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ADMINISTRATIVE PROCEEDING
FILE NO. 3-2451

FILE COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
STONE SUMMERS & COMPANY ALEXANDER J. STONE THOMAS E. SUMMERS BOBBY LAYNE SUMMERS	:
(8-13804)	:
	:

INITIAL DECISION

Washington, D.C.
August 27, 1971

David J. Markun
Hearing Examiner

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APPEARANCES: Joan H. Saxer, Cecil S. Mathis, and Charles T. Rose for the Division of Trading and Markets.

Gene Stipe, of Stipe, Gossett, Stipe & Harper, Oklahoma City, Oklahoma, and George F. Saunders, of Saunders and Dotsun, Oklahoma City, Oklahoma, for respondents.

BEFORE: David J. Markun, Hearing Examiner

THE PROCEEDING

This public proceeding was instituted by an order of the Commission dated May 13, 1970, against five respondents pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the respondents committed various charged violations of the Securities Act of 1933 ("Securities Act") and of the Exchange Act and the remedial action, if any, that might be appropriate in the public interest.

The Commission's order provided that there be determined first the question whether suspension of the registration of Stone Summers & Company ("registrant") on an interim basis, pending final determination of the issues presented by the order, was necessary or appropriate in the public interest. This question was resolved under a stipulation of June 11, 1970, between the Division and respondents under which registrant subjected itself to various limitations upon its activities pending final determination of the issues raised in this proceeding. 1/

The evidentiary hearing, held in Oklahoma City, Oklahoma and involving 7 hearing days, commenced October 12, 1970 and was concluded December 2, 1970.

On June 14, 1971, the Commission made findings and entered a default order against one of the respondents, Paul L. Rice ("Rice"), 2/

1/ Respondents' motion for modification of the stipulation is treated below at p. 26 (footnote 62), p. 27.

2/ Exchange Act Release No. 9206. Rice's application for reconsideration of the default order, which barred him from association with any broker or dealer, was denied by the Commission on July 28, 1971.

formerly a salesman with registrant. Accordingly, references in this decision to "respondents" do not include Rice. The remaining parties have filed proposed findings, conclusions and supporting briefs pursuant to Rule 16 [3/] of the Commission's Rules of Practice. The findings and conclusions herein are based upon the record and upon observation of the demeanor of the various witnesses.[4/]

FINDINGS OF FACT AND LAW

The Respondents

Stone Summers & Company ("registrant"), an Oklahoma corporation with offices in Oklahoma City, has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since March 29, 1968. Originally registered as Professional Investors, Inc., registrant changed to its present name by amendment filed November 4, 1968, when respondents Thomas E. Summers ("Tom Summers") and Bobby Layne Summers ("Bob Summers"), who are brothers, became partners [5/] in the firm, which had originally been organized by respondent Alexander J. Stone ("Stone"). Registrant is a member of the National Association of Securities Dealers, Inc.

Respondent Stone, 54, is President of the registrant and a director and is one of the firm's registered principals.[6/] Respondent

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3/ 17 CFR 201.16.

4/ Decision was reserved as to admissibility of Division's exhibits 35 through 40. It is concluded that any attorney-client privilege that may have obtained as respects such exhibits was waived by their voluntary prior production at an investigative hearing, and the same are accordingly hereby received in evidence. See also footnote 15.

5/ When they first bought in, the Summers brothers jointly owned half the firm's common (voting) stock and Stone owned the other half; currently each of the three owns 1/3 of the common stock.

6/ Stone has been in the securities business since January, 1966. The registrant's only other registered principal, George Bishop, came to the firm in April, 1969, and is not a respondent.

Tom Summers, 43, was Vice President of the firm during the times here material [7] and was then and still is a director. Respondent Bob Summers, 33, was Secretary-Treasurer during the times here material [8] and was and is a director. Rice was a registered representative with the registrant about a year from September 11, 1968, until September 26, 1969.

Registrant's business as a broker dealer has been primarily wholesale though it has had some retail customers.[9] It has dealt primarily in low-priced over-the-counter stocks selling under $5 a share.

During the times here material registrant had from a half dozen to thirty one employees, from two to seven traders, up to 350 trades per day, and traded in from about 30 stocks up to 225 stocks.

Sale of Unregistered UAO Stock and Related Violations.

The order for proceeding includes a charge that during the period November 1, 1968 to the date of the order (5-13-70) respondents wilfully violated and wilfully aided and abetted violations of Section 5(a) and 5(c)[10] of the Securities Act by offering to sell,

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7/ Tom summers resigned as Vice President in May, 1970. He holds a law degree but has not been admitted to the bar and has been in the securities business since February, 1962. He has not taken the principal's examination.

8/ Bob Summers has been in the securities business since May, 1964. He has twice taken, but did not pass, the principals' examination.

9/ See footnote 49 below.

10/ 15 U.S.C. 77e. Under Section 5(a) it is unlawful to sell or deliver a security by use of the mails or the facilities of interstate commerce unless a registration statement is in effect as to the security. Under Section 5(c) it is unlawful to offer to sell or offer to buy a security by such means unless a registration statement has been filed as to the security.

selling, and delivering after sale, by use of jurisdictional means, the common stock of United Australian Oil, Inc. ("UAO") for which no registration statement was filed or in effect under the Securities Act.

The record establishes that during November, 1968, registrant, as agent for Paul Dawson ("Dawson"), sold 100,000 shares of UAO to various broker-dealers in various amounts, on or by November 22, 1968. Thereafter, on November 26, 1968, registrant bought 100,000 shares of UAO stock from Dawson as principal and subsequently sold such shares to other broker-dealers prior to December 10, 1968.

The record shows further that from December 10, 1968, through December 24, 1968, registrant sold as agent for Charles I. Allen ("Allen") 498,000 shares of UAO stock to various broker dealers.

Respondents concedes, as the evidence shows, that the 698,000 UAO shares thus sold by the registrant, or first purchased and then sold by it, were never registered under the Securities Act and that jurisdictional means (the mails and telephones) were employed in their purchase and/or sale.

Respondents contend, however, that their purchase on December 26, 1968, of 100,000 shares of UAO from Dawson and their subsequent sales of such shares were exempt as dealers' transactions under §4(3) 11/ of the Securities Act. The other transactions, i.e. the sale by respondents of 100,000 shares of UAO as agent for Dawson on December 22, 1968, and the sale by respondents as agent for Allen of 498,000

11/ 15 U.S.C. 77d(3).

shares of UAO, are claimed by respondents to have been exempt as brokers' transactions under the provisions of §4(4) [12/] of the Securities Act.

The Division urges that neither claimed exemption is applicable because registrant was a statutory underwriter.

These conflicting contentions necessitate an examination into the circumstances surrounding the subject securities transactions.

Dawson acquired the 200,000 UAO shares here involved [13/] from an Oklahoma corporation named Sound-Tronics, ("Sound-Tronics") shortly after Sound-Tronics was acquired in August, 1967 as a subsidiary of UAO. Sound-Tronics received 2,222,222 shares of UAO stock when it became a subsidiary of UAO, and Sound-Tronics utilized a good bit of this UAO stock to pay off its various obligations to entities and individuals, including Dawson.

Dawson had in June or July 1967 taken over management of Sound-Tronics with the promise of an ownership interest, and had become its President by the time it was acquired by UAO. Earlier, from about April 1966 to about June 1967, Dawson had been engaged under a $50,000 contract with H.B. Todd ("Todd") [14/] to perform a feasibility study concerning a Texas firm called Sound-Tronics, Inc. ("Sound Tronics of Texas"). Dawson also performed numerous services for Todd incident to Todd's acquisition of an interest in UAO and in

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12/ 15 U.S.C. 77d(4).

13/ The 200,000 shares here involved were represented by two 100,000-share certificates dated August 27, 1967.

14/ Todd controlled Sound-Tronics and Sound Tronics of Texas and conceived the idea of acquiring a controlling interest in UAO, then largely dormant, as a vehicle through which Sound-Tronics and other companies could be held as subsidiaries.

connection with private stock placements for UAO and UAO's acquisition of Sound Tronics. As Dawson put it in his testimony, [15/] he ". . . was kind of the errand boy for UAO up to a point . . . ."

Sound-Tronics and Todd had not fully compensated Dawson for his various services. In addition, Dawson had made certain advances of funds to Sound-Tronics for which he took shares of Sound-Tronics as "security". As compensation for such services and for such advances to Sound-Tronics Dawson received a total of 400,000 shares of UAO stock, of which the 200,000 shares here involved were a part. This was supposed to be stock held for investment but Dawson had no intention of treating it as such and sold off portions of it as the opportunity presented itself. Dawson had earlier purchased 120,000 shares of UAO and he disposed of all his 520,000 shares during 1968 and 1969. As he testified, [16/] "I mean it was in payment for salaries and things and I needed to live."

15/ When called to testify at the hearing by the Division, Dawson declined to do so, invoking the Fifth Amendment. Thereafter his prior testimony, given in the course of an investigation by the Commission's staff, was received in evidence over respondents' objections. Such prior testimony is utilized herein not on the question whether there was a prima facia violation of Sections 5(a) and 5(c) of the Securities Act, but (only) on the question whether respondents' claims that the transactions were exempted under Sections 4(3) and 4(4) are valid or not, on which contention the respondents have the burden of proof. SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953).

16/ See footnote 15 above.

Since Dawson acquired the 200,000 shares of UAO here involved from the issuer (because Sound-Tronics was a subsidiary controlled by the issuer) with a view to distribution of the stock he became a statutory underwriter under Section 2(11) of the Securities Act.[17/] When registrant sold 100,000 of such shares for Dawson as his agent and when it purchased the other 100,000 of such shares and subsequently sold them to other broker dealers registrant became a sub "underwriter" and had a "direct or indirect participation" in the distribution within the meaning of Section 2(11).[18/]

It is well settled that the exemption afforded a dealer under Section 4(3) of the Securities Act does not apply to a dealer engaged in a distribution.[19/]

Likewise, the exemption for brokers' transactions afforded under Section 4(4) of the Securities Act does not apply when the broker is executing sales by a statutory underwriter.[20/]

17/

18/ See note 17 above. This result does not depend, as respondents mistakenly contend, upon establishing that Dawson was a "control person" of UAO.

19/ SEC v. Mono-Kearsarge Con. Min. Co., 167 F. Supp. 248 (1958); SEC v. Culpepper, 270 F.2d 241, 246-7 (C.A. 2, 1959); SEC v. North American Research & Development Corporation, 280 F. Supp. 106, 124-5 (1968).

20/ See Securities Act Releases 4445, 4669, 4818, 4997.

The Commission's Rule 154 under the Securities Act, referred to by respondents, in which the Commission defined the term "brokers' transactions" as used in Section 4(4) in connection with transactions by a broker acting as agent for a controlling person, is inapplicable to the factual situation here presented since the registrant here sold for a statutory underwriter (Dawson) rather than for a controlling person. There is at present no rule comparable to Rule 154 covering sales by a broker for a customer who turns out to have been a statutory underwriter. The "Wheat Report" 21/ comments on this disparity in treatment of unsolicited brokers' sales for controlling persons as compared with such sales for underwriters and proposes a solution through rule broadening as follows:

> "Under the present Rule 154, if the broker selling for the account of a controlling person is unaware of circumstances indicating that his principal is engaged in making a distribution, the broker escapes liability even though his principal may have violated the '33 Act. [Citing U.S. v. Wolfson, C.C.H. Fed. Sec. L. Rep. (current) para. 93,328 (C.A. 2, December 27, 1968).] If, however, the broker sells securities for the account of a shareholder who is, in fact, an underwriter of the securities under Section 2(11), the broker, however innocent, is also an underwriter. No rule exists which grants the broker absolution in such a case. It is the Study's recommendation that Rule 154 be revised to protect a broker under both sets of circumstances if, after reasonable inquiry of his customers, he has no grounds for believing and does not believe that the customer's sale amounts to a 'distribution' under Rule 162."

Even if Rule 154 were applicable to registrant it would not help the respondents here since the record in this proceeding shows clearly that respondents failed to exercise reasonable diligence in

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21/ Disclosure to Investors (the "Wheat Report"), CCH No. 5213, p. 224 (1969).

determining the source of the customer's stock and the circumstances under which he (Dawson) had obtained it.

Thus, though Rice and the respondents generally knew of Dawson's association with UAO's subsidiary Sound-Tronics, [22] and with H.B. Todd, UAO's President, and in general what Dawson had gotten the stocks for, respondents did nothing more to check on the status of Dawson's UAO stock than to observe that the certificates themselves were not marked with any restrictive legend and to make a pro forma call to the transfer agent [23] for assurance that the stock was not restricted. [24] This was the limit of their inquiry even though respondents were aware of the fact that Dawson earlier in 1968 had encountered problems in disposing of some of his UAO stock through another broker-dealer, Hagen & Co., where Rice and the Summers brothers were then employed. [25] Neither Rice nor any of the respondents asked Dawson where he had gotten the stock or under what circumstances, [26] even though respondent Tom Summers,

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22/ Registrant's "know your customer" card for Dawson showed his employment by Sound-Tronics.

23/ UAO acted as its own transfer agent.

24/ Where circumstances are such as to put a respondent on notice that further inquiry is called for, his merely calling the transfer agent is obviously not a sufficient inquiry. Robert T. Stead v. SEC, (C.A. 10, 1971), No. 382-70, decided July 2, 1971.

25/ Dawson eventually cleared his shares and sold them under a questionable opinion that he had had a change of circumstances.

26/ Nor did any of the respondents direct Rice, who was the registered representative for the Dawson account, to make such inquiry.

according to respondent Stone's testimony, is normally "highly suspicious" when a person comes in with a large quantity of stock.[27] The fact is, as the testimony of the respondents abundantly demonstrates, that they were not disposed to make the proper inquiry that the circumstances known to them dictated because so far as they were concerned the stock was "good" if it transferred.[28]

Respondents simply ignored the numerous "red flags" that warned them of the need to make further inquiry.[29]

Likewise, the record establishes that the claimed exemption under 4(4) of the Securities Act is not available to respondents with respect to the 498,000 shares of UAO stock sold by registrant as agent for Allen.

The 498,000 shares of UAO that respondents sold as agent for Allen were part of 500,000 shares purchased by Allen from Todd, president of UAO, under the following circumstances.

Allen, an attorney[30] who had performed various legal services for Sound-Tronics at Todd's direction, had received as compensation 100,000 shares of UAO stock. He sold these through Hagen & Co. in late 1967 and early 1968, a fact known to Rice[31] and to respondents Tom Summers

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27/ Tom Summers, also, testified that large quantities raise questions.

28/ Essentially respondents procedure for determining tradeability of a security was to have the certificates transferred into street name and if this could be accomplished without raising questions the stock was considered tradeable. Thus, the two 100,000 share UAO certificates received from Dawson on November 1, 1968, were sent by registrant to the transfer agent and transferred into the name of registrant in two hundred 1000-share certificates.

29/

30/ In 1968 Allen's license to practice was suspended in connection with a fee dispute.

31/ Rice was the salesman handling Allen's account at Hagen & Co.

and Bob Summers, who also knew generally of Allen's relationship to Sound-Tronics. Thereafter Allen negotiated for the purchase of 500,000 UAO shares from a certain Bouchier Trust, which he intended to resell through registrant. Tom Summers had earlier indicated to Rice that any such stock should be put into registrant's name to ensure its transferrability, in keeping with their general practice, before registrant would handle it. When Allen found out that the Bouchier Trust stock was restricted stock, he went to see Todd about whether the restriction could be removed. Todd advised Allen that he would not remove the restriction on the Bouchier Trust stock but that he could get Allen other UAO stock, ostensibly from another shareholder, on the same terms. Thereafter Allen received 500,000 shares of UAO stock delivered to him on a Saturday by Ralph Powell, one of Todd's employees. Allen was to sell this stock through registrant with Rice as the salesman and pay for it by cashier's check to "W.H. Walker", who turned out not to be another shareholder but a pseudonym or alias for Todd. [32/]

On the following Monday, December 9, 1968, Allen delivered to registrant the 500,000 shares of UAO stock, which were in registrant's name in 1000 share certificates. [33/] Registrant sold 498,000 of these shares to other brokers during the period December 10, 1968, to December 24, 1968. The mails and telephones were used in connection with these transactions.

32/ Unknown to respondents, Rice and Allen had an agreement that they would split the profits from the sale of Allen's UAO shares with a view to setting up their own broker-dealer firm.

33/ Rice informed Tom Summers of this delivery.

Since Allen's 500,000 shares of UAO were acquired by him from the issuer [34] with a view to their distribution, Allen became a statutory underwriter within the meaning of Section 2(11) of the Securities Act. [35] When registrant thereafter sold 498,000 of such shares as agent for Allen it became a sub "underwriter" and had a "direct or indirect participation" in the distribution of such shares within the meaning of said Section 2(11). For reasons discussed above in connection with the Dawson stock, the exemption under Section 4(4) is therefore not available to the registrant.

As bearing on sanctions, it should be noted that although respondents were aware of Allen's relationship to Sound-Tronics, a UAO subsidiary, and that he had previously gotten UAO stock in payment for legal services, respondents did not make the necessary inquiries that would have disclosed the true source of the 500,000 shares of Allen's UAO stock. Under the circumstances here present it was not sufficient inquiry merely to check with the transfer agent. [36]

Respondents place much reliance on the private agreement between Rice and Allen to split Allen's profits from the sale of his UAO stock, from which they seek to have the Commission infer that any inquiry respondents might have made would have been fruitless. This argument is not persuasive. First of all, respondents made no inquiry as to the identity of "W.H. Walker" to ascertain if he was a "control" person.

34/ Todd was President and a controlling person of UAO under Section 2(11) of the Securities Act.

35/ Quoted in footnote 17 above.

36/ Robert T. Stead v. SEC (C.A. 10, No. 382-70, decided July 2, 1971).

This should have been done, in view particularly of the large block of shares involved[37] as well as the other circumstances present.

Secondly, the argument is irrelevant except on the question of sanctions since, as discussed above concerning the Dawson stock, due inquiry is pertinent only to a claim under Rule 154 and such rule is not applicable here where registrant made executions not for a control person but for a statutory underwriter.

These violations of Sections 5(a) and 5(c) of the Securities Act by the registrant were wilful[38] and the violations were wilfully aided and abetted by respondents Stone, Tom Summers and Bob Summers.

The record also establishes that while respondents were participating in the above-found distribution of UAO securities they were at the same time bidding for, through placing quotes in the National Daily Quotation Service, the so-called "pink sheets", and purchasing for their own account, such securities. This establishes the charged wilful violations of Section 10(b) of the Exchange Act and Rule 10b-6[39] thereunder.

These violations were wilfull.[40]

37/ See footnote 27 above and text thereto.

38/

39/ Bruns, Nordeman & Company, 40 SEC 652, 660 (1961); J.H. Goddard & Co., Inc., et al., 41 SEC 964, 968 (1964). Rule 10b-6 (17 CFR 240.10b-6) provides that it is a manipulative or deceptive device for a broker-dealer participating in a particular distribution of securities to bid for or purchase such securities for any account in which he has a beneficial interest during the course of the distribution.

40/ See footnote 38 above.

The Division urges that the charged violations of the antifraud provisions of Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder are established by the conceded facts that registrant did not disclose to the broker dealers to whom it sold the Dawson and Allen UAO shares that (1) the UAO shares were unregistered stock that was not subject to sale or distribution without registration and (2) that registrant was bidding for and purchasing the UAO stock while participating in a distribution thereof.

It is concluded that under the circumstances here present omitting the disclosures referred to was not wilfull.

Alleged Antifraud Violations Involving Trading in "Shell" Corporations

The order for proceeding includes a charge that respondents wilfully violated and wilfully aided and abetted violations of the antifraud provisions of Section 10(b) [41/] of the Exchange Act and Rule 10b-5 [42/] thereunder by engaging in a course of business that involved trading in various low-priced stocks including, among others, twelve named stocks in which trading had been suspended by the Commission for periods before or after registrant traded them and three stocks whose issuers (and others) had had permanent injunctions issued against them enjoining them from violations of the registration and/or antifraud provisions of the Federal securities laws as respects such securities. The Division contends that the registrant, [43/] by trading the stock of numerous "shell"

41/ 15 U.S.C. 78j(b). Section 10(b) makes it unlawful for a person by use of jurisdictional means to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . ."

42/ Rule 10b-5, which proscribes various manipulative and deceptive devices, provides in pertinent part that it is unlawful for any person, directly or indirectly, in connection with the purchase or sale of any security via jurisdictional means "(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . ."

43/ The term "shell" corporation generally refers to a company that has essentially no operations and little or no assets.

corporations and the stock of numerous other corporations which was "of little or no value" engaged in a pattern of trading or a course of business that operated as a fraud and deceit upon purchasers and prospective purchasers of such securities.

Respondents defend against these allegations on the stated grounds, among others, that under existing requirements and standards the trading activity complained of was entirely lawful and that numerous other broker-dealers throughout the country similarly traded such stocks and still are trading them; that there is no adequate definition of a "shell" corporation prescribed by law or regulation having the force and effect of law and no law or regulation forbidding trading in such securities; and that the Division's theory of liability is a novel one predicated upon non-existent standards of a kind that could only be prescribed by the Commission in a rule-making proceeding, i.e. by promulgation of a definition of "shell" corporations and a regulation proscribing trading in their securities.

At the outset, it should be noted that there is no contention that registrant traded any stock while trading therein was suspended by the Commission or in violation of any injunction.

Secondly, the evidence does not indicate that registrant or the other respondents engaged in any manipulation of the prices of any of the subject stocks in which registrant traded. Nor is there proof of any affirmative misrepresentation by respondents in connection with their making markets in the subject securities.

Thirdly, there is no specific proof of any fraudulent scheme, device, or practice with respect to registrant's trading in any one of

the subject securities, that is, in the sense of showing the existence of some affirmative scheme to defraud the public by price manipulation or other manipulative device.

The general theory under which the Division here seeks to prove its antifraud charges was perhaps best expressed in a "warning letter" of November 24, 1969, from the Commission's Regional Administrator in Fort Worth to the registrant, which among other things transmitted copies of a Commission release on shell corporations, the penultimate paragraph of which letter stated as follows:

> "You should be aware that a pattern of wholesale or retail trading of securities of companies with little or no assets or operations (or lack of information concerning such) may be considered by the Commission as constituting a course of business which operates as a fraud in violation of Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934." 44/

The Division lays considerable stress on the conceded fact that registrant deals predominantly in low-priced stocks. 45/ It urges that in view of this fact registrant had an obligation to be "particularly vigilant in making reasonable inquiry into the stocks traded," on the theory that penny stocks of industrial, oil and mining companies, are peculiarly subject to shell manipulation. No regulation or decisional authority is cited in support of this proposition. Nor does logic suggest any reason why the degree of vigilance required of

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44/ This "warning", of course, does not have the status of a regulation of the Commission nor does it serve, as such, to add new duties or responsibilities.

45/ Most of the stocks traded by registrant sold for under $5.00 a share and a good portion of them were under $1.00. About 90% of the shares traded were low-priced industrial, oil and mining company stocks.

a broker-dealer trading in a shell corporation or other low-priced issue should turn, in and of itself, upon the proportion of his business that is dedicated to such activity. Likewise, registrant's concentration on trading low-priced issues [46/] does not in and of itself constitute a building block in the alleged fraudulent "course of business", as the Division appears to imply.

The Division urges further that the allegedly fraudulent course of business of the registrant involved failures to disclose material information of various kinds. First, they urge that registrant had in its possession, in its research files, "inside" information concerning stocks traded which respondents failed to disclose to the other broker-dealers [47/] with whom they had transactions. The Division does not specify what "inside" information they have in mind. It is concluded that the record fails to establish that registrant was in possession of any "inside" information concerning the stocks traded by it of a kind properly classified as "inside" information under recent decisions.[48/]

46/ Respondent's vice president, respondent Tom Summers, testified that they favored the low-priced issues because trading them involved less capital investment and because that was what customers seemed to want. Respondents and witnesses called by them testified that they selected stocks for trading based upon considerations of supply and demand and activity and liquidity and that as broker-dealers it was not their function to attempt to assess the inherent worth of a security. Registrant never itself initiated trading in a security and never got into one unless 4 or 5 broker dealers were already in the pink sheets for the particular stock.

47/ Registrant was primarily a wholesaler. See footnote 49 below.

48/ E.g. Texas Gulf Sulphur Co., 401 F.2d 833 (C.A. 2, 1968), cert. den. 394 U.S. 976 (1969); Investors Management Co., Inc., et al., July 29, 1971, Securities Exchange Act Release No. 9267.

Secondly, the Division contends that registrant was under a duty to make known to anyone with whom it traded the securities the substance of pertinent Commission releases, e.g. the Commission's Release No. 8297 under the Exchange Act respecting Meter Maid, Inc., wherein the Commission in fairly typical language, stated:

> "[B]roker-dealer firms should consider carefully the financial and other information concurrently being made by the company in connection with future transactions in Meter Maid stocks; and broker-dealers should be particularly mindful of their obligations under the Federal securities laws in effecting transactions in the shares of Meter Maid."

Nothing in the quoted language of the Release purports to impose any new or additional disclosure requirement upon broker dealers. The release is a public document available to all broker dealers equally and it would have made little sense for the registrant to attempt to advise other broker dealers 49/ with whom it traded of its contents. Nor is it required, necessarily, that its contents be disclosed to a retail customer. While particular circumstances may well call for such disclosure in a given instance, there has been no proof here of any such particular circumstances.

49/ Registrant is primarily a wholesaler, dealing with up to 200 other broker dealers in New York City, Los Angeles, Salt Lake City, and elsewhere. The testimony indicates that during the times here material less than 5% of registrant's transactions involved retail customers and that of the retail transactions about 80% involved purchasers. Although registrant at one point had three or more registered representatives serving retail customers it has had no such representative since Rice left the firm. The Division has not sought to establish that particular "shell" or other securities involved in the instant charge were sold directly to retail customers, it being their position that registrant's sales to other broker-dealers eventually found their way to retail customers.

Lastly, it is contended by the Division that respondents failed to disclose that the companies whose securities they were selling had "little or no assets or income" and that respondents were quoting the securities "without any relation to their actual value." The Division cites no apposite authority supporting a claim that respondents had any duty to attempt in effect to "value" the securities it was trading and to advise its customers (other broker dealers or retail customers) of its valuation of such stocks.

Accordingly, it is concluded that registrant is not properly chargeable with any failure to disclose material information.

The Division introduced evidence establishing that on some of the stocks traded by the registrant it had "inadequate" or no information available 50/ concerning the company. The Division contends that the

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50/ The record establishes that as to many stocks traded by it registrant did not have available in its research files current audited financial statements. As to 25 corporations registrant had a file consisting of trading information on an index card or a page from the "National Monthly Stock Summary", but no financial information or information concerning operations. As to another 18 securities traded by registrant its files reflected "operations" of the companies but no supporting financial statements. In its brief, pp. 15, 16, respondents offered to produce additional evidence through the testimony of George Bishop to rebut the Division's contention that as to some 193 companies the respondents failed to produce research files or Standard and Poor Summary Digests, although production thereof had been ordered under subpoena. This request of respondents to adduce additional proof is herewith denied on dual grounds: first, the record is clear that production of all research material on corporations traded between August 1968 through June 1970 was demanded by subpoena and that respondents had full opportunity to produce such information prior to the close of the hearing. Second, the research files were not relied on to determine whether or not to trade a stock or to inform purchasers routinely (information was given purchasers only if requested). Thus it does not appear that the disposition of this proceeding depends in any material way on whether registrant did or did not have research files, or reasons for not having them, as to those stocks for which research files were not produced at the hearing.

trading of securities without having any information upon which an intelligent investment decision could be reached and the publishing of quotations on such securities constitutes a "course of business which operates . . . as a fraud and deceit upon [a] person in connection with the purchaser or sale of a security" within the meaning of Rule 10b-5.[51/] This argument by the Division is apparently interrelated with its further argument that the registrant, a broker-dealer (primarily a wholesaler) allegedly responsible for "putting into the market place thousands of shares of worthless shell securities", must be held responsible under a concept of implied warranty of merchantability.[52/]

The Division cites no law, regulation, or apposite decisional authority in support of either branch of its argument, and none has been found. If trading in securities is to be subject to the prior possession by the broker-dealer of particular information concerning the issuer, such requirement will likely have to come via the Commission's rule-making process.[53/] It would offend due process to import such a requirement into this proceeding and apply it against respondents, where none has existed to date, whatever the merits of the situation may be conceived to be. The Division notes the absence in the over-the-counter

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51/ See footnote 42 above.

52/ The Division urges that as a minimum the implied warranty of merchantabilit extends to assurance that the security is registered (or exempt from registration) and that it is "a viable entity of some value."

53/ By order of June 24, 1970, filed June 29, 1970, the Commission gave notice that it has under consideration a proposal to adopt Rule 15c2-11 (17 CFR 240.15c2-11) under the Securities Exchange Act of 1934 to prohibit the initiation or resumption of quotations respecting a security by a broker or dealer who lacks minimum specified financial and other information concerning the security and the issuer. Federal Register, Vol. 35, No. 126, June 30, 1970, p. 10597.

market of any listing requirements comparable to those of the New York Stock Exchange and other exchanges and urges that because of this a broker-dealer trading OTC stocks must exercise caution in policing his own activities and not violate "a duty to keep himself informed and provide appropriate restraints," citing Pennaluna & Co., Inc. v. S.E.C.[54/] Unfortunately for the Division's case, the quoted language in Pennaluna was used in a wholly different context[55/] and affords no support for the Division's contention here.

Likewise, there is no law, regulation or decision supporting the Division's contention that by dealing in a security a broker dealer impliedly warrants that the security is that of a "viable entity of some value."[56/] Moreover, even if some such requirement did obtain, there is no satisfactory proof in this record that any specific security traded by the registrant failed to meet the reputed minimum requirement while it was being so traded.[57/]

54/ 410 F.2d 861, 869 (C.A. 9th, 1969), cert. den., 396 U.S. 1007.

55/ For one thing, Pennaluna involved the making of affirmative misrepresentations in the knowledge that they were false or misleading.

56/ The very vagueness of this language suggests immediately substantial problems that would make its application as a standard difficult if not impossible. Respondents contention that more objective standards would be required has merit. See footnote 53 above.

57/ Thus, although there is some indication in materials contained in registrant's "research" files that various companies whose stocks were traded had been "dormant" for some time, or had little or no assets, or were not in a position to furnish current information, there is no satisfactory proof in the record that the company did not in fact have "some value", or that it was not a "viable entity."

Accordingly, it is concluded that the charge that respondents wilfully violated or wilfully aided and abetted violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder is not established by the record. 58/

Failure to Supervise

The order for proceeding includes an allegation that registrant and the other respondents failed reasonably to supervise other persons under their supervision with a view to preventing violations committed by such other persons.

The record herein establishes that respondents Stone, Tom Summers, and Bob Summers all failed reasonably to supervise with a view to preventing the violations of Sections 5(a) and 5(c) of the Securities Act by Rice and by the registrant that have been found above, as well as the violations of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder. The evidence shows that during the time such violations occurred, Stone, although he was the president and only principal of the firm, came into the offices only 2 or 3 days a week, because of his other business activities. 59/ Stone was aware that the firm was trading the UAO stock for Dawson and for Allen, and he failed to take the steps to insure that proper inquiry was made. According to the testimony of registrant's witnesses, Stone shared supervisory responsibility over Rice about equally with Tom Summers. Tom Summers, who

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58/ In view of this ruling on the merits, it is unnecessary to consider respondents' motion that the charge of violation of Section 10(b) and Rule 10b-5 be dismissed because of alleged prejudgment by the Commission.

59/ Stone is president of Professional Investors Life Insurance Co.

functioned primarily as a trader, was Rice's direct supervisor on a day-to-day basis, and in his absence Bob Summers, who also functioned primarily as a trader, was supposed to supervise Rice, though, in fact, Bob Summers exercised little real supervision. For that matter, supervision by Stone and Bob Summers was also minimal. Both Summers brothers were aware of what Rice was doing, and should have properly supervised [60/] Rice to forestall the violations. While Tom Summers' responsibilities in this regard were greater, nevertheless the record shows that Bob Summers, too, had some de facto supervisory responsibility.[61/] Registrant had no written procedures governing supervision.

Conclusions

In general summary of the foregoing, the following conclusions of law are reached:

(1) During November and December of 1968 registrant wilfully violated and Respondents Stone, Tom Summers and Bob Summers wilfully aided

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60/ The status of all three individual respondents as officers and major owners of the registrant should have heightened their awareness of the need for diligent supervision. This should have been particularly true since at the time the registrant had no particular individual whose duties centered upon administration and supervision. George Bishop, who is currently vice president, a director, and a principal in the firm, and who now exercises primary responsibility over salesmen of tne firm and over back-office personnel, including research, did not come to the firm until April, 1969, subsequent to the Section 5 violations found herein.

61/ The two brothers worked together closely and, generally speaking, either could take over the duties of the other temporarily.

and abetted violations of Section 5(a) and 5(c) of the Securities Act by selling via jurisdictional means some 698,000 shares of unregistered UAO stock bought from or sold on behalf of Paul Dawson and Charles I. Allen, for which no exemption was available. Registrant and the other respondents also wilfully violated or wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in connection with such transactions in UAO.

(2) Within the meaning of Section 15(b)(5)(E) of the Exchange Act respondents Stone, Tom Summers and Bob Summers failed reasonably to supervise Rice and others subject to supervision with a view to preventing the violations of Section 5(a) and 5(c) of the Securities Act committed by Rice and the registrant and the violations of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder.

(3) The allegation that respondents wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by a course of dealing in the stock of various "shell" and other corporations is not sustained by the record.

PUBLIC INTEREST

The statutory and regulatory provisions found to have been wilfully violated by respondents are vital to the protection of investors.

In determining the sanctions necessary in the public interest it is appropriate to consider the circumstance that since June 11, 1970, the respondents, pursuant to a stipulation between them and the Division entered into in order to obviate a hearing on the interim-suspension question raised by the order for proceeding, have been subjected to

certain stated limitations upon the activities that registrant could engage in pending final determination of the issues raised in this proceeding.[62/] These limitations have exerted an adverse economic effect upon registrant, and of course, upon the other respondents, who are its owners.

Registrant has not committed any prior violations, nor has respondent Stone or Bob Summers. Tom Summers was enjoined in 1965 on a consent decree from aiding or abetting F.R. Burns & Company from violations of Regulation T and the Net Capital Rule. On the basis of Stone's status as the then-only principal, and Tom Summer's greater knowledge of Rice's activities, it is concluded that Stone and Tom Summers had primary responsibility for the failure properly to supervise Rice and for the failure to have taken other steps to avoid the violations, but Bob Summers, too, shared some of that responsibility.

On the basis of the foregoing considerations and on the basis of all mitigative factors urged and of the entire record, it is concluded that it will be appropriate and sufficient in the public interest to suspend registrant for seven days and to suspend respondents Stone and Tom Summers each for 30 days and to suspend respondent Bob Summers for 15 days.

62/ A motion by respondents to modify the stipulation, on which oral argument was heard on March 26, 1971, was denied by order of April 16, 1971, but jurisdiction was retained to reconsider the motion in the course of issuance of the initial decision. On the basis of the findings and conclusions made herein it is concluded that interim-suspension of the registrant's activities pending final determination of the issues (or the partial suspension or curtailment effected under the stipulation) is no longer necessary in the public interest. Accordingly, this decision will provide for revocation of the stipulation.

ORDER

Accordingly, IT IS ORDERED as follows:

(1) The registration as a broker and dealer of Stone Summers & Company is hereby suspended for a period of seven (7) days and registrant is also suspended for the same period from membership in the National Association of Securities Dealers, Inc.

(2) Respondent Alexander J. Stone is hereby suspended from being associated with any broker or dealer for thirty (30) days.

(3) Respondent Thomas E. Summers is hereby suspended from being associated with any broker or dealer for thirty (30) days.

(4) Respondent Bobby Layne Summers is hereby suspended from being associated with any broker or dealer for fifteen (15) days.

IT IS FURTHER ORDERED that the stipulation between the Division and the respondents, dated June 11, 1970, relative to certain interim restrictions on registrant's activities, 63/ is hereby revoked.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not within fifteen (15) days after service of this initial decision upon him filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a

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63/ See footnote 62 above.

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. 64/

David J. Markun
Hearing Examiner

Washington, D.C.
August 27, 1971

64/ To the extent that the proposed findings and conclusions submitted by the parties are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected. Certain proposed findings and conclusions have been rejected as not relevant or as not necessary to a proper determination of the issues presented.