it. In any event, I would not change my earlier finding even if it were open to me to do so.

Bynum's own purchases represented an investment of over $38,000. His 15,000-share purchase on March 24 represented his largest single investment in any security during the entire year 1980. And, as the Division points out, he increased his position in Gulf stock by 167 percent. The explanation which Bynum offered at the hearing, relating to NASDAQ listing, is not convincing. It appears that Gulf stock began trading on the NASDAQ system on March 21. However, Gulf had already announced in a March 17 press release that it had applied for such listing. Moreover, as indicated, the NASDAQ explanation is not consistent with Bynum's investigative testimony given much closer to the events in question, when he stated that he could recall no special event causing him to make the purchases. 16/

Wentz argues that the pattern of trading in his account suggests nothing more than the usual activities of a broker who is recommending a security for purchase by his customers, and that the trading pattern in registrant's inventory account did not differ from that before and after the period under consideration. However, Wentz's 20,000-share purchase on March 24 was far from "an ordinary purchase,"

16/ This and other investigative testimony by Bynum was received in evidence as his admissions. It is not evidence as against Wentz and has not been considered in making findings in Wentz's case. The converse is of course true with respect to Wentz's investigative testimony.

as he would have me find. In fact, it was by far his biggest single investment in Gulf stock during 1980. And it should be noted that realistically, this purchase was made on March 21 and was simply financed by registrant through the inventory account until the following business day.

Mr. K.'s testimony is somewhat equivocal. However, the statements he attributed to Bynum to the effect that it looked like Gulf had hit a well and the well was going to be a wildcat strike are consistent with the Division's scenario. It is not significant, in this connection, that Mr. K. was not given statistical data concerning test results.

2. Materiality of Inside Information

In order to find a violation of Section 10(b) and Rule 10b-5 for trading on inside information, it must be found that the inside information was of a material nature. The basic test of materiality is that set forth by the Supreme Court in TSC Industries, Inc. v. Northway, Inc.: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to [act]. . ." [17/] Under that standard, the

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17/ 426 U.S. 438, 449 (1976). The issue in that case was the adequacy of a proxy statement. But the standard has been applied in other contexts where materiality was an issue.

results of the drill stem test were material information.

As noted, Cox testified that she considered the recovery of 550 feet of oil in the drill stem test to be significant because there was no production at that depth in the Denver basin previously and the amount of oil recovered was more than in any previous well. Cox further testified that the significance of the test was that, because the particular rock formation had not been productive before, the test "opened up hundreds of cubic miles of additional potential reservoir rocks in that area" (Tr. Dec. 14, p. 157). She testified that she felt they "probably had a well," although she did not know how good it would be. (Id. at 158). Cox acknowledged that it was not possible, based only on drill stem test information, to determine whether the well would be a producer or the potential amount of production.

The record also includes testimony by Paul Roberts, a petroleum engineer, who is director of the Nebraska Oil and Gas Conservation Commission. On direct examination, he testified that, considering the location of the McMillen well, its depth and the approximate pressures, the drill stem test recovering 550 feet of oil was significant -- "it would indicate a successful or commercial well" (Tr. Dec. 14, p. 73). On cross-examination, Roberts stated that a drill stem test was only one of several tools in making the determination whether to complete a well. He went on

to testify that the fact that a drill stem test recovered 550 feet of oil was not by itself a significant fact. One would have to know other factors, such as whether anything else, such as water, was recovered with it, how long the test was open, and what the pressures were. Roberts stated that he considered the McMillen well significant because it was the first production of oil in that portion of the Denver basin below the cretaceous level.

While it is true, as Wentz points out, that the drill stem test alone did not establish even the existence of one commercial well, it did indicate the presence of oil at a level not previously productive and in an area in which Gulf was a participant in leases on vast acreage. Both the Division and Wentz claim to find support for their arguments on the materiality question in the leading decision in S.E.C. v. Texas Gulf Sulphur Co.[18/] That case involved the materiality of results of a single drill core taken from an exploratory hole drilled into a base metal deposit. It would appear that the drill core, which the Court characterized as "remarkable" and "unusually good,"[19/] was more significant than the drill stem test results here. Nevertheless, those results were of a very favorable nature. And the potential for significant discoveries was great in both cases. As the Texas Gulf

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18/ 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied 394 U.S. 976 (1969).

19/ Id. at 843-4.

court pointed out, the materiality of facts relating to a particular event depends on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.[20] Or, as stated in the recent First Circuit decision in S.E.C. v. MacDonald,[21] the materiality of facts regarding a contingent future event is simply a function of the anticipated magnitude of the event if it occurs, discounted by the probability of its occurring. Here, I agree with the Division that for a small company such as Gulf the substantially enhanced prospects of finding large quantities of oil at a previously untapped level would be of extreme interest to a potential investor.

I cannot agree with Wentz that a lack of materiality can be inferred from an "apparent lack of enthusiasm" by the "persons involved" (Wentz Brief, p. 14), i.e., Cox and Shultz. On the contrary, Cox "got excited" upon hearing about the drill stem test from the well-site geologist (Tr. Dec. 14, p. 116). The fact that she did not immediately pass on the news to Shultz is not significant -- it would have taken a great deal of nerve for Cox to call Shultz in the middle of the night. Wentz's assertion that Cox did not call Shultz immediately when she arrived at her office is not supported by the record. On the page cited by Wentz,

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20/ Id. at 849.

21/ CCH Fed. Sec. L. Rep. §99,078 (Feb. 1, 1983).

she testified that she could not recall whether she called him immediately. The record also fails to support Wentz's assertion that Shultz reacted to the information with equanimity. Cox simply testified that Shultz was not a particularly effervescent person and had "the type of demeanor that you're not always boisterous around him. . ." (Tr. Dec. 14, p. 157).

The purchases by Bynum and Wentz for themselves and others following receipt of the inside information constituted "highly pertinent evidence and the only truly objective evidence" of the materiality of that information.[22-23/] Finally, the March 26 Gulf press release indicates that the company itself attached considerable significance to the results of the drill stem tests.

3. Respondents' "Liability" In Light of Dirks.

In my original decision, I began the discussion of the insider trading issue by outlining what then appeared to be the governing principles: (1) a corporate insider who trades in the securities of his company on the basis of material nonpublic information without first disclosing such information violates Rule 10b-5; and (2) "tippees" of an insider who themselves trade are also violators, provided they know the information is nonpublic and know or should know it came from an insider.

22-23/ S.E.C. v. Texas Gulf Sulphur Co., supra, at 851.

In Dirks, the Supreme Court declined to go along with the second of those propositions, which the Commission had followed in its Dirks decision and had urged the Court to adopt. Rather, the Court adopted the following analysis of tippee liability: The mere receipt of nonpublic information, even from an insider, does not give rise to a duty to disclose or abstain; only a specific relationship does that. The fact that the information came from an insider does not of itself create a special relationship between the tippee and the corporation's shareholders such as exists between the insider and the shareholders. The key to the existence of a tippee duty lies in the insider's "purpose." The insider, not being permitted to use inside information for his own advantage, may not give it to an outsider for the same improper purpose of exploiting the information for his personal gain. A tippee assumes a fiduciary duty to the corporation's shareholders to disclose or abstain only when the insider has breached his fiduciary duty by disclosing the inside information to the tippee, and the tippee knows or should know there has been a breach.

The Court went on to discuss the circumstances under which an insider's tip constitutes a breach of his fiduciary duty. It held that this depends in large part on the purpose of the disclosure. The test is whether the insider receives a direct or indirect personal benefit from his

disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. Objective circumstances often justify such an inference. For example, said the Court, there may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.

The Division urges that the instant record reflects the additional elements necessary under Dirks to establish Rule 10b-5 violations by Bynum and Wentz. It contends that Shultz divulged the inside information to obtain a personal benefit. Specifically, it argues, Shultz, who was Gulf's largest stockholder, gave the tip to the respondents, with whom he already had an established relationship, in the expectation that they would promote Gulf stock and thereby boost its price. This they in fact proceeded to do by means of their own purchases, their customers' purchases and Wentz's research reports on Gulf issued in September and November 1980, which Shultz himself used as a promotional tool. As a result of all the promotional efforts, Shultz was able to sell his Gulf holdings at peak prices beginning in September 1980.

While I concur with the Division's view that a purpose

such as it describes would meet that part of the Dirks standards dealing with the insider's breach of duty, the Division is seeking to stretch the record, as it has now been supplemented, too far. The circumstantial evidence, while sufficient for the finding that Bynum and Wentz received the inside information on March 21 from Shultz, directly or indirectly, does not indicate by whom or under what circumstances that information was actually conveyed. With the record in that posture, to make a finding as to any "purpose" or "expectation" on the part of Shultz would be to indulge in conjecture.

Consequently, the insider trading charges must be dismissed.

Misleading Research Report (Wentz)

In early September 1980, a research report on Gulf was published under registrant's name. The report was prepared by Wentz and was signed by him, with the titles "C.F.A. [chartered financial analyst], Senior vice president, INVESTMENT RESEARCH DEPARTMENT." Wentz had 15,000 copies printed. Of these, about 1,000 were distributed to customers and prospective customers of registrant and the other 14,000 through Shultz. When the latter asked for additional copies in November 1980, 8,000 more were printed, with the only changes made being the date and the current share price. Of these, registrant retained 500-1000 copies for distribution.

The Division alleges that the report was materially false and misleading with reference to the following matters:

1. The extent of oil production from the McMillen well and from the related Christensen and Deaver wells, and the prospects for future production in the area where those wells were located;

2. The failure to disclose the role of Gulf's management in the preparation of the report;

3. The failure to disclose Gulf's payment of the cost of publishing the report; and

4. The failure to disclose Wentz's personal liability on registrant's inventory of Gulf stock. 24/

1. Oil Production

The tone of the report was set in its opening paragraph, entitled "Summary and Conclusion" (Div. Exs. 12, 13). There Gulf was described as a "highly successful" oil, gas and coal company. The report went on:

> With revenues and reserves of oil and gas rising dramatically due to several new and important discoveries, one of which has been described as the most significant discovery of oil in the Denver basin in 3 decades, we believe the common stock at its present price represents one of todays (sic) truly undervalued equities and strongly recommend purchase to investors interested in near to intermediate term capital gains.

24/ The Division would also have me find that the report was misleading in its discussion of the value of Gulf's assets and sales of stock by Gulf's insiders. However, those matters are not encompassed within the allegations in the order for proceedings; therefore they cannot be the subject of adverse findings.

In the section of the report dealing with oil, it was stated in part that Gulf held large acreage leases which appeared to be very valuable due to a recent discovery in Nebraska. Specifically, the report pointed out, Gulf had a 25 percent interest in some 55,000 acres in Cheyenne County, Nebraska, surrounding the McMillen wildcat well "recently completed at a depth of 7,300 feet with an initial flow of over 100 barrels a day of high gravity crude." The report went on to state that the Christensen, an "offset" well, drilled one mile from the McMillen, was also a success and flowed at over 100 barrels a day at 7,700 feet, and that the Deaver, another offset well one mile in the opposite direction, was being drilled and would be completed in three to four weeks. According to the report, these wells, which "have the first" production from this formation in the Denver basin, were very important.

The report further stated that "oil industry observers" who had closely watched the Shamrock and Gulf activity in this area explained that

> the oil being produced from the McMillen hole taps the Pre-Cretaceous formation, which is deeper and usually has a much longer production life than the Cretaceous structures which have been producing in the Panhandle since 1949. Extensive seismic studies have been made by Gulf Energy and Diamond Shamrock in this area and it appears that much of the 55,000 acres could be productive. With 40 acre spacing this field alone could provide a vast reservoir of several hundred production wells.

In writing this section of the report, Wentz relied primarily on Gulf press releases, articles in newspapers, periodicals and trade journals and information furnished by Shultz. He also had in his files various other material concerning Gulf, including Gulf's annual and other reports to shareholders and its Form 10-K reports filed with the Commission. And he discussed Gulf's situation with persons associated with Shamrock and possibly with others. Some of the statements noted or quoted above and others interspersed among them were taken verbatim or almost so from a Gulf press release and from articles in a trade publication and a newspaper published in a town near the drilling area.[25/]

The Division challenges as inaccurate various statements in the report. While disputing that characterization

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25/ The Division is critical of the use of this material without attribution. That practice has not in itself been alleged as a deficiency of the report, and there is no occasion for me to comment on it. It may not be amiss, however, to note the sloppiness with which this material was inserted in the report and the resultant confusing presentation. For example, after referring to the completed McMillen well, the report quoted almost verbatim two paragraphs of an April 1980 article in the Oil & Gas Journal, which referrred to the already obsolete drill stem test reports from that well. A second example: an excerpt from the newspaper article cited a statement by officials of the Nebraska oil regulatory agency that a certain development was "extremely important to the future of oil production in western Nebraska." The news to which the article referred was the possible success of the Christensen well as an offset to the McMillen well. In the report, on the other hand, the development on which the state official purportedly commented was entirely different.

in certain respects, Wentz argues principally that he made a reasonable investigation of the matters covered in the report and therefore had a reasonable basis for his statements and for his overall recommendation.

With respect to the report's statements concerning the McMillen well, the Division urges that the references to a "recently" completed well, to a "flow" of oil, and to "high gravity crude" were all inaccurate or misleading. It points out that the well had been completed in April 1980 and thus was not "recently" completed as of September and a fortiori not as of November. Cox and Roberts both testified that the term "flow" means that a well is flowing without the need for or use of a pump, which was not the case with the McMillen well. The record is not clear as to whether the oil extracted from the McMillen well was high gravity oil, which is more valuable than low gravity oil. The principal deficiency asserted by the Division, however, is that it was materially misleading for the report to refer to an "initial flow of over 100 barrels a day." The Division does not dispute that the McMillen well's initial production was of that order of magnitude. It asserts, however, that production of an oil well almost invariably declines from initial levels; that Wentz, an experienced oil company analyst, was awere of this general principle and was also aware that production from the McMillen well was declining; that Wentz could have obtained information from Shultz concerning actual

production at the time he prepared the research report; and that he also could have obtained production information from reports filed with the Nebraska regulatory agency. Wentz, on the other hand, contends that there was no representation in the report concerning current production; that the reference to initial production was merely an indication that the McMillen was a successful producing well rather than a dry hole; and that, even if a reader inferred that the statement in the report pertained to current production, the record does not show what such production actually was.

The sentence under consideration, by referring to recent completion and initial flow, conveyed the impression that the McMillen well was still in the stage of initial production. As noted above, it was inaccurate in that respect. Further, it was misleading in failing to disclose, if that was the fact, that as of the date of the report production had already declined to a substantially lower level, or at the least that current production was unknown but in the normal course of events would have declined from the initial level. 26/

The evidence shows that the production of the McMillen well at the time the reports were issued had

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26/ The disclosure in the report may be contrasted with that in a March 1981 Special Report to Shareholders, in which Gulf referred to an "initial pump rate" of 115 barrels per day and a current production of about 30 barrels per day (Div. Ex. 83).

declined below initial production levels, but not by how much. Cox testified that as of September 1980 the well was not producing as much as 100 barrels per day. Monthly production reports filed by Shamrock, the well operator, with the Nebraska agency showed that beginning with June 1980 production steadily declined to an average of less than 50 barrels a day by August. It is true, however, that these reports did not indicate the number of days the well was actually in operation, so that daily production could not be determined. And, as Wentz points out, Roberts testified that it was not uncommon for a new well to have "down hole pump problems" which would interrupt production (Tr. Dec. 14, p. 98).

In his investigative testimony, Wentz stated that he got the information concerning the McMillen well's initial production from Gulf's press release of April 22, 1980. That release, headed "Gulf Energy Reports Successful Nebraska Wildcat," stated that the McMillen, "an important discovery well," had been successfully completed and "swab tested through the tubing at a rate of more than 180 barrels of oil per day" (Div. Ex. 36). Wentz testified that he reduced this figure to 100 barrels so as to be conservative and because he knew that production inevitably declined. 27/ He

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27/ In fact, it appears that it was 115 barrels a day, not 180, that was announced as the initial production figure. The distinction was pointed out in Gulf's March 1981 report which stated that the McMillen well had "tested" at rates as high as 180 barrels per day and was completed with an initial "pump rate" of 115 barrels per day.

further testified that "at the time of the [September] report" Shultz told him production had declined to "over 100 barrels a day" (Div. Ex. 4, p. 130). At a later point in his testimony of the same day, however, Wentz, in response to the question whether, at the time he was preparing his report, he sought to obtain actual production information on the McMillen well, testified that he was not "on top" of what was happening at that well. He stated that he knew production was declining, but not by how much. And, he further testified, he did not ask Shultz for production figures, because that would have been inside information which Shultz would not have given him 28/ (Div. Ex. 4, p. 171-3). It follows that Wentz had no reasonable basis for the representation made concerning production from the McMillen well.

The parties' arguments are similar with respect to the report's statements concerning the Christensen well. Gulf announced completion of that well in a July 21, 1980 press release. The release stated that the well, an "offset" to the McMillen well, had "tested" at the rate of more than 130 barrels of oil per day. And Wentz argues that he reasonably relied on this release and was not on notice that subsequent production varied materially from this figure. It is not at all clear that the testing rate referred to in the release was an initial production rate. Thus, Cox testified that the

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28/ The Division, pointing to Bynum's investigative testimony, states that Shultz was willing to provide Bynum with production information on request. However, Bynum's investigative testimony is not part of the record as to Wentz. See note 15, supra.

Christensen never pumped 100 barrels a day.[29/] The record does not establish what the actual production was at the time the research reports were distributed. It was materially misleading, however, to refer to an initial production rate without disclosing that current production was unknown, but must be presumed to be lower. Additionally, as with the McMillen well, it was inaccurate to state that the well "flowed," when in fact the oil had to be pumped.

As noted, the report stated that an additional offset well, the Deaver, was being drilled and would be completed in 3 to 4 weeks. Wentz claimed that this statement was based on information received from Shultz. Especially considering Wentz's long experience as an analyst of oil and gas companies, the choice of words was poor, in that it obfuscated the difference between the drilling and completion processes. As explained by Cox, "completion procedures" are undertaken following the completion of drilling (Tr. Dec. 14, p. 123). As Gulf had announced in the July 21 press release, another part of which Wentz quoted in the report, the drilling of the Deaver well had been completed by then and completion procedures were under way. In mid-August 1980, the well was "shut in" pending further analysis, because when it was "perforated," all zones,

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29/ The reports filed with the Nebraska agency (Div. Ex. 52) indicate that the actual figure was far below 100. The highest monthly figure through the month of October 1980, which is the latest month included in the exhibit, was 339 barrels.

including one which had previously indicated some oil, tested water (Div. Ex. 83). While Wentz may not have been aware of this at the time he wrote the report, he was then aware that drilling had been completed by July 21. 30/ Since the period of 3 to 4 weeks mentioned in the report would have elapsed before the report was printed, he must have known the report was inaccurate. By the time of the November report, which as noted was in effect identical, Wentz had additional information which clearly signalled the misleading nature of the report's statement about the Deaver well. Thus, Gulf's first-quarter report for fiscal year 1981, dated September 19, 1980, informed the shareholders, among them Wentz, that the Deaver well had been drilled to total depth and was "shut-in" while cores and samples were being analyzed (Div. Ex. 93). In addition, Wentz testified that prior to issuance of the November report, Shultz had told him that there were unspecified "structural problems" with the Deaver well (Div. Ex. 3, pp. 95-98).

Wentz's argument that the statement in the report concerning the Deaver well was accurate and consistent with Gulf's press releases and reports, in representing that the well was in the phase of development between initial boring of the hole and the steps necessary to produce oil involves

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30/ A Gulf press release of July 30, 1980, also received by Wentz, stated that the Deaver well had been drilled to total depth and was "currently in completion" (Div. Ex. 36).

a distortion of the English language and lacks merit.

As previously noted, the report referred to extensive seismic studies made by Gulf and Shamrock in the 55,000-acre area and stated that it appeared that much of that area "could" be productive. It went on to state that with 40-acre spacing, "this field alone could provide a vast reservoir of several hundred production wells." Wentz, stressing the use of the word "could," seeks to characterize these statements as mere indications that those results "possibly" could occur. In context, however, the statements conveyed the impression of a likelihood rather than a mere possibility of the indicated events transpiring. Wentz's principal argument is that he had a reasonable basis for the opinions expressed. I cannot agree.

In addition to containing somewhat technical inaccuracies,[31/] the above statements were materially misleading in extrapolating from two producing wells, whose current production level Wentz did not even know, to a potential "vast reservoir" of several hundred producing wells, particularly since the anomaly on which the McMillen and Christensen wells

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31/ For example, it was inaccurate to describe the entire 55,000-acre area as a "field," a term denoting "a designated producing area, generally contiguous producing wells" (Tr. Dec. 14, p. 147). The field within which the McMillen and Christensen wells were located comprised only about 160 acres.

were located was only about 800-900 acres in size. 32/

It is true that some of Gulf's press releases and shareholder reports, by stressing the size of the area in which Gulf had an interest, implied some such extrapolation, though without ever suggesting the "vast reservoir" or several hundred producing wells. And when a draft of the report was submitted to Shultz, one of the insertions he made was the reference to "several hundred" production wells. Wentz testified that he questioned Shultz about this, and that Shultz told him that was what he and Gulf's geologist (Cox) thought.

This raises the question as to the extent to which Wentz was entitled to rely on Gulf's and Shultz's representations. The basic governing principle is that a securities salesman or research analyst who recommends a security or makes a representation concerning an issuer represents that he has conducted a reasonable investigation and that there exists a reasonable basis for his recommendation or representation. 33/

32/ However, contrary to the Division's arguments, it does appear that seismic tests made by Shamrock covered areas other than this particular anomaly and suggested promising possibilities (See Div. Exs. 64 and 83). For example, in late 1980 a well was drilled on a different seismic anomaly about six miles from the McMillen well (See Ex. 83, p. 2). This is not to suggest that there was a reasonable basis for the wildly optimistic projections.

33/ Hanly v. S.E.C., 415 F.2d 589 (2d Cir. 1969); Heft, Kahn & Infante, 41 S.E.C. 379 (1963); Ross Securities, Inc., 41 S.E.C. 509 (1963); Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 14149 (November 9, 1977), 13 SEC Docket 646.

He may not blindly rely on the issuer for information, although the degree of independent investigation which must be made depends on all the circumstances.[34/]

Wentz concedes that the report's projections regarding large-scale future production were predicated on the success of the McMillen and Christensen wells and the anticipated completion of the Deaver well. But, as previously noted, at the time the report was published in September and November 1980 he had no data regarding the then production of the McMillen and Christensen wells, and he was on notice of problems with the Deaver well. It may well be that there were no independent sources from which Wentz could have obtained daily production information. But, lacking such information, he was not justified in accepting at face value and publishing Shultz's wildly optimistic projections.

2. Management's Role in Preparation of Report

As noted, the report is further alleged to be deficient in failing to disclose the role of Gulf's management in its preparation. While the Division has not spelled out precisely what it believes should have been disclosed, it is apparently referring to what it considers inordinate and uncritical reliance by Wentz on information provided by Shultz. It seems clear that it would be materially misleading to pass off a research report

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34/ See Hanly v. S.E.C., supra; Merrill Lynch, Pierce, Fenner & Smith, Inc., supra.

as the objective analysis of a broker-dealer when it was actually prepared by the management of the company which is the subject of the report. While Wentz placed great reliance on Shultz, it would not be accurate to describe the product as a management-prepared report. Short of that situation, I do not believe the Commission has taken the position, and I am not prepared to hold, that a research report is misleading if it does not disclose the extent to which management is the source of material therein. If a statement in the report is inaccurate or has no reasonable basis because it is based solely on management's representations, the resultant violation of the antifraud provisions is attributable to the report's substantive deficiencies.

3. Gulf's Payment of Printing Costs

The Division alleged that the report was further deficient in failing to disclose that Gulf paid the costs of printing it. The pertinent facts are as follows: After Shultz had returned the draft report to Wentz with proposed changes and additions, Wentz told him he planned to have 1,000 copies of the final report printed. Shultz asked Wentz to increase the order to 15,000 copies. Of these, 10,000 were to be shipped to Gulf's headquarters; Shultz indicated he wanted to distribute these to Gulf's shareholders. Of the remainder, 4,000 copies were to be stored at registrant's office for later use by Shultz. 35/ When Wentz objected that registrant

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35/ Shultz later picked these up for distribution at talks he gave to brokers' groups on the West Coast and elsewhere.

would not pay for printing that many copies, Shultz stated that Gulf would cover the expense. Gulf in fact paid the total printing cost of $1,685. In November 1980, Shultz requested additional copies of the report. This led to the printing of 8,000 copies of the November report, which, as noted, differed from the September report only in the date and current share price. Gulf again paid the printing cost, amounting this time to $1,234. With the exception of 500-1000 copies retained by registrant, the reports were sent to Gulf.

Neither report disclosed that Gulf had paid the printing costs. The Division maintains that such disclosure should have been made, on the theory that Gulf's payment of printing costs of an unusually large number of reports suggests a less than arms-length association between Gulf on the one hand and Wentz and registrant on the other, which would have been of concern to a prospective investor reading the report. Wentz, on the other hand, argues that this was not material information. He stresses the "trivial" amount represented by that portion of the printing cost attributable to the copies retained by registrant.

I am not persuaded of the materiality of the omitted facts. The cases cited by the Division such as Chasins v. Smith Barney & Co., Inc.,[36/] dealing with disclosure of possible conflicts of interest in the making of investment recommendations, do not seem to be pertinent to this situation.

36/ 438 F.2d 1167 (2d Cir. 1971).

If the report had been accurate, which in fact it was not, it would not have been of interest to a reasonable investor that the company wanted to make use of it, even widespread use. As far as the record shows, the arrangement for paying the printing costs was made only after the report had been completed. And the amounts which Gulf paid for the copies retained by registrant were in fact de minimis, totalling at most about $260.

4. Wentz's Liability On Gulf Stock In Inventory Account

The final alleged deficiency in the report on Gulf is its failure to disclose Wentz's potential liability on Gulf stock held in registrant's inventory account during the time the report was in preparation. During 1980, Wentz had responsibility with respect to the placing and disposition of equity securities in the inventory account. He was authorized to cause the account to acquire equity securities selected by him and to approve salesmen's requests to inventory such securities. Registrant's policies regarding the account were as follows: When securities were purchased by the account, registrant paid for them. However, the employee at whose instance the purchase was made was responsible for any losses subsequently realized. Any gains that were realized were divided between the employee and the firm, according to specified percentages. It was also a part of

the policy, though one that was not rigidly applied, that a security could not remain in the inventory account for more than five business days. If it was still there at the end of that period, it was either to be transferred to the employee's personal account or sold on the market.

On July 17, 1980, Wentz authorized the purchase of a block of 150,000 shares of Gulf stock at 1-13/16 for the inventory account. Admittedly, he was financially responsible for those shares in the sense outlined above. By July 24, when the account was long 105,500 shares, the market price of Gulf stock (as reflected in the high bid) had gone down to 1-11/16. As a result, there was an unrealized loss in the account of about $14,500. Throughout the balance of July, all of August and until September 2, 1980, the day before the printer was to deliver the 15,000 reports, there continued to be an unrealized loss on the Gulf stock in the inventory account, for which Wentz was responsible, reaching as high as almost $34,000.

Wentz acknowledged that the unrealized loss and the potential for realized loss that it posed for him were a matter of concern. Since under the registrant's policies the salesmen earned no commission when selling stock from the inventory account at less than its cost, they had no incentive to sell while the market price was below cost. As Wentz put it, "you're just sitting there hopelessly, helplessly while there's no buying taking it out of inventory" (Div. Ex. 5, p. 259). Wentz testified that it would have been financially difficult for him to put the stock into his own account. The upshot

was that the firm's "managing partner," who discussed the situation with Wentz on a continuous basis, permitted him to leave the Gulf stock in the inventory account in the hope that it would appreciate.

The Division maintains that Wentz should have disclosed the fact that during the period he was preparing the Gulf report he faced a substantial liability which could be relieved only by a rise in the price of Gulf stock. I agree with the Division that this was material information and that the failure to disclose it rendered the report misleading. Contrary to Wentz's argument, the "boiler-plate" statement at the end of the report that registrant "may in the normal course of business" maintain a long position in Gulf stock did not adequately disclose Wentz's situation. And I also agree with the Division that the fortuitous fact that the market rose just as the report came out and wiped out the unrealized loss has no bearing on the fact that Wentz was subject to severe financial pressures while preparing the report. Prospective investors should have been given the opportunity, in evaluating the report's strong recommendation of Gulf stock, to take into account the extent to which that recommendation may have been motivated by Wentz's personal economic interest in stimulating purchases of the stock which in turn would tend to cause

the price to rise. 37/

5. Conclusions Regarding Research Report

By preparing and distributing a report which was materially untrue and misleading as found above, Wentz willfully violated Sections 17(a)(2) and (3) of the Securities Act. Scienter is not necessary to establish violations of those provisions. With the possible exception of the failure to disclose his financial exposure during the time he prepared the report, I further find that Wentz acted with scienter and therefore also willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as well as Section 17(a)(1) of the Securities Act. Relying almost exclusively on information supplied by the issuer's management which did not, however, include current production data of a critical nature, Wentz nevertheless expressed Gulf's prospects in unqualifiedly optimistic terms. He permitted the identical report to be circulated two months later, under a current date, when he knew that

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37/ Cf. Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1971); Zweig v. The Hearst Corporation, 594 F.2d 1261 (9th Cir. 1979); Paulson Investment Company, Inc., Securities Exchange Act Release No. 19603 (March 16, 1983), 27 SEC Docket 781, 783-4.

vital information in the report had become even more stale.[38] His conduct was of a reckless nature, which, as previously noted, has been held sufficient to satisfy the scienter requirement.

Price Increase Prediction (Bynum)

Mr. O., a Bynum client, bought 1,000 shares of Gulf stock in late March 1980 and another 1,000 shares in early April 1980. Between these purchases, he and Bynum had several conversations in which Bynum told him many things about Gulf, including "his feelings about the price ranges . . . he thought the stock would reach" (Tr. Dec. 15, p. 127). During the week beginning March 31, at a time when the price was 2-1/8, Bynum told Mr. O. he thought or felt the price would go to $4-5 in two weeks and to $10 in a year. In late May 1980, Bynum told him it was his opinion or feeling that Gulf stock, which had gone down to below $2 a share, would or could rise to $3 in one month, to $4 to $5 by December and to $10 in 18 months.[39] In response to the

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38/ Wentz points out that in its 1981 fiscal year Gulf's revenues and earnings were up sharply. He argues that this was the type of "explosive growth" which he anticipated in his research report and which was the basis for his recommendation of Gulf stock. The record does not show the sources of the increased revenues and earnings. In any event, the accuracy of his report must be determined on the basis of the facts and circumstances existing at the time the report was published. Cf. Heft, Kahn & Infante, Inc., 41 S.E.C. 379, 382 (1963).

39/ Mr. O. was not asked to relate his reaction to the fact that some of the prices mentioned in the earlier conversation had not materialized.

question whether Bynum had qualified his statements about future prices, Mr. O. testified that Bynum normally would say things like "of course, there is no guarantee" or "it is simply my opinion" or words to that effect (Ibid, p. 138). Among reasons mentioned by Bynum why he thought the stock would go up were progress being made on the McMillen well, the large amount of acreage in which Gulf had an interest, and the anticipated listing of Gulf stock on NASDAQ.

While denying that he specifically predicted that the price of Gulf stock would increase to a certain level, Bynum acknowledged discussing "numbers" to which the price might increase, subject to "an awful lot of qualifications" (Tr. Dec. 17, p. 65).

Bynum raises no question concerning Mr. O.'s credibility. He does suggest that Mr. O.'s testimony was less than precise. However, the reliability of the testimony concerning the price levels stated by Bynum is enhanced by the fact that Mr. O. made contemporaneous notations of those figures and the related time periods. Bynum, of course, does not dispute the long-established principle that predictions of specific and substantial increases in the price of a speculative security of an unseasoned company are inherently

fraudulent and cannot be justified.[40] His argument is that he did not "predict" price increases, but spoke in terms of what "could" happen, qualified his statements as indicated above and referred to the factors on which he based his opinion regarding future prices of Gulf stock. As the Commission pointed out in the Merrill Lynch case, however, statements regarding a future price of securities are still "predictions," within the meaning of the principle, even if couched in terms of a possibility or probability.[41] Such statements simply cannot be justified, no matter what favorable factors may exist. There is no basis for Bynum's apparent suggestion that the Gulf stock was not of a speculative nature.

Accordingly, I find that in this respect Bynum willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Undisclosed Below - Market Purchases

The order for proceedings alleges that, in willful violation of the antifraud provisions, Wentz and Bynum engaged in the undisclosed practice of buying Gulf stock from

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40/ See Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 14149 (November 9, 1977), 13 SEC Docket 646, 652 and cases cited in notes 17 and 18.

41/ Ibid.

registrant's inventory account for their own accounts at prices below the current market price, while concurrently customers' orders for Gulf stock were pending and were executed at the higher market price.

Registrant's practice, where customers' purchase orders were executed on a principal basis, was to ascertain the best interdealer offer and to sell at that price plus a markup conforming to the 5 percent policy of the National Association of Securities Dealers. No question has been raised about the general fairness of the prices paid by customers under this system. The record further shows, however, that in a few instances Wentz and Bynum bought Gulf stock from the inventory account at prices which were actually below the lowest current interdealer offer. 42/

The Division, citing Bohn-Williams Securities Corporation, 43/ urges that respondents could not legally prefer themselves over their customers or at least owed them a duty to disclose the practice they engaged

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42/ The Division also cites instances where other employees of registrant and the wife of an employee bought shares from the inventory account at prices below the best inside offer and below prices at which customers' transactions were concurrently executed. However, the alleged violation is limited to purchases by Wentz and Bynum. The other transactions are not encompassed within that allegation.

43/ 44 S.E.C. 709 (1971).

in. 44/ In my opinion, that case is distinguishable, and no violation has been proven by the Division.

The facts, in brief, are as follows: On February 4, 1980, Wentz purchased 10,000 shares from the inventory account at $.67 a share. That was the cost of the shares when placed in inventory 11 days earlier. The low interdealer offer on February 4 was 1-1/8. The differential between the price paid by Wentz and the apparent market price was $4,548. However, there were no customer purchases of Gulf stock on February 4, and it does not appear that customer orders were pending. Hence, there can be no question of preferential pricing.

On March 24, 1980, Wentz purchased 20,000 shares of Gulf stock from the inventory account at 1-7/16, at a time when the low interdealer offer was 1-5/8. The differential totalled $3,748. On the same day, one customer paid 1-7/16, another 1-3/4, in principal transactions. As noted in the "insider trading" section, the 20,000 shares had been purchased by the inventory account on March 21, at 1-7/16. It seems clear that Wentz was financially responsible for them. As such, he bore the entire risk of loss. It seems reasonable to view the inventory account arrangement that registrant had as one where the beneficial interest in the shares was

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44/ The Division also cited a second case. As respondents point out, however, the findings and order there issued by the Commission were based on the respondents' consent as part of a setttlement and are not of precedential value. See Carl L. Shipley, Investment Company Act Release No. 8394 (June 21, 1974), 4 SEC Docket 476, 479, n. 6.

in the responsible employee, with the registrant sharing in profits to compensate it for providing temporary financing for the transaction. Under that view, there was no sale of the beneficial interest when Wentz transferred the shares to his personal account.[45/] Viewed from another perspective, a customer not subject to a comparable risk could not legitimately claim entitlement to equal treatment. The same reasoning applies to two additional purchases by Wentz from the inventory account at prices below the current best offer.

In the case of Bynum, the Division points to two transactions with the same characteristics: a purchase price below the current low offer, and concurrent customer purchases from the inventory account at higher prices. It does not appear that the shares which Bynum purchased were in the inventory account at Bynum's risk. However, the responsible employee must have given Bynum permission to buy the shares as well as negotiated the price with him (see Tr. Dec. 16, pp. 80-1). For the reasons set forth above, the employee properly could have taken the shares into his own account at the cost price; therefore he could permit Bynum to do so.

45/ When questioned about the transaction, and specifically why he paid only 1-7/16 when the best offer in the market was 1-5/8, Wentz stated "because that [1-7/16] was the cost figure and it was my stock" (Div. Ex. 7, p. 40). When asked why it was his stock, he replied that it was because he assumed full responsibility for it. While it is true that the employee responsible for placing stock in the inventory account apparently could circumvent registrant's entitlement to a share of the profit by taking it into his own account at cost after the market price had risen, this was an intra-firm matter of no concern to customers.

The Bohn-Williams case involved an entirely different situation. There, at a time when customer orders were pending, the principals of the respondent broker-dealer bought shares for their own accounts and resold these to the customers at higher prices. In other instances, the firm bought shares on behalf of the principals at a lower price than shares bought on the same day for customers. The Commission held that the preferential treatment accorded the principals, which was not disclosed to customers, was fraudulent. Here, by contrast, the differential treatment had a legitimate basis and registrant's customers were not entitled to prices below current market prices.

Since this allegation is not supported by the record, the alleged supervisory failure by Wentz, which, as noted, is urged by the Division only as to Bynum's below-market purchases, must also fall.

Public Interest

Having found that respondents committed willful violations as indicated, the remaining issue concerns the remedial action that is appropriate in the public interest.

As previously noted, in my original decision I concluded that Wentz should be suspended from association with any broker or dealer for 100 days, Bynum for 75 days. In determining those sanctions to be appropriate, I rejected both the Division's position that more severe sanctions should be

imposed and respondents' arguments that only the mildest, if any, sanctions were justified. My conclusion of course reflected the dismissal of the preferential pricing allegation (and with it the inadequate supervision allegation). And while I noted that the violations that had been found were of a serious nature, I also took into consideration the fact that, so far as the record shows, respondents have not been the subject of other disciplinary action in their extended careers in the securities business.

Now I have also dismissed the insider trading allegation. Under the circumstances, I conclude that a 60-day suspension of Wentz and a 20-day suspension of Bynum from association with a broker or dealer will be appropriate in the public interest, serving to impress on them (and others) the need for scrupulous propriety in their securities activities. 46/

Accordingly, IT IS ORDERED that Keith E. Wentz and Ronald P. Bynum are hereby suspended from association with a broker or dealer for periods of 60 days and 20 days, respectively.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

46/ All proposed findings and conclusions and all contentions have been considered. They are accepted to the extent they are consistent with this decision.

Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him, 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.

Max O. Regensteiner
Administrative Law Judge

Washington, D.C.
May 15, 1984