IN THE MATTER OF

MARK E. O'LEARY

WILLIAM R. STEIGERWALD

THEODORE BARNETT

RICHARD A. SORENSON

File No. 3-503. Promulgated July 25, 1968

Securities Exchange Act of 1934—Section 15(b)

BROKER-DEALER PROCEEDINGS

Grounds for Bar from Association with Broker-Dealer
False and Misleading Representations
Sale of Unregistered Securities
Excessive Mark-Ups

Where salesmen of registered broker-dealer, in offer and sale of speculative security, distributed false and misleading brochure and offering circular and made oral misrepresentations concerning, among other things, condition and prospects of issuer and issuer's hotel and prospective rise in market price of security; offered, sold and delivered unregistered securities for which no exemption from registration was available; and sold security at prices they had reason to know included excessive mark-ups, *held*, willful violations of anti-fraud and registration provisions of securities acts, and in public interest to bar salesmen from association with broker-dealer.

APPEARANCES:

Alexander J. Brown, Jr., William R. Schief, and *Burton H. Finkelstein,* of the Washington Regional Office of the Commission, and *Thomas N. Holloway,* for the Division of Trading and Markets.

James E. McLaughlin and *William R. Caroselli,* of McArdle & McLaughlin, for respondents.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these proceedings pursuant to Section

15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that Mark E. O'Leary, a director of Langley-Howard, Inc. ("registrant"), then a registered broker-dealer, should be suspended from association with any broker or dealer for 6 months, and that William R. Steigerwald, registrant's trader, Theodore Barnett and Richard A. Sorenson, salesmen of registrant, should each be suspended from such association for 4 months.[1] We granted a petition for review filed by our Division of Trading and Markets ("Division") with respect to, among other things, the examiner's findings that those respondents had not committed certain of the willful violations with which they were charged in the order for proceedings and with regard to the adequacy of the sanctions imposed upon them. The Division and the respondents filed briefs and we heard oral argument. Our findings are based upon an independent review of the record.

FRAUDULENT REPRESENT(TIONS

The hearing examiner concluded that during the period May 1964 to December 1965, O'Leary, Steigerwald, Barnett, and Sorenson, all of whom engaged in the offer and sale of the stock of Bahamas Hotel Corporation ("Bahamas"), willfully violated and willfully aided and abetted violations of the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b–5 and 15c1–2 thereunder in connection with such activities.

The facts found by the examiner with respect to these violations are unchallenged. Bahamas, which was controlled and headed by registrant's president, was organized as a Pennsylvania corporation in May 1964. O'Leary became treasurer, and a clerical employee of registrant, secretary; and the three principal officers served as the corporation's directors. Throughout the relevant period Bahamas' sole activity was the operation of a resort hotel on Bimini Island[2] which it directed from registrant's offices. During the period in question, respondents sold a total of 84,775 shares of Bahamas stock at prices ranging from $3 to $6.50 per share. In soliciting purchases of such stock respondents used a colorful travel brochure obtained by registrant, the photographs and text of which were a grossly inaccurate representation and description of the facilities of the hotel, and an offering circular which was

[1] No review was sought of the hearing examiner's order revoking registrant's broker-dealer registration and barring its president from association with any broker-dealer. *Langley-Howard, Inc.*, Securities Exchange Act Release No. 8098 (June 8, 1967).

[2] The hotel was under lease to Bimini Hotel, Ltd., a Bahamian corporation all of whose stock was owned by Bahamas.

issued by Bahamas and contained misleading representations. In addition, respondents made fraudulent oral representations and predictions to customers.

The brochure depicted, among other things, an attractive swimming pool, tennis court, and hotel room and pertinent facilities. It stated, "No other Bimini resort offers facilities so modern, spacious, luxurious . . . such beautiful rooms and lavish apartments. The Bimini Hotel is unquestionably Bimini's largest, finest, smartest resort."

The brochure was used to induce purchases despite a highly unfavorable report on the physical condition of the hotel property prepared by a consulting engineering and real estate firm engaged by registrant, which was sent to registrant on September 11, 1964, and which registrant's president discussed with respondents and made available for their examination. The report advised that the property was in a general state of disrepair and was getting progressively worse. More particularly, the report stated that the hotel's plumbing, heating, painting, roofing, and electrical wiring had deteriorated badly; many of the room air conditioning units were undersized and not in working order; there was "a general profusion of missing doors, broken windows and unworkable hardware"; the swimming pool was inoperable because it needed waterproofing, repair of cracks, and new plumbing and chlorination systems and pumps; the ocean side of the beach was rough coral and the property included no area satisfactory for a bathing beach; the tennis court was unusable; and much equipment was rusted or broken.[3] The report indicated that there were large, modern, well-run hotels on the island in competition with that of Bahamas, and that unless substantial improvements were made and competent management hired the hotel would not retain or attract business. It was estimated that an expenditure of about $220,000 was necessary for renovation and replacement of facilities.

The offering circular, which was dated August 15, 1964, was distributed to customers in connection with claimed "intrastate" offerings of Bahamas stock between August and December 1964, and in April 1965. It stated that one of the principal purposes of the "offering" was to finance "the modernization and operation of the hotel," and that part of the proceeds, about $44,470, would be

[3] The report further noted, among other things, that the water in the hotel's "fresh water cistern" emitted "such strong odors" that the cistern was "entirely unusable" and in need of immediate repairs, and that the "damaged sewer outfall" deposited "waste on the beach less than 50 feet from the most expensive accommodations," and concluded that the hotel "in its present physical condition can be operated only as a second class retreat for youthful skindivers and drunken romeos."

used for those purposes. However, it was not amended to disclose, as detailed in the September 1964 report, the hotel's state of disrepair or that much more than $44,470 would be needed to rehabilitate the property. Moreover, the offering circular recited that Bahamas had loaned over $55,000 (about 20 percent of its assets) to Orange Sun Lines, Inc. ("Orange Sun"), which operated a daily motor vessel from Miami to Bimini and had agreed, as part consideration for the loan, to transport hotel guests free during 1964 and for 40 percent of the regular fare during 1965. The circular further stated that this arrangement would "inure to the best interests of [Bahamas] by stimulating the business of [its] hotel and club facilities." No disclosure was made during the initial period that, as respondents knew, Orange Sun had filed a petition for reorganization under Chapter X of the Bankruptcy Act on August 27, 1964, and that its vessel had been seized early in September 1964, under a libel to foreclose on a mortgage.[4]

IN April 1965, the offering circular was accompanied by an undated addendum which, among other things, recited that, since August 15, 1964, repairs and alterations had been made to the hotel but that active operations had not yet commenced, and that Bahamas had operated at a loss during the interval. Although the addendum disclosed that Orange Sun had filed a Chapter X petition and stated that there was no assurance that any part of the money loaned to that company by Bahamas could be collected,[5] there was still no disclosure of the incapacity of Orange Sun's motor vessel.

As previously stated, respondents also made fraudulent oral representations and predictions to customers. O'Leary told a customer that Bahamas stock could or would appreciate manyfold. Steigerwald represented to one customer that Bahamas, then being offered at 5, was "a seven and one-half to ten dollar stock," and to another customer that he should not be concerned over his investments since, if the hotel could not be operated profitably, the corporation's liquidating value was about $8 to $10 per share. Barnett told a customer that the potential price of Bahamas stock might be about twice its $5 offering price and that Orange Sun's motor vessel would be available to carry tourists to Bimini. Sorenson variously represented to four customers that the hotel had "more prospects of becoming one of the top spots on Bimini than

[4] In November 1964, the vessel was ordered released to the trustee in bankruptcy but remained impounded because the latter had no funds to pay storage and insurance charges. Thereafter, the ship deteriorated in storage and ultimately was released to the mortgagee.

[5] Bahamas' December 31, 1964 balance sheet, which accompanied the addendum, did not however reflect the doubtful collectibility of the Orange Sun loan which at that time constituted about 25 percent of Bahamas' assets.

any of the other hotels on the island," that Bahamas stock had a very good potential for growth in price and was a good investment on which the customer would definitely make money, that the hotel was operating at a profit, and that Orange Sun's cruise ship should bring large numbers of passengers to Bimini. As found by the examiner, these representations and predictions reflected unwarranted optimism and a failure to disclose the serious adverse factors of which respondents were aware.

SALES OF UNREGISTERED SECURITIES

The hearing examiner found that registrant's sales of Bahamas stock during the period May 1, 1964, to December 31, 1965, were in willful violation of the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933, and that respondents aided and abetted these violations but that their misconduct was not willful.

From May 1964 through August 1965, registrant, through respondents, sold 84,775 unregistered shares of Bahamas stock, purportedly in six separate offerings. A "private offering" exemption from registration under Section 4(2) of the Securities Act was claimed with respect to four of such offerings and an "intrastate" exemption under Section 3(a)(11) with respect to two.[6] Neither of those exemptions was available, however.

There was no basis for any private offering exemption. Offers and sales of Bahamas stock were made in the assertedly "private" offerings to various inadequately informed persons whose strongest common tie was that many or most of them had purchased another security from registrant pursuant to investment letters. It is clear that such persons did not occupy a relationship to the issuer giving them access to the same kind of information that a registration statement under the Securities Act would have sup-

[6] The following table summarizes the sales in question:

Date	*Claimed Exemption*	*No. of Purchasers*	*No. of Shares Sold*	*Offering Price*	*Total Dollar Proceeds*
May-June 1964	Private Offering	10	15,000	$3	$ 45,000
August-December 1964	Intrastate	229	39,975	5	199,875
December 1964	Private Offering	9	8,300	4	33,200
March 1965	Private Offering	7	5,000	5	25,000
April 1965	Intrastate	84	10,500	6.50	68,250
July-August 1965	Private Offering	8	6,000	5	30,000
			84,775		$401,325

plied, nor did they possess such information. Under such circumstances it is well established that a small number of offerees is not determinative of whether an offering is private,[7] nor is the fact that investment letters are signed by the purchasers.[8] Accordingly the requirements of a private offering exemption were not met. Moreover, no exemption was available for the claimed intrastate offerings since Bahamas did not perform "substantial operational activities" in the state of its incorporation.[9]

Finally, even apart from the fact that each of the six offerings did not qualify for the claimed exemptions, it is clear that such exemptions were not available since those offerings constituted a single integrated offering of Bahamas stock.[10] Whether a series of stock offerings over a period of time should be integrated is a question of fact to be determined by consideration of various criteria, any one or more of which may be determinative. Among the factors to be taken into account are whether the offerings involve the same class of security, are made at or about the same period of time and for the same general purpose, and whether the same type of consideration is received.[11] It is evident that all of the purportedly separate offerings of Bahamas stock, which ran almost continuously for a period of fifteen months, were part of an integrated plan to finance the acquisition of an interest in, and rehabilitation of, a run-down hotel.[12]

We find that in the offer, sale and delivery of Bahamas stock

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[7] *S.E.C.* v. *Ralston Purina Co.*, 346 U.S. 119 (1953); *Gilligan, Will & Co.* v. *S.E.C.*, 267 F.2d 461 (C.A. 2, 1959), *cert. denied* 361 U.S. 896 (1959); *Advanced Research Associates, Inc.*, 41 S.E.C. 579 (1963); Securities Act Release No. 4552 (November 6, 1962).

[8] *United States* v. *Custer Channel Wing Corporation*, 376 F.2d 675, 679 (C.A. 4, 1967), *cert. denied* 389 U.S. 850 (1967); *Hayden Lynch & Co., Inc.*, 43 S.E.C. 25, 26 (1966); Securities Act Release No. 4552, *supra*.

[9] Securities Act Release No. 4434 (December 6, 1961). Section 3(a)(11) exempts from registration any security with is a part of an issue offered and sold only to persons resident within a single state where the issuer, if a corporation, is incorporated by and doing business within such state. The cited Release states: "The doing business requirement is not met by function in the particular state such as bookkeeping, stock record and similar activities or by offering securities in the state."

[10] The private offering exemption was clearly unavailable for the claimed intrastate offerings, which involved offers and sales to large numbers of persons; and sales were made to out-of-state residents during the purported private offerings.

[11] See *Unity Go'd Corporation*, 3 S.E.C. 618, 625 (1938); *Peoples Securities Company*, 39 S.E.C. 641, 651 (1960), *aff'd* 348 F.2d 588 (C.A. 5, 1961); Securities Act Release Nos. 4434 and 4552, *supra*.

[12] The fact that some of the Bahamas stock was offered and sold on behalf of registrant does not change this conclusion. Registrant received its Bahamas shares from the newly incorporated issuer in return for stock of Bimini Hotel, Ltd. Registrant's prompt resale of those shares indicates that it acquired them with a view to distribution. Accordingly, registrant was an underwriter with respect thereto within the meaning of Section 2(11) of the Securities Act (see *Peoples Securities Company, supra*) and the issuance of those shares to registrant was part of the overall plan of distribution on behalf of Bahamas.

respondents violated the registration provisions of Sections 5(a) and 5(c) of the Securities Act, and that such violations were willful within the meaning of Section 15(b) of the Exchange Act. Respondents are not relieved of responsibility by reliance on their employer,[13] or the fact that registrant's president obtained opinions of counsel that each of the claimed private and intrastate exemptions was available before he instructed respondents to sell the stock.[14] However, evidence relating to such factors can be relevant in deciding what sanctions are appropriate in the public interest.

EXCESSIVE MARK-UPS

The hearing examiner found that during the period January 1962 through June 1964, registrant, in 873 sales to customers of stock of The Onego Corporation ("Onego") at prices of 3/8 to 1–1/2, charged excessive mark-ups ranging from over 9 percent to 100 percent above prevailing market prices as indicated by registrant's contemporaneous costs for such security, and thereby willfully violated the anti-fraud provisions cited above. He further found that 699 of those transactions were effected through respondents. The record supports these findings for the most part, although it requires their modification to some extent. The examiner failed to take into consideration as countervailing evidence of market price various sales of Onego stock by registrant to other dealers which were substantially contemporaneous with respondents' retail sales and in which the sales prices were higher than registrant's cost of purchases.[15] We have recomputed respondents' mark-ups to give recognition to such sales. In 78 of those transactions in which the mark-ups as found by the examiner ranged from 20 percent to about 33 percent we have reduced the mark-ups to a range of over 9 percent to 15.8 percent, with most of them amounting to 10 percent or 11.1 percent. As to 38 other transac-

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[13] As we recently had occasion to point out, "salesmen, no less than broker-dealers, should be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act, and they should be reasonably certain such an exemption is available" before engaging in the offer and sale of unregistered securities. *Strathmore Securities, Inc.*, 43 S.E.C. 575, 582 (1967). See also *R. Baruch and Company*, 43 S.E.C. 13, 16 (1966).

[14] *Cf. Morris J. Reiter*, 41 S.E.C. 137, 141 (1962); *The Whitehall Corporation*, 38 S.E.C. 259, 270 (1958); *Cornelis De Vroedt*, 38 S.E.C. 176, 180 (1958); *Gearhart & Otis, Inc.*, 42 S.E.C. 1, 22 (1964), *aff'd*, 348 F.2d 798 (C.A.D.C., 1965).

[15] See *Langley-Howard, Inc.*, 43 S.E.C. 155, 161 (1966); *Gateway Stock and Bond, Inc.*, 43 S.E.C. 191, 194 (1966).

tions, our recomputation reduces the mark-ups found by the examiner to a range which we do not consider to be excessive.[16]

Despite the excessive mark-ups in respondents' transactions, the hearing examiner was of the opinion that "absent control and evidence of knowledge of violations" their participation in registrant's mark-up violations "should not be deemed willful." He reached this conclusion on the ground that the evidence in this proceeding as to respondents' knowledge of the mark-ups did not differ sufficiently from that in a prior proceeding involving respondents, in which we set aside findings by the National Association of Securities Dealers, Inc. ("NASD") that they charged unfair mark-ups in the sale of Onego stock,[17] to warrant a different result here.

In the NASD case, the charges of unfair mark-ups in the sale of Onego stock related to part of the same period at issue here. We found that there was no evidence in the record in that proceeding that respondents knew or should have known that generally no inter-dealer sales were effected by registrant or other dealers at or about the offers quoted in the sheets published by the National Quotation Bureau, Inc., and therefore that those offers were not fairly representative of the current market.[18] On the basis of the evidence in the present record, however, we conclude that respondents could not rely on such offers.

The record now before us, unlike that in the NASD proceeding, contains testimony by the respondents in which they admit they were aware on a daily basis of the prices which registrant was paying for Onego stock.[19] Respondents knew or should have known, as we have repeatedly pointed out, that absent countervail-

[16] The following table summarizes the unfair mark-ups which we find were charged in transactions effected by respondents.

Range of Mark-ups (%)	*O'Leary*	*Steigerwald*	*Barnett*	*Sorenson*
9 to 15	41	16	37	17
15 to 25	44	12	33	28
25 to 45	128	50	102	94
45 to 75	17	7	17	13
75 to 100	0	2	1	2
	230	87	190	154
Number of Markups of $500 or More	19	3	8	4
Highest Dollar Mark-up	$1250(33%)	$575(25%)	$750(25%)	$1250(40%)

[17] *Langley-Howard, Inc.*, 43 S.E.C. 155 (1966).

[18] *Id.*, at p. 161.

[19] Such prices were reported on registrant's teletype machine to which respondents had ready access.

ing evidence a dealer's contemporaneous cost is the best evidence of market price for the purpose of computing mark-ups,[20] and that the mark-ups they were charging customers in sales of Onego stock were excessive on the basis of such cost. Under the circumstances, they had an obligation to refrain from selling stock at prices which included such mark-ups unless they could first discover "countervailing evidence" which established a wholesale market price for Onego in excess of contemporaneous cost that was reasonably related to the retail prices they were charging. This they failed to do. With knowledge of registrant's cost, respondents could not simply accept the offers quoted in the sheets as better evidence of the prevailing market price.[21]

We conclude that respondents willfully violated the designated anti-fraud provisions in the sale of Onego stock at unfair prices. Where salesmen are or should reasonably be aware that their customers may be defrauded through the charging of unfair prices, their responsibility is no less than that of their employer.

PUBLIC INTEREST

The examiner found that respondents' selling activity revealed "a recklessness in each man and an indifference to the need for full and accurate disclosure" calling for the imposition of sanctions in the public interest. But he was of the opinion that leniency should be accorded because he considered that the "more flagrant types of high-pressure" selling were absent and that respondents had relied on registrant's president, thought that Bahamas' hotel was being improved and might be a profitable venture, and did not intend to defraud the public. Respondents assert, among other things, that the hotel was in fact remodeled and that it was not shown that any customer-witness lost money and in fact some customers made a profit.

It is clear, however, that respondents, who were experienced in the securities business,[22] deliberately used false and misleading representations and predictions in the sale of Bahamas stock, and the fact that a customer may have suffered no loss or made money does not excuse the serious fraud shown.[23] On the basis of such fraud alone bar orders are warranted. Moreover, as we have

[20] See, *e.g.*, *J. A. Winston & Co., Inc.*, 42 S.E.C. 62, 68 (1964); *Shearson, Hammill & Co.*, 42 S.E.C. 811, 837, n.57 (1965)

[21] *Naftalin & Co., Inc.*, 41 S.E.C. 823, 827–8 (1964); *C.A. Benson & Co., Inc.*, 42 S.E.C. 952, 954 (1966); *Langley-Howard, Inc.*, *supra*, at p. 161; *Gateway Stock and Bond, Inc.*, *supra*, at p. 194.

[22] Steigerwald has been employed by registrant for over ten years, O'Leary for about eight, Barnett about seven and Sorens about three and one-half years. Prior to his employment with registrant, Sorenson for about three years had been a salesman and regional manager for a broker-dealer engaged in selling mutual funds.

[23] *Sidney Tager*, 42 S.E.C. 132, 137 (1964), aff'd 344 F.2d 5 (C.A. 2, 1965).

found, respondents' violations included effecting numerous transactions at excessive mark-ups.

Respondents argue that our power to increase the sanctions imposed by the hearing examiner, which respondents analogize to criminal sentences, "is at best dubious," and that, in any event, this area should be left to the examiner's discretion as a matter of policy. It is, of course, well settled that broker-dealer proceedings are remedial rather than penal in nature,[24] and neither the Administrative Procedure Act nor our own Rules of Practice restrict our power to impose more severe sanctions whenever, as here, the issue of their adequacy is properly raised on review of an examiner's decision.[25] While we give due consideration to an examiner's initial decision, the final determination within the scope of our review must and should be our own.

An appropriate order will issue.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT and SMITH

[24] See *Century Securities Company*, 43 S.E.C. 371, 382 (1967), and cases there cited.

[25] The Administrative Procedure Act (5 U.S.C.. §557(b)) provides that, "On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule." Rule 17(g)(2) of our Rules of Practice (17 CFR 201.17(g)(2)) provides, "On review the Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, the initial decision by the hearing officer and make any findings or conclusions which in its judgment are proper on the record."