ADMINISTRATIVE PROCEEDING
FILE NO. 3-1958

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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| In the Matter of | : | |
| ROBERT STEAD<br>EDWIN GOMER JONES, JR.<br>THEODORE AVCHEN<br>MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC.<br>JOHN CLARKE<br>GEORGE STROMBERG<br>BILLY NEIGHBORS | :<br>:<br>:<br>:<br>:<br>: | (PRIVATE PROCEEDINGS) |



# INITIAL DECISION

Washington, D. C.
December 21, 1971

Irving Schiller
Hearing Examiner

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APPEARANCES: Joseph F. Krys, Matthew J. Zale, and H. Michael Spence, of the Denver Regional Office of the Commission for the Division of Trading and Markets.

Norman S. Johnson for Robert Stead.

Rodney K. Potter of O'Melveny & Meyers initially for Edwin G. Jones, Jr., currently pro se.

Sanford Ehrmann for Theodore Avchen.

Richard Conway Casey and Robert A. Foy of Brown, Wood, Fuller, Caldwell & Ivey for Merrill, Lynch, Pierce, Fenner & Smith, Inc., George Stromberg and John Clarke.

Leon S. Gottlieb of Locke, Black & Locke for Billy Neighbors.

BEFORE: Irving Schiller, Hearing Examiner

These are private proceedings instituted by the Securities and Exchange Commission ("Commission") pursuant to Section 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the following, among others[1/], Robert Stead ("Stead"), Edwin Gomer Jones, Jr. ("Jones"), Theodore Avchen ("Avchen"), Merrill, Lynch, Pierce, Fenner & Smith, Inc. ("Merrill, Lynch"), and John Clarke ("Clarke") willfully violated Sections 5(a) and (c) of the Securities Act of 1933 ("Securities Act"); whether George Stromberg ("Stromberg") and Billy Neighbors ("Neighbors") failed reasonably to supervise the persons under their supervision with a view to preventing the violations alleged in the Commission's order for proceedings and whether any remedial action is appropriate in the public interest pursuant to the above-mentioned Sections of the Exchange Act.

The order for proceedings alleges in substance that during the period from approximately June 1967 to on or about August 1968 the

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1/ The Commission's order for proceedings dated April 21, 1969 also sets forth charges against the following firms and persons whose cases have been determined by the Commission as reflected in the Commission's respective releases as noted: V. E. Anderson & Company, and V. E. Anderson, Exchange Act Release No. 8755, dated November 21, 1969; Babcock and Company and Louis Babcock, Exchange Act Release No. 8804, dated January 21, 1970; E. H. Coltharp and Company and E. H. Coltharp, Exchange Act Release No. 9053, dated January 5, 1971; Goodbody and Company and Arnold Newman, Exchange Act Release No. 9122, dated April 2, 1971; Kleiner, Bell and Company, Inc., and Ralph Shapiro, Exchange Act Release No. 9031, dated November 30, 1970; Sierega and Company, Inc., Exchange Act Release No. 9009, dated October 23, 1970; Quinn and Company, Inc. and John Dormacker, Exchange Act Release No. 9062, dated January 25, 1971; Dean Witter and Company, Inc. and Lawrence Smith, William Lashbrook, George Vanderhoff and Richard Brown, Exchange Act Release No. 8700, dated September 19, 1969 and Robert P. Woolley and Company and Robert P. Woolley, Exchange Act Release No. 8804, dated January 21, 1970.

persons and firm mentioned above willfully violated Sections 5(a) and (c) of the Securities Act in that they offered to sell, sold and delivered after sale shares of the common stock of Mountain States Development Company, Inc. ("Mountain"), when no registration had been filed or was in effect as to said securities pursuant to the Securities Act. The approximate number of shares sold by each of the broker-dealer firms named in the order is set forth therein together with the dates of such sales. The order further alleges that the two individuals mentioned above failed reasonably to supervise persons under their supervision with a view to preventing the violations alleged in the order for proceedings.

After appropriate notice, hearings were held before the undersigned hearing examiner. Proposed findings of fact and conclusions of law and briefs were filed by the Division of Trading and Markets ("Division") and by the above-named remaining respondents.

The following findings and conclusions are based upon the preponderence of the evidence as determined by the record, the documents and exhibits therein and the hearing examiner's observation of the various witnesses.

Mountain

Since the order for proceedings relates to alleged violations of the Securities Act and the Exchange Act arising out of the asserted offer, sale and delivery after sale, by at least ten brokerage concerns and seventeen individuals, of approximately 1,019,000 shares of the

common stock of Mountain during the period July 1967 through August 1968 it is deemed essential to chronicle the background of Mountain, the manner in which control of the said company was acquired, the various transactions culminating in the sale of Mountain stock and the modus operandi as a result of which such stock was publicly distributed. The involvement of each of the remaining respondents in such distribution will be detailed below. Mountain was incorporated in Utah in December 1919. From that date until the latter part of 1962 the company was engaged in owning and holding oil and gas leases in Utah and the record does not disclose whether any of such leases were productive. Though the company acquired additional leases thereafter it had no production during 1964 and 1965 and its net share of oil produced in 1966 was 544 barrels. As of December 1966 the company had no proved reserves nor was it the operator of any wells. As of approximately the same date the company has authorized 2,500,000 shares of common stock, 1¢ par value of which there was outstanding 1,700,774 shares. Of the outstanding shares one W. D. Nebeker, Jr. ("Nebeker"), president of Mountain, owned 28.24% and all of the officers and directors owned approximately 29%. Under the law of the State of Utah the capital stock of Mountain was assessable. In March 1967 Mountain increased its authorized capital stock to 10,000,000 shares and issued 1,282,141 shares to acquire the assets of Ute Royalty Corp. ("Ute"), also a Utah corporation. Ute was merged into Mountain. Following the merger Mountain had outstanding 2,982,915 shares of its stock of which Nebeker, who had also owned 19,000 shares of Ute prior to the merger,

became the owner of 536,861 shares of Mountain or 18.3% of the outstanding stock. Earl M. Henderson ("Henderson") the former president of Ute became the owner of 560,777 shares of Mountain (18.8%). Henderson became president of Mountain, Nebeker its vice president and Maxwell Bently secretary and treasurer.

Shortly prior to July 1, 1967 Charles E. Graham, Jr. ("Graham") met with Nebeker and Bently, told them he was interested in "making a deal" with Mountain, that he had oil properties he wanted to "get into the company" and that he was looking for a public company. At a meeting in Denver, Colorado on July 16, 1971 an agreement was entered into between Graham and Nebeker and Henderson whereby the latter two each sold 500,000 shares of Mountain to Graham. The agreement stated that Graham was purchasing the stock for investment and not for resale or distribution and that the stock being sold was "control" stock and "as such may not be traded, sold or exchanged except in accordance with the legal requirements of the said Securities and Exchange Commission." However, Graham testified he disclosed to Nebeker and Henderson at that time, that he was purchasing the stock for himself and a group composed of Sam Manchel ("Manchel") who was to receive one-half of the 1,000,000 shares Graham purchased, Newell Hays ("Hays") who was Graham's principal financial backer, E. P. Rister ("Rister") and C. Scott Ferguson ("Ferguson"). He also told the sellers that he was a 60% general partner in Graham Oil Company and that Ferguson and Rister were his partners each with a 20% interest. The record shows that Graham and Manchel entered into an agreement (undated

but stated to be effective as of July 28, 1967) whereby Graham sold Manchel one-half of the 1,000,000 shares he was acquiring from Henderson and Nebeker. The record also shows that on or about July 16, 1967 of the 1,000,000 shares of Mountain stock purchased from Nebeker and Henderson 485,000 shares were transferred into Graham's name, 405,000 shares in the name of Manchel, 5,000 shares in Ferguson's name, 5,000 shares in the name of James W. Branson ("Branson") and 100,000 shares were transferred into the name of Maxine Bennett ("Bennett"), the daughter of Manchel. On August 17, 1967 Graham transferred 95,000 shares of his stock to Ferguson and 100,000 shares to Rister.

On July 17, 1967, the day after the agreement noted above, an agreement was entered into between Mountain and Graham Oil Company for the sale of oil properties by Graham Oil to Mountain for $490,000 in notes, one of which was for $280,000 convertible into common stock of Mountain at any time prior to July 17, 1969. On January 11, 1968, the note was converted by Graham Oil into 1,801,813 shares of Mountain common stock and Mountain was directed to issue 1,151,813 of such shares to Graham, 325,000 of such shares to Ferguson and 325,000 of such shares to Rister. Contemporaneously with their acquisition Graham, Ferguson and Rister signed letters acknowledging they were receiving the shares for investment and not with a view to public resale or distribution. The letters further stated that each of the persons was familiar with a Commission release discussing the Section 4(1) exemption and the

letter quoted pertinent portions of the release discussing the concepts of taking for investment. Notwithstanding, the record discloses that on the same day, January 11, 1968, Graham transferred 362,500 shares to Hays and 25,000 to Alvin Marks and Rister transferred 100,000 shares to six persons. It is clear from the record that the certificates for the 1,000,000 shares of Mountain stock acquired from Nebeker and Henderson and the certificates for the 1,151,813 shares of Mountain stock acquired upon the conversion of the $280,000 note, were kept by Graham in a personal drawer and were indiscriminately delivered by Graham and transferred into the names of Ferguson, Rister, Manchel, Hays and others as Graham determined from time to time. In other words when the occasion arose for Graham to deliver shares of Mountain stock to cover sales or other obligations he simply reached into the drawer and furnished certificates without distinguishing whether they came from the 1,000,000 share block or the 1,151,813 share block.

On or about August 10, 1967 Graham agreed to buy from one Leon Fromkess ("Fromkess") his half interest in Laser Power Industries, Inc. ("Laser"). Laser at that time had outstanding 10,000 shares of stock and Fromkess owned 5,000 shares which were in the name of his daughter Bennett. An agreement was entered into between Graham and Bennett for the purchase by Graham of 5,000 shares of Laser for $30,000 payable in notes, one of which was for $20,000 with the right of Bennett to convert into common stock of Mountain. To induce Fromkess to sell his interest in Laser, Graham offered to sell Fromkess 100,000 shares of Mountain stock for $5,000. The stock was purchased

in Bennett's name and she signed a letter dated August 9, 1967, addressed to Nebeker, stating she was aware she was receiving her stock from the 500,000 shares control stock sold to Graham on July 16, 1967 and that she was taking the stock for investment and not in contemplation of resale or distribution. The investment letter was prepared by Graham and after Bennett signed it the letter was given to Graham. Fromkess asked Graham when he could dispose of the stock and Graham told him it would be "anywhere from six months to a year." At the time these transactions were taking place Graham told Fromkess the Mountain stock was assessable and an assessment of 10¢ per share would shortly be made. Fromkess expressed concern about the necessity of paying an additional $10,000 on the assessment. Graham offered to loan Fromkess the money which Fromkess would then loan to Mountain. When the assessment would be levied the loan would be cancelled. Fromkess accepted the offer and Graham loaned Fromkess $10,000 which he then loaned Mountain. Graham held the above-mentioned 100,000 shares of Mountain as collateral for the said loan.

On or about February 25, 1968 Fromkess and Bennett met with Graham Bentley, Hays and others in Los Vegas, Nevada at which time Bennett converted the above-mentioned $20,000 note into 102,744 shares of common stock of Mountain. Fromkess told Graham he wanted to dispose of his Mountain stock and Graham said he would arrange for the sale of such stock. Graham then told Fromkess he had sold the stock to one Irving Cobb ("Cobb") for the latter's notes and when Fromkess told Graham he did not want to sell for notes Graham guaranteed payment of

the notes. Whereupon Bennett transferred both the 100,000 shares and the 102,744 shares of Mountain to Cobb by letters dated February 26, 1968. In the letter relating to the 102,744 shares Cobb acknowledged he was acquiring the shares for investment and not with a view to distribution. In fact Graham handled the entire transaction for the sale to Cobb. Graham already had the 100,000 share block as collateral for the above-mentioned loan and Bennett merely executed a power of attorney to Graham. The 102,744 share block was physically given to Graham at the time the above-mentioned letters to Cobb were signed. When Cobb was unable to pay the notes he had given at the time he purchased the 102,744 share block he met with Graham and Hays and they arranged for Hays to pay Bennett $40,000 for which Hays received the aforementioned shares. In the latter part of July 1968 Hays delivered a portion of such shares to cover sales of Mountain he effected through a brokerage concern in Utah.

In May 1968 Graham met with William Nathan ("Nathan"), Robert H. Collins and Larry Mills ("Mills") who were equal shareholders and officers and directors of Manhattan-West Corporation ("Manhattan-West") and entered into an agreement on behalf of Mountain for the sale of Laser to Manhattan. As a part of that transaction, which also involved the sale of other securities, Manhattan-West was to receive 150,000 shares of Mountain stock for $41,000 in cash. Nathan informed Graham he intended to sell the 150,000 shares of Mountain stock. Graham thereupon undertook to supply Nathan with what he termed free trading stock by arranging with Hays for the latter to supply the 150,000

shares to Nathan which the latter promptly sold publicly. In late May or early June 1968 Manhattan-West arranged with Graham for the purchase of an additional 100,000 shares of Mountain stock for $54,000 informing Graham they intended to sell such stock immediately to recoup at least the $54,000. Graham again arranged with Hays for the latter to deliver to Manhattan-West 100,000 shares which Hays owned. Manhattan-West promptly sold approximately 44,000 of such shares and the remaining 56,000 shares were, in accordance with the agreement with Graham, split between Manhattan-West and one Edward Ashdown ("Ashdown"), the west coast representative and office manager of Mountain's Los Angeles office and the finder of the Manhattan-West-Laser deal.

The record discloses that on or about February 10, 1967 Mountain had outstanding 1,700,744 shares of its common stock, that as at December 31, 1967 following the Ute merger in March 1967, noted above, Mountain had outstanding 2,982,915 shares; that as at January 1, 1968, it had outstanding 4,990,216 shares and as at April 30, 1968 Mountain had 5,093,716 shares outstanding. The common stock of Mountain was registered for trading on the Salt Lake Stock Exchange ("Salt Lake Exchange") under the Exchange Act on March 25, 1948.[2/] Trading in Mountain stock was suspended on such Exchange by this Commission on August 28, 1968[3/] and the Salt Lake Exchange had suspended exchange

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2/ The Salt Lake Stock Exchange has been registered as a national securities exchange since October 1, 1934.

3/ Exchange Act Release No. 8396.

trading on August 22, 1968. In April 1969, Mountain and certain of its officers and associates were enjoined on consent from violating the registration, anti-fraud and reporting provisions of the securities laws.[4/] The suspension of trading was terminated on April 28, 1969.[5/]

In January 1967 the price of Mountain stock on the Salt Lake Exchange ranged from a low of 5¢ to a high of 6-1/2¢; in June the price ranged from a low of 6¢ to a high of 7¢; in July the range was low 7-1/2¢ high 16¢ and in December the range was low 7-1/2¢ high 12¢. The monthly volume of trading during the year on the said Exchange ranged from 2,500 shares in January 1967 to 186,300 shares in July and 90,500 in December 1967. The cumulative total for the year was 645,425 shares traded of which a total of 584,425 were traded between July and December 1967. In January 1968 the price range of Mountain stock on the said Exchange was low 11-1/2¢ high 15¢ and by August of that year, prior to suspension of trading, the range was low $1.50 high $2.87-1/2. The monthly volume of trading in Mountain stock between January and August 1968 on the said Exchange ranged from 208,577 in April to 672,150 in February. The cumulative total of trading in the eight months of 1968 was 3,167,924 shares. During the same period weekly trading ranged from 14,250 for the period July 1 to July 5,to 395,350 for the period February 26 through March 1, 1968. The record establishes

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4/ Civil Action No. C-68 -69, U.S.D.C., D. Utah; Litigation Release No. 4313 (May 7, 1969).

5/ Exchange Act Release No. 8583 (April 24, 1969).

and the hearing examiner finds that during the entire period 1967 through 1968 no registration statement was filed with this Commission nor was any registration under the Securities Act in effect during the said period. The hearing examiner further finds that during the period July 1967 and August 1968 Mountain was engaged in a massive distribution of its securities. Thus, during the said period Graham and his group purchased at least 2,800,000 shares of Mountain stock out of approximately 5,000,000 shares outstanding. Between January and August 1968 in excess of 400,000 of such unregistered shares were publicly distributed through a number of brokerage concerns in Utah and California.

Sale of Mountain Stock by Stead

Stead is charged with having effected sales of 55,400 shares of Mountain stock during the period January through August 1968. Stead was employed in April 1967 as a registered representative of Babcock Co. ("Babcock"), a broker-dealer registered under the Exchange Act.[6/] During the term of his employment, which terminated in August 1968, his duties including acting as one of the traders for the firm. As a registered representative his shared commissions on certain accounts with Paul Barraco until April 10, 1968 when Barraco left and thereafter Stead was the sole representative handling such accounts. One such account was that of Ted Paulsen ("Paulsen") and his wife Gayle.

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6/ See footnote 1.

Between February 19 and February 23, 1968, Stead sold through Babcock 12,500 shares of Mountain stock for the Paulsen account and on April 22 he sold 1,000 shares of such stock for the same account. All such shares were purchased by the Babcock trading account. On August 15, 1968 Stead sold an additional 1,000 shares of Mountain stock for the same account. The record discloses that the order tickets for the sales of the 14,500 shares were written by Stead. Paulsen was employed by Mountain as transfer agent of the company's securities in July 1967, after Graham acquired control of Mountain 7/ and was also office manager of Mountain's Salt Lake City office. In July 1968 he became assistant secretary.

In the latter part of May 1968 Cobb, office manager of the El Paso, Texas office of Mountain, told Paulsen he wanted to sell stock of Mountain and Paulsen took him to Babcock's office where an account was opened for Cobb. The record discloses that 15,000 shares were sold through such account in two transactions on May 21 and 29, 1968 and that Stead was the registered representative who handled the account at that time. The record further shows that the order tickets

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7/ Prior to Paulsen's assumptions of duties as transfer agent he was employed by Nebeker, the former president of Mountain, and by various companies controlled by Nebeker and Bentley. He also performed transfer functions for Mountain prior to acquiring the title of transfer agent.

for the foregoing sales were in Stead's handwriting.[8/] Stead's testimony at the hearing denying knowledge of the Cobb account is not credited. Moreover, the record discloses that the said 15,000 shares sold from the Cobb account were purchased by the Babcock trading account. The decision, to acquire such shares for the firm's trading, was made by Stead. Paulsen testified he received instructions from Cobb to sell shares of Mountain stock and the record reflects that Paulsen relayed such orders to Stead. Some of the shares which were furnished to Babcock to cover the sales for the Cobb account were delivered by Cobb to Paulsen who brought them to the Babcock firm, the remainder were sent by Cobb directly to the said firm. Paulsen also accompanied Cobb to Babcock's office when Cobb received payment for the Mountain stock he had sold and to a local bank to facilitate Cobb in cashing the Babcock check. The 15,000 shares which were delivered into the Cobb account to cover the above-described sales came from the block of 1,801,813 shares of newly issued stock by Mountain upon the conversion, on January 11, 1968, of the $280,000 note. As noted earlier 325,000 of such shares had been transferred into the name of Rister and 15,000 of such shares were transferred into the name of L. W. Babcock and delivered to cover the sales in the Cobb account by Stead.

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8/ Stead's contention that Babcock's testimony identifying Stead's handwriting on the order tickets should be disregarded since Babcock was "not a handwriting expert" is without substance. Babcock testified he was familiar with his (Stead's) handwriting, having seen it on order tickets. He was thus competent to identify the handwriting.

It is evident from the record that sales of Mountain stock were made from accounts which Paulsen maintained at a number of brokerage firms in his own or his wife's name or in the names of Graham, Ferguson, Hays and Cobb. The hearing examiner finds that during 1968 Paulsen was receiving instructions from Graham concerning sales of various brokerage firms in Salt Lake City. There is no doubt from the record that Paulsen bought and sold stock for Graham through the Paulsen account at Babcock and transmitted funds from that account to Graham. Paulsen either received Mountain shares from Graham or the other above-named persons and delivered or told such persons to deliver shares into their accounts, that he either received checks in payment for such sales in his name and transmitted the funds or directed the brokerage firm to make the checks payable directly to such persons. Paulsen accounted to Graham for all such sale transactions and furnished him with a statement of the various transactions and payments.

During the period of his employment by Babcock, Stead knew that Paulsen was an employee of Mountain and was performing stock transfer functions for Mountain. After Graham acquired control of Mountain he met with Stead, Paulsen and others at Babcock's office to interest the salesmen in selling Mountain stock. Stead described the Graham group as "another bunch of promotors" who were "promoting the stock."

Stead acquired additional information about Mountain, for the record shows that shortly after January 8, 1968, when an assessment was levied by Mountain on its stock Stead was called by a Philadelphia bank seeking information about Mountain, on behalf of one of its trust

accounts, to determine whether the trust should pay the assessment or sell the stock. Stead through Paulsen arranged for a conference call with Graham who told the bank representatives about Mountain. Later the bank again telephoned Stead and after obtaining a market quote on Mountain stock directed him to sell the stock. Stead purchased the stock, sold a portion to customers who had given him buy orders and personally purchased 30,000 shares. Stead subsequently sold such shares.

Notwithstanding his contacts with Graham, who he knew was president of Mountain and Paulsen, who he knew was the transfer agent, Stead testified he had no knowledge in 1968 nor did he attempt to ascertain whether Mountain stock was registered under the Securities Act of 1933, did not know or make any effort to ascertain the amount of stock held or sold by Paulsen or persons for whom Paulsen was acting, did not know or attempt to ascertain the source of the stock Paulsen was selling in his account and did not inquire who Cobb was or Cobb's relationship to Mountain, Graham or Paulsen.

Stead's Violation of the Securities Act

As noted earlier Stead is charged with sales of Mountain stock in willful violation of Section 5 of the Securities Act. The record is abundantly clear and the hearing examiner finds that in connection with Stead's sale of Mountain stock for the Paulsen and Cobb accounts, detailed above, the facilities of the Salt Lake Exchange were used, constituting a means of instrument of interstate commerce (U. S. v. Re

336 U.S. 2d 306 (1964), (cert denied 379 U.S. 904), that the mails were used to confirm such sales and that Stead offered and sold Mountain stock for the accounts mentioned above at a time when no registration was filed or in effect for Mountain stock.

Section 5 of the Securities Act makes it unlawful for any person to use the mails or means of interstate commerce, to offer for sale, sell or deliver a security unless a registration under the Securities Act has been filed with the Commission and to sell or deliver after sale a security unless a registration statement under the Securities Act is in effect. However, Section 4 of the Securities Act exempts certain transactions from Section 5.

The Commission and the Courts have long held that the burden of proving the availability of any exemption under the Securities Act rests with the person claiming such exemption. S.E.C. v. Ralston Purina Co., 346 U.S.119; S.E.C. v. Culpepper, 270 F. 2d 241, 246 (C.A. 2, 1959); In the Matter of Dunhill Securities Corporation, Exchange Act Release No. 8653 (1969). Stead asserts that all transactions he effected at Babcock were exempt under Sections 4(3) and 4(4) of the Exchange Act. Stead urges that under Section 4(3) his transactions in the Paulsen and Cobb accounts were exempt since they were transactions by a dealer and under any circumstances the Stead sales were within the exception in clause A of the said Section since such sales were effected more than 40 days after the date the security was bona fide offered to the public by the issuer or by or through an underwriter. In support of the latter claim Stead argues that if there

was a public offering it commenced in July 1967 by the initial sales of Mountain stock to Graham. Stead also contends that his sales of Mountain stock were merely trading transactions and contrary to the position of the Division, the exception in paragraph (C) of Section 4(3) of the Securities Act is not applicable.

The hearing examiner is of the opinion that the exemption claimed by Stead under Section 4(3) is not available. Section 4(3) was designed to recognize the distinction between distributions springing from an issuer, or persons in control of an issuer, and ensuing trading transactions with the intention of the said Section to exempt solely the latter. The Section did not intend to exempt transactions by either issuers or underwriters. Support for such conclusion is found in the legislative history 9/ and can be derived from the statutory language. 10/ The Courts and the Commission have recognized the foregoing principles. 11/ In a recent case the Commission

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9/ H. R. Rep. No. 85, 73d Cong., 1st Sess. 15-16 (1933) which points out that the exemption distinguishes between distribution and trading and states that "the dealer is exempted as to trading when such trading occurs. . . (after the distribution period). . . Hence, a dealer effecting transactions during an actual distribution were obviously not intended to be exempt, and the underwriter is, by definition, a participant in the distribution.

10/ Clause (C) of the said section excepts from the dealer's exemption "transactions. . .by such dealer as a participant in the distribution of such securities by the issuer or by. . .an underwriter."

11/ S.E.C. v. Computronics Industries Corp., 294 F. Supp. 1136, 1138-39 (N.D. Tex., 1968); S.E.C. v. Mono-Kearsarge Consolidated Mining Co., 167 F. Supp. 248, 256 (D. Utah 1958); Ira Haupt & Co., 23 S.E.C. 589, 604 and footnote 23 (1946).

has held that the Section 4(3) exemption is not available to a dealer who is selling unregistered securities for an underwriter. Quinn and Company, Inc., Exchange Act Release No. 9062 (January 25, 1971).* It is apparent from the House Report that the Section 4(3) was intended to provide an exemption for a dealer with respect to his trading when such trading occurs after a period of distribution.[12/] It thus becomes clear that transactions by a dealer during the period of distribution are not exempt from the registration and prospectus requirements. Ira Haupt & Co., supra. Such conclusion is particularly compelling when the dealer is acting directly for a statutory underwriter.

The hearing examiner finds that both Paulsen and Cobb, for whose accounts Stead effected sales of Mountain, were underwriters of Mountain stock. The term "underwriter" is broadly defined in Section 2(11) of the Securities Act to include "any person who has purchased from an issuer, with a view to, or offers or sells for an issuer in connection with the distribution of any security or participates or has a direct or indirect participation in any such undertaking. . ." and an "issuer" is defined to include ". . .any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." The record clearly demonstrates that at the time Stead sold Mountain stock for Paulsen the latter was employed as Mountain's transfer agent, that he was acting as a nominee for Graham's purchases and sales of Mountain stock as well

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12/ H. R. Rep. No. 85, 73 Cong., 1st Sess., p. 16 (1933).

* IMMEDIATELY PRIOR TO THE PRINTING OF THIS INITIAL DECISION IT WAS LEARNED THAT THE COMMISSION'S DECISION WAS AFFIRMED BY THE COURT OF APPEALS FOR THE TENTH CIRCUIT ON DECEMBER 17, 1971 (C.A. 10, NO. 71 - 1090).

as nominee for other persons whose names were given him by Graham or they were recommended to him by Graham and for whom he either opened accounts at several brokerage concerns in his or his wife's name or in the names of the other persons. In this connection it is evident from the record that Graham suggested to Paulsen that he use the names of Cobb and Hays as nominee accounts and gave him instructions for the Cobb account at the Babcock firm and for the Hays account at other firms. Paulsen testified that, in fact, he commingled his wife's, Cobb and Hays accounts. However, Paulsen kept records of the sales of Mountain stock at various brokerage firms, including some sales at the Babcock firm and gave Graham a breakdown of the sales of Mountain stock in the various accounts. The evidence shows that Paulsen and his wife, Hays and Cobb, for whom he was acting under instructions from Graham, sold in excess of 92,000 shares of Mountain stock during the period February through August 1968 at various brokerage firms who were respondents in these proceedings. In light of the foregoing it is evident that Paulsen was a part of the group under direct or indirect common control of Mountain and offered to sell for Mountain and became a participant in the distribution which Mountain was effecting. The hearing examiner concludes that Paulsen was an underwriter as defined in the Securities Act.

Cobb was office manager of Mountain's Texas office. As noted above, Cobb's purchases of the two blocks of Mountain stock (the 100,000 share block and the 102,744 share block) was arranged by Graham and the latter issued instructions with respect to Cobb's sales of his shares.

At the time Cobb acquired the block of 102,744 shares from Bennett he knew they had been acquired by him from Mountain and were stated to be investment securities and he acknowledged he was taking them for investment. However, the record shows he sold them within the next five months. Thus the hearing examiner concludes that Cobb acquired his shares with a view to resale, that Cobb was a participant or, at the very least, had a direct or indirect participation in the distribution by Mountain and was an underwriter as defined. Accordingly, the Section 4(3) exemption was not available to Stead who was acting on behalf of and for underwriters.

The hearing examiner rejects Stead's argument that since his sales occurred more than 40 days after the Mountain stock was first bona fide publicity offered, which he says commenced in July 1967, the Section 4(3) exemption was available by reason of Clause (A) of Section 4(3). Notwithstanding that a dealer's transaction involving an underwriter cannot qualify for the Section 4(3) exemption regardless of whether it occurred during the 40-day period or thereafter, Stead's interpretation would frustrate the registration and prospectus requirements of the Securities Act for it would permit a person to fragment an offering by selling only a part thereof, then delay for a period of 40 days before offering the remaining portions. To give content to the statute it is the view of the hearing examiner that when a distribution takes place through a number of underwriters, each of whom commences the offering of his security at a different time, the period of an offering

by a particular underwriter begins at a time when such underwriter commences his distribution to the public.[13/]

As noted above Stead also urges that his sales of Mountain were exempt under Section 4(4) of the Securities Act, which exempts "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." Stead, in essence, argues that his sole interest in the sale of Mountain stock he effected was the receipt of usual and ordinary commissions, that under Section 4(4) of the Securities Act, as implemented by Rule 154 under the Securities Act, his exemption is preserved even if Paulsen was a control person since the conditions of the said Rule were satisfied. All of such arguments are rejected. As a threshold matter it is well recognized that the brokers' exemption in Section 4(4) like the dealers' exemption in Section 4(3), discussed above, exempts only trading transactions and was never intended to exempt distributions emanating from an issuer or a person in control or under common control of an issuer. The legislative history clearly points out that transactions by a dealer during a distribution were obviously

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13/ Stead's argument that the exception in clause (C) of Section 4(3) is not applicable is also rejected. That clause provides that dealers' exemption is not available for transactions as to securities constituting the whole or a part of an unsold allotment to the dealer as a participant in the public sale of such securities by or through an underwriter. In the instant case since Stead's sales through the Babcock firm were for persons found to be underwriters such sales could be considered an unsold allotment to the dealer as a participant in the distribution of Mountain by or through an underwriter.

not intended to be exempt.[14] In the Matter of Herbert L. Wittow the Commission in discussing the availability of a Section 4(4) exemption held, "That exemption is not available when the broker knows or has reasonable grounds to believe that his customer is an underwriter, since in that event the broker likewise violates Section 5 by participating in a non-exempt transaction." Exchange Act Release No. 9303 (August 24, 1971). In a number of releases the Commission has repeatedly emphasized that a broker-dealer has an obligation, when asked to sell a block of unregistered securities, to take such steps as are necessary to be certain he is not participating in transactions involving an underwriter and that a broker has no right to rely on the Section 4(4) exemption when he is aware of circumstances indicating his principal is an underwriter.[15] From the evidence in the record the hearing examiner finds that Stead was aware of circumstances indicating that his customers Paulsen or Cobb or both were underwriters of Mountain stock and that the transactions were a part of a distribution of Mountain stock on behalf of his customers. Stead was one of the traders of Mountain stock at the Babcock firm and shared

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14/ H. R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933). When the Act was adopted, the brokers exemption appeared as Section 4(2); See also Loss, Securities Regulation, Vol. 1, p. 698 (2nd Ed. 1961).

15/ Quinn and Company, Inc., supra, See e.g. Securities Act Releases Nos. 4445, p. 2 (February 1962); 4818, pp. 1-2 (January 1966); 4997, p. 11 (September 1969); 5087, p. 3 (September 1970). Cf. Rule 154(a)(4) under the Securities Act which excludes from the term "brokers' transactions" those by a broker acting as agent for a person in a control association with an issuer, where the broker is aware of circumstances indicating his principal is an underwriter.

responsibility for inserting bid and asked quotations in the National Daily Quotations Sheets for Mountain stock between January and May 1968. Stead knew that Graham had acquired control of Mountain in July 1967 and was "promoting" its stock. Paulsen had introduced Cobb to the Babcock firm and Stead knew that Paulsen was carrying on the functions as Mountain's transfer agent, that Paulsen was giving him instructions to sell Mountain stock for his own account and for the accounts of others. Stead took orders to sell Mountain stock for the Cobb account, from either Cobb or Paulsen or both without even obtaining the required customer account card. Stead's sales of Mountain stock for Paulsen and Cobb under the foregoing circumstances were factors sufficient, at the very least, to raise red flag warnings that inquiry was called for, concerning the persons for whom he was effecting sales of Mountain stock.[16/] It is well settled that a salesman is required 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. In the Matter of Strathmore Securities, Inc., Exchange Act Release No. 8207 (1967); Hanly v. S.E.C., 415 F. 2d 589 (1969); see also Stead v. S.E.C. (C.A. 10, No. 382-70, July 2, 1971). The evidence discloses that Stead made no effort to ascertain Cobb's relationship to Graham and Mountain nor did he learn that Paulsen was

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16/ S.E.C. v. Mono-Kearsarge Consolidated Mining Co., supra.

acting as nominee for Graham. Stead's contention that he knew nothing about Cobb and very little of Paulsen other than he was the transfer agent, does not immunize him from his responsibilities to make appropriate inquiry as to the availability of an exemption. During the period July 1967 through May 1968 Stead admitted he knew nothing about Mountain, other than the fact that Graham acquired Mountain and was promoting the company, made no effort to ascertain who were its officers or directors or large stockholders or whether the company had recently issued securities or the source of the stock being sold in the Paulsen or Cobb accounts or, Cobb's relationship with Mountain. The hearing examiner finds Stead failed, in light of the circumstances noted above, to make due and appropriate inquiry concerning his customers, which would have revealed they were participating in a distribution and that they were underwriters. The hearing examiner accordingly finds Stead did not have available the exemption afforded by Section 4(4) of the Securities Act. The hearing examiner concludes that Stead sales, as noted above, were in violation of Section 5 of the Securities Act and that such violation was willful.[17/]

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17/ It is well settled that "willful" 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. Tager v. S.E.C., 344 F. 2d 5 (C.A. 2, 1965).

Sale of Mountain Stock by Jones

Jones is charged in the Order for proceedings with selling 37,300 shares of Mountain stock during the period June - August 1968 when he was a registered representative of Goodbody & Co. in their Hollywood, California office. The record discloses and the hearing examiner finds that between June 3 and August 13, 1968 (dates are trade dates with settlement dates about 7 days later) Goodbody sold 38,600 shares of Mountain stock of which 5,000 was sold as agent for Crocker Citizens National Bank of Hollywood, California ("Crocker bank") and the remainder 33,600 shares as agent for Ashdown. There is no dispute that Jones was the registered representative at Goodbody who handled the sale for the Crocker bank, opened the Ashdown account and accepted the orders to sell Mountain stock for Ashdown. A brief review of the circumstances surrounding the sales of Mountain stock effected by Jones for the Crocker bank and Ashdown is essential in evaluating the charges against Jones.

Prior to July 1967 Ashdown knew that Graham was searching for a "vehicle" into which to place the Graham oil partnership assets and informed Graham that Mountain was such a possibility. After Graham acquired Mountain he advised Ashdown he would receive a finders fee for his efforts and for other similar services Ashdown had rendered. In January 1968 after the conversion of the $280,000 note into the 1,801,813 shares of Mountain stock, Ashdown received 150,000 such shares of stock from Graham. He testified the certificates he received were in Ferguson's name. Thereafter, Ashdown became the West Coast

representative of Mountain, its office manager in Los Angeles, California and did "PR" work for the company. Mountain's 1967 annual report listed Ashdown as its Los Angeles office manager. Ashdown introduced Graham to the Manhattan-West group, participated in the discussions and negotions leading to the agreement whereby Manhattan-West acquired 150,000 shares of Mountain stock and participated in drafting the closing statement. For his help in connection with the said agreement and for other services he had rendered to Mountain for which he had not been paid (estimated by Ashdown at approximately $10,000) Ashdown received 28,000 shares. In all, Ashdown obtained approximately 200,000 shares of Mountain stock (the 150,000 shares as finder, the 28,000 noted above and 5,000 which he purchased). Ashdown sold between 150,000 and 160,000 such shares.

Ashdown maintained a personal checking account at the Crocker bank. On January 4, 1968 the Crocker bank informed Ashdown that one of the checks he deposited in his account failed to clear and there was an overdraft in his account of approximately $850. Apparently attempts by the Crocker bank to have Ashdown make good the overdraft were not successful and on March 22, 1968 after a number of conversations between Ashdown and officials of the bank an arrangement was entered into whereby the Crocker bank loaned Ashdown $3,000 secured by 10,000 shares of Mountain stock. At the time the loan was made Ashdown informed an officer of the bank that he did not expect to have the money to repay the loan and the bank would have to sell the stock. The bank's records also show Ashdown received his stock for

services rendered to Mountain, that Mountain had asked him not to sell the stock and that Ashdown "chooses this means of getting around the company's request." By letter dated May 31, 1968, Ashdown requested the bank to sell 5,000 shares of Mountain stock and apply the proceeds to his loan. On June 3, 1968 an official of the Crocker bank delivered one certificate for 10,000 shares of Mountain stock to Jones and requested him to sell the stock. The bank official told Jones the sale was to satisfy an overdraft by Ashdown. Jones was aware that the certificate was in the name of C. Scott Ferguson. However, Jones did not know and made no inquiry of the aforesaid bank official concerning the identity of Ferguson nor where or how Ashdown acquired his Mountain stock. The Ferguson certificate for 10,000 shares of Mountain stock was, in fact, the certificate mentioned above as part of the 1,801,813 shares of new stock issued upon the conversion of the $280,000 convertible note.

On or about June 14, 1968 Ashdown opened an account at Goodbody after speaking with Jones. The new account card, signed by Jones, reflects that Ashdown informed Jones he was employed by Mountain in its "Acquisition Department." He also told Jones that he was Mountain's West Coast Representative, that he intended to sell more Mountain stock and that he held "quite a few shares" of Mountain stock. On the day the account was opened Ashdown placed a sell order for 5,000 shares of Mountain stock. The shares of stock used to consummate this sale were the 5,000 shares remaining of the 10,000 share Ferguson certificate used for the Crocker bank sale. Jones knew the source of this

stock was the balance remaining after the Crocker bank transaction. Thereafter, during July and August (the last sale was on August 13, 1968) Jones continued to effect sales of Mountain stock on the Salt Lake Exchange for Ashdown, the total of all such sales amounting to 33,600 shares. Although Ashdown testified he could not recall that Jones ever asked him how he obtained his stock, the hearing examiner finds, as admitted by Jones, that between June 16 and July 25, 1968 after the sale for Ashdown of about 10,000 shares of Mountain stock Jones became "concerned" with several matters relating to the Ashdown account, viz., the volume of trading, the fact that certificates being delivered into the Ashdown account to cover the latter's sales bore the name of one of Jones' customers, a Robert Champion, known by Jones to be a friend of Ashdown, for whom Jones was buying Mountain stock at the time he was selling Mountain stock for Ashdown and finally the question of whether Ashdown's stock was control stock.

During this period Ashdown told Jones that he bought Mountain stock in the open market, that he was selling Mountain stock at other brokerage concerns, the names of which he gave Jones, and that Mountain had acquired Laser Power Industries, Inc. for stock of Mountain. The record discloses that between June 16 and July 25, 1968 Jones made two telephone calls to Paulsen, Mountain's employee who was acting as transfer agent, the first of which was to ascertain if the certificate bearing Ferguson's name was transferable and the second about a month later to find out whether the certificates being delivered into the

Ashdown account represented control stock. Paulsen apparently told Jones the certificates were transferable, that the Ashdown stock was not control stock, and that control stock certificates were in 50,000 share denominations. Jones also admits that during the period he was selling Mountain stock for Ashdown he requested Ashdown to furnish him with two copies of Mountain's annual report. Ashdown delivered two copies of Mountain's 1967 annual report which listed Ashdown as Mountain's Los Angeles Office Manager, listed Ferguson as one of the directors, contained information relating to the Company's recent acquisitions and reflected that for the three-month period January 1 to March 31, 1968 Mountain had issued in excess of 1,000,000 shares. Jones' suspicions and concerns relating to Ashdown's sales continued to the last sale on August 13, 1968 for on that day one of Goodbody's partners distributed a memorandum alerting its staff that Mountain stock was "extremely active" and there was a risk that "some stock may be control and/or investment stock" and urged that care be taken not to expose the firm to any risks. On the same day Jones, on instructions from his superiors at Goodbody, gave Ashdown an indemnity agreement to sign which contained a representation by Ashdown that he owned all the Mountain stock sold, that he knew "of no investment letter or other legal restrictions. . .that would prevent their being freely transferred. . ." and holding Goodbody blameless from all liability for acting as agent in the sales.

Jones' Violation of the Securities Act

The hearing examiner finds that Jones, during the period June

through August 1968 offered shares of Mountain stock at a time when no registration statement was filed with the Commission and sold and delivered after sale stock of the said company when no registration was in effect, in willful violation of Sections 5(a) and (c) of the Securities Act. Jones in his defense asserts that the foregoing sales were exempt from Section 5 by reason of Sections 4(3) and (4) of the Securities Act. The burden of establishing such defenses is upon the respondent. S.E.C. v. Ralston Purina, supra. The hearing examiner has previously discussed the availability of the claimed exemptive sections and reiterates his conclusions that neither the Section 4(3) nor the Section 4(4) exemption is available to broker-dealers selling for an underwriter. Quinn & Co., supra. The hearing examiner finds that Ashdown was an underwriter as defined in the Securities Act. In this connection the record amply discloses that Ashdown was instrumental as a finder in connection with Graham's acquisition of Mountain stock in July 1967 for which Ashdown acquired at least 178,000 shares of Mountain stock as a finders fee as well as for other services rendered to Mountain. 150,000 of such shares were delivered to him in January 1968 and were part of the 1,801,813 shares of newly issued Mountain stock which Graham received upon conversion of the $280,000 note. Within two months after acquiring such shares Ashdown gave a portion thereof to the Crocker bank as collateral, informing such bank it would have to sell the stock to satisfy his loan. Within approximately five months after receiving such stock Ashdown commenced selling the stock with Jones effecting such sales. The conclusion that Ashdown acquired his shares from the company with

with a view to distribution is clearly established in the record. Such conclusion is fortified not only by his sales shortly after he received stock from the issuer but by his statements to the Crocker bank noted above, when he deposited the 10,000 share certificate in Ferguson's name. Ashdown was thus an underwriter as defined in the Securities Act. Since the transactions effected by Jones for Ashdown were transactions by an underwriter occurring as a part of the process by which stock flowed from the issuer to the public, the Sections 4(3) and 4(4) exemptions were not available.

With respect to Jones' contentions that his claimed exemptions under the Securities Act were available, it is well settled that broker-dealers have a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act and should be reasonably certain an exemption is available. Quinn & Co., supra. In the instant case Jones' conduct shows he made little, if any, effort to be reasonably certain an exemption was available. Jones knew that Ashdown was an employee of Mountain, learned that he had received stock for services and that he owned a large amount of Mountain stock which he intended to sell. During the period he was selling Jones became aware that Ashdown was also selling Mountain stock at other brokerage concerns. He knew that the first shares of stock delivered by Ashdown came from Ferguson yet he made no effort to ascertain that Ferguson was a director. He made no attempt to get any information about Mountain, its officers or directors. Jones never attempted to ascertain if the company had ever filed a registration statement with the Commission. Jones made no

effort at the outset to learn how Ashdown acquired his stock. It is evident from Jones' own testimony that at some time during the sales for Ashdown he was concerned with the problem of whether Ashdown stock was control stock, yet he did no more than make a perfunctory phone call to the transfer agent to ascertain if the stock was transferable. When told it was, Jones simply continued his sales without further checking or inquiry. The Courts have held such inquiry, under the circumstances, is obviously insufficient. Stead v. S.E.C., supra. As a salesman who acquired knowledge that problems were apparent in the Ashdown account Jones had the duty to satisfy himself that an exemption was available. With all the red flag warnings Jones was on notice of sufficient facts to have caused him to make further inquiry regarding not only the status of his customer, Ashdown, but the fact that unregistered securities were being sold. S.E.C. v. Mono-Kearsarge, supra. Such facts include in addition to the knowledge he acquired as set forth above concerning the background of Ashdown as furnished him by the Crocker bank but significantly that Ashdown was trying to get around the company's request not to sell the stock by pledging it as collateral and informing the bank it would have to sell such stock. That coupled with the fact that Jones knew that Ashdown had a certificate in the name of Ferguson should certainly have caused Jones to make a more searching inquiry. It is the hearing examiner's view that Jones failed to properly exercise his responsibilities as a salesman and failed to make reasonably certain there was an exemption available. See Strathmore Securities, Inc., supra.

The hearing examiner rejects Jones' argument that his sales in June 1968 were exempt by Section 4(3) of the Securities Act since they were effected more than forty days after the Graham group commenced

publicly disposing of its shares which he urges "occurred as early as February 19, 1968." As noted above with respect to Stead, it is the hearing examiner's view that a new forty-day period begins to run when Ashdown, an underwriter, sold his Mountain stock through Goodbody and the claimed exemption under Section 4(3) is thus unavailable. Jones' reliance upon S.E.C. v. North American Research & Development Co., 280 F. Supp. 106 (1968) is not apposite for in that case there was no evidence that anyone offered the security in the United States prior to forty days before sales by respondents and hence all sales were within the forty-day period. In the instant case, a number of underwriters undertook sales at different periods and a proper interpretation requires that the period begin when the first bona fide offering of the portion being distributed by the particular underwriter was publicly commenced. In the case of Jones' sales of Ashdown's stock, the record fails to establish Jones first made a bona fide offering forty days before his sales commencing in June 1968. It is concluded that Jones willfully violated Sections 5(a) and (c) of the Securities Act.

Sales of Mountain Stock by Avchen

The order for proceedings charges that Avchen was a registered representative and vice president of Sierega and Co., Inc. ("Sierega") from June 1967 through July 1968 during which period Sierega sold 77,000 shares of Mountain stock and that from late July 1968, after terminating his employment at Sierega, Avchen was employed by Kleiner, Bell and Company, Inc. ("Kleiner, Bell") as a registered representative.

Kleiner, Bell is alleged to have sold 23,000 shares between May and August 1958.[18/] Avchen testified he was a "partner" at Sierega and his duties included acting as sales manager, hiring and supervising between one and five registered representatives. There is no substantial dispute by Avchen with respect to the facts relating to the acquisition of Mountain stock by the persons named below for whom he opened accounts at Sierega and Kleiner, Bell and the shares of Mountain stock he personally purchased. However, Avchen differs with the conclusions reached by the Division from such facts and urges that certain exemptions under the Securities Act were available to him. In the light of such defenses it is essential to review the manner in which Avchen's customers and Avchen acquired their Mountain stock together with the circumstances surrounding Avchen's sale of such stock.

Briefly stated, the record discloses that in May 1968 Avchen was introduced to William Nathan ("Nathan") and Larry Mills ("Mills") by Robert Collins ("Collins") a personal friend of Avchen. At that time Nathan, Mills and Collins were equal shareholders in Manhattan-West. Shortly prior to the foregoing introduction, Nathan had entered into an agreement with Graham, Mountain's president, whereby Mountain agreed to sell its battery manufacturing plant in California (Laser Power Industries, referred to earlier) to Manhattan-West in exchange for stock of a company controlled by Manhattan-West and other siderations. The agreement was somewhat modified and as finally

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18/ Since the alleged violations against Avchen relate to his sales of Mountain stock while he was employed by Kleiner, Bell, the statement in the text is intended solely to indicate the total sales effected by the firm and is not intended to indicate that any violations are charged against Avchen for sales by the firm prior to his employment.

concluded Manhattan-West was to receive 150,000 shares of Mountain stock and was to pay $41,000 in cash. The cash was paid and 150,000 shares of Mountain stock was delivered to Manhattan-West. It is abundantly clear from the evidence that immediately prior to the time the above transaction was concluded Manhattan-West wanted cash but Graham persuaded them to take Mountain stock. In agreeing to accept the stock, Manhattan-West told Graham it would sell the Mountain stock to obtain the cash. In order to permit Manhattan-West to sell, Graham arranged with Hays for the latter to deliver 150,000 shares of his personal stock to Manhattan-West, receive the $41,000 which Hays was to make available to Mountain. These arrangements were carried out. Graham promised to return 150,000 shares of Mountain stock to Hays which he did by delivering previously unissued Mountain stock in July 1968.

The record shows that on January 11, 1968 Graham received a block of 1,151,813 shares when the latter converted the $280,000 convertible note and on the same day transferred 362,000 shares to Hays. The 150,000 shares delivered to Manhattan-West, referred to above, came from Hays' block of 362,500 shares. Within about two weeks after receipt of the shares and on May 23, 1968 Nathan telephoned Avchen at Sierega, asked him for a quotation on Mountain stock, which Avchen obtained, and Nathan thereupon told him to sell 4,000 shares which he did. That same day Nathan asked Avchen to sell another 4,000 shares and Avchen sold those shares as well. It is significant that at the time both orders were placed with him Avchen admittedly had never heard of Mountain nor did he make any inquiry concerning the manner in

which Nathan obtained his stock nor how many shares Nathan owned. Between May 23 and July 23, 1968 Avchen sold on behalf of Nathan, Mills and Manhattan-West a total of 63,000 shares of Manhattan-West stock.

Shortly prior to June 13, 1968 Nathan approached Graham and told him that Laser needed an additional $50,000. To obtain such funds Graham arranged for Nathan to purchase an additional 100,000 Mountain shares, again from Hays, for $54,000 which Nathan would sell and the profit from such sales would be divided equally between Graham and Manhattan-West. On or about June 13, 1968 Manhattan-West purchased the 100,000 shares of Mountain stock from Hays for $54,000 and promptly sold approximately 44,000 of such shares to recover the $54,000 purchase price. Of the remaining 56,000 shares, one-half or 28,000 shares were delivered, at Graham's direction, to Ashdown, as noted earlier, and the remaining 28,000 shares were disposed of by Manhattan-West for its benefit. There is no doubt, and the hearing examiner finds, that at the time these 100,000 shares of Mountain were acquired it was for the purpose of immediate resale.

On about June 10, 1968, after Avchen had sold approximately 58,000 shares of Mountain stock for Nathan and Mills, they offered to sell Avchen 25,000 shares of Mountain stock at $1.25 per share and to guarantee him against any loss. On June 12, 1968 Manhattan-West entered into a written agreement with Avchen in which Avchen agreed to purchase the 25,000 shares of Mountain for $31,250 with a guarantee against loss for a two-week period after which time the risk free

feature would no longer be effective. The record discloses that on June 13, 1968 Mountain transferred a 100,000 certificate, in the name of Hays, into certificates for 25,000 shares in the name of Avchen, 25,000 shares in the name of Nathan and 50,000 shares into Manhattan-West. Avchen received his 25,000 shares on June 18, 1968. At about the time Avchen agreed to purchase the Mountain stock he discussed the purchase with Billy Neighbors ("Neighbors"), who was then vice president of Sierega, and showed him the purchase agreement. Neighbors, at Avchen's request, called an attorney who informed him in a two-minute telephone conversations that the Avchen purchase would be all right if the stock was free trading and not control stock, that Avchen should so satisfy himself and if he had further questions to consult an attorney. Neighbors relayed this information to Avchen telling him to make certain the Mountain stock was free trading. On the date Avchen received his stock he requested someone in the cashier's department of Sierega to call the transfer agent to ascertain if the Mountain stock recently transferred into Avchen's name, as noted above, was "free-trading." Avchen was told the transfer agent said it was free-trading stock. Avchen was assured by Nathan that the stock was not control stock. Avchen was aware that the Manhattan-West group owned 100,000 shares and that the 25,000 shares he purchased were part of the said 100,000 shares which Nathan had bought. Two days after he received his stock Avchen commenced selling at Sierega and disposed of 15,000 shares before leaving that firm. About the end of July 1968 Avchen was employed by Kleiner, Bell as a registered

representative. He opened accounts at his new firm for himself and Manhattan-West and sold 12,000 shares of Mountain stock for his personal account and 5,000 shares for the account of Manhattan-West. At the time the sales were effected both at Sierega and Kleiner, Bell, Avchen had no information or knowledge of Mountain, its officers or its operations nor did he know or make inquiry concerning the source of the stock acquired by Manhattan-West nor the length of time it held the stock. In connection with the sales at Sierega and Kleiner, Bell the mails and means and instruments of transportation and communications were used.

Avchen's Violation of the Securities Act

The hearing examiner finds that during the period from approximately the latter part of May through July 1968 Avchen offered and sold Mountain stock for customers as a registered representative of Sierega; that in June and July, 1968, he offered and sold shares of the same stock for his personal account at Sierega and that in August 1968 he offered and sold shares of Mountain stock for customers as a registered representative of Kleiner, Bell and for his personal account at the latter firm, all of which foregoing sales were effected at a time when no registration statement was on file or in effect with this Commission in willful violation of Sections 5(a) and (c) of the Securities Act. In his defense Avchen urges his sales were exempt under Sections 4(1) and 4(4) of the Securities Act. As noted above Avchen has the burden of establishing the availability of any exemption under the Securities Act. S.E.C. v. Ralston Purina, supra. It is the

opinion of the hearing examiner that Avchen failed to sustain the burden of establishing that any of the claimed exemptions are available. Avchen urges that under Section 4(1) his claimed exemption was available since he was neither an issuer, underwriter or dealer. The hearing examiner disagrees and finds that Avchen was both an underwriter, as defined in Section 2(11) of the Securities Act and a dealer, as defined in Section 2(12) of the said Act. The term "underwriter" is defined to include, as pertinent here, any person who purchases from an issuer with a view to the distribution of any securities or participates or has a direct or indirect participation in a distribution of any security. Avchen purchased for his own account 25,000 shares of Mountain stock, as principal, with the avowed intent of selling such shares immediately to the public. Although Avchen paid the Manhattan-West group for his stock there is little doubt his funds constituted part of the payment of $54,000 the group made to Mountain for the block of 100,000 shares it purchased. His purchase was, in fact, made contemporaneously with and knowledge of the purchase by Manhattan-West. Both such purchases were made with a view to distribution. Hence, Avchen could be said to have purchased from an issuer with a view to distribution since privity of contract is not essential. Chinese Consolidated Benevolent Association, Inc. v. S.E.C., 120 F. 2d 738, Cert. denied 314 U.S. 618 (1941). In addition, by selling his own stock contemporaneously with sales for Manhattan-West and its group who were undoubtedly underwriters (See discussion infra of the Section 4(4) exemption.) he became a participant in the distribution

of Mountain stock since he knowingly joined in and participated in a distribution of Mountain stock.

There is no substance to Avchen's argument that he was not a dealer but merely a registered representative of a dealer. Avchen's sales at both Sierega and Kleiner, Bell on behalf of Manhattan-West and its principals were effected as agent for both firms who were admittedly dealers. The term "dealer" is defined in Section 2(12) of the Securities Act to include a broker or an agent for a broker. The hearing examiner finds Avchen was selling as agent of a dealer and not entitled to the 4(1) exemption. Any other result would emasculate the provision of Section 5 of the Securities Act prohibiting the sale of unregistered securities since every securities salesman employed by a dealer who is either an underwriter or acting for an underwriter or otherwise participating in a distribution could, by the simple expedient of claiming he was merely acting as a registered representative, claim exemption under Section 4(1) of the said Act.

With respect to Avchen's claimed exemption under Section 4(4) of the Securities Act the hearing examiner concludes such exemption was not available. For the reasons noted earlier in this decision Section 4(4) was not intended to exempt transactions by underwriters. In addition to the finding that Avchen was himself an underwriter, his sales for Manhattan-West, Nathan and Mills were transactions for persons who were also underwriters. The evidence clearly establishes that the latter three purchased a total of 250,000 shares of Mountain stock from Mountain the issuer under circumstances which make it

abundantly clear that they intend to dispose of their stock. The closing statement at the time the Manhattan-West group acquired their Mountain stock specifically states the said stock was free trading stock which the hearing examiner finds supports the finding that they intended to sell immediately. Moreover, when they insisted on obtaining stock which could be immediately sold Graham arranged to have Hays deliver his certificates for this purpose. The device by Mountain, the issuer, to borrow certificates of stock from Hays for delivery pursuant to its agreement to sell its stock to Manhattan-West group does not change the character of the transaction from a sale by an issuer to persons who were taking with a view to resale into an exempt brokers transaction because the certificates delivered to the broker happened to bear the name of Hays. It would be incredulous to believe the registration requirements of the Securities Act could be so easily frustrated. Accordingly, the hearing examiner concludes that the Manhattan-West group purchased stock from an issuer with a view to distribution and were underwriters.

With respect to Avchen's claim that exemptions were available under the Securities Act, the hearing examiner repeats that broker-dealers have a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act and should be reasonably certain an exemption is available. This requires inquiry by a broker to ascertain facts reasonably sufficient to determine whether his customer was an underwriter or engaged in a distribution. The hearing examiner finds Avchen

made no effort to secure information concerning the manner in which the Manhattan-West principals acquired their stock. Avchen's claim that he made every effort to inquire into the legality of the transaction and was given advice that his conduct was proper in the circumstances, is not supported by the record. Avchen appears to have made two inquiries, first from Sierega's vice president who purportedly asked an attorney who, the record shows, advised in a two-minute phone call that if the stock were free trading and not control stock the transaction would be all right and a second inquiry made by his firm's cashier who called the transfer agent who stated the stock in Avchen's name was free trading. A broker-dealer has a duty to investigate and cannot ignore that which he has a duty to know. Hanly v. S.E.C., 415 F. 2d 589, 595-596 (C.A. 2, 1969). Avchen's efforts to ascertain the availability of any exemption with respect to the sale of a security he "never even heard of" prior to speaking with the Manhattan-West principals coupled with his failure to ascertain the source of this stock, fall far short of the responsibility which devolves upon broker selling securities of an unknown company, S.E.C. v. Culpepper, 270 F. 2d 241 (C.A. 2, 1959); Strathmore Securities, Exchange Act Release No. 8207, December 1967. In connection with his inquiry to the transfer agent to ascertain if unregistered stock was freely tradeable the Court in a recent case held "the act of. . .in calling the transfer agent is obviously not a sufficient inquiry." Stead v. S.E.C., (C.A. 10, No. 382-70, July 2, 1971). Even if Avchen's belief that he was acting in good faith were acceptable it does not, per se, operate to make an exemption available particularly where

he could have ascertained information which would have revealed the persons he was acting for were underwriters. See e.g. Skeatron Electronics and Television, supra; Quinn and Company, Inc., Exchange Act Release No. 9062 (January 1971); S.E.C. v. Mono-Kearsarge Consolidated Mining Co., 167 F. Supp. 248. Avchen's argument that there is no evidence of willfulness within the meaning of the Securities Act is rejected. It is sufficient that a person charged with a duty know what he is doing. Hughes v. S.E.C., 174 F. 2d 969 (C.A.D.C. 1949); Tager v. S.E.C., 344 F. 2d 5 (C.A.2, 1965). The hearing examiner concludes Avchen willfully violated Section 5 of the Securities Act.

Sale of Mountain Stock by Merrill Lynch and Clarke

The order for proceeding alleges that Merrill Lynch and Clarke sold 10,000 shares of Mountain stock in August, 1968 in willful violation of Sections 5(a) and 5(c) of the Securities Act. In light of the defenses urged by the said respondents it is essential to outline briefly the facts and circumstances surrounding the transactions in Mountain stock effected by Merrill Lynch and Clarke.

Merrill Lynch is a corporation registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act since March 12, 1959.[19/] Clarke was and is associated with Merrill Lynch and was employed by the said firm as a registered representative in its Salt Lake City, Utah office during 1968. There is no dispute that between August 12 and August 20, 1968 Merrill Lynch sold 10,000 shares of Mountain stock for

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19/ Merrill Lynch is a member of the American, Detroit, Midwest, New York, Pacific Coast, Philadelphia-Baltimore-Washington, and Salt Lake City Stock Exchanges, the Chicago Board of Trade and the National Association of Securities Dealers.

the account of Harry Feder ("Feder") and that Clarke was the registered representative who effected the said sales. Feder, a geologist since 1946 and a resident of Bakersfield, California, was the owner of royalty interests in certain oil properties in Nevada. Late in 1967 he met with one James Bramson ("Bramson") who said Mountain was interested in purchasing Feder's royalty interests. Branson was a director of Mountain. Feder informed Bramson he was not interested. Thereafter, immediately prior to February 12, 1968, Bramson again approached Feder telling him Mountain wanted to buy his oil interests and following discussions Feder informed Bramson he would sell such interests if Mountain had common registered stock they could give him, so that he could save a brokerage fee, plus $1,000 cash which he needed. After making a phone call Bramson told Feder he had a deal.

On February 13, 1968 an agreement (dated the prior day) was entered into between Bramson on behalf of Mountain and Feder, which provided that Feder would receive "free and clear 12,000 shares of Mountain registered common stock, assessment paid," plus $1,000 in cash, "said stock and cash shall be paid to Feder within 10 days of the date of this agreement." The record is abundantly clear that Feder wanted negotiable stock which he would be free to sell at a brokerage concern "immediately-the next day." When the draft of the agreement was prepared by Bramson and Feder it included the phrase "U. S. free and tradeable" and Feder, to be certain he could immediately sell the stock, telephoned his lawyer who dictated the words which eventually appeared in the agreement. Feder received the $1,000

called for by the agreement approximately three weeks after the date of the agreement. The delay occurred by reason of the fact that the original check Feder received from Mountain had been returned for insufficient funds. Although the agreement called for the delivery of the Mountain stock within 10 days, the stock was, in fact, not delivered until four months after February 12, 1968 despite repeated requests for delivery by Feder.

In the early part of June 1968 Feder received a certificate for 10,000 shares of Mountain stock in the name of Robert Gardner ("Gardner"). Feder knew that Gardner was an employee of Mountain and Gardner delivered the stock on behalf of Mountain pursuant to the said agreement. Gardner had sold Mountain certain of his assets and on or about March, 1968 received from Graham 66,550 shares which Graham gave him from the 1,151,813 shares Graham received upon conversion of the note on January 11, 1968. Graham asked Gardner to give Feder 10,000 shares of his Mountain stock which he (Graham) promised to replace.[20/] Gardner gave the above-mentioned 10,000 shares of Mountain stock, registered in his name to Feder. The remaining 2,000 shares of Mountain stock called for by the agreement has never been delivered to Feder despite numerous requests. There is no dispute that at the time Gardner delivered the 10,000 shares of Mountain stock to Feder he told Feder that the reason the 10,000 shares were registered in his name was for

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20/ Since Graham had delivered his personal stock to Gardner to consummate the acquisition of the Gardner assets, Graham was issued 66,500 newly-issued stock of Mountain on May 17, 1968.

Mountain's convenience and that Gardner would be reimbursed by the company.

On August 9, 1968 Feder, having learned that Mountain was acting as its own transfer agent, called Paulsen to inquire whether the assessment had been paid on the certificate he held. He was told it was. On the morning of August 12, 1968 Feder and one Howard Price, described by Feder as "an accompanying witness," stopped first at the office of Maxwell Bentley, who he knew as the former transfer agent of Mountain, exhibited the 10,000-share certificate in Gardner's name and asked Bentley whether it was a genuine and valid certificate not a forgery. Bentley confirmed that it was a valid certificate.[21/] Paulsen was in Bentley's office when Feder entered but left shortly thereafter. From Bentley's office Feder and Price went to Mountain's office and were ushered into Paulsen's office. Paulsen was then talking to Graham on the telephone, explaining that Feder has arrived wanting to sell his stock. At this point a dispute apparently arose concerning the transferability and sale of Feder's Mountain stock. Paulsen thereupon handed the telephone to Feder. Feder testified that Graham told him he could not sell the stock and that Graham was "going to stop transfer" the shares. Feder argued with Graham on the telephone stating he had a signed agreement and insisted he would sell the stock. Apparently Feder handed the phone back to Paulsen who talked at length with Graham.

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21/ The record discloses that the meeting with Bentley took no more than 10 minutes.

After the conversation was concluded Paulsen informed Feder that he would issue the certificates in Feder's name, that they were free and clear and that Feder could sell them all that day. Paulsen thereupon issued ten certificates of one thousand shares each in Feder's name in exchange for the one certificate in Gardner's name.

Upon receiving the certificates Price suggested they go to his broker, Merrill Lynch, to sell the stock. That same morning they went to Merrill Lynch's office in Salt Lake City where Price introduced Feder to George Stromberg ("Stromberg"), manager of the office. After conferring briefly with Stromberg, Price introduced Feder to Clarke who had handled transactions for him in the past. Feder explained to Clarke the circumstances of his acquisition of the Mountain stock, showed Clarke a copy of the contract, explained that he acquired the stock for properties which he had sold to Mountain and told Clarke he wanted to sell the stock. Feder also told Clarke he had consulted an attorney "to insure. . . that he could sell it at any time." Clarke, having observed that the certificates had been recently transferred to Feder's name, inquired where Feder had obtained the ten certificates and was told that Paulsen, the transfer agent, had given them to him. Clarke called Paulsen and was told the shares were "fully registered" free and clear of all assessments and would be transferred if Feder sold them. Clarke also called Bentley to determine the intent of Mountain at the time the agreement was made by Feder to acquire the Mountain stock. Bentley told Clarke the company intended to give Feder "fully registered, free and tradeable stock." Feder also told Clark of his visit to Paulsen

that morning and that the company had finally agreed to transfer the stock. Clarke thereupon entered an order to sell 5,000 shares. Clarke did not ascertain prior to the sale, that the Mountain stock was given to Feder by Gardner and that the stock was in Gardner's name prior to said delivery. The record discloses Clarke had no knowledge that Graham was Mountain's president, nor did Clarke know or make inquiry concerning Bramson who had signed the contract on behalf of Mountain. Clarke made no attempt to learn whether, in fact, Mountain stock had been "registered" with this Commission notwithstanding that he believed the word "registered" in the Feder contract meant registered with this Commission.

Later that same day Feder and his witness Price went to another broker in Salt Lake, John Potter, a board member of the Salt Lake Exchange and spoke to him about selling his Mountain stock. Feder explained the circumstances surrounding his acquisition of the Mountain stock and showed Potter a copy of the agreement and the certificates he wanted to sell. Potter examined the contract and the certificates and after some questioning of Feder made a phone call and informed Feder that the stock was "in a gray area" and that he would not handle it. Feder immediately returned to Merrill Lynch's office and related to Clarke his conversations with Potter including Potter's characterization of the stock and the latter's refusal to sell. Notwithstanding that Clarke had already sold 5,000 shares of Mountain stock, Feder again explained to Clarke the manner in which he acquired his Mountain stock, again showed him a copy of the contract by which he acquired the stock and left the office to afford Clarke an opportunity to "figure out" the situation. Later that

same day Feder returned to Merrill Lynch's office and was informed by Clarke that everything had been cleared, whereupon Feder placed an order with Clarke to sell the Mountain stock. Such shares were sold over the next eight days with the last sale occurring on or about August 20, 1968.

Neither Merrill Lynch nor Clarke dispute the fact that no registration statement has ever been filed or was ever in effect under the Securities Act with respect to Mountain stock. Neither of the said respondents dispute the fact that the sales of the 10,000 shares of Mountain stock for Feder by Merrill Lynch were effected on the Salt Lake Exchange and that the mails were used in connection with these transactions. The record discloses that during the period September 14, 1967 and August 20, 1968 respondents Merrill Lynch bought 113,850 shares and sold 63,200 shares of Mountain stock as agent for customers.

It is evident that the transactions by Merrill Lynch and Clarke in selling unregistered Mountain shares, described above, were in violation of Sections 5(a) and 5(c) of the Securities Act unless an exemption was available as to them.[22/] It is well established that the burden of proving the availability of an exemption from the registration requiremenss of the Securities Act rests with the person claiming the exemption.[23/] The hearing examiner finds that Merrill Lynch and Clarke

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22/ See e.g. Gilligan, Will & Co., 38 SEC 388, 391 (1958), aff'd 267 F. 2d 461 (C.A. 2, 1959), cert. denied 361 U.S. 896.

23/ S.E.C. v. Walston Purina Co., 346 U.S. 119 (1953); S.E.C. v. Culpepper, 270 F. 2d 241, 246 (C.A. 2, 1959).

have not sustained such burden in the instant case.

These respondents urge that they are entitled to the exemption afforded by Sections 4(4) and 4(3) of the Securities Act, that the inquiry undertaken by Merrill Lynch under the circumstances, here present was wholly reasonable and that,assuming arguento,that Merrill Lynch violated Section 5, such violation was not willful. In support of their argument that the transactions effected by Merrill Lynch are exempt under Section 4(4) of the Securities Act it is urged that Merrill Lynch merely acted as a broker for Feder, that Feder's orders were executed on the Salt Lake Exchange and that Merrill Lynch did not solicit any of the said order. The hearing examiner reiterates the conclusion stated earlier in this initial decision that where a dealer is acting on behalf of an underwriter or an issuer of securities in the distribution of such securities the Section 4(4) exemption is not available. In the Quinn & Co., Inc. case, supra, the Commission stated: "The provisions of Sections. . .4(3) and 4(4) are intended to exempt trading transactions with respect to securities already issued to the public and that they could not be used to exempt distributions by issuers or underwriters or the acts of other persons who engaged in steps necessary to such distribution." It is thus essential to determine whether Feder is an underwriter within the meaning of the Securities Act. The term "underwriter" is defined, as pertinent here, in Section 2(11) of the Securities Act to include "any person who has purchased from an issuer with a view to. . .the distribution of any security." In the instant case Feder acquired his shares from Mountain, pursuant to the contract noted above, with the intent, which he carried

out, to immediately resell them to the public. The record is abundantly clear that at the time Feder acquired his stock he had no intention of holding said securities as an investment in Mountain. As indicated from his testimony he was continually concerned with his ability to obtain shares which were "free and tradeable" and could be sold "immediately." Both the Commission and the Courts, in considering the registration requirement of Section 5 of the Securities Act, have held that persons who had purchased stock from the issuer with a view to resale were underwriters since their resales, as contemplated and executed were a "public offering as that term has been defined by the Supreme Court. . ." Gilligan, Will & Co. v. S.E.C., 267 F. 2d 461 at 466 (C.A. 2), cert. denied 361 U.S. 846 (1959); See also S.E.C. v. Computronics Industries Corp., 294 F. Supp. 1136, 1139 (N.D. Texas 1968). Merrill Lynch and Clarke further argue that Rule 154 does not preclude the availability of the Section 4(4) brokers exemption apparently on the theory that since the said Rule allows brokers to sell insubstantial amounts of unregistered stock for control persons, it is broad enough to permit sales of similar amounts for a person like Feder who did not control the issuer, Mountain. The argument must be rejected. The question is not whether Feder was or was not a control person, rather that he was participating in a distribution, having taken securities from an issuer for public resale and in essence effecting a primary distribution. Rule 154 is designed to be applicable to secondary distribution, i.e. distribution not emanating from the issuer, as in the instant case, but from a controlling stockholder

of the issuer. Stated differently Feder's sales of Mountain stock are clearly those of an underwriter who has taken stock from an issuer for immediate resale. Assuming, arguendo, that Merrill Lynch could somehow take advantage of Rule 154 which defines the term "brokers' transactions" appearing in Section 4(4), it is the opinion of the hearing examiner that, since each of the four subdivisions stated in the Rule must be complied with for the Rule to be operative, Merrill Lynch has not established conformance with at least one of the key provisions, namely that it was not aware of the circumstances indicating that its principal, Feder, was an underwriter. As appears below, Merrill Lynch and Clarke were both aware of circumstances indicating Feder was an underwriter.

These two respondents also urge that the Section 4(4) exemption is available because Feder was "an innocent purchaser. . .who believed that the stock was registered and freely tradeable" and that "a defrauded purchaser acting in the belief that a registration statement is in effect as to the securities he seeks cannot be held to be an underwriter under the 1933 Act" (Securities Act). Respondents further urge that "even if such were possible there was a sufficient change of circumstances in Feder's case so as to make his sales not inconsistent with prior investment intent." Both such arguments are not acceptable. The argument that a defrauded investor cannot be an underwriter must be rejected. It is clear that there is no exemption from the registration requirements of the Securities Act for a person, otherwise subject thereto, on the ground he was defrauded by the issuer. A person's

status as an underwriter under the statutory definition is not changed thereby. Quinn & Co., Inc., supra, at p. 5. Moreover, the record does not support the claim that Feder believed the Mountain stock was "registered." The record is overwhelming and the hearing examiner finds that Feder wanted stock "free and tradeable, to wit, stock he could sell immediately. The word "registered" finally inserted in the agreement between Feder and Mountain had little, if any, significance to Feder for the record demonstrates the word was included at the suggestion of an attorney who was called by Feder on the telephone and meant nothing more to Feder than give him comfort that he would be able promptly to sell his stock. This conclusion finds support in the fact that prior to effecting the first sale of Mountain stock it never occurred to Feder, Clarke or Merrill Lynch to simply call this Commission, which incidentally had a branch office in Salt Lake City, as did Merrill Lynch, to ascertain whether in fact Mountain had ever filed a registration statement. There is no evidence that Clarke or Merrill Lynch sought legal advice under the circumstances here present but contented themselves with telephone calls to the issuer itself.

The argument that even if Feder were an underwriter there was a change of circumstances so as to render his sales not inconsistent with prior investment interest is without basis and rejected. In the first place the testimony by Feder makes it evident that he never had a so-called investment intent. Without attempting to define investment intent as a general proposition, the record here demonstrates that what Feder wanted was stock he could sell immediately and it is of little significance whether he was the beneficial owner of the stock six months

before he sold or came into physical possession of the shares three months before he sold since under either situation the hearing examiner finds Feder had no intention to make an investment in Mountain but had the intention of disposing of his stock. His true intent in acquiring the Mountain stock can best be determined by his actions and such intent becomes clear by his insistence that he obtain stock which was "free and tradeable," his testimony that he wanted stock he could sell "immediately" and the fact that within a comparatively short time after he entered into the agreement he sold the Mountain stock. The purported change of circumstances urged by Merrill Lynch and Clarke is wholly insufficient to establish that they were, as urged, "not inconsistent with prior investment intent." Thus, the failure of Mountain promptly to pay Feder for his properties, the issuance of a check by Mountain, which was dishonored but paid shortly thereafter, and the failure to deliver the remaining 2,000 shares, do not furnish an adequate basis to establish such a change of circumstances as to make the sales not inconsistent with investment intent. In fact, Feder testified the only reason he held the stock was upon advice of his "income tax people" to hold for six months and he determined to sell immediately thereafter because the stock had risen from 25¢ to $2.50 a share. The hearing examiner finds Feder never had any intention to hold the stock for investment.

Merrill Lynch and Clarke though conceding "that under certain circumstances a broker has an obligation to make an inquiry" where such broker undertakes to sell stock for a customer it argues that under the circumstances here presented ". . .such an inquiry was not required. . ."

and further assuming such inquiry was required Merrill Lynch satisfied this requirement by the inquiry it made. The hearing examiner rejects both the arguments. The Commission has consistently held that a broker-dealer asked to sell a block of unregistered securities has the obligation to take whatever steps are necessary to be sure that he is not participating in transactions involving an underwriter and that a broker cannot rely on the Section 4(4) broker's exemption when he is aware of circumstances indicating his principal is an underwriter.[24/] In the instant case the hearing examiner finds that Merrill Lynch and Clarke knew, prior to undertaking the first sale of Mountain stock by Clarke for Feder, two crucial factors which should have indicated to them that Feder was an underwriter and that his sales did not constitute normal trading activities. In addition, they learned later that same day of an additional element which should have alerted them that more searching inquiry was required before undertaking the remaining sales. The two essential factors were first that Feder, pursuant to a written agreement had sold properties to the issuer and obtained shares from such issuer which were to be "free and clear. . .registered common stock. . .' and second, that Feder sought to sell such shares to the public within a relatively short time after receiving them. The third element referred to above was that Clarke was told by Feder within hours after the first sale that another broker who had also been shown

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24/ Quinn & Co., Inc., supra, pp. 7-8 and footnote 21 on p. 8.

the Feder agreement and advised of the circumstances surrounding Feder's acquisition of the stock, had refused to sell Feder's stock because they were "in a grey area." All of these factors should certainly have alerted Merrill Lynch and Clarke that additional inquiry was, under the circumstances, essential.

The record fails to establish that either Clarke or Merrill Lynch made appropriate or sufficient inquiry to be reasonably certain the Section 4(4) exemption exists. They argue that Clarke's phone call to Paulsen, the transfer agent, to determine whether the stock was registered and freely tradeable coupled with Clarke's call to Bentley, Mountain's former attorney, was sufficient inquiry since Clarke was purportedly told the stock was registered and freely tradeable. It is further argued that Clarke's second call to Paulsen later in the day, after being informed Potter would not sell Feder's stock, is further evidence of "more than reasonable" inquiry. Such arguments are rejected. The hearing examiner finds the inquiries made by Clarke were, under the circumstances here present i.e. knowledge that Feder obtained stock from the issuer shortly prior to his request to sell, Clarke's failure to ascertain from any source other than the company whether in fact Mountain stock was "registered" with this Commission and the refusal of another broker to sell because the stock "was in a grey area," wholly insufficient and inadequate.[25/] It is well settled a salesman is required to make

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25/ Cf. S.E.C. v. Mono-Kearsarge Consolidated Mining Company, 167 F. Supp. 248, 259 (D. Utah 1958); See also Dlugash v. S.E.C., 373 F. 2d 107, 109 (C.A. 2, 1967).

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. Strathmore Securities, Inc., Exchange Act Release No. 8207 (1967). In a recent decision the court held that the act of a salesman in calling the transfer agent for information as to whether stock is registered "is obviously not on sufficient inquiry." Stead v. S.E.C., supra, petition for rehearing denied (August 16, 1971).

With respect to the arguments by Merrill Lynch and Clarke that Section 4(3) of the Securities Act affords an available exemption the hearing examiner reiterates his conclusions above that such exemption is not available to a dealer who is selling unregistered securities for an underwriter. With respect to the argument that since the Mountain stock was first bona fide offered to the public substantially 40 days before the Feder transaction the exemption afforded by Section 4(3) is available, the hearing examiner repeats his conclusion stated above that, assuming arguendo, that Mountain stock was offered to the public six months before Feder's transactions, as contended by Merrill Lynch and Clarke, a new 40-day period commenced to run when Feder, an underwriter, sold his Mountain stock through Merrill Lynch.

Finally, the argument that, even assuming violations of Section 5 by Merrill Lynch and Clarke, such violations were not willful is also rejected. It is urged that since Merrill Lynch had no knowledge the Mountain stock was unregistered it cannot be said any violation was willful. It is well settled that a finding of willfulness under the

Exchange Act does not require an intent to violate, but merely an intent to do the act which constitutes the violation. Tager v. S.E.C., 344 F. 2d 5, 8 (C.A. 2, 1965). As noted above Merrill Lynch and Clarke knew that Feder had obtained his stock from the issuer shortly prior to the transaction and that Feder never intended to keep the stock for investment purposes. Moreover, the record discloses that while Merrill Lynch and Clarke certainly realized there was a question as to the availability of an exemption based on the facts known to them and certainly brought home vividly when another broker refused to sell the stock, sought no legal counsel of their own nor, as indicated above, made any attempt to contact the staff of the Commission regarding the claimed "registration" of the securities, and relied solely on some statements by the company's transfer agent. Their failure to take adequate precaution to assure themselves by proper inquiry is further proof of their willful violation of Section 5 of the Securities Act.

Failure of Stromberg to Supervise.

The order for proceedings charges Stromberg with violation of Section 15(b)(5)(E) of the Exchange Act in failing reasonably to supervise the persons under his supervision with a view to preventing the violations. With respect to Stromberg the alleged failure relates to the charges concerning Clarke's sales.

Stromberg was and is employed by Merrill Lynch as manager and vice president of its Salt Lake Office. During the month of August 1968 his duties included supervision of Clarke, the registered representative who handled the Feder account. On August 12, 1968 when Feder and his

witness went to Merrill Lynch, Feder testified he was first introduced to Stromberg and told Stromberg he was from Bakersfield, California, and that he was in Salt Lake for the purpose of selling his Mountain stock. Although Stromberg testified he had no recollection of this introductory meeting the hearing examiner credits Feder's testimony in this respect. There is no dispute that Clarke, after he had sold the first 5,000 shares of Mountain stock for Feder, met with Stromberg, told him that he had sold the Mountain stock for Feder and that he was "concerned about the stock." Stromberg inquired of Clarkeas to whether he had checked all of the necessary requirements to establish that the stock was not control or investment stock. Clarke informed him that he had called the transfer agent and Mountain's attorney and had seen the agreement between Feder and Mountain all of which indicated to him that the stock could be sold. Stromberg gave Clarke no further instructions as to procedures to be followed in connection with the Feder sales since he was of the view that Clarke's inquiries were similar to any instructions which he might have given. Stromberg also testified his concerns were to be certain that the stock was transferable and was not investment letter stock nor control stock. Stromberg admits he did not have in mind at that time any exemption from the registration requirements which he was relying upon in connection with the Feder sale.

Stromberg never saw the Feder contract, never inquired from Clarke the manner in which Feder had obtained his stock nor did he make any effort himself to ascertain any of the facts concerning Feder's

Mountain stock. Stromberg did not make any effort to contact Paulsen, the transfer agent, whom he knew to be a former secretary of the Salt Lake Exchange, the staff of the Commission nor Merrill Lynch's attorney, nor anyone else. Though Feder testified he made several visits to Merrill Lynch's office between August 12 and 20, during which period his Mountain stock was sold, there is no evidence in the record that any such visits were of a substantive nature.

The record discloses that Merrill Lynch had an "Operations Manual" in effect at the time of the Feder transaction which set forth information required to be obtained by account executives at or prior to effecting sales on behalf of a customer including specific inquiries required to be made under certain circumstances.[26/] The hearing examiner finds that Stromberg failed to adhere to the requirements of his firm's Operations Manual. Thus the record demonstrates that Stromberg did not, as he was required to do, find an exemption available under the Securities Act for Feder's sales since the circumstances indicated that Feder

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26/ During the course of the hearing, the hearing examiner received in evidence a certain number of specified pages of Merrill Lynch's Operational Manual relating to "control," and "distributions" transactions under the Securities Act of 1933 and two appendices thereto. Since the Operations Manual was deemed to be of a "confidential nature" the pages received in evidence were marked "confidential and available solely to counsel for Merrill Lynch, the staff, the Commission and its staff, and the hearing examiner" and such exhibit was not included in the record of exhibits in this proceeding but maintained separately as a confidential document. In view of the fact that this initial decision will be served on parties other than Merrill Lynch, Clarke, and Stromberg, the hearing examiner will make every effort to retain the confidential nature of the document and refrain from divulging the specific contents of the Operations Manual in the text of this initial decision but will, of necessity, make reference to the said Operations Manual as the need dictates, to properly permit the making of findings of fact and conclusions of law.

may be an underwriter. As the hearing examiner has found above, Stromberg was informed by Clarke that Clarke was "concerned about the stock," that there was a written agreement between Feder and Mountain whereby Feder obtained stock for properties sold to Mountain, that Clarke had made phone calls to Mountain's transfer agent and an attorney he was told represented Mountain, all of which should have alerted him to the fact that Feder sales may involve sales by an underwriter. In addition, Stromberg failed to follow instructions to make further inquiry where a customer obtains stock in exchange for property. Stromberg also failed to make further inquiry, as required, with respect to the length of time the customer held the securities in order to determine the investment intent of such customer, particularly where such securities were held for less than six months. The record further reflects that there was no basis upon which Srromberg, as office manager, was justified in concluding, as he was required to do, that Feder did not acquire his stock with a view to distribution. It is also evident that the Feder transactions were, under the circumstances described above, certainly in a "doubtful case" category requiring a written opinion of the customer's counsel to be forwarded with all the facts to Merrill Lynch's legal counsel for approval. The record is clear that such requirement was never fulfilled by Stromberg. Finally, Stromberg failed to recommend to Clarke that the matter be presented by the customer to the staff of this Commission in order to resolve problems as to whether the customer was an underwriter. The hearing examiner finds that on the basis of the information

which Stromberg had, he should have been aware that Feder was, or in the very least, could be deemed to be an underwriter and on the basis of his experience should have recommended to Clarke that the matter be presented by the customer to the Commission staff. The record is clear that Stromberg gave no such thought to the matter nor did he ever attempt to find out from the Commission's staff in Salt Lake as to whether the Mountain stock had ever been registered with this Commission. The hearing examiner concludes that within the meaning of Section 15(b)(5)(F) Stromberg failed reasonably to supervise Clarke with a view toward preventing Clarke's violation as found above.

Failure of Neighbors to Supervise

The order for proceedings charges Neighbors with violation of Section 15(b)(5)(E) of the Exchange Act in failing reasonably to supervise persons under his supervision with a view to preventing the violations. In the case of Neighbors the alleged failure relates to charges concerning sales by Avchen. Having found above that Avchen willfully violated Sections 5(a) and (c) of the Securities Act there remains for determination the question whether Neighbors' conduct violated the above-cited Section of the Exchange Act. In his brief, Neighbors argues that there is no violation of Section 5 of the Securities Act by Avchen or Sierega by reason of the availability of exemptions under Sections 4(4) and 4(3) of the said Act and hence Neighbors' alleged failure to supervise is in essence moot and that under any circumstances Neighbors was not Avchen's supervisor and cannot be found to have failed to supervise. The hearing examiner reiterates his previous conclusions

with respect to Avchen's activities relating to his sales of Mountain stock. However, in light of the contentions made, it becomes necessary to consider briefly facts, in addition to those noted above concerning Avchen's sales of Mountain stock, particularly with respect to Neighbors' knowledge, actions or lack thereof as they bear upon the alleged violation as well as the alleged supervision of Avchen by Neighbors.

Neighbors was a vice president of Sierega during the period Avchen effected sales of Mountain stock. Neighbors testified he was a co-founder of Sierega and in June and July 1968 it was a small organization with at most some thirteen salesmen including four officers with various responsibilities. He further testified that the lines of responsibility were not "that direct," that if Sierega, the president, were not available or if Avchen had questions requiring answers it would fall "in my area of responsibility" and Avchen might even consult him rather than Sierega. In those respects Neighbors testified he was one of Avchen's supervisors. It is clear from the record that after Avchen entered into the agreement to purchase his Mountain stock he determined to seek advice from Neighbors. There is no dispute that Avchen spoke with Neighbors with respect to his personal acquisition of Mountain stock, furnished Neighbors with a copy of the purchase agreement and was told by Neighbors that if he had any doubts about the transactions to consult an attorney. Though Neighbors could not recall any aspect of the securities laws which was discussed he admitted suggesting to Avchen that he seek legal advice and when Avchen

said he did not know an attorney Neighbors called his own attorney, read him the terms of the agreement and was told the "transaction was all right" but that the attorney would have to have all of the facts before he could give anything other than a "curbstone opinion." This, Neighbors relayed to Avchen together with the statement that the lawyer said if Avchen had any questions he should consult counsel. Avchen never consulted any other attorney. It is significant to note that Neighbors admits that he never heard of Mountain before talking to Avchen, knew nothing of its operations or its officers, did not inquire of, nor did Avchen tell him, from whom he was purchasing his stock and did not know that Avchen was selling Mountain stock for the very customers of Sierega from whom he was purportedly purchasing his stock nor did he make any other inquiries concerning such transactions.

Neighbors argues, as did Avchen, that the sales of Mountain stock at Sierega were exempt from Section 5 of the Securities Act by reason of Section 4(4) of that Act. The burden of establishing this exemption is, of course, upon the person claiming the exemption. S.E.C. v. Ralston Purina, supra. The burden has not been met by Neighbors. For the reasons stated above with respect to Avchen the hearing examiner concludes that the Section 4(4) exemption was not intended to exempt transactions by issuers or underwriters. Quinn and Company, Inc., supra. The sales by Avchen for Manhattan-West and its principals were sales by underwriters for the reasons stated above in connection with Avchen's sales. The hearing examiner has also found that when Avchen sold the stock he acquired, he was participating in a distribution and he

too was an underwriter as defined in Section 2(11) of the Securities Act. Neighbors further argues that Rule 154 does not preclude, in the circumstances here present, the availability of the Section 4(4) brokers exemption and the said Rule is not limited to transactions on behalf of controlling persons. The hearing examiner disagrees. Rule 154 by its very terms permits a broker to sell insubstantial amounts of unregistered securities for controlling persons. In the opinion of the hearing examiner the said Rule is inapplicable even for control persons where the controlling person sells securities which he acquired from the issuer with a view to distribution since in that situation he would be an intermediary in a primary distribution emanating from the issuer. Rule 154 applies in essence to so-called secondary distributions, i.e. distributions emanating not from the issuer. In the instant case there is little doubt that Avchen, in effecting sales for Manhattan-West and its principals, was selling for persons who had purchased their stock from an issuer with a view to distribution and deemed underwriters. Moreover, assuming arguendo, Rule 154 could be considered applicable or extended to situations where a broker is selling for a noncontrolling person, such sales must comply with four essential elements under the said Rule. In the instant case the hearing examiner finds that one of such elements is not supported by the record since Avchen was or should have been aware of circumstances indicating that his principals were underwriters. In addition, with respect to Avchen's sales of his personal stock he was clearly an underwriter and the Section 4(4) exemption is unavailable.

Neighbors' argument that a defrauded investor, acting in the belief that a registration statement is in effect as to the securities he seeks to sell, cannot be held to be an underwriter, is rejected. The Commission held in the Quinn and Company, Inc., supra, case that there is no exemption from the registration provisions of the Act for a person otherwise subject thereto, on the ground he was defrauded by the issuer. A person's status as an underwriter under the statutory definition is not changed thereby.

Neighbors' argument that the Avchen transactions were exempt since Section 4(3) of the Securities Act is also rejected since that Section, like Section 4(4), it is unavailable to transactions involving an underwriter. Quinn and Company, Inc., supra. Neighbors' argument that the exception under Section 4(3)(A) is applicable by reason of the fact that the first offering of stock to the general public occurred as early as February 1968 and Sierega's transactions commenced more than 40 days thereafter, is also rejected. In the view of the hearing examiner a new 40 day began to run when Manhattan-West and its principals, who were found to be underwriters, sold their stock through Sierega.

The hearing examiner finds that Neighbors was a supervisor of Avchen within the meaning of the Exchange Act. Neighbors' claim he was merely acting in a friendly capacity to Avchen is not sustained by the record. Avchen went to Neighbors for advice as to whether he could acquire his shares obviously for purposes of resale and Neighbors took steps to determine whether the transactions would comply with the Securities Act requirements with which he was familiar. Thus Neighbors'

claim that he was not Avchen's supervisor in this instance is not supported by the record. He did not suggest that Avchen consult Sierega's president or any other person who purportedly had supervisory functions over Avchen but essayed to help solve what he recognized to be a Securities Act problem. Clearly he could have informed Avchen that Sierega would not effect the transactions. Neighbors failed to make the appropriate inquiry which the circumstances dictated. He admits he had never heard of Mountain before Avchen approached him, never inquired about the persons from whom Avchen was purchasing his stock, and notwithstanding the fact that he apparently was aware that a Securities Act problem was involved did nothing more than telephone an attorney from whom he admittedly received a curbstone opinion. When told by the attorney that all the facts should be known before a final opinion could be rendered, Neighbors never attempted to ascertain what all the facts really were. In addition, no written procedures had been established at Sierega which would or at the very least could reasonably have prevented violations by persons under Neighbors' supervision. Under the circumstances, the hearing examiner finds that Neighbors failed reasonably to supervise Avchen to prevent his violations.

Public Interest

Having found each of the respondents charged with violations of the Securities Act with having willfully violated Sections 5(a) and (c) of the said Act there remains for determination what, if any, sanction is appropriate in the public interest.

In view of the fact that each of the respondents charged with violations contend, in general, that they made inquiry, with respect

to whether the Mountain stock was registered or free-trading or both, the question arises whether such conduct exculpates them. In this connection, the law applicable to the duties and responsibilities of registered representatives and brokers is reviewed at the outset and the application of the principles to each respondent will be considered separately below. Both the Commission and the Courts have stated the basic standards of conduct required of broker-dealers in meeting their responsibilities in connection with sales of unregistered securities.[27/] In Strathmore Securities, Inc., supra, the Commission held "a salesman is required, however, to make certain basic inquiries concerning the sellers and the sources of their stock when he is asked by unknown persons to sell substantial amounts of little known securities." In Securities Act Release No. 4445 (February 2, 1962) the Commission stated that when a dealer offers to sell a substantial amount of securities he "must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts'", citing S.E.C. v. Culpepper, supra. In Hanly v. S.E.C. the Court held "Brokers and salesman are 'under a duty to investigate and their violation of that duty brings them within the term "wilfull" in the Exchange Act'."

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27/ See e.g. the following Securities Act Releases-No. 4445, p. 2 (February 2, 1962); No. 4818, pp. 1-2 (January 21, 1966); No. 5168 (July 7, 1971).

In S.E.C. v. Mono-Kearsarge Consolidated Mining Co., supra, the Court, in considering the duties of dealers, stated "The defendants are held to have knowledge of those facts which they could obtain upon reasonable inquiry;" that ". . .they were not entitled to rely solely on self-serving statements. . ." and that "With all these red flags warning the dealer to go slowly, he cannot with impunity ignore them and rush blindly on to reap in quick profit." Finally, as noted earlier the Court, in Stead v. S.E.C., supra, held "The act of Stead in calling the transfer agent is obviously not a sufficient inquiry."

Stead pleads that no sanction is appropriate because the record reflects many instances in which Mountain, its officers, directors, transfer agent and legal counsel denied inquiring parties the information they sought regarding the source of shares and control blocks, that Stead, his employer Babcock and Company and his co-workers received assurances the Mountain stock was freely tradeable both from the transfer agent and the company itself and that the SEC and the Salt Lake Exchange had reason to believe that possible illegal activities were taking place but did nothing to disseminate this information. Stead further urges that the sanction sought by the Division is disproportionate to the sanctions imposed on other respondents who effected settlements with the Commission. None of the arguments advanced by Stead are sufficiently persuasive to dispense with the imposition of a sanction. Stead knew he was effecting sales for the account of a person who was Mountain's transfer agent and knew or should have known that his sales for the Cobb and Paulsen were sales by underwriters. Such efforts as he testified

he made to ascertain whether the stock he was selling for the accounts he handled were, under the circumstances, insufficient and inadequate since he made no effort to ascertain the source of the stock he was selling and was content with receiving self-serving statements that the Mountain stock was tradeable. In the light of the fact that Stead's customers were underwriters his argument that he relied upon his firm's efforts to assure compliance with the securities acts, in addition to his own, that the Mountain stock was freely tradeable is meaningless in this case. It is well established that broker-dealers, as professionals, in the securities business and as individuals who deal with the investing public, have a responsibility to assure themselves that compliance with the securities laws is achieved to protect the public investors from illegal offerings.[28/] Indeed, such a professional has a duty to be familiar with the registration requirements of the Securities Act as well as the circumstances under which an exemption from such requirements is available. The reliance Stead purportedly made upon statements of the issuer and its transfer agent does not provide him with an excuse to escape his own responsibility to assess the legality of the very sales he was effecting. Nor is there any substance to Stead's argument that neither the Commission nor the Salt Lake Exchange disseminated information of illegal activities to the public. When, after investigation, the Salt Lake Exchange and the Commission concluded that an illegal distribution was being effected they both took appropriate action. The hearing examiner also takes official notice of the Court's decision in Stead v. S.E.C., supra, in which the Court of Appeals for the Tenth

28/ NEES v. S.E.C., 414 F. 2d 211 (C.A. 9, 1969); Berko v. S.E.C., 316 F. 2d 137 (C.A. 2, 1963); Walker v. S.E.C., 383 F. 2d 344 (C.A. 2, 1967).

Circuit affirmed a sanction imposed by the Commission against Stead in a matter involving, among other things, a finding of sales of unregistered securities. Stead v. S.E.C., supra.[29/] Stead's penchant for illegally selling unregistered securities must be arrested in the public interest. Stead will be barred from association with a broker-dealer with the proviso that he may become employed in a supervised capacity after four months upon an appropriate showing that he would be adequately supervised.

Jones, in his brief, argues that he had no actual knowledge of any facts which could have led him to believe he was acting for either control persons or underwriters and that he is not chargeable with any implication of impropriety with respect to his sales of Mountain stock. It is well established that proof of actual knowledge of facts which result in willful violation is not required, since an intent to violate the law is not required for a finding of willfulness, it being sufficient that the person charged with the duty intentionally commits the act which constitutes the violation. Tager v. S.E.C., supra. Within the framework of the Court's decision in S.E.C. v. Mono-Kearsarge Consolidated Mining Co., supra, Jones had sufficient information to warrant his making a reasonable inquiry or at the very least he was under a duty to make further inquiry and not be satisfied with self serving statements or the transfer agents' statements that the shares he was selling were tradeable and that control stock was only in 50,000 share blocks. Jones

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29/ On November 10, 1971 Stead filed a petition for writ of certiorari in the Supreme Court having previously obtained a stay of the mandate pending the application for the said writ. In accordance with Rule 41 of the Federal Rules of Appellate Procedure the stay continues until final disposition by the Supreme Court.

concedes in his brief that, at best, the facts known to him "were not indicative of anything more than a mere possibility of control." It is precisely such possibility which professionals have a duty to investigate. In Jones' case there is no doubt that at some point between half to three-quarters through the transactions he definitely became aware of facts that raised questions as to the availability of an exemption under the securities laws. In fact, he knew that Ashdown had received stock for services rendered and was told by Ashdown that the method he chose, of making loans (with Mountain stock as security), was his means of "getting around the company's request not to sell the stock." Finally, the record discloses that Jones did not even follow a "Trading and Underwriting Memorandum" on the "Sale of Control Stock and Investment Letter Stock" distributed by his firm to all salesmen by failing, as required, to inquire as to the source of the stock he was selling for Ashdown until at least half way through the sales, did not ascertain, as required, whether Ashdown was part of "a group which may be influential with the company" and did not ascertain, as required, the details of Ashdown's past sales of Mountain stock at other brokers. It is appropriate in the public interest for a sanction to be imposed upon Jones and he will be suspended from association with Goodbody and Company or any other broker-dealer for a period of fifteen business days.

Merrill, Lynch, Clarke and Stromberg in addition to urging their violations, as found above, were not willful further urge that the firm has always been well aware that it is illegal to sell

unregistered securities in a non-exempt transaction and it was "for this reason that, despite the absence of a restrictive legend on the certificates, Clarke called the transfer agent and also the corporation's attorney in order to be certain that the stock was registered." They further urge that when Clarke learned that another broker was suspicious of the securities, Clarke called the transfer agent again in order to reassure himself that the stock was registered. They conclude that upon the basis of the efforts that Clarke and Stromberg undertook to assure themselves that the stock was registered, it could not be said they had knowledge that the stock was unregistered, least of all that they were wanton or careless as to the legality of the transaction. The emphasis on the fact that the firm and the two individuals believed the stock was registered is of little significance since as the record shows no registration statement with respect to Mountain stock was filed. Belief as to legality of a public sale of securities is no substitute for the responsibility and duty of a salesman to determine whether securities are legally saleable or whether an appropriate exemption is available. What the record demonstrates is not that the firm or the two individuals made adequate attempts to ascertain whether the Mountain stock was registered or whether any exemption was available, rather that their efforts were directed to attempting to ascertain whether the stock, which was offered for sale by Feder, would, if sold, be transferred by the transfer agent. If the concern was whether the stock was registered, there appears to be no reasonable explanation for the failure to make appropriate inquiry from their own legal counsel as

to the availability of an exemption or consult the Commission staff as to whether the securities were registered. See e.g., Quinn and Co., supra, p. 9. Two aspects of the Feder transactions stand out as indicative of the fact that the firm and Clarke failed to carry out their responsibilities as broker-dealer to make reasonable inquiry. First, it is clear from the record that Clarke was aware from having been furnished with the Feder contract that the latter obtained stock from an issuer in exchange for securities which should have immediately alerted him to the fact that he was dealing with an underwriter. Second, the record shows that several hours after Clarke effected the first transaction he was told by Feder another broker was, to use his (Feder's) own phrase, "suspicious of the securities," yet he made no further inquiry, to allay the doubts in his mind, other than a second telephone call to the transfer agent. Clarke was thus clearly on notice of facts which should have caused him to make further inquiry. The insufficiency of calls to a transfer agent, under these circumstances has been noted above. Stead v. S.E.C., supra. For his failure to carry out his responsibilities and the resultant violations a sanction against Clarke is appropriate in the public interest.

In so far as Merrill Lynch is concerned though it was admittedly aware of the registration requirements of the Securities Act and had adopted certain procedures ostensibly designed to detect whether an exemption from registration requirements was available it is evident that the procedures were either insufficient to accomplish the avowed purposes or were so inadequately administered as to prevent the

occurrence of violations of the said Act. Under the circumstances a sanction against the firm is appropriate in the public interest. Merrill Lynch will be suspended from trading on the Salt Lake Exchange for a period of five business days and Clarke will be suspended from association with the firm or any other broker-dealer for ten business days.

Stromberg's failure reasonably to supervise to prevent the violation by Clarke has been detailed above and needs no further repetition. In determining whether a sanction is appropriate for Stromberg, consideration is given not only to his failure to make appropriate inquiry concerning the Feder stock nor direct Clark to make such inquiry but also to his nonobservance, as Clark's supervisor, of the written procedures extant at the firm for attempting to ascertain if any exemption was available. Stated differently, it is evident that Merrill Lynch had established written procedures which, at best, were designed to detect whether an exemption was available but there is nothing in the record to demonstrate that the system for applying such procedures was adequate and the record shows that Stromberg failed to discharge the duties and responsibilities incumbent upon him by neglecting to assure himself that the procedures were, in fact, being complied with. For such failure a sanction is in the public interest and he will be suspended from association with Merrill Lynch or any other broker-dealer for five business days.

Avchen not only failed to ascertain the facts which would determine status of his customers as underwriters prior to effecting transactions

for them but himself purchased Mountain stock for resale under an agreement which was designed to assure him a profit. His sole concern appeared to be whether the Mountain stock he was selling for his customers and himself was free trading with apparently no thought of obtaining information necessary to be reasonably certain that an exemption was available. Quinn and Company, Inc., supra. Avchen was certainly aware of facts which imposed upon him the duty to make further inquiry and his failure so to do raises serious questions as to his qualifications to act as a registered representative. It is appropriate in the public interest that a sanction be imposed upon Avchen and he will be barred from association with any broker-dealer with the proviso that he may become employed in a supervised capacity after six months upon a showing that he will receive additional training and would be appropriately and adequately supervised.

With respect to Neighbors, who was found to have failed reasonably to supervise Avchen with a view to prevent his violation, it is appropriate in the public interest that a sanction be imposed. As noted above, Neighbors saw a copy of the agreement whereby Avchen acquired his stock and notwithstanding his two-minute phone call to an attorney concerning the contract never pursued the matter further nor suggested that additional information should be obtained or that no further transactions should be effected until he could be reasonably satisfied an exemption was available. Neighbors will be suspended from association with any broker-dealer for ten business days. Neighbors' request that he "be severed from all other respondents" appears to be without

merit and will be denied.[30/]

IT IS ORDERED that Robert Stead be, and he hereby is, barred from associating with any broker or dealer, except that, after a period of four months, he may become employed in a supervised capacity upon an appropriate showing that he would be adequately supervised.

IT IS FURTHER ORDERED that Edwin Gomer Jones, Jr. be, and he hereby is, suspended from associating with any broker-dealer for a period of fifteen business days.

IT IS FURTHER ORDERED that Theodore Avchen be, and he hereby is, barred from associating with any broker-dealer, except that, after a period of six months, he may become employed in a supervised capacity upon an appropriate showing that he would be adequately supervised.

IT IS FURTHER ORDERED that Merrill Lynch, Pierce, Fenner & Smith, Inc. be, and it hereby is, suspended from membership on the Salt Lake Stock Exchange for a period of five business days

IT IS FURTHER ORDERED that John Clarke and George Stromberg be, and they hereby are, suspended from associating with any broker-dealer for a period of ten and five business days respectively.

IT IS FURTHER ORDERED that Billy Neighbors be, and he hereby is, suspended from associating with any broker-dealer for a period of ten business days and that his request that he "be severed from all other respondents" be denied.

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30/ To the extent proposed findings and conclusions submitted by the parties are in accordance with the views set forth here they are sustained and to the extent they are inconsistent therewith they are expressly overruled.

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

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for review of this initial decision by the Commission within 15 days after service of such decision on him. In accordance with the provisions of Rule 17(f) this initial decision shall become the final decision of the Commission as to each of the parties unless such parties file a petition for review pursuant to Rule 17(b) or the Commission pursuant to Rule 17(c) determines on its own initiative to order review as to each such party. If a party timely files a petition to review or the Commission takes action to review as to a party, this decision shall not become final as to that party.

Irving Schiller
Hearing Examiner

Washington, D. C.
December 21, 1971