

IN THE MATTER OF

STRATHMORE SECURITIES, INC., ET AL.\*

File No. 8-7323. Promulgated December 13, 1967

Securities Exchange Act of 1934—Sections 15(b) and 15A

**BROKER-DEALER PROCEEDINGS**

Grounds for Revocation of Registration

Grounds for Expulsion from Registered Securities Association

Grounds for Bar, Suspension, or Censure of Individuals

Fraud in Offer and Sale of Securities

Bids and Purchases during Distribution

Offer, Sale and Delivery of Unregistered Securities

Failure to Comply with Records Requirements

Where registered broker-dealer, which was underwriter with respect to offering of securities by issuer pursuant to claimed Regulation A exemption from registration requirements of Securities Act of 1933, participated in transfer of securities to designees of controlling person of issuer at offering price with view to subsequent repurchase and distribution following reported completion of offering and at prices in excess of stated offering price; bid for and purchased such securities during distribution; offered, sold and delivered unregistered securities which had been issued in exchange for corporate assets of and shares of stockholders in other companies; and failed to record certain transactions on its books and records, *held*, conduct constituted willful violations of anti-fraud, anti-manipulation, registration, and record-keeping provisions of securities acts, and it is in public interest to revoke broker-dealer's registration, expel it from membership in registered securities association, bar broker-dealer's principal who actively participated in all its violations from association with any broker-dealer, and suspend certain of the salesmen who participated in violations of registration provisions from such association.

Participation by salesman for another broker-dealer firm in distribution of unregistered shares issued in exchange for corporate assets, *held*, willful violation of registration provisions of Securities Act of 1933 since salesman failed to make adequate inquiries concerning sellers and source of their shares, and it is in public interest to censure him.

\* Auldus H. Turner, Jr.; Theodore B. Henjum; Ronald D. Turner; T. Theodore Turner; Michael R. Ventura.

### Practice and Procedure

Contention by registered broker-dealer and associated persons that they were denied due process because of Commission staff's retention of registrant's books and records which assertedly prevented preparation of adequate defense, *rejected*, where books and records were made available to them for examination and they had use of charts prepared by staff on basis of such records.

Contention by securities salesman for another broker-dealer that he was prejudiced by refusal to sever proceedings as to him because of substantial evidence adduced on fraud charges against other respondents in which he was not involved, *rejected*, since proceedings involved common questions of law and fact, hearing examiner was legally trained and judicially oriented, and his findings were reviewed by Commission.

### APPEARANCES:

*Alexander J. Brown, Jr., William R. Schief, and Michael J. Stewart* of the Washington Regional Office of the Commission, for the Division of Trading and Markets.

*Joseph S. Schuchert, Jr.*, of Schuchert, Schuchert & Sheerer, for Strathmore Securities, Inc., Auldus H. Turner, Jr., Ronald D. Turner and T. Theodore Turner.

*Theodore B. Henjum, pro se.*

*Ralph H. Demmler, Gilbert J. Helwig and Harry H. Weil*, of Reed, Smith, Shaw & McClay, for Michael R. Ventura.

### FINDINGS AND OPINION OF THE COMMISSION

Following extensive hearings in these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that the registration as a broker and dealer of Strathmore Securities, Inc. ("registrant") should be revoked and that it should be expelled from membership in the National Association of Securities Dealers, Inc. ("NASD"); that Auldus H. Turner, Jr., who was vice president of registrant, should be barred from association with any broker or dealer; that Ronald D. Turner and T. Theodore Turner, salesmen of registrant, should be suspended from such association for 12 months; and that Theodore B. Henjum, a salesman of registrant, and Michael R. Ventura, a salesman of another broker-dealer, should be suspended from such association for 30 days.<sup>1</sup>

<sup>1</sup> Other respondents, Ethel I. Weber, who was a branch office manager of Blair F. Claybaugh & Company, then a registered broker-dealer, and Louis A. Moore, Alan J. Davis and Hugh M. Casper, who were salesmen for that firm, were suspended from association with any broker or dealer for various periods pursuant to the initial decision on the basis of their failure to petition for review. The examiner's decision also became final as to another Claybaugh salesman, as to whom the examiner imposed no sanction. The firm's registration as a broker-dealer was revoked in other proceedings. *Siltronics, Inc.*, Securities Exchange Act Release No. 7158 (October 18, 1963).

We granted petitions for review filed by these respondents, briefs were filed by them and by our Division of Trading and Markets ("Division"), and we heard oral argument.<sup>2</sup> On the basis of an independent review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

1. *Distribution of Stock Pursuant to Claimed Regulation A Exemption*

On January 22, 1960, registrant became the underwriter with respect to a public offering by L. F. Popell Co., Inc. ("Popell Co.") of 100,000 shares of stock at \$3 per share, which had commenced on December 21, 1959, pursuant to a claimed exemption under Regulation A from the registration requirements of the Securities Act. On March 10, 1960, Popell Co. filed a report of sales which stated that the offering had been completed on January 29, 1960, and that all the shares in the offering had been sold. However, we find that the distribution continued at least until September 1960, with sales being made at prices in excess of the \$3 offering price.

Leo Popell, president of Popell Co., arranged for the sale in February 1960 of 18,500 shares at the offering price to the accounts of 10 individuals designated by him who were relatives, friends or acquaintances, or employees or former employees of Popell Co. This was apparently done in order to effect the disposition of additional shares of the offering, which had in fact been unsuccessful, without Popell's being openly involved in the transactions because of his control status in the issuer and the registration requirements of the Securities Act. Transfers of 8,500 of those shares to six of the designees were effected through registrant. None of these six designees previously had an account with registrant or communicated with registrant to open accounts or order the purchase or subsequent sale of these shares. Two designees gave registrant a 90-day option to purchase the shares at  $3\frac{1}{4}$ . Payments for the shares allocated to five of these designees were made by checks that did not bear their names, and registrant did not send stock certificates to two of them. The remaining 10,000 shares were transferred to two of the same designees and to the other four designees through a selling group member. None of these persons paid for the shares, payment being arranged by Leo Popell or other Popell Co. personnel. Between February 26 and September 26, 1960, Leo Popell caused the sale to registrant from the accounts of the 10 designees of a total of 16,500 shares at

<sup>2</sup> On October 13, 1967, we determined that it was not necessary or appropriate in the public interest to impose any sanction upon Henjum and discontinued the proceedings as to him. However, we indicated that formal findings and an opinion with respect to him as well as the other respondents would follow in due course.

prices ranging from 3 to  $4\frac{5}{8}$ ,<sup>3</sup> and between early February and September 1960, registrant sold those shares to customers and dealers at prices ranging from  $3\frac{3}{8}$  to 6.

Registrant and A. Turner knew or under the circumstances should have known that the 10 designees were not the actual purchasers and that a substantial portion of the Regulation A offering was transferred to them at the offering price with a view to its subsequent repurchase by registrant and distribution to the public.<sup>4</sup> These respondents therefore must have been aware that the distribution was not completed on January 29 but continued until the resale to the public of the repurchased shares. As stated in *Lewisohn Copper Corp.*,<sup>5</sup> a distribution of securities comprises "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public." By virtue of the distribution of the Popell shares after the purported completion date of the offering and at prices in excess of the stated offering price, no Regulation A exemption was available for the public offering of such stock, and since no registration statement had been filed or was in effect with respect to that stock registrant and A. Turner in the offer, sale and delivery of such stock willfully violated Sections 5(a) and 5(c) of the Securities Act.

In addition, registrant did not disclose, at least to those customers who testified,<sup>6</sup> the plan of distribution with respect to the portion of the offering represented by the shares transferred to the 10 designees of Leo Popell and repurchased and distributed by registrant.<sup>7</sup> Moreover, during its distribution of those shares, registrant purchased at least 35,000 shares from customers and dealers and, beginning in March 1960, entered bids for the stock on a daily basis in the National Quotation Bureau sheets. Such bids and purchases in the course of a distribution are expressly prescribed by the anti-manipulation provisions of Rule 10b-6 under the Exchange Act.<sup>8</sup> By such conduct, registrant, together with or aided and abetted by A. Turner, willfully violated anti-

<sup>3</sup> Of the total of 16 purchases by registrant from the 10 record owners, 6 were effected at prices substantially lower than its contemporaneous bids in the sheets published by the National Quotation Bureau, Inc., or the prices paid by registrant for purchases of such stock from others. Registrant sent the payments for its purchases from 7 of the 10 designees to various Popell Co. officials rather than to the designees.

<sup>4</sup> Cf. *Atlantic Equities Company*, 43 S.E.C. 354, 362 (1967); *Sidney Tager*, 42 S.E.C. 132, 136 (1964), *aff'd* 344 F.2d 5 (C.A. 2, 1965).

<sup>5</sup> 38 S.E.C. 226, 234 (1958).

<sup>6</sup> In addition to the shares of the offering transferred to the Popell designees, registrant sold 60,140 shares between February 1 and 10, 1960, directly to customers at the stated offering price and to broker-dealers at that price less a discount.

<sup>7</sup> See *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 869 (1965) *aff'd* 366 F.2d 446 (C.A. 2, 1966), *cert. denied*, 389 U.S. 991 (1967).

<sup>8</sup> *Ibid.*, at 870.

fraud provisions of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c) (1) of the Exchange Act and Rules 17 CFR 240.10b-5, 10b-6 and 15c1-2 thereunder.

2. *Distribution of Stock issued in Exchange for Corporate Assets*

On November 15, 1960, Popell Co. issued 28,600 shares of its stock to Perma Cement Products of America, Inc. ("Perma") in exchange for the latter's assets, pursuant to an agreement approved by Perma's 19 stockholders. Of those shares, 10,306 shares were distributed by Perma to nine of its stockholders, 8,294 shares, which were allocated to A. Turner for his assistance in arranging the exchange, were issued to Perma's vice president as Turner's nominee, and the remaining 10,000 shares were placed in escrow with Popell Co. counsel against any unknown liabilities of Perma. In the offer and sale of such shares, as described below, registrant, A. Turner, R. Turner, T. Turner, Henjum, and Ventura willfully violated Sections 5(a) and 5(c) of the Securities Act.

Although Perma's shareholders, at Popell Co.'s request, had agreed to hold the Popell Co. shares for investment, sales of such shares commenced almost immediately and continued into 1962. Charles N. Caputo, Perma's president and an attorney, testified that a number of Perma's stockholders asked him to sell their Popell Co. shares, and that A. Turner or Charles E. Klein, then president of registrant, informed him that registrant would not handle such sales but offered the use of registrant's salesmen to find purchasers. It was agreed that such salesmen would sell the stock for investment at a price somewhat lower than the market price, and that Caputo would open a bank account as trustee to receive payments for the stock and disburse them to the Perma stockholders. Purchasers were to sign an investment letter, which was drafted by Caputo and counsel for Popell Co., stating that the stock would not be "transferred or recorded for at least one year."

Pursuant to these arrangements, 2,800 shares of the 10,306-share block were sold to eight customers between December 1 and 9, 1960, by registrant's salesmen, including T. Turner (1,200 shares to three customers) and R. Turner (500 shares to two customers), and by A. Turner. Of the 8,294 shares beneficially owned by A. Turner, 1,100 shares were sold between December 1960 and February 1961, to five customers, including two of the eight customers previously mentioned, by registrant's salesmen, including T. and R. Turner and Henjum (each of whom sold 100 shares to a customer), with the payments being made first to the Caputo trustee account and, beginning in January 1961, to the

account of Harvey E. Schauffler, Jr., an attorney, who succeeded Caputo as trustee.<sup>9</sup> An additional 3,000 shares out of the two blocks of 10,306 shares and 8,294 shares were sold in December 1960 and January 1961, by salesmen for another broker-dealer to whom A. Turner allotted such shares. Between September 26, 1961, when the 10,000 escrowed shares were released, and January 25, 1962, sales of 2,500 shares of such stock were effected to six customers including a previous purchaser, by registrant's salesmen, including R. Turner who sold 500 shares to one customer. The proceeds of these sales were similarly paid into the trustee accounts.

Although, according to Caputo, A. Turner or Klein had stated that registrant would not itself handle the sale of any Popell stock for the Perma shareholders, it in fact did effect sales of a total of 8,590 shares without using the trustee accounts. Thus, between March and October 1961, registrant sold 3,030 shares of the 10,306 shares initially distributed to Perma shareholders, between September 1961 and April 1962, sold 3,194 shares of the block beneficially owned by A. Turner, and by January 25, 1962, sold 2,366 shares of the escrowed stock. The purchasers included at least nine individuals, one of whom had made a previous purchase from a Perma stockholder, and two broker-dealers. T. Turner was responsible for the sale of 1,750 shares to two customers.

Registrant and the Turners contend that the sales of Popell Co. stock by the Perma stockholders were exempt from registration pursuant to Section 4(1) of the Securities Act as "transactions by any person other than an issuer, underwriter, or dealer." We do not agree. Although under Securities Act Rule 17 CFR 230.133 the exchange of Popell Co. stock for the assets of Perma did not constitute a sale of such stock with respect to Perma's stockholders for purposes of the registration provisions of the Act, any control person of Perma who acquired such stock with a view to distribution is deemed to be an underwriter under the rule. Caputo, who held about 30 percent of Perma stock, was clearly a control person of Perma. Respondents assert that he sold the bulk of the 5,577 Popell Co. shares received by him in the exchange in unsolicited brokers' transactions, and therefore he would not be deemed to be an underwriter nor to have engaged in a distribution under paragraphs (d) and (e) of the rule because the stock sold by him within a period of 6 months did not exceed 1 percent of the stock outstanding.<sup>10</sup> In fact, 1,500 of Caputo's shares were sold by

<sup>9</sup> Schauffler testified that his trustee account was opened with a deposit of \$10,450 represented by a check from registrant.

<sup>10</sup> Popell Co. had outstanding a total of approximately 300,000 shares during the period in question.

registrant prior to October 23, 1961, and since registrant's offers in the sheets during this period constituted solicitations of orders to buy,<sup>11</sup> the exception in Rule 133 would not cover such sales. In any event, registrant admitted that its sales of 1,000 of such shares were solicited.

Moreover, the record supports the finding of the hearing examiner that all the Perma stockholders were members of a control group of Perma dominated by Caputo, and it is clear that the sales by such group (even assuming they were effected in unsolicited brokerage transactions) exceeded 1 percent. Perma was a small corporation and most of its 19 stockholders were united by family, personal or business ties and acted in concert with or acquiesced in the actions of Caputo as their leader. Although, as previously mentioned, they had agreed to hold the Popell Co. stock for investment, most of the Perma stockholders who participated in the initial allocation of Popell Co. shares arranged with Caputo, shortly after the exchange, for the sale of such stock, and thereafter a number of the Perma stockholders, including those whose stock was held in escrow, sold their shares directly through registrant or through the Schaufler trustee account.

We reject respondents' contention that the Perma control group did not acquire the Popell Co. stock with a view to distribution and therefore was not an underwriter within the meaning of Rule 133. Respondents assert that sales by the group did not constitute a public offering because they were limited to about 20 persons and those persons were stockholders of Popell Co. with access to information about the issuer, in most instances executed investment letters, and held the shares for a long period before reselling them. Respondents, who have the burden of proving the availability of an exemption,<sup>12</sup> have not established that there were only 20 purchasers, or that there were no additional offerees who did not effect purchases. Indeed, on this record, there is a basis for inferring that there were considerably more than 20 purchasers and offerees. As we have seen, a substantial number of shares were sold within a year to broker-dealers, and respondents have not asserted that such broker-dealers did not purchase for distribution. Nor have respondents established that sales, as well as offers, were confined to Popell Co. stockholders by the broker-dealers to whom registrant effected sales. In any event, the number of persons to whom shares are offered is not determinative of the ques-

<sup>11</sup> Securities Act Release No. 4818, p. 4 (January 21, 1966).

<sup>12</sup> *S.E.C. v. Ralston Purina Company*, 346 U.S. 119 (1953). See also *Robinette & Co., Inc.*, 42 S.E.C. 199, 200 (1964); *Gilligan, Will & Co. v. S.E.C.*, 267 F.2d 461 (C.A. 2, 1959), cert. denied 361 U.S. 896.

tion whether a distribution or public offering is involved, and respondents have not shown that those offerees who were stockholders of Popell Co. had such a special relationship to it as to "have access to the same kind of information" that registration would disclose.<sup>13</sup> Moreover, investment letters signed by purchasers are "necessarily self-serving and not conclusive" as to their actual intent.<sup>14</sup> As we stated in *Elliott & Company*:<sup>15</sup>

"The basic policy of registration under the Securities Act may not be frustrated by the technique of mechanically obtaining so-called investment intent letters from . . . purchasers."

Indeed, "a limitation upon resale for a stated period of time," in this case 1 year, "would tend to raise a question as to original intent."<sup>16</sup> And it is not claimed that investment letters were signed by the broker-dealers to whom Popell Co. stock was sold by registrant.<sup>17</sup>

We also reject the contention of R. and T. Turner that any violations of Section 5 by them were not willful. They assert that they were unaware of any wrongdoing, were subject to the direction of their superiors and were told they could make private placements, and knew that Caputo and Schauffler were attorneys who were responsible for the receipt and disbursement of funds and for the preparation of the investment letters. However, salesmen, no less than broker-dealers, should be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act, and they should be reasonably certain such an exemption is available, particularly in circumstances where their activities depart from normal business practices as the Turners' activity did. The distribution of the Popell Co. stock outside of the normal channels used by registrant; the 1-year limitation in the investment letters; and the number of persons to whom they offered Popell Co., stock all should have caused these salesmen to question the availability of an exemption from the registration provisions of the Securities Act. Their customers,

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<sup>13</sup> *S.E.C. v. Ralston Purina Company*, *supra*, 346 U.S. at 125-6. See also *S.E.C. v. Sunbeam Gold Mines Co.*, 95 F.2d 699, 702 (C.A. 9, 1938); *Robinette & Co., Inc.*, *supra*.

<sup>14</sup> Securities Act Release No. 4552 (November 6, 1962). See also *U. S. v. Custer Channel Wing Corporation*, 247 F. Supp. 481, 489-90 (D. Md., 1965), *aff'd* 376 F.2d 675 (C.A. 4, 1967).

<sup>15</sup> 38 S.E.C. 381, 385 (1958).

<sup>16</sup> Securities Act Release No. 4552 (November 6, 1962).

<sup>17</sup> No exemption from registration was available, as respondents further contend, under Section 4(2) of the Securities Act which relates to "transactions by an issuer not involving any public offering," since those shareholders obviously were not issuers. Our conclusion above that those persons were underwriters because they acquired the Popell Co. stock with a view to distribution has disposed of the question of the availability of an exemption under Section 4(1) which is the only section that is applicable.

although stockholders of Popell Co., were entitled to the protection of registration, and the right to such protection was not nullified by the signing of the investment letters. Nor would the participation by lawyers preclude a finding of willfulness.<sup>18</sup>

As to Ventura, the record shows that he had known Caputo, who had an account with his employer, for a long time, and that in late 1960 Caputo asked him to make a private placement of Popell Co. stock for a client. Caputo could not recall informing Ventura at that time why the stock could not be freely traded. Ventura did not produce a buyer. In April 1961, at Caputo's request, Ventura sold 900 shares of Popell Co. stock for Caputo's account. Caputo testified that he indicated to Ventura at that time that the stock was freely tradeable. In August 1962, Ventura sold two additional shares for Caputo's account at his request, and Caputo suggested that Ventura call two of Caputo's clients who also wished to sell Popell Co. stock. Ventura obtained information from those persons as to their employment and sold a total of 246 shares for them. One of them, for whom Ventura sold 207 shares, held those shares as a nominee of Caputo. The record does not show whether the shares of the other client were part of the shares issued to him as a result of the exchange of Popell Co. stock for Perma's assets. In September 1962, Ventura sold 45 shares for Caputo, and at his order, 1,243 shares for two other clients, after Ventura ascertained the nature of the employment of one and of the husband of the other. Of the 1,180 shares sold for one of these clients, 1,122 shares were beneficially owned by Caputo.<sup>19</sup> Altogether, between April 1961 and September 1962, Ventura sold 2,436 shares of unregistered Popell Co. stock for Caputo and his clients.

Ventura contends that the sales by him, which were handled by the trader in the firm with which he was associated, were exempt from registration under Section 4(4) of the Securities Act as broker's transactions executed upon purchasers' unsolicited orders. In our opinion, Ventura has not sustained his burden of establishing the availability of such exemption. His testimony that he gave the sell orders to the trader does not negate the possibility that customers' orders were solicited. But even assuming that the purchases were not solicited, the circumstances were such as to

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<sup>18</sup> Cf. *Morris J. Reiter*, 41 S.E.C. 137, 141 (1962); *The Whitehall Corporation*, 38 S.E.C. 259, 270 (1958); *Cornelis De Vroedt*, 38 S.E.C. 176, 180 (1958). See *Tager v. S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965). "It has been uniformly held that 'willfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the rules or Acts."

<sup>19</sup> Caputo testified that the purpose of the nominee arrangements was "personal," and he was not asked to elaborate.

alert Ventura to make further inquiry as to the source of the shares.<sup>20</sup>

Ventura argues that his investigation was adequate under the circumstances then known to him. He asserts that he did not know that Caputo beneficially owned 1,329 of the shares sold for two clients, that there was no reason for further inquiry because of the small size of the transactions and the recommendations of the sellers by Caputo whom he knew to be a reputable attorney, and that the nature of the employment of Caputo's clients made it highly unlikely that any of them was a control person of Popell Co.

A salesman is required, however, to make certain basic inquiries concerning the sellers and the source of their stock when he is asked by unknown persons to sell substantial amounts of little known securities. Ventura did not know two of the clients and had never done business with the other two and was acquainted with one or both of them only on a casual social basis. The transactions were not small. Ventura's first transaction for Caputo amounted to about \$6,650, and his transactions for two of Caputo's clients to about \$3,400 and \$22,800, respectively. Caputo's inquiry of Ventura in late 1960 concerning a private placement of Popell Co. shares should have indicated that Caputo believed registration to be required for such shares unless a private offering exemption were available. He did not question Caputo or use his employer's facilities to determine whether his sales were part of a larger distribution. The account cards prepared by Ventura for two of the clients listed as their telephone number what he recognized to be Caputo's office telephone number and Ventura caused most of the checks and confirmations to be sent to Caputo's office. Although he "looked" at Popell Co. advertising materials which his employer had on file, he did not attempt to ascertain whether a registration statement was in effect with respect to the stock, did not inquire as to the source of his principals' stock, and remained ignorant of the Popell Co.'s acquisition of Perma. We consider that the inquiries he did make were substantially deficient.<sup>21</sup>

Ventura asserts that further inquiry would have been fruitless. We disagree, although we need not speculate as to what reasonable inquiry would have disclosed where no such inquiry is made. Ven-

<sup>20</sup> Cf. Rule 17 CFR 230.154, which defines "brokers' transactions" in Section 4(4) of the Securities Act to include transactions by a broker in behalf of a controlling person of the issuer, where, among other things, "the broker is not aware of circumstances indicating that his principal is an underwriter in respect of the securities or that the transactions are part of a distribution of securities on behalf of his principal." See Securities Act Release No. 4818 (January 21, 1966).

<sup>21</sup> See *Century Securities Company*, 43 S.E.C. 371, 381 (1967).

tura admits that additional questioning might have revealed Caputo's nominee arrangements, but discounts their significance. More diligence should have disclosed the acquisition of Perma, Caputo's position in that company, and the immediate commencement of the distribution by the Perma stockholders.

Ventura contends that additional inquiry would merely have indicated the propriety of the transactions, arguing that the former Perma stockholders did not constitute a control group of Perma, and that under Rule 133 neither Caputo nor any other Perma stockholders assumed to be control persons would be deemed to be underwriters because assertedly they sold their Poppel Co. stock in unsolicited brokers' transactions and the amount sold by each such stockholder within a period of 6 months did not exceed 1 percent of the stock outstanding. We have already found that Caputo sold at least 1,500 shares through solicited broker's transactions, and that the Perma stockholders were members of a control group whose sales exceeded 1 percent of the outstanding stock. But Ventura further asserts that Rule 133, in defining an underwriter, applies only to "any person" who controls the constituent corporation, and that the first intimation that a control group of a constituent company might be deemed an underwriter and its sales lumped together for purposes of the 1 percent test in Rule 133 appeared in a Commission Release issued on February 17, 1964,<sup>22</sup> long after Ventura's last transaction. The group concept, however, is not new, having previously been applied in a court decision which involved that rule. In 1959, the Court of Appeals for the Second Circuit expressly held that Rule 133 does not provide an exemption for a subsequent sale of unregistered stock by a control group of the constituent company.<sup>23</sup> Moreover, we held in 1950 that a number of stockholders who distributed shares of the issuer through broker-dealers were members of a cohesive group in control of the issuer, and therefore were "issuers" within the meaning of Section 2(11) of the Securities Act, even though the term "issuer" is defined to include "any person" controlling the issuer.<sup>24</sup>

In view of Ventura's failure to make reasonable inquiry despite the various factors which should have alerted him to the need for such inquiry,<sup>25</sup> we conclude that his violations were willful. Ventura's contention that even if he were negligent, it would not

<sup>22</sup> Securities Act Release No. 4669 (superseded by No. 4818 (January 21, 1966)).

<sup>23</sup> *S.E.C. v. Culpepper*, 270 F.2d 241, 247-8 (C.A. 2, 1959).

<sup>24</sup> *The S. T. Jackson & Company, Inc.*, 36 S.E.C. 631 (1950).

<sup>25</sup> See *S.E.C. v. Culpepper*, *supra*, 270 F.2d at 250-1; *S.E.C. v. Mono-Kearsarge Consolidated Mining Company* 167 F. Supp. 248, 261 (D. Utah, 1958).

constitute willfulness and that gross negligence must be shown is rejected. We hold that careless disregard of his responsibilities as a securities salesman was enough.<sup>26</sup>

3. *Distribution of Stock Issued in Exchange for Shares of Stockholders in Another Corporation*

Similar willful violations of Sections 5(a) and 5(c) of the Securities Act were committed by registrant, A. Turner, R. Turner and T. Turner following the issuance by Popell Co. on December 27, 1961, of 50,139 shares of its stock to the stockholders of Manor Lake Development Corporation ("Manor Lake") in exchange for their shares. Klein, who was president of Manor Lake as well as of registrant, received 3,065 Popell Co. shares, A. Turner, a director, 2,440 shares, Walter Criste, secretary and counsel for Manor Lake, 750 shares, and Schaufler, a principal stockholder, 9,500 shares. An additional 10,000 shares were issued in Criste's name with the understanding that they would be sold through registrant and the proceeds used to discharge a mortgage on Manor Lake property.

Sales of the Popell Co. shares commenced within a month after their issuance to the Manor Lake shareholders. Registrant sold 2,000 shares to six customers in October and November 1961, and made delivery by using 1,000 of A. Turner's shares and 1,000 of Klein's shares purchased from them in January 1962. It sold 1,000 Popell Co. shares to 13 customers in January and February 1962, and made delivery with shares it purchased from Klein in March 1962. In addition, 1,440 of A. Turner's shares were sold by or through registrant to various customers and to other broker-dealers in February 1962, and thereafter. Registrant also purchased 1,000 shares of Schaufler's Popell Co. stock in April 1962, and used them to make delivery in sales made to four persons during the preceding month. It purchased an additional 2,000 shares from Schaufler in July and August 1962, and subsequently resold them to various brokers.

In December 1961 and January 1962, registrant purchased 1,570 of the 10,000 shares issued in Criste's name and sold them to various customers. Its salesmen, generally using the procedures employed in the sale of Popell Co. shares held by the Perma shareholders through the trustee bank accounts, also arranged sales of 3,800 shares of the same block to seven individuals. T. Turner was responsible for a sale of 500 shares to one customer and R. Turner for 100 shares to one customer. Payments were

<sup>26</sup> See *Mayflower Associates, Inc.*, 38 S.E.C. 110 (1957); *Loss, Securities Regulation* (1961 ed.), p. 1309.

made to the Schaufler trustee account, to a trustee bank account which Criste had opened, and in one instance directly to Manor Lake's mortgagee. Further, registrant supplied a Claybaugh salesman with 500 of 1,500 shares in Criste's name that the salesman sold to a customer in February 1962.

No Section 4(1) exemption was available for the sales of Popell Co. stock by Klein, A. Turner, Criste, and Schaufler. We agree with the findings of the hearing examiner that these individuals constituted a control group of Manor Lake and that such group acquired the Popell Co. shares with a view to distribution and was therefore an underwriter under the terms of Rule 133. Klein was the dominant figure in the group and, with A. Turner's assistance, was instrumental in arranging for the agreement with Popell Co.<sup>27</sup> Criste supported Klein and executed stock powers to him with respect to the 10,000 shares issued in his name but delivered to Klein. Schaufler occupied a strategic position by virtue of his ownership of 19 percent of Manor Lake's stock, with the remaining shares held by more than 200 persons, and he acquiesced in or implicitly supported the actions of Klein and A. Turner.

Nor was a private offering exemption under Section 4(2) available for the sales of the stock in Criste's name as "investment stock," which were assertedly made to only eight persons who were stockholders of Popell Co. Our reasons set forth earlier for rejecting the similar contention with respect to the sales of Popell Co. shares by the former Perma stockholders need not be repeated here. Moreover, as in the case of the Perma exchange, Popell Co. shares were sold to undisclosed customers by registrant. The contention of R. and T. Turner that their sales of shares issued in Criste's name did not constitute willful violations is rejected for the reasons discussed in connection with their sales on behalf of the former Perma stockholders.

#### FAILURE TO MAINTAIN BOOKS AND RECORDS

Registrant, aided and abetted by A. Turner, willfully violated the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder in that it failed to record its transactions in the Popell Co. stock received by Perma and Manor Lake stockholders and effected through the Caputo, Schaufler, and Criste trustee bank accounts, as described earlier in this opinion.

<sup>27</sup> In late 1961, Klein suffered the first of a series of heart attacks that culminated in his death in February 1964. However, notwithstanding respondents' contrary assertion, it is clear that he continued to dominate Manor Lake's affairs until shareholder approval of the acquisition.

Registrant and A. Turner assert that they did not suggest the opening of the trustee accounts, that such accounts are merely a conventional tool used by attorneys to assure the proper handling of transactions, and that registrant did not act as principal or agent in any of those transactions and received no compensation in connection with them. However, most of the sales were negotiated by registrant's salesmen, including R. and T. Turner and Henjum, who solicited customers after receiving detailed instructions from A. Turner and used registrant's office facilities in effecting sales. A. Turner personally solicited customers and effected sales. As previously mentioned, 10,000 shares were issued in Criste's name with the understanding that they would be sold to or through registrant, and the Criste as well as the Schaufler trustee account was used with respect to a substantial portion of those shares.

Moreover, disbursements at least from the Schaufler and Criste trustee accounts were controlled by Klein or A. Turner. When Schaufler became trustee,<sup>28</sup> Caputo instructed him to follow any instructions he might receive from them. On January 25, 1961, pursuant to such instructions, Schaufler remitted \$5,000 to registrant in payment for certain securities purchased by it.<sup>29</sup> In addition, a year later, Schaufler executed a check for \$10,000 to Klein and one in the same amount to A. Turner. While Klein and A. Turner executed notes providing for repayment in 36 and 42 months, respectively, such long-term loans were inconsistent with the stated purpose of the trustee account.<sup>30</sup> Schaufler also forwarded \$6,000 to a broker-dealer in March 1962 in satisfaction of a personal obligation of A. Turner.<sup>31</sup>

The hearing examiner found that the transactions effected in the trustee accounts by registrant's salesmen and A. Turner were in fact registrant's transactions. We find that, at the least, the handling of the transactions was under the control of registrant and its principals, and those transactions should have been recorded on registrant's books.

#### OTHER MATTERS

Registrant and the Turners contend that they were denied due

<sup>28</sup> As previously mentioned, Schaufler testified that the opening deposit of \$10,450 in his trustee account was made with a check by registrant.

<sup>29</sup> Schaufler had deposited a \$5,000 check drawn by registrant on the preceding day. The record does not disclose the source of those funds.

<sup>30</sup> No effort to collect the ostensible loan to Klein, which was overdue, had been made at the time Schaufler testified in February 1965. Schaufler stated that because of these proceedings and out of consideration for Klein's widow, Caputo had decided not to take immediate action. Repayment of the purported loan to A. Turner was not yet due at the time.

<sup>31</sup> Schaufler testified that he regarded this payment as a loan to A. Turner and it appears that the trustee account was reimbursed in September 1962.

process by our staff's allegedly wrongful retention of their books and records. On February 19, 1964, registrant transferred certain records reflecting its transactions in Popell Co. stock to a staff investigator who executed a receipt promising their return within 30 days. Our staff was unable to complete its examination within such period, and registrant's counsel advised it that return of the books was not then required. On May 21, 1964, registrant turned over other books and records to the staff and a similar receipt was executed undertaking to return them within 30 days.

Upon the request of A. Turner, who had been subpoenaed to testify in the investigation, that examination of the records be permitted, they were made available at a Federal building from September 27 to October 16, without restriction to normal working hours.<sup>32</sup> Registrant's representatives examined the records under this arrangement for a total of less than 11 hours and did not request an extension. Registrant's books and records were subpoenaed by the staff in November 1964, and these proceedings were instituted in January 1965.

These respondents assert that our staff's retention of registrant's records impeded their ability to ascertain and investigate sources of relevant information as well as to check the details of particular transactions. They further assert that making the records available at the Federal building for 3 weeks was inadequate because their examination was hindered by the presence of staff personnel and because an investigator employed by registrant was taken ill.

We recognize that a respondent must not be hindered from preparing an adequate defense by staff denial of access to their records and that our staff must return such records after a reasonable time taking into account the purposes for which they were produced.<sup>33</sup> While the staff's question whether the period of retention was reasonable, no showing of prejudice to respondents has been made.<sup>34</sup> Respondents had ample opportunity to examine the books and records in the Federal building. The Division states that the employee who had custody of the books had been instructed to absent himself when registrant's representatives were present and respondents have cited no specific instance of interference by him. If other circumstances prevented respondents from taking full advantage of the arrangement, they could have requested an ex-

<sup>32</sup> The Division disputes respondents' claim that they had previously orally requested return of the records.

<sup>33</sup> Cf. *John Rosenblum, Inc. v. Gillespie*, 187 F. Supp. 258, 260 (S.D. N.Y., 1960); *Bendix Aviation Corporation*, 58 F. Supp. 953 (S.D. N.Y., 1945).

<sup>34</sup> See *Bornn v. Page*, 14 F. Supp. 767, 768 (E.D. N.Y., 1936).

tension and no explanation of their failure to do so has been offered.

In addition, respondents had further opportunities to examine their records during the hearings. The hearings were recessed for a total of 120 calendar days. The hearing examiner, although denying respondents' motions for an extended recess and sole possession of registrant's records, advised them that he would adjourn the hearings for any period reasonably necessary for the preparation of their defense and not merely, as they assert, to prepare for cross-examination. Despite this offer, respondents introduced no evidence after the Division had completed its case, claiming, among other things, that their ability to do so had been undermined by lack of access to the records.

We also note that the preparation of respondents' case was facilitated by the introduction in evidence of charts prepared by the staff tracing the sales of Popell Co. shares by the Perma and Manor Lake shareholders. The charts listed the record buyers and sellers and the dates, sale prices and volume of sales, and the accuracy of such data was stipulated after an agreement upon certain corrections. In view of these charts and the fact that respondents necessarily were familiar with the relevant transactions in which they participated, we do not consider that respondents were prejudiced by the extended period of time required by the staff to prepare its case.

Registrant and A. Turner also complain that the hearing examiner improperly drew the inference from A. Turner's failure to testify concerning facts and circumstances peculiarly within his knowledge that such testimony would have been adverse. He was called as a witness by the Division but refused to answer any questions, except those concerning the extent of his stock ownership in registrant and his official position and duties, on the ground that his answers might tend to incriminate him. Our proceedings are civil in nature<sup>35</sup> and the weight of authority permits an adverse inference to be drawn in such proceedings from the failure of a party to testify or even from the invocation of the privilege against self-incrimination.<sup>36</sup> However, although the examiner considered that it was appropriate to draw an adverse inference, he indicated that it was unnecessary to do so since, in

<sup>35</sup> See *Blaise D'Antoni & Associates, Inc. v. S.E.C.*, 289 F.2d 276, 277 (C.A. 5, 1961), rehearing denied, 290 F.2d 688, cert. denied, 368 U.S. 899; *Associated Securities Corp. v. S.E.C.*, 283 F.2d 773, 775 (C.A. 10, 1960); *Pierce v. S.E.C.*, 239 F.2d 160, 163 (C.A. 9, 1956); *Wright v. S.E.C.*, 112 F.2d 89 94 (C.A. 2, 1940).

<sup>36</sup> 8 Wigmore, Evidence §2272 (3rd ed. 1940). See also *In re Sterling Harris Ford, Inc* 315 F.2d 275, 279 (C.A. 7, 1963), cert. denied, 375 U.S. 814; *Rubenstein v. Kleven*, 150 F. Supp., 47, 48 (D. Mass., 1957); *N. Sims Organ*, 40 S.E.C. 573, 577 (1961), aff'd 293 F.2d 78, 80-81 (C.A. 2, 1961), cert. denied, 368 U.S. 968.

his opinion, his findings were warranted without such an inference, and we have not relied on any such inference.

Ventura contends that the refusal of the hearing examiner and the Commission to sever the proceedings as to him violated his rights under the due process clause and the Administrative Procedure Act. He asserts that the accumulation of evidence on the charges of conspiracy and fraud which were not pertinent to him probably resulted in confusing the facts and arguments relevant to the other respondents with those relevant to him. We do not agree. These proceedings involve a number of questions of law and fact common to the issues affecting Ventura and the other respondents, including the organization and operation of Perma, the circumstances surrounding its acquisition by Popell Co., the subsequent sales of Popell Co. stock by Perma's shareholders, and the availability of a Section 4(1) exemption. All of those questions were subjects of extensive proof and argument, and separate proceedings would have been uneconomical. Moreover, the hearing examiner is legally trained and judicially oriented and his findings and conclusions have been reviewed by us.<sup>37</sup>

#### PUBLIC INTEREST

We agree with the hearing examiner that registrant's registration as a broker-dealer should be revoked, that it should be expelled from the NASD, and that A. Turner should be barred from association with any broker or dealer. The extensive violations we have found demonstrate gross indifference to the requirements of the securities laws and are inconsistent with the continued engagement of registrant in the securities industry. These are not the first disciplinary proceedings against them. In 1959 the NASD fined registrant for sales of securities at unfair prices. In April 1966, we sustained the NASD's findings of similar violations by registrant and A. Turner and of violations of Regulation T by registrant, and registrant's membership in the NASD and A. Turner's registration as a registered representative was suspended for 90 days.<sup>38</sup> And on July 11, 1967, we suspended registrant from membership in the NASD for 90 days and named A. Turner a cause of such suspension on the basis of findings of their

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<sup>37</sup> Cf. *Marketlines, Inc.*, 43 S.E.C. 267, 274 (1967), *aff'd*, 384, F.2d 264 (C.A. 2, 1967); *J. A. Winston & Co., Inc.*, 42 S.E.C. 62, 71 (1964); *Clinton Engines Corporation*, 41 S.E.C. 408, 410 (1963); See also *Donnelly Garment Co. v. N.L.R.B.*, 123 F.2d 215, 224 (C.A. 8, 1942): "One who is capable of ruling accurately upon the admissibility of evidence is equally capable of sifting it accurately after it has been received."

<sup>38</sup> *Strathmore Securities, Inc.*, 42 S.E.C. 993 (1966), *aff'd* C.A.D.C., No. 20,175, January 3, 1967, *cert. denied* 387 U.S. 918.

participation in a scheme to defraud in the sale of a "hot issue" and of violations of the registration provisions.<sup>39</sup>

Although the violations committed by R. and T. Turner and Ventura are of a serious nature, they were not found to involve fraud, and these are the first disciplinary proceedings against them. Moreover, the record does not indicate they committed any violation in connection with the Regulation A offering of Popell stock, and, unlike A. Turner, they were not deeply involved as participants in the other distribution of Popell Co. stock. Ventura's participation in the distribution, unlike that of R. and T. Turner, was peripheral in nature. He was not involved in sales of so-called "investment stock" through the trustee accounts and it does not appear that he personally solicited purchases. Under the circumstances, we consider it appropriate in the public interest to reduce the 12 months' suspensions of R. and T. Turner to 90 days and to censure rather than suspend Ventura.

An appropriate order will issue.

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

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<sup>39</sup> *Atlantic Equities Company*, 43 S.E.C. 354.