ADMINISTRATIVE PROCEEDING
FILE NO. 3-1680

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
INVESTORS MANAGEMENT CO., INC. ANCHOR CORPORATION MADISON FUND, INC. J. M. HARTWELL & CO. J. M. HARTWELL & CO., INC. HARTWELL ASSOCIATES PARK WESTLAKE ASSOCIATES VAN STRUM & TOWNE, INC. FLESCHNER BECKER ASSOCIATES A. W. JONES & CO. A. W. JONES ASSOCIATES FAIRFIELD PARTNERS BURDEN INVESTORS SERVICES, INC. WILLIAM A. M. BURDEN & CO. THE DREYFUS CORPORATION

INITIAL DECISION

Warren E. Blair
Hearing Examiner

Washington, D.C.
June 26, 1970

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Appearances: Otto G. Obermaier, Irwin M. Borowski, Alfred E. T. Rusch, Richard H. Kogan, John J. Kelleher, Ralph K. Kessler, and Daniel Glickman, for the Division of Trading and Markets of the Commission.

John E. Hoffman, Jr., W. Foster Wollen, and Lewis C. Evans II, of Shearman & Sterling, for Investors Management Co., Inc., and Anchor Corporation.

Frederic L. Ballard, Oliver C. Biddle, Duncan O. McKee, and Frederic W. Clark, of Ballard, Spahr, Andrews & Ingersoll, for Madison Fund, Inc.

Joseph A. McManus, Stephen Seyre Singer, David H. Smith, and Charles R. Stevens, of Coudert Brothers, for J. M. Hartwell & Co., J. M. Hartwell & Co., Inc., Hartwell and Associates, and Park Westlake Associates.

William E. Jackson, Andrew J. Connick, and Anthony C. Stout, of Milbank, Tweed, Hadley & McCloy, for Van Strum & Towne, Inc.

Marvin Schwartz and M. Blane Michael, of Sullivan & Cromwell, for Fleschner Becker Associates.

Eugene P. Souther and Anthony R. Mansfield, of Seward & Kissel, for A. W. Jones & Co. and A. W. Jones Associates.

Joseph B. Levin, of Brown Lund & Levin, for Fairfield Partners.

Samuel E. Gates and Standish F. Medina, Jr., of Debevoise, Plimpton, Lyons & Gates, for Burden Investors Services, Inc., and William A. M. Burden & Co.

Stanley Godofsky, William S. Greenawalt, Guy C. Quinlan, Ronald E. Brackett, and James J. Maloney, of Royall, Koegel & Wells, for The Dreyfus Corporation.

Before: Warren E. Blair, Hearing Examiner.

These proceedings were instituted by an order of the Commission dated August 26, 1968 ("Order"), pursuant to Sections 15(b), 15A, and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203 of the Investment Advisers Act of 1940 ("Advisers Act") to determine whether the respondents named in the Order had, as alleged by the Division of Trading and Markets ("Division"), wilfully violated and wilfully aided and abetted violations of the anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act and rules thereunder, and whether remedial action pursuant to the provisions of the Exchange Act and Advisers Act is necessary.

Prior to the commencement of the hearing, respondents Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch"), and fourteen of its officers and employees made offers of settlement which, upon acceptance by the Commission and the issuance of the Commission's Findings, Opinion and Order in November, 1968, terminated these proceedings as to them.[1/] At the outset of the hearing on December 16, 1968 Anchor Corporation was added as a respondent in this matter upon application by the Division for an amendment to the Order, and respondent City Associates, announcing that the Commission had accepted its offer of settlement, withdrew

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1/ Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 8459 (November 25, 1968).

from further participation in the hearing.[2/]

In substance, the Division's allegations are that during the period from about June 20, 1966 through June 24, 1966, each of the respondents appearing and participating in the hearing[3/] wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the sale of common stock of Douglas Aircraft Co., Inc. ("Douglas"). Allegedly, non-public material information about lower earnings that Douglas would report for the first six months of its fiscal year ("FY") 1966 and about the reduction by the company of its estimates of earnings for FY's 1966 and 1967 was acquired by Merrill Lynch and certain of its officers and employees during June 17, 1966 through June 22, 1966 by virtue of Merrill Lynch being the prospective managing underwriter of a Douglas convertible debenture offering. It is further charged that prior to those facts becoming public, respondents received information from Merrill Lynch personnel about the lower earnings and reduced estimates, and sold Douglas common stock without a disclosure of that information.[4/]

2/ Subsequently, the Commission issued an order accepting the offer of settlement. City Associates, Securities Exchange Act Release No. 8509, Investment Advisers Act Release No. 242 (January 31, 1969).

3/ Hereinafter, unless otherwise indicated, "respondent(s)" is not a reference to Merrill Lynch or its officers or employees nor to City Associates.

4/ Pursuant to stipulation, sales of Douglas stock during the period June 21 through June 23, 1966, executed on the New York (cont'd)

Answers filed by respondents to the Order denied the alleged violations and, as one of the defenses, asserted lack of Commission jurisdiction in these proceedings over respondents and their activities. All respondents appeared through counsel who participated throughout the hearing.

4/ (Cont'd)
Stock Exchange or otherwise executed by use of the mails and of the means and instrumentalities of transportation and communication in interstate commerce, were made by a respondent or attributed to the recommendation of a respondent as follows:

	Respondent	Date	Shares Sold Long	Shares Sold Short	Price	Total Price (Nearest $1,000)
1.	Investors Management Co., Inc.	6/22	54,000	-	88½-90	$4,854,000
		6/23	59,300	-	77⅞-88¼	4,902,000
2.	J. M. Hartwell & Co.	6/21	1,600	-	87 -87¼	139,000
3.	Hartwell and Associates	6/22	-	2,500	90	225,000
4.	Park Westlake Associates	6/22	-	1,500	90	135,000
5.	Van Strum & Towne, Inc.	6/22	1,500	-	88 -88⅜	132,000
6.	Fleschner Becker Associates	6/22	-	5,000	89¼-90	447,000
		6/23	-	3,500	87¾-88½	307,000
7.	Fairfield Partners	6/21	-	900	89¾	81,000
8.	Burden Investors Services, Inc.	6/23	7,100	-	84¼-87¼	605,000
9.	William A. M. Burden & Co.	6/23	3,900	-	84⅜-87½	331,000
10.	The Dreyfus Corporation	6/23	21,300	-	80¼-81¾	1,713,000

It also appears uncontroverted that Madison Fund, A.W.Jones & Co. and A.W. Jones Associates executed sales of Douglas stock on the New York Stock Exchange as follows:

11.	Madison Fund	6/21	6,000	-	87½-88½	527,000
12.	A. W. Jones & Co.	6/22	-	4,900	88 -90½	438,000
13.	A. W. Jones Associates	6/22	-	2,800	88½-89⅞	250,000

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by the parties to these proceedings.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.[5/]

RESPONDENTS

During 1966, Investors Management Company, Inc. ("IMC"), then a wholly-owned corporate subsidiary of Anchor Corporation ("Anchor"), was the investment adviser to certain investment companies, including Fundamental Investors, Inc., and Diversified Growth Stock Fund, Inc. IMC lost its corporate identity in April, 1968 when it was absorbed by Anchor Corporation and became the Investment Management Division of that company.

Anchor, in addition to having been the parent of IMC in 1966 and successor to IMC's business in 1968, is and has been a broker-dealer registered under the Exchange Act since March 21, 1968, and has been registered as an investment adviser under the Advisers Act since November 28, 1968.

5/ Respondents' contention that the quantum of proof required to establish the alleged violations is greater than a preponderance of the evidence is rejected. Norman Pollisky, Securities Exchange Act Release No. 8381 (August 13, 1968); Underhill Securities Corporation, Securities Exchange Act Release No. 7668 at 6 (August 3, 1965).

Madison Fund, Inc. ("Madison") is and has been registered as an investment company under the Investment Company Act of 1940 since September 14, 1941.

During 1966, J. M. Hartwell & Co. ("Hartwell & Co."), a partnership whose business J. M. Hartwell & Co., Inc. ("Hartwell, Inc.") succeeded late in that year, was registered as an investment adviser under the Advisers Act and in June, 1966 managed investment portfolios for individuals, institutions, and two investment companies. A withdrawal of Hartwell & Co.'s registration as an investment adviser became effective in September, 1967, and Hartwell, Inc. became registered as an investment adviser on November 23, 1966.

Hartwell and Associates (named in the Order as "Hartwell Associates") is a partnership formed in 1964 for investment purposes, and in 1966 carried on its business as a "hedge fund."[6/]

Park Westlake Associates ("Park Westlake") is an investment partnership formed in 1964 which has functioned as a "hedge fund" since inception.

Van Strum & Towne, Inc., ("Van Strum") has been registered as an investment adviser under the Advisers Act since April 6, 1958

6/ The term "hedge fund" is frequently used to identify a private limited partnership which carries on trading operations in the securities markets by means that customarily include the use of borrowed money, options, and short sales.

and in addition to offering investment advisory services to the public, acts as investment adviser and supervises the investments of several mutual funds, including Channing Growth Fund and Channing Balanced Fund.

Fleschner Becker Associates, A. W. Jones & Co. ("Jones & Co."), A. W. Jones Associates ("Jones Associates") and Fairfield Partners ("Fairfield") are limited partnerships and each carried on an investment operation as a "hedge fund," in 1966.

William A. M. Burden & Co. ("Burden & Co.") is a partnership whose business in 1966 was the investing of funds of certain members of the Burden family and of various trusts of which those family members are either the beneficiaries or trustees.

In 1966 Burden Investors Services, Inc. ("Burden, Inc.") performed bookkeeping, accounting, and tax work for the Burden family, and also acted as investment adviser to those members of the family who were not general or limited partners of Burden & Co.

The Dreyfus Corporation was registered as a broker-dealer under the Exchange Act from January 28, 1947 until July 5, 1968, when its withdrawal of registration became effective, and in 1966 was also the investment adviser and manager of the Dreyfus Fund, a mutual fund.

JURISDICTION

Thirteen of the respondents[7] who are neither registered broker-dealers nor applicants for registration as such under the Exchange Act challenge the jurisdiction of the Commission to take remedial action against them in an administrative proceeding pursuant to Section 15(b) of that Act. These respondents correctly point out that Section 15(b)(5) of the Exchange Act which authorizes administrative action against "any broker or dealer" is not applicable to them,[8] but their further assertion that Section 15(b)(7) does not confer requisite jurisdiction is contrary to the clear-wording,[9] the legislative history,[10] and

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7/ IMC, Madison, Hartwell & Co., Hartwell, Inc., Hartwell Associates, Park Westlake, Fleschner Becker Associates, Jones & Co., Jones Associates, Fairfield Partners, Burden, Inc., Burden & Co., and Dreyfus Corporation.

8/ See Wallach v. SEC, 202 F. 2d 462 (D.C. Cir. 1953).

9/ Section 15(b)(7) provides that certain conduct specified therein constitutes a basis upon which:

> The Commission may, after appropriate notice and opportunity for hearing, by order censure any person, or bar or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer, . . . (emphasis added).

10/ Hearings on S. 1642 Before the Subcommittee on Securities of the Senate Committee on Banking and Currency, 88th Cong., 1st Sess. (1963) ("Senate Hearings"); Hearings on H.R. 6789, H.R. 6793, and S. 1642 Before the House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. (1963) ("House Hearings").

Commission interpretation[11/] of that section of the Exchange Act.

Respondents would have "any person" as used in Section 15(b)(7) take on an entirely different complexion by limiting the term to a class of persons who are "registered broker-dealers or to individuals associated with such broker-dealers." Reading the term "any person" in the context in which it is used in Section 15(b)(7) affords no warrant for rejecting the accepted definition of those words and substituting that urged by respondents. If the intent was that the Commission receive a lesser jurisdiction, other terms expressing such limitation were readily available and, in fact, used in connection with the 1964 amendments which brought Section 15(b)(7) into the Exchange Act.[12/]

The legislative history of Section 15(b)(7), although not extensive, cannot be viewed as support for respondents' contention. At the Senate Hearings on the 1964 amendments the Commission submitted a Technical Statement[13/] which referred to proposed amendment Section 15(b)(3), the now Section 15(b)(7),

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11/ Norman Lollisky, supra at 3.

12/ E.g. Section 3(a)(18) of the Exchange Act defines the term "person associated with a broker or dealer" for purposes of the Act.

13/ Senate Hearings at 364-65.

as a vehicle through which the Commission could "warn the public and the broker-dealer community of violations" by proceeding administratively against a person even though he has not been, and is not, associated with a broker or dealer." Contrary to respondents' statement, the Commission pursued the same position with respect to Section 15(b)(7) at the House Hearings, submitting a Technical Statement which stated that under the proposed amendment "[t]he Commission could proceed against and bar, suspend, or censure a person even though he has not been, and is not, associated with a broker or dealer. Such action would, among other things, warn the public and the broker-dealer community of violations."[14/]

Respondents argue, however, that before enactment of the 1964 amendments the Commission backed away from the indicated position, and that because the House Committee in its Report stated that Section 15(b)(7) "would in no way overrule"[15/] Wallach v. SEC, supra, the intention to limit the application of Section 15(b)(7) to a person associated with a registered broker-dealer is established. The excerpts relied upon cannot carry

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14/ House Hearings at 227.

15/ House Report at 22-23.

respondents' argument. The testimony of former Commission Chairman Carey[16/] referred to by respondents is his review of courses of action that could be followed by the Commission upon enactment of Section 15(b)(7) against a broker-dealer and individuals associated with it, but nowhere is there an indication that such courses of action were to be the only ones that could be pursued, and nowhere is there testimony in which he departs from or rejects the position taken in the Commission's Technical Statements. Nor does a construction of Section 15(b)(7) that permits the Commission to proceed against respondents do violence to the House Report and overrule Wallach v. SEC, supra. The Wallach case would still be applicable were the Commission to follow its old procedure rather than that now permitted under Section 15(b)(7).[17/]

Further, the Commission has ruled that its jurisdiction under Section 15(b)(7) extends to "any person who wilfully violated provisions of the Securities Act regardless of whether or not he was associated with a broker or dealer as a salesman or in any other capacity when he committed those violations."[18/] Respondents'

16/ House Hearings at 1219, 1221.

17/ 5 Loss Securities Regulation, 3385-86 (Supp. to 2d Ed. 1969).

18/ Norman Pollisky, supra at 3.

view that the Commission did not in the Pollisky case pass upon the question now presented is rejected as being too narrow an interpretation of the Commission's ruling therein.[19/]

In view of the foregoing, it is concluded that the Commission has jurisdiction under Section 15(b)(7) over those respondents who are neither registered broker-dealers nor applicants for registration as such, and has the right therefore to proceed against those respondents administratively and, if appropriate, to take remedial action pursuant to Section 15(b)(7).

RECEIPT AND DISCLOSURE BY MERRILL LYNCH OF INFORMATION CONCERNING DOUGLAS

Douglas, now merged into McDonnell Douglas Corp., was engaged in the aerospace industry in 1966, and was a leading producer of commercial transport airplanes. Its common stock was listed and actively traded on the New York Stock Exchange and Pacific Coast Exchange.

In need of investment banking counsel early in 1966, Douglas called upon Merrill Lynch, generally considered the largest securities firm in the United States, which had previously acted as Douglas underwriter and investment banker in 1957 and 1958. Conferences between Douglas management and Julius Sedlmayr, New York based director of Merrill Lynch's Underwriting Division and Dean Woodman, head of the West Coast Department of the division, took place in March, 1966 out of which arose a

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19/ See 5 Loss, Securities Regulation, supra.

stand-by agreement dated April 12, 1966 by which Merrill Lynch became managing underwriter in connection with the redemption by Douglas of then outstanding convertible debentures. In addition, by letter of intent dated March 31, 1966 Merrill Lynch indicated its willingness to become managing underwriter of a new Douglas convertible debenture offering which was to take place following the redemption of the outstanding issue.

During the negotiations that led to the April 12 agreement, Douglas furnished Sedlmayr and Woodman with balance sheet information and management's cash flow projections which included earnings projections of $4 to $4.50 per share for FY 1966 and $8 to $12 for FY 1967.[20/] In keeping with a then existing policy of communication with Merrill Lynch's Research Department in New York City, Woodman passed on the Douglas earnings projections to Archangelo Catapano, then senior analyst covering the aerospace industry. Toward the end of April, 1966 while working on the registration statement covering the new debenture offering, Woodman learned that Douglas management had reduced its earnings estimate to about $3.50 for FY 1966, and he informed Sedlmayr of the change. Woodman then gave Catapano the same information in order to have Catapano's views on whether Merrill Lynch should proceed with the Douglas underwriting and to keep Catapano conversant with Douglas developments. Around June 1, Woodman followed the same procedure of

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20/ The Douglas fiscal year was from December 1 to November 30.

informing Sedlmayr and Catapano, after hearing from Donald Douglas, Jr., then president of Douglas, that earnings estimates for FY 1966 had been revised downward to a range of $2 to $3 and learning that forthcoming figures were expected to show that the company broke even for the months of March and April, 1966. He further discussed with Catapano the reasons given by the company for the lowered estimates, the corrective measures that Douglas was contemplating to increase its rate of profitability, and his own view, with which Sedlmayr had agreed, that Merrill Lynch should continue with the proposed Douglas financing. Woodman specifically told Catapano that the registration statement Douglas intended to file with the Commission early in June would disclose that the company's earnings for the first five months of FY 1966 were no more than for the first three months, and that the prospectus to be filed would explain the decreased rate of profitability.[21/] Catapano acknowledged the help the information provided in developing his knowledge and understanding of Douglas' affairs, and agreed not to discuss the information with anyone outside of Merrill Lynch and with no one inside the firm except Sedlmayr or Winthrop Lenz, Merrill Lynch's executive vice-president. Ignoring his commitment to Woodman, Catapano acquainted his assistant, Carol Neves, and Phillip Bilbao, then head of Merrill Lynch's

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21/ The Douglas registration statement covering a proposed offering of $75,000,000 of its convertible debentures was filed June 7, 1966 and became effective July 12, 1966.

Institutional Services Department,with the earnings data. In turn, Bilbao passed that inside information to Merrill Lynch institutional salesmen, as well as to Thomas Martin, president of Van Strum,and to Stephen Swid of Dreyfus Fund, before it became publicly available. Van Strum and Dreyfus Fund were two of a few institutional accounts which Bilbao assisted in servicing in addition to his other Merrill Lynch duties.

News of the filing of the Douglas registration statement on June 7 was carried in the June 8 Wall Street Journal. The story announced the filing and that "[t]he debentures are to be offered publicly through a group of underwriters led by Merrill Lynch, Pierce, Fenner & Smith, Inc."

Sometime early in June, 1966 Douglas personnel working with Woodman on the registration statement told him, and he in turn told Sedlmayr and Catapano a day or two later, that plane deliveries delayed in April had been delivered in May along with scheduled May deliveries, and that there was a possibility that Douglas had earned as much as 76¢ per share in the month of May, although that rate of profitability was not indicative of what could be expected for the remainder of the year.[22/] However, the profit picture represented to Woodman was entirely changed on Friday, June 17,when he was told not only that the 76¢ figure was

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22/ Under Douglas accounting practices, the sale of a plane was not reflected in a revenue account until the plane was delivered.

out, but that Douglas, Jr. was so concerned about the indicated May earnings that he was sending a special team to the aircraft division headquarters to determine if some error had been made in reports received from there. Woodman telephoned Sedlmayr in New York, and not reaching him at the office left a message for him to the effect that Douglas earnings for its first six months were much worse than had been expected by Merrill Lynch, and that Douglas was attempting to clarify the figures over the week-end.

The sequence and substance of conversations during the following week of June 20 are not as free from doubt as those of the earlier weeks because of repeated inability of witnesses to recall dates and details of their conversations. However, the weight of the evidence establishes that Woodman relayed Douglas information he received from Douglas, Jr. in the morning of June 20 to Sedlmayr and Catapano, and that Catapano during that week gave that information or the substance of it to account executives in Merrill Lynch's Institutional Sales Office.

The critical information in question was given to Douglas, Jr. early Monday morning, June 20, 1966 by the task force of top company financial and accounting men who had worked the previous week-end to check on the results of Douglas operations for its first six months. They found and reported that earnings for the period were down to 49¢ per share, and that estimates for the

entire year's earnings ranged between a profit of 40¢ and a loss of 20¢ per share, and for FY 1967 a profit of from $5.55 to $5.87 per share.

Anxious about the impact of the reported figures upon the proposed underwriting, Douglas, Jr. called Woodman, telling him that it appeared that Douglas had lost money in May, and that estimated earnings were down to 49¢ for the first six months, about break-even for the year, and $5 to $6 for 1967, and asking about Merrill Lynch's willingness to continue with the financing. Woodman indicated that the information raised a problem and arranged to meet with Douglas, Jr., early next morning, June 21. Woodman advised Sedlmayr of the conversation with Douglas, Jr. and they agreed that a decision on the underwriting should be delayed until after Woodman's visit to Douglas headquarters the next day. Although Woodman has no recollection of whether he also spoke to Catapano on June 20, he does not deny doing so, and the evidence otherwise establishes that he did and that he informed Catapano of the estimated 49¢ earnings for six months, the break-even prospect for the entire year, and the projected $5 to $6 earnings for 1967.

In the early afternoon of Tuesday, June 21, Catapano acquainted Lawrence Zicklin, an institutional salesman for Merrill Lynch, with at least the basic fact that Douglas was estimating that its earnings for six months would be less than its first

five months of FY 1966. A little later, at about 2:30 P.M., Lee Idleman, another Merrill Lynch institutional salesman, received a telephone call from Catapano suggesting that Idleman might be interested in Douglas information he had heard. Catapano went on to indicate that Douglas might have lost 36¢ per share for the month of May as against a profit of 31¢ for that month in 1965, that Douglas profits for six months were 49¢ compared to $1.50 for that period in 1965, and that earnings for FY 1966 would be zero, with the company possibly earning $5 to $6 in FY 1967 and $15 to $20 in the following year. In response to Idleman's questions, Catapano attributed the anticipated earnings performance to slippage in Douglas commercial aircraft programs, behind schedule on DC-8 and DC-9 commercial jets and becoming worse.

Realizing that the information received from Catapano would be of immediate interest to certain of their clients, Zicklin telephoned his client "hedge funds," Jones & Co., City Associates, Fleschner Becker Associates, and Fairfield, and Idleman called Madison, Robert Edwards of Manhattan Fund, and Affiliated Fund. Each gave the gist of the information received from Catapano to his respective clients. Shortly after speaking to Madison, Idleman received an order from Madison to sell its holdings of 6,000 shares of Douglas common stock, which sale was accomplished on June 21 prior to the close of the market on the New York Stock Exchange.

Between 2:30 and 3:30 P.M. on June 21, Idleman in a group conversation with Zicklin and institutional salesmen Elias Lazor and James McCarthy discussed, at least in general terms, the Douglas information in question. When McCarthy left the group, having to his recollection heard that the Douglas second quarter would be lower than the first and the year as a whole would be "flat,"and realizing that those results were disappointing, he called his clients, Burden & Co. and Hartwell & Co., and gave them the substance of his information on the Douglas earnings and prospects. Lazor also called his client, IMC, immediately after the group conversation, and advised Edward Button, IMC vice-president and fund manager of Diversified Growth Stock Fund, that Douglas earnings for its six months would be disappointing and that Douglas would break-even in FY 1966. It further appears that the institutional salesmen intended to call other accounts they were servicing and would have done so except for the intervention of Norman Heindel, Jr., their office manager, who directed them to stop activity on Douglas until he could check on the information being used.

Shortly after 9:00 A.M. on Wednesday, June 22, Lazor again phoned Button of IMC to call his attention to a lead article in the June 22 Wall Street Journal that he considered "bullish" on prospects for the aerospace industry, and also spoke to Robert Baines, vice-president of IMC and fund manager of Fundamental

Investors, for the same purpose, at which time Lazor also told Baines that Douglas earnings for six months would be disappointing and that Douglas would break-even for the year. A few minutes later, Lazor received a call from Robert Anderson, IMC's aerospace analyst, who, without mentioning why he was doing so, asked if Catapano would call IMC. Lazor took care of the request through Heindel, who telephoned Catapano. However, during the course of that call, and without previous reference to Douglas, Heindel handed the telephone to Lazor to have him answer Catapano's question of what had been told IMC about Douglas. Lazor said he had told IMC he had heard that the six months earnings would be disappointing, but he made no mention of the fact he had also told Button and Baines that Douglas would break-even for the year. A few minutes later, in a conference call with IMC officers, Catapano referred to IMC's awareness of the problems Douglas was having with its production and stated that the problems were continuing to have an adverse effect on earnings; he then estimated Douglas earnings for FY 1966 at $2 to $3 and over a period of 3 to 4 years a total of $40 per share.

The Wall Street Journal article on the aerospace industry also came into play in a conversation early in the morning of June 22 when Idleman's reference to the article's optimism satisfied a telephone inquiry from Madison on why Douglas had opened several points higher that morning. It also appears that Idleman decided

to make certain of the accuracy of his information by taking the matter up with Bilbao. After discussing the substance of Idleman's information on Douglas, Bilbao indicated he would attempt to verify it.

Also that morning Carol Neves, at Catapano's direction, reached Woodman by telephone at home following his return from Douglas headquarters. In response to her inquiries, Woodman told her that Douglas deliveries of DC-9's had slipped an additional four planes, to a total of 19; that costs were increasing because of labor shortages, material costs, and difficulties with contractors; that the problems were caused by the Viet Nam situation; that earnings for Douglas for six months would be 43¢ [23/] and that the outlook for the year was for little or no profit, with the following year showing a profit of at least $6 per share.

This information was repeated to Bilbao by Catapano or Neves shortly after its receipt. The same day, June 22, Bilbao advised Van Strum by telephone of the information that he had acquired on Douglas. The next day, June 23, Bilbao made a telephone call to Swid, the analyst employed by the Drevfus Fund, and spoke to two other accounts, in the course of which they were acquainted with the same Douglas information.

23/ The 43¢ was given by Woodman instead of 49¢ in consequence of an inadvertent error on his part.

Respondents' argument that no showing has been made that Woodman transmitted information to Catapano on June 20, 1966 is contradicted by the record. While it is true that Woodman testified that his best recollection was that he did not speak to Catapano on June 20, his recollection of the events of that day was not sufficiently strong to allow him to deny that such conversation took place. Weighing the remainder of the evidence on this question against what was obviously not a clear recollection, it is found that the preponderance favors a finding that Woodman advised Catapano on June 20 of the news concerning Douglas earnings and prospects received that morning from Douglas, Jr. The policies and practices of Merrill Lynch in 1966 and Woodman's personal feeling toward and earlier conversations with Catapano in connection with the Douglas underwriting are persuasive on that point.

In connection with a proposed underwriting, it was the policy of Merrill Lynch's underwriting division in 1966 not to go forward until the views of the appropriate industry specialist in the firm's research division were obtained, and the practice was for the senior man assigned to the deal to speak to the research specialist. In the present instance, the policy and practice called for Woodman to communicate with Catapano on important Douglas developments and that he did, regarding Catapano as a "partner" in whom he "had the utmost confidence as to his

professional judgment."

Commencing early in 1966, Woodman kept Catapano abreast of the changing earnings picture as supplied by Douglas management in connection with the underwriting. In early April, 1966 Woodman informed Catapano that Douglas was estimating its earnings for FY 1966 at $4 to $4.50 per share, and $8 to $12 for FY 1967. When, several weeks later Douglas lowered its projection to $3.56 for FY 1966, Woodman discussed the downward revision and the impact of the new estimates upon the continued participation of Merrill Lynch in the underwriting with Catapano. Again, toward the end of May, Woodman advised Catapano that Douglas estimates had been further reduced to a range of $2 to $3 per share for FY 1966, and did the same when the information became available shortly before the Douglas registration statement was filed that Douglas earnings for the first five months of FY 1966 were 85¢ per share and that Douglas had broken even in its fourth and fifth month. In the early part of June, Woodman was told by Douglas counsel with whom he had been working that there was a possibility that Douglas would earn 76¢ for May, 1966 but that "it was a very, very tentative possibility." This information was relayed to Catapano within a day or two, with emphasis upon the tentative character of the information.

It is highly unlikely, in view of Woodman's evidenced concern about keeping Catapano abreast of Douglas developments,

financial and otherwise, and the practice consistently followed prior to June 20, that Woodman would not have informed Catapano on June 20 of Douglas, Jr.'s report that Douglas fortunes had taken a dramatic change for the worse, with Douglas earnings reaching only 49¢ per share for its first six months, an unfavorable comparison with the 85¢ five months earnings, and the year earnings indicated at about break-even. Woodman apprised Sedlmayr as soon as he was able about the significant darkening in the earnings picture, and they agreed that the situation was serious enough for Woodman to travel to Douglas headquarters to seek out the trouble. Woodman's next logical step in keeping with his previous conduct and practice would have been to make certain that Catapano heard the news without delay.

Respondents argue that Woodman had "no faith in the tentative figures given him by Douglas, Jr." on June 20 and that such information would not have been transmitted to Catapano. The short answer is that Woodman acknowledged that he had advised Catapano just a few days earlier of the "very, very tentative possibility" that Douglas would earn 76¢ in May. Moreover, much of the information that Woodman relayed in March, April, and May was considerably more speculative than the Douglas, Jr. report on June 20.

The testimony of Carol Neves, Catapano's assistant in 1966, cited by respondents to show that Woodman did not speak to Catapano on June 20 cannot prevail over the reasonable inferences to be

drawn from the remainder of the record, and her testimony in certain respects cannot be given credence.

Her version of the purported "Kidder, Peabody telephone call" received on June 20 which supposedly brought Catapano's attention to the critical Douglas earnings situation is rejected as being a story concocted by Catapano and accepted by her, consciously or otherwise, as an accurate reconstruction of events. Moreover, Miss Neves' demeanor on the witness stand, her reactions and uncertainty in responding to critical questions, and unexplained departures from conduct that would have normally been expected on June 20 and succeeding days, indicate that a bias favoring Merrill Lynch tainted her recollections.

If, in fact, Catapano had asked Miss Neves on June 20, following a call from Kidder, Peabody, to find out from Woodman whether Douglas was reporting 49¢ for the first six months, it would be passing strange,in view of the information that Woodman had lately given to Catapano that Douglas might earn 76¢ in May alone,for neither Catapano nor Miss Neves to exhaust every effort to reach Woodman that day rather than to rest on uncompleted calls to his office. Even more unlikely would be the lack of any further attempt to telephone Woodman until 2:00 P.M. on June 21, a failure that day also to try to reach him elsewhere, and then the next day, June 22, to finally decide to try his home. That course of conduct which is Miss Neves' recollection of the efforts to verify the purported

extremely important "Kidder, Peabody information" is simply incredible. A further indication of a faulty recollection by Miss Neves is found in notes that she prepared in July, 1966 memorializing the "stories on Douglas" during the week of June 20. There is no entry in those notes indicating that Kidder, Peabody called on June 20 with information that Douglas would be reporting 49¢ earnings for its first six months.

Testimony of Bilbao and Merrill Lynch salesmen to the effect that Catapano was attempting to contact Woodman to check the information he had received does not rebut an inference that the information came from Sedlmayr and Woodman. The checking indicated by that testimony was taking place on June 21, and would have been reasonable for Catapano to undertake in view of the fact that the information Douglas, Jr. had given Woodman on June 20 was in sharp contrast with earlier information, and was subject to possible change.

Also untenable is respondents' argument that if Catapano had received the Douglas earnings information on June 20, he would not have given contradictory information to IMC, a good customer, on June 22. Under the circumstances transpiring at the time Catapano spoke to IMC on June 22, it is evident that he had unexpectedly to face the choice of whether to confirm information about Douglas that he had just learned had been given to IMC by Lazor. In fact, his adherence at that moment of stress to the $2

to $3 per share earnings estimate for Douglas is most telling against him for it discloses a realization that his most recent data was inside information received from Woodman and Sedlmayr on June 20 and not from Kidder, Peabody. Otherwise there should have been no reluctance to give IMC the same information he had confided to the salesmen on June 21. Further on the point, the chilling of the personal relationships that Catapano initiated in connection with the institutional salesmen following June 21 clearly shows Catapano's displeasure at their failure to protect him from identification as the source of their Douglas information.

But even if the evidence were not found to establish that Woodman spoke to Catapano on June 20, it is still sufficient on which to base a finding that either on June 20 or no later than early June 21 Sedlmayr relayed Woodman's reported earnings figures and estimates to Catapano. The testimony of Sedlmayr is that he did speak during the week of June 20 to Catapano about the Douglas earnings figures in question, and did so not only to keep him informed so that he would not give out false information to Merrill Lynch customers, but also to determine if Catapano had a judgment as to the effect sharply lower earnings would have on the market for Douglas stock. Under all the circumstances it is reasonable to infer that the conversation between Sedlmayr and Catapano would take place no later than a few minutes after Sedlmayr had concluded his unsettling conversation with Woodman which ended with a directive

to Woodman to "go down to Los Angeles and find out what was wrong."

Respondents' further contention that the decline in Douglas earnings and the reasons therefor were common knowledge at the time of the transactions in question is not borne out by the record, at least not insofar as the inside information which is here in issue. It is true, as pointed out by respondents, that there were rumors abroad on June 21, 22,and 23, 1966 regarding Douglas earnings for its first six months, and also true that aerospace analysts during the first half of 1966 had indicated pessimism concerning Douglas operations by periodically reducing their estimates on Douglas earnings, but the sum of what was known to the analysts and what fell within the pale of common knowledge was not that which was being conveyed to respondents by Merrill Lynch personnel.

Two of the analysts who testified relied upon analytical ability in reaching conclusions that Douglas problems required successive lowerings of estimated earnings, and had no access to precise earnings information on which to base their predictions. In fact, one of the analysts was completely surprised by the substantial difference between his estimate and the Douglas earnings as released on June 24. A third analyst did indeed learn the substance of the Douglas inside information on June 22 from a source a step removed from Merrill Lynch, and recognizing its significance, telephoned a Douglas officer for confirmation of the

information. But when in the course of that conversation the analyst independently concluded that the information was accurate, the analyst indicated recognition of the non-public character of the data by advising the Douglas officer that "the information belonged on the [Dow-Jones] broad tape."

Neither does the market action in Douglas stock during the week of June 20 establish that the Douglas data had been effectively disclosed prior to respondents' sales. Certainly, the volume of trading increased on June 21 and 22, and reached its highest volume for the month of June, 1966 on June 23, at a considerably lower closing price. But market action is only one factor to be considered in determining whether respondents could have reasonably believed that the Douglas information received had become available to the investing public at the time of their transactions. It may be noted that the trading of June 21 and 22, 1966 which closed on each of those days with the price of Douglas stock up over a point, hardly indicates that the investing public was aware then of the poor earnings of Douglas.

MARKET PERFORMANCE OF DOUGLAS COMMON STOCK ON NEW YORK STOCK EXCHANGE

During 1965 Douglas stock actively traded on the New York Stock Exchange at prices ranging from a low of 29-1/8 on January 4 to a high of 83-1/4 reached on December 20.

The following tables relate to the trading activity of Douglas common stock on that Exchange by month during 1966, and to the daily activity during the week of June 20, 1966. 24/

Date	Price per Share High	Low	Close	Volume
January	92⅞	74¼	91⅝	429,800
February	111⅞	88⅝	103⅞	699,100
March	108⅛	78⅛	95¾	713,600
April	107	95½	97¼	600,500
May	98¼	77	85⅛	610,600
June	90½	61	63⅛	1,538,200
July	68⅛	51⅞	52⅞	771,100
August	59¼	47¾	51	576,000
September	55¼	36⅜	36⅜	607,900
October	38⅝	30	34¾	793,600
November	44	34½	44	644,500
December	49½	42⅛	45½	971,600
June 20	85	81⅞	85	24,500
June 21	90	86	86¼	66,200
June 22	90½	87½	87½	66,500
June 23	88¾	77⅝	78¾	261,500
June 24 25/	77	74½	76	211,100

24/ Investment Statistics Laboratory, Division of Standard & Poor's Corp., ISL Daily Stock Price Index, New York Stock Exchange, 1966.

25/ A Douglas press release issued prior to the opening of the market on June 24 reported a second quarter net loss of 66¢ per share, a net profit for the first six months of FY 1966 of 12¢ per share, and an estimate of nominal, if any, earnings for the full FY 1966.

APPLICABILITY OF ANTI-FRAUD PROVISIONS OF SECURITIES LAWS AND REGULATIONS TO RESPONDENTS' SALES OF DOUGLAS STOCK AFTER RECEIPT OF INSIDE INFORMATION

Before detailing the circumstances surrounding respondents' transactions in Douglas stock, consideration will be given to the standards by which respondents' conduct should be judged. Section 17(a) of the Securities Act, which the respondents are charged with violating, was designed for the protection of investors, and, in general terms, prohibits fraud, manipulation or deception of all kinds in connection with the offer or sale of securities.[26/] Rule 10b-5, which is also alleged to have been violated, was promulgated pursuant to the authority reposed in the Commission by Section 10(b) of the Exchange Act to define the manipulative, deceptive, or otherwise fraudulent devices or contrivances which that Section made

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26/ Section 17(a) of the Securities Act, 15 U.S.C. § 77q reads:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly --
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> (1) to employ any device, scheme or artifice to defraud, or
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> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

unlawful. In adopting Rule 10b-5, the Commission borrowed, with little change, the language embodied in Section 17(a) of the Securities Act.[27/]

For the purpose of determining whether violations of these anti-fraud provisions have occurred, it is clear from the similarity of their language and the views set forth by the Commission in Cady, Roberts & Co.,[28/] that for consideration of the present issues the standards of conduct exacted by each of the provisions are essentially the same. Narrowing the problem to the alleged misconduct of respondents, the question becomes whether the allegations, even if true, constitute violations of the anti-fraud provisions. The answer must be in the affirmative.

Doubts about whether an insider has an obligation of appropriate disclosure of inside information when he sells securities affected by that information were dispelled by the Commission's decision in the Cady, Roberts case. There the Commission, describing the case as "one of signal importance in our administration of the Federal securities acts," flatly rejected the concept that "an insider's responsibility is limited to existing stockholders and that he has no special duties when sales of securities are made

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27/ However, Section 17(a) of the Securities Act is applicable to only offerers or sellers of securities, whereas Rule 10b-5 applies "in connection with the purchase or sale of any security."

28/ 40 S.E.C. 907 (1961).

to non-stockholders."[29] Cady, Roberts also made clear that the special obligation of affirmative disclosure of material information imposed upon insiders under the anti-fraud provisions is not limited to those holding positions as corporate officers, directors, and controlling stockholders, but falls upon all persons who "are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities."[30] As put succinctly by the United States Court of Appeals for the Second Circuit in SEC v. Texas Gulf Sulphur Co.,[31] at 848:

> The essence of the Rule [10b-5] is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i.e., the investing public. Matter of Cady, Roberts & Co., 40 SEC 907, 912 (1961). Insiders, as directors or management officers are, of course, by this Rule, precluded from so unfairly dealing, but the Rule is also applicable to one possessing the information who may not be strictly termed an "insider" within the meaning of Sec. 16(b) of the [Exchange] Act. Cady, Roberts, supra. Thus, anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.

29/ Id. at 913.

30/ Id. at 912.

31/ 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

As enunciated in the Cady, Roberts and Texas Gulf Sulphur cases, the obligation of affirmative disclosure extends beyond those who happen to hold traditional corporate insider positions or relationships. Encompassed also under the rationale of those cases are so-called "tippees" falling within the description of persons who through an insider become aware of information which should be used "only for a corporate purpose and not for personal benefit of anyone."[32/]

Rejected as too narrow is the concept advanced by respondents that a continuing and close relationship must exist between a corporation or the insider and the person using "inside" information before a violation of Section 10b-5 or Section 17(a) can occur. While such relationship may well have been necessary in earlier years, the emphasis of the Texas Gulf Sulphur decision is upon the informational equality of investors in the market place. Since the avenues leading to that result are alternatively through "traditional fiduciary concepts . . . or on the 'special facts' doctrine . . . .,"[33/] a "special relationship" of the kind urged by respondents would not be essential under circumstances indicating that the person using material inside information knew or should have known its character and that the insider from whom it was received was

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32/ See Kuehnert v. Texstar Corporation, 286 F. Supp. 340 (S.D. Tex. 1968), aff'd, 412 F.2d 700 (5th Cir. 1969).

33/ SEC v. Texas Gulf Sulphur Co., supra at 848.

providing "unequal access" to corporate information. Such circumstances, of course, might also be regarded as sufficient reason to impute the fiduciary obligation of the insider and a basis for considering that a "special relationship" did exist between the recipient of the information and the insider.

Rejected also as too limiting is respondents' suggestion that a tippee must be shown to have actual knowledge of an underlying breach of trust by the insider before the tippee's trading on inside information can be found violative of Rule 10b-5. The appropriate test indicated by Texas Gulf Sulphur is whether the tippee had actual or constructive knowledge that the company was the source of the informant's knowledge.[34/]

The gauge for materiality of the information received is, as pointed out by respondents, that of "whether a reasonable man would attach importance * * * in determining his choice of action in the transaction in question."[35/] However, in testing materiality, the importance of reliability in terms of the underlying accuracy of the information wanes as that accorded to the character of the information increases. Thus, a company's earnings results and own projections which are of manifest importance to investment judgment fall nonetheless in the category of material information though

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34/ See also Bromberg, Securities Law: Fraud -- SEC Rule 10b-5 § 7.5(6)(c) at 190.16 (Supp. 1969).

35/ SEC v. Texas Gulf Sulphur Co., supra at 849.

subject to future adjustment or reconsideration. If, of course, as respondents seem to suggest, information is so unreliable that a reasonable person would refuse it credit, there would be no reason to regard the information as material.

As asserted by respondents, some reliance in the sense of use of inside information by a tippee must be shown before a duty of disclosure of such information may be imposed upon him in connection with trading in the affected securities. The prohibition of Cady Roberts and Texas Gulf Sulphur runs to a failure to disclose information when the insider receives an advantage or obtains personal benefit from such information. A tippee derives neither advantage nor personal benefit from information which for one reason or another he does not use. However, the Division's view that use of the inside information may be inferred from its materiality if not otherwise shown by the facts also appears in accord with the principles laid down in Texas Gulf Sulphur.[36/]

Respondents fairly point out that a definition of "non-public" information has not been undertaken by the courts or the Commission. But it does not follow from the absence of a definition that a determination cannot be made whether particular inside information has been sufficiently disseminated to the public to relieve a tippee of his burden of disclosure in connection with a transaction

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36/ Id.

in the affected securities. That issue may be resolved by a consideration of the circumstances existing at the time the order for the questioned transaction was placed by the tippee. If it appears that the tippee knew or should have known that the information received was not yet in general circulation with the company credited as the source, then the tippee may be deemed to have acquired "non-public" inside information requiring disclosure. 37/

Respondents further claim that the insider's duty of disclosure should not be imposed upon them because they were neither insiders nor "even the immediate 'tippees' of such insiders." They argue that such remoteness creates critical practical problems that make the application of the disclosure rule extremely unfair to them. In particular they cite problems in determining whether information is coming from an insider and whether it is still non-public. They refer also to problems which beset a tippee in attempting to disclose inside information and in deciding when to act on the information received.

While agreeing that tippees may be faced with difficulties in resolving the problems raised by respondents, no perceptible reason appears for accepting such problems as a predicate for a blanket exemption from the disclosure requirement. Even less

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37/ Cf. Bromberg, Securities Law -- Fraud: SEC Rule 10b-5 § 7.5(6)(d) at 190.17 (Supp. 1969).

persuasive are respondents' arguments when viewed in connection with situations where persons such as respondents, highly sophisticated in financial matters, are the tippees.

Moreover, it does not appear that the difficulties assigned by respondents are overly burdensome in the present instance. Respondents received their information directly from Merrill Lynch, and the fact that employees within that firm may have relayed it one to another does not cause the end communication from them to take on the remoteness claimed by respondents. Under circumstances where respondents either knew or should have known that Merrill Lynch was an insider, they could readily have taken reasonable action to determine that the information was "non-public" by asking direct questions of responsible officers of Merrill Lynch or of Douglas, or by satisfying themselves that the analysts whom they respected had not become aware of the specific information. Reasonable action far short of the press release viewed by respondents as impractical for them to prepare could well meet the obligation imposed. Disclosure to the world is not required of tippees, only that there be equality of information with those with whom they trade.

Further, in balancing the equities between the tippee and the person with whom he effects a transaction in the affected securities, protection should be afforded the latter in keeping

with the purpose of the securities acts, the prevention of inequitable and unfair practices.

It is manifest that the Douglas earnings, estimates, and projections now in question were material facts that would directly affect the market value of Douglas securities. Equally clear is that the information was made available to Merrill Lynch only because of its position as managing underwriter of the proposed Douglas debenture offering, and that Douglas intended and Merrill Lynch knew that the information should be treated as confidential and used only for Douglas corporate purposes. For the duration of that relationship, Merrill Lynch became a Douglas corporate insider, and those who were aware of the capacity in which Merrill Lynch was acting for Douglas may be deemed to have had actual or constructive knowledge that Merrill Lynch had acquired the status of a Douglas insider.

If, therefore, respondents obtained, directly or indirectly, material non-public information about Douglas from Merrill Lynch, and with actual or constructive knowledge of the non-public nature of that information and of Merrill Lynch's then relationship to Douglas made use of the information in effecting or causing to be effected sales of Douglas stock either prior to public disclosure or without disclosure of that information to the buyers of that stock, they may be held to account for violations of the anti-fraud provisions of the securities laws.

SALES OF DOUGLAS STOCK BY RESPONDENTS
AFTER RECEIPT OF INSIDE INFORMATION

Investors Management Co., Inc.
Anchor Corporation

During 1966, IMC, then a wholly-owned subsidiary of Anchor, managed Fundamental Investors, Inc., Diversified Growth Stock Fund, Diversified Investment Fund, and Westminster Fund, and acted as the investment adviser of those funds. Within IMC, individual fund managers were designated, and each of them was responsible for recommendations affecting his respective fund portfolio.

Investment possibilities which were conceived or received by anyone in IMC were processed by the IMC research organization, which included not only a large group of industry specialists but a network of outside brokerage firms and a highly sophisticated computer program. The results of that processing were submitted to the appropriate fund manager for use in making an investment judgment. If he decided that a securities transaction should be effected, he would prepare a recommendation, and submit it for consideration by IMC's investment committee. If Robert Daniel, IMC's president and a committee member, together with one other committee member concurred in the recommendation, it would be forwarded in writing to an officer of the affected fund for approval and action.

IMC's interest was drawn to Douglas in late 1965 when it became aware that the new Douglas DC-9 aircraft program was likely

to enjoy a substantial success, and that with other Douglas commercial aircraft programs and military business, sizeable earnings could be expected in future years. In January, 1966 following consultation with the aerospace analyst of one brokerage firm, a meeting with another brokerage firm known for its familiarity with the aerospace industry, and internal considerations, including an analysis of Douglas by IMC's aerospace analyst, Robert Anderson, IMC recommended purchases of 15,000 shares of Douglas stock by Diversified Growth Stock Fund and 100,000 shares by Fundamental Investors. In identical letters dated January 19, 1966 addressed to each of the two funds, IMC supported its Douglas "buy" recommendation by references, among others, to an expectation that Douglas earnings would approach $5 per share in FY 1966 and to a prospect of "a doubling or possible tripling of earnings" over the next several years. Acting on IMC's recommendations, Fundamental Investors purchased 100,000 shares of Douglas stock in January, 1966 [38/] and in the same month Diversified Growth Stock Fund acquired 15,000 shares, later supplemented by a purchase of 6,000 Douglas shares on April 13, 1966.

Shortly after the April purchase, IMC became aware of the difficulties Douglas was encountering with parts suppliers and labor

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38/ The record does not disclose the date Fundamental Investors acquired the other 3,000 shares of the 103,000 share position it sold out between June 22 and June 27, 1966.

problems but continued to believe that the troubles were temporary until late May or early June, 1966 when IMC dropped its estimate of Douglas earnings from $4.75 to $3.50 per share for FY 1966.

A few days prior to June 7, 1966 39/ Lazor, of Merrill Lynch, learned that a Douglas financing of $50,000,000 to $75,000,000 was in the offing. Knowing that two of the IMC managed funds held Douglas stock, he informed Edward Button, vice-president of IMC and its fund manager for Diversified Growth Stock Fund, of the prospective financing. Button indicated unconcern about the possible effect of the financing upon the funds' Douglas stock. After the Douglas preliminary prospectus came out and before June 20, 1966 IMC gave Lazor an unsolicited indication of interest in the forthcoming debentures on behalf of Diversified Growth Stock Fund.

Lazor's telephone call to Button on June 21 acquainting him with the news that Douglas would have disappointing earnings for the first six months and would break-even for FY 1966, and the similar conversation on June 22 with Robert Baines, another vice-president of IMC and fund manager of Fundamental Investors, precipitated a conference call from IMC to Catapano. In a brief early morning IMC analysts' meeting preceding the call, the bullish article on aerospace appearing in the Wall Street Journal was discussed, and the group was advised by a member of the IMC trading

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39/ The date of the preliminary prospectus covering the $75,000,000 Douglas convertible debenture offering.

department that a substantial demand for Douglas stock could be expected at the opening of the market. The group, which included Daniel, all of the fund managers, Anderson, and some assistant fund managers, then adjourned to Daniel's office, where telephone facilities permitted all persons in the office to participate in a telephone conversation. Anderson placed a call to Catapano at about 9:30 A.M., and various members of the group asked for and received Catapano's views on the Douglas situation. Catapano referred to the Douglas production and other problems of which they were already aware and indicated he expected Douglas earnings for FY 1966 in the range of $2 to $3 per share with an aggregate of $40 per share earnings over the next three or four years. In response to the direct question whether he would buy Douglas stock, Catapano answered in the negative.

Upon completion of the Catapano call, some of the group remained in Daniel's office discussing Douglas. The prevailing sentiment was that Catapano had shed no new light on Douglas, and Baines indicated that he would prefer to dispose of Douglas stock in view of the uncertainties. Baines also told Anderson after the telephone call to Catapano that Catapano could not or would not "present the story as he knew it in a conference call situation," and that "he was inclined therefore to believe the story given him by Mr. Lazor and had decided to sell the stock."[40/]

40/ Division Exhibit 60.

Shortly after the meeting, and between 10:30 and 11:00 A.M., Baines advised Daniel of his recommendation that Fundamental Investors sell its Douglas stock, as also did Button with respect to Diversified Growth Stock Fund's holdings of that stock. A few minutes before 11:00 A.M., IMC's recommendations,duly authorized by the respective funds, for the sale of 21,000 Douglas shares by Diversified Growth Stock Fund and 103,000 shares for Fundamental Investors were submitted to the Anchor trading department for execution. By about 3:00 P.M. on June 22, the 21,000 Douglas shares owned by Diversified Growth Stock Fund were sold, as were 33,000 shares of Fundamental Investors, and on June 23, an additional 59,300 shares of Douglas stock were sold for Fundamental Investors' account. Neither in connection with these sales nor the further sales of Douglas stock effected on behalf of Fundamental Investors on June 24 and June 27, 1966 did IMC disclose, directly or indirectly, to any purchaser of that stock information of any kind concerning Douglas.

Before the Douglas stock sales commenced on June 22, Daniel learned from Baines during the discussion following the Catapano conference call that Merrill Lynch was the managing underwriter of the Douglas debenture offering, and it is obvious that Button as well as Baines had known of that fact prior to June 22. The weight that was given to the information received from Lazor in the telephone calls to Button and Baines clearly shows that top officials of IMC

knew that IMC was a recipient of inside information. Under the circumstances, IMC assumed the responsibility of an insider to make a full disclosure of that information at least to those who purchased Douglas stock from IMC managed funds prior to June 24, 1966, the date on which Douglas issued a press release disclosing interim earnings for its second quarter and first six months, and its estimate that earnings, if any, for FY 1966 would be nominal.

IMC having failed to make the necessary disclosure, it is concluded that IMC wilfully violated, and wilfully aided and abetted violations of Sections 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In addition, Anchor, by virtue of its being a broker-dealer and a registered investment adviser and having been the parent and in control of IMC during 1966, becomes subject to appropriate remedial action pursuant to Section 15(b) of the Exchange Act,[41/] and Section 203(d) of the Advisers Act.[42/]

41/ Section 15(b)(5) of the Exchange Act, inter alia, authorizes remedial action against a broker or dealer where a "person associated with a broker or dealer" has wilfully violated or wilfully aided or abetted violations of any provision of the Securities Act or Exchange Act. Section 3(a)(18) of the Exchange Act provides:

> the term "person associated with a broker or dealer" means . . . or any person directly or indirectly controlling or controlled by such broker or dealer, . . .

42/ Section 203(d) of the Advisers Act provides, inter alia, that the registration of an investment adviser may be revoked where "any person directly or indirectly controlling or controlled by" that investment adviser has wilfully violated or has aided and abetted violations of the Securities Act or Exchange Act or any rule or regulation under those statutes.

Adding to the arguments that all respondents advance on the law and the common facts, IMC and Anchor take the position that the information IMC received from Lazor is not shown to be material corporate information. The contrary is found from the review of the record.

The contention that "all Lazor told IMC was that he 'had heard that Douglas Aircraft's six month earnings would be disappointing,'" ignores the testimony of Anderson. On June 22, according to Anderson, Baines stated that both he and Button had received calls from Lazor in which Lazor offered his opinion that "Douglas would break even during fiscal 1966." That testimony, coming from an IMC employee, and squaring as it does with the information that Lazor had received from Idleman, is accepted as evidence that Baines and Button received not only the information that Douglas six month earnings would be disappointing, but also that Douglas would have no earnings for FY 1966. While it may be argued that Anderson's testimony indicates only that Lazor was expressing a personal opinion about the year's earnings, the actions that IMC took following Lazor's calls evidence IMC's understanding that Lazor was giving a tip on non-public corporate information. Moreover, the disclosure that Douglas six months earnings would be disappointing, which IMC concedes was received, was itself non-public corporate information even though not reduced to specific figures.

The argument that the Lazor information was not material appears inconsistent with IMC's statement that "[i]n the Spring of 1966, Boeing and United Aircraft reported less than expected quarterly earnings," which resulted in IMC's recommending "substantial reductions in the funds' holdings of both these companies." Since IMC admits that "the price of its [Douglas] stock could be greatly affected by a relatively minor change in its fortunes," it is not likely that information alerting IMC to a substantial change in the Douglas earnings picture would influence IMC any less than did the earnings performance of Boeing and United Aircraft earlier in 1966. Further, it is conceded in the brief of IMC and Anchor that $10,000 in commission business was directed by IMC to Merrill Lynch in part for ". . . Lazor's having passed on, in a very prompt and effective manner, the story he had heard and which ultimately proved to be basically correct." In addition, IMC and Anchor admit that Lazor's information was one of the factors entering into IMC's sell recommendation. That admission is itself very persuasive on the questions of materiality and use of the Lazor information. As a factor affecting IMC's judgment, it is clear that the same information could well have affected the investment judgment of those who purchased the Douglas stock from the Anchor funds on June 22 and 23, 1966.

Also rejected is the proposed conclusion of law that the Commission has no jurisdiction over IMC, "which has not been in

existence since April, 1968." As found earlier, jurisdiction based upon Section 15(b)(7) extends to any person, a term which includes a corporation for purposes of the Exchange Act.[43/] Of course, if IMC's existence was terminated by corporate dissolution in April, 1968 or thereafter, further consideration would have to be given to whether that action affected the Commission's jurisdiction.[44/] But the record does not reflect that the corporation was dissolved, only that Anchor acquired all of the business and assets of IMC on April 1, 1968. In the absence of proof to the contrary, it is presumed that IMC's corporate life has continued, a status sufficient for purposes of Section 15(b)(7) of the Exchange Act even though IMC is no more than a corporate shell.

Madison Fund, Inc.

As of June 1, 1966 Madison had no portfolio position in Douglas stock. It had held that stock previously, and Roland Wilhelm, one of its vice-presidents and an aerospace analyst, had kept abreast of Douglas developments. On June 7, 1966 Madison's president, Edward Merkle, was told by Muriel Siebert, an aerospace analyst and general partner in the brokerage firm of Brimberg & Company, that she felt Douglas earnings for its second quarter and for FY 1966 would be favorable. Upon the strength of Miss Siebert's

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43/ Section 3(a)(9) of the Exchange Act.

44/ Cf. Peoples Securities Co. v. SEC 289 F. 2d 268, 275 (D.C. Cir. 1961).

views, Merkle placed an order the same day through Brimberg & Company for 5,000 shares of Douglas stock.

Merkle also discussed Madison's investment in Douglas with Wilhelm, who had reservations about Douglas ability to show earnings in 1966 but felt that the market action of Douglas stock indicated a possible rise in price. The decision arrived at was for Madison to take a position in Douglas stock of 20,000 shares, with 10,000 shares to be purchased immediately. Implementing that decision, a second 5,000 share order for Douglas stock was given to Brimberg & Company in the afternoon of June 7, but only 1,000 shares of that order were acquired before the open portion was canceled on June 8 because of the rise in price of Douglas stock. No further Douglas stock was purchased by Madison before the sale of its entire 6,000 share position on June 21, 1966.

Prior to Madison's purchasing Douglas stock in June, 1966 Wilhelm read that the company was proposing to make a convertible debenture offering and early in June, 1966 learned that Merrill Lynch would be the managing underwriter. Wilhelm called Lee Idleman, the institutional salesman with whom Madison dealt at Merrill Lynch, and asked for the Douglas preliminary prospectus when available. On June 13 Idleman telephoned Wilhelm to tell him that the preliminary prospectus was being sent, and Wilhelm then indicated a possible interest, subject to price, of $1,500,000 to $2,000,000 of the Douglas debentures. In memoranda dated June 14 and 16 addressed to

Merkle, Wilhelm indicated that Madison would be showing an interest of up to $2,250,000 in the $75,000,000 Douglas debenture offering and that the underwriting was being headed by Merrill Lynch.

As noted before, Idleman received information concerning Douglas current and prospective earnings from Catapano in the afternoon of June 21. Having in mind Madison's interest in the Douglas debenture offering, Idleman called Wilhelm to apprise him of the information just received from Catapano. The notes Wilhelm made of that conversation reflect that Idleman indicated Douglas expected to lose 35¢ per share for May, 1966 as compared to a profit of 35¢ for May, 1965, to earn 50¢ per share for the first six months of FY 1966 versus $1.50 for the same period of FY 1965. Idleman also stated that Douglas would be "lucky to break even" for FY 1966, and that the estimate for FY 1967 had been reduced to $5 to $6 per share from $10 to $12, and was $15 for FY 1968. Madison does not dispute that the information was material.

Immediately after Idleman's call, a brief meeting between Wilhelm and Merkle ensued in which they discussed the Idleman information in context with other available facts on Douglas and Wilhelm's previous reservations about the company. A decision was quickly reached to sell Madison's 6,000 shares of Douglas stock, and no more than ten or fifteen minutes elapsed from the time that Idleman telephoned to the time that Wilhelm personally called Idleman and placed the sell order. The order, placed at 3:04 P.M. without

price limitation, was executed on the New York Stock Exchange through Merrill Lynch at 3:28 P.M., June 21, at prices ranging downward from 88½ for the first 1,500 shares to 88 for the next 700 shares, 87-3/4 for the following 300, and 87½ for the last 3,500. No disclosure was made to purchasers of those 6,000 shares of Douglas stock concerning the information that Idleman had given to Wilhelm a few minutes earlier.

The reasonable inference to be drawn from the record is that Wilhelm and Merkle, knowing that Merrill Lynch was the managing underwriter for the Douglas debenture offering and privy to confidential Douglas financial data, sold Madison's 6,000 shares of Douglas with the least possible delay after receiving Idleman's call on June 21 because they believed they were beneficiaries of material inside information. There appears no other acceptable explanation for the immediate reaction to the information relayed by Idleman on June 21, nor for the unquestioning reliance placed upon it at a time coming less than two weeks after Merkle had, in the face of Wilhelm's doubts about Douglas, persisted in purchasing Douglas stock. It is concluded under all the circumstances that Madison wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

At the outset of its argument, Madison contends that the principal issue involved is the integrity of Wilhelm and Merkle, and

then appears to proceed on the assumption that a finding of a wilful violation necessarily resolves that issue against them. The flaw in that approach is that "wilfulness" for purposes of Section 15(b) of the Exchange Act does not require that a person know that he is breaking the law, but only that he intended to do the act that resulted in the violation.[45/] Measured by that standard, Wilhelm and Merkle could, as Madison contends, have been "simply going about their ordinary business of making investment decisions" and yet, as found herein, been responsible for Madison's wilful violations of the securities acts. The fact that the broad scope of Section 17(a) of the Securities Act and Rule 10b-5 may have been unknown to Madison can be taken into account in mitigation of its violation, but it cannot be determinative of whether the violation occurred. As the Court noted in Texas Gulf Sulphur, where insiders act "pursuant to a mistaken belief as to the applicable law such an ignorance does not insulate them from the consequences of their acts."[46/] That rule is equally applicable to tippees.

Contrary to Madison's further argument, Wilhelm and Merkle reacted to Idleman's information in a manner indicating that they had actual or constructive knowledge of its non-public corporate

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45/ Tager v. SEC, 344 F. 2d 5 (2d Cir. 1965); Hughes v. SEC, 174 F. 2d 969, 977 (D.C. Cir. 1949); Churchill Securities Corp., 38 SEC 856, 859 (1959).

46/ 401 F. 2d at 852, n. 15.

character. It is not alone the quick action taken to dispose of Madison's Douglas shares after Idleman's call, but also the sudden loss of confidence in Muriel Siebert's recommendation of two weeks earlier, the failure to consult her on June 21, and the unquestioning acceptance of Idleman's information that compel the conclusion that Wilhelm and Merkle had reason to know that an insider was furnishing a tip. And the fact that in the eyes of Madison, Idleman was to be trusted as a person who would not act inconsistently "with his and his employer's unblemished reputation" cannot alter the foregoing conclusion where circumstances otherwise indicate that Wilhelm had notice that Idleman was relaying inside information.

J. M. Hartwell & Co.
J. M. Hartwell & Co., Inc.
Hartwell Associates
Park Westlake Associates

William Campbell is president and a 17% stockholder of Hartwell, Inc., and John Hartwell ("Hartwell") is a director, portfolio manager, and owner of about 65% of the company's stock. Hartwell, Inc., succeeded in November, 1966 to the business of Hartwell & Co., a partnership still in existence but inactive. Hartwell and Campbell formed Hartwell & Co. in 1964 for the purpose of engaging in an investment counseling business which in 1966 consisted of managing on a discretionary basis around 200 individual and institutional securities portfolios, managing the portfolio of

Hartwell and Campbell Fund, Inc. ("Hartwell-Campbell"), and furnishing advice pursuant to three investment advisory contracts. One of the three contracts was with A. W. Jones & Co., which relied on Hartwell & Co. for management of a $2,000,000 segment of its portfolio. Hartwell and Campbell in 1966 were also general partners of Hartwell and Associates, a hedge fund, and with a third general partner managed the firm's investment portfolio. Park Westlake is another hedge fund in which Hartwell was a general partner in 1966 with responsibility for investment decisions.

Hartwell & Co. had been a customer of McCarthy of Merrill Lynch for two or three years prior to June 3, 1966, the date that he called Campbell to inform him that a Douglas convertible debenture financing of $50,000,000 to $75,000,000 by Merrill Lynch was forthcoming. McCarthy also told Campbell in that conversation, although it was still four days until the Douglas preliminary prospectus made the information public, that Douglas earnings for the first five months of FY 1966 were 85¢ per share compared to $1.25 for the same period of FY 1965. McCarthy also disclosed to Campbell that Douglas deliveries were 20 planes behind schedule for March and April, 1966 and that earnings estimates for Douglas were $2 per share for FY 1966 and $10 for FY 1967.

Hartwell and Campbell had frequently discussed Douglas with each other in 1966 as a prospective investment and Hartwell had spoken about Douglas with aerospace analysts. In June, 1966 he had

become familiar with their viewpoints. Campbell at that time had doubts about the near term prospects for Douglas, and because he was skeptical about Douglas stock as an investment made certain that Hartwell received the notes on the McCarthy conversation of June 3 which reflected estimated Douglas earnings for FY 1966 of $2 per share in contrast with considerably higher earnings that aerospace analysts were then forecasting. On the other hand, Hartwell, the dominant partner in Hartwell & Co., was very interested in Douglas stock on a long-term basis. After speaking on June 6 to a highly regarded aerospace analyst who estimated Douglas earnings for FY 1966 at $3.25 to $3.75 per share and minimized the importance of reduced earnings for the current year, Hartwell on June 9 purchased 1,000 shares of Douglas stock for Society of Ethical Culture, one of the accounts managed by Hartwell & Co., and 400 shares for the portfolio of Hartwell-Campbell.

On June 16, 1966 Hartwell prepared a memorandum containing his analysis of the prospective market action in Douglas stock, and therein he concluded that the investment risk was high but that the stock had the potential for a rise to 105 by May, 1967 and to 145 in 1968. In arriving at these projections, Hartwell employed a price-earnings multiple of 12 which he selected as appropriate to apply to estimates of Douglas earnings through a comparison with the past market performance of Boeing stock. The next day, June 17, Hartwell purchased 200 more shares of Douglas stock for

Hartwell-Campbell holdings as a long-term investment.

Hartwell & Co. also considered the forthcoming Douglas debentures as a possible investment vehicle, and gave McCarthy an indication of interest for around $1,000,000 of those bonds sometime before June 21, the day that McCarthy called Campbell at about 2:30 P.M. to tell him of the poor earnings Douglas would be reporting. After learning from McCarthy that Douglas earnings for its second quarter would probably show a loss and for FY 1966 would be "flat," Campbell immediately telephoned Hartwell, who happened to be at the offices of the brokerage firm used by Hartwell & Co., and relayed the McCarthy information to him. Hartwell assumed that "flat" was intended to mean zero earnings, and indicated by his response that he viewed the news as both important and contrary to his expectations.

After no more than a few minutes reflection on the import of Campbell's message, Hartwell caused his broker to sell the 1,600 Douglas shares held by the Society for Ethical Culture and Hartwell-Campbell before the close of the market. The next morning, June 22, Hartwell read the bullish Wall Street Journal article on the aerospace industry, and received reports from brokers that an influx of buy orders would probably cause the market to open higher than the previous close. Hartwell then decided to make short sales of Douglas stock for the accounts of Hartwell and Associates, Park Westlake, and A. W. Jones & Co., and during the course of the day sold short 2,500

shares, 1,500 shares, and 2,000 shares, respectively, on their behalf at prices ranging from 89½ to 90. No disclosure of the information which was transmitted to Campbell by McCarthy on June 21 was made to the purchasers of the Douglas stock sold on June 21 and June 22 for accounts managed by Hartwell.

There is no question concerning the materiality of the information that Campbell received from McCarthy and passed on to Hartwell on June 21. The information, in Hartwell's words, "cast real doubt on my estimate." The record also establishes that on June 21 Hartwell and Campbell knew of the underwriting relationship between Merrill Lynch and Douglas and were aware of the fact that Merrill Lynch had access to inside information; McCarthy had earlier given them confidential Douglas earnings information Merrill Lynch had obtained in the course of the underwriting and they knew at the time they acted on McCarthy's information of June 21 that it was not available to the purchasers of Douglas stock Hartwell sold on June 21 and 22. Hartwell and Campbell, therefore, knew or should have known that they were receiving inside information from McCarthy on June 21, and that a disclosure of that information to prospective purchasers was required by them in connection with any sales of Douglas stock until the information was generally public. The requisite disclosures not having been made, Hartwell & Co., Hartwell and Associates, and Park Westlake, by the actions and omissions of Hartwell and Campbell, wilfully violated

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. By virtue of the control Hartwell and Campbell have over the affairs of Hartwell, Inc., their existing though inactive control over Hartwell & Co., and their control of the other Hartwell respondents, it appears that Hartwell, Inc., is, within the meaning of Section 203(d) of the Advisers Act, an investment adviser directly or indirectly controlling or controlled by the other Hartwell respondents, persons herein found to have wilfully violated provisions of the Securities Act and Exchange Act. Accordingly, Hartwell, Inc., becomes subject under the provisions of Section 203(d) of the Advisers Act to such remedial action as may be found appropriate under that act. 47/

Neither Campbell's nor Hartwell's actions on June 21 and 22, 1966 are consistent with the argument of the Hartwell respondents that the sales of Douglas stock in question were not a result of receiving what Campbell and Hartwell knew or should have known was inside information from McCarthy. If Campbell had not recognized McCarthy's call as such, it would not have been reasonable for him to take pains to locate Hartwell in order to pass on the information as quickly as possible, and if Hartwell had not understood that McCarthy had furnished an insider's tip, Hartwell's discarding of

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47/ See n. 42, supra at 44.

his own careful personal analysis of Douglas earnings prospects after ten minutes or less of thought after learning of McCarthy's call would be irrational.

Hartwell's short sales on June 22 confirm the certainty that had been attached to the McCarthy information of the day before. Hartwell testified that he expected the price of Douglas stock to drop when the information he had received on June 21 was disseminated. Such testimony clearly indicates Hartwell's appreciation of the fact that he had received hard information that could be relied upon, not mere research analysis. Further, Hartwell's testimony establishes that he knew on June 21 and June 22 that McCarthy's information had not been effectively disclosed. The extent that he believed information had been disseminated was no further than to institutional customers, and he assumed that buyers of the Douglas stock he sold did not have his information regarding Douglas. The disclosure of the inside information assumed by Hartwell to have taken place at the time of his sales, and that shown to have taken place is insufficient by far to excuse disclosure by the Hartwell respondents.

The further arguments of the Hartwell respondents concerning jurisdiction are also rejected. As earlier concluded, Section 15(b)(7) of the Exchange Act authorizes the Commission to proceed against any person for violations of the securities acts. Hartwell & Co., Hartwell and Associates, and Park Westlake are persons within

the meaning of the Exchange Act accused of violations of the securities acts, and therefore fall within the ambit of Section 15(b)(7). Hartwell, Inc., is in a different position by reason of not participating in the violations with the other Hartwell respondents. However, it too is properly a respondent by reason of its registration under the Advisers Act and its control or being under control of the other Hartwell respondents, violators of the securities acts.

The additional contention that jurisdiction over Hartwell & Co. was lost when the Commission permitted it to withdraw its registration as an investment adviser in September, 1967 without instituting proceedings under Section 203(d) of the Advisers Act is without merit. The jurisdiction over Hartwell & Co. in the present proceedings rests upon Section 15(b)(7) of the Exchange Act, an entirely separate and distinct statutory enactment providing an alternative course of action which may be pursued by the Commission independently of Section 203(d) of the Advisers Act. Unquestionably, Hartwell & Co. became insulated against any administrative action pursuant to the Advisers Act when the withdrawal of its registration under that Act became effective, but that registration is not a jurisdictional requirement under Section 15(b)(7) of the Exchange Act. The withdrawal of the registration, therefore, could not and did not confer immunity upon Hartwell & Co. from proceedings instituted pursuant to the Exchange Act.

Van Strum & Towne, Inc.

As investment adviser to the Channing Balanced Fund, the Channing Common Stock Fund, the Channing Growth Fund, the Channing Income Fund, and the Channing Special Fund during 1966, Van Strum made the investment decisions for each of those mutual funds. Internally, Van Strum appointed a fund manager for each fund, Thomas Martin being fund manager for Channing Growth Fund as well as president of Van Strum. Martin was also chairman of the decision-making investment committee whose membership included each of the other fund managers, and the manager of Van Strum's department for investment counsel of individuals. In addition, Anthony Healey, Martin's assistant in the management of the Growth Fund, participated as a committee member in preparation for appointment as manager of that fund. In 1966 the investment committee held special as well as regular weekly meetings in which a fund manager would present investment recommendations for consideration and adoption. It was also possible for a fund manager to obtain approval of a desired transaction by obtaining concurrence from a requisite number of the committee through conversations with individual members by telephone or visits at their respective offices.

Van Strum's interest in Douglas as an investment was initially aroused in 1965, but did not become strong until the early part of 1966 when various public announcements revealed the rapid growth of business and earnings of aircraft manufacturers. During that period

Martin spoke to several highly regarded aerospace analysts about aircraft manufacturers, including Douglas. Among those consulted were Bilbao, who serviced the Channing accounts at Merrill Lynch, and Muriel Siebert.

Late in May, 1966 Martin asked William Altschuler, then Van Strum's aerospace analyst, to investigate the possibilities of Douglas stock. Altschuler spent a day and a half reviewing reports and other material on Douglas in the files of Van Strum and talking to a number of analysts and other knowledgeable people outside of Van Strum. He then reported to Martin that on the basis of available information Douglas stock appeared to be a good long-term investment.

Early in June, Martin became aware that Merrill Lynch was the managing underwriter of the Douglas debenture offering, and also had a conversation with Bilbao who told him that Douglas first five months earnings in FY 1966 were 85¢ per share and that Merrill Lynch had lowered its estimate to $2 to $3 for the year. Although neither Martin nor Bilbao could recall whether the conversation took place prior to June 7, the date of the Douglas preliminary prospectus which made the five-month earnings public, the fact that Bilbao received his information from Catapano on June 3, Bilbao's belief that he was free to use the information without restriction, and his recollection that he gave similar information to a Dreyfus Fund analyst prior to June 7, indicate that Martin had the benefit

of then non-public information. On June 8, Bilbao sent a Douglas preliminary prospectus to Martin which confirmed that the five-month earnings were 85¢.

A decision to purchase Douglas stock was made by Martin on June 10 with the expectation that the stock would appreciate as its price began to reflect what he anticipated would be Douglas earnings over the next 18 months. In line with that decision, the Van Strum investment committee that same day approved purchase of 50,000 shares of Douglas stock for the Growth Fund, but for reasons Martin could not recall, the planned purchase of Douglas stock was not commenced until June 20, when 1,500 shares were bought for the Growth Fund.

On June 22, 1966 while attending a luncheon for institutional investors sponsored by Muriel Siebert's brokerage firm, Martin overheard remarks implying that Douglas would have no earnings, or its earnings would be down. No specific figures were used, nor was any time period mentioned.

Upon returning to his office after the luncheon, Martin called Healey and Altschuler to attempt to verify the accuracy of the overheard remarks. He told Altschuler that he had heard that Douglas would have no earnings for FY 1966, and asked for his opinion. After Altschuler responded that such result was "possible but highly improbable," and gave his reasons, Martin directed him to call and discuss the question with a number of persons who were familiar with

the aerospace industry. Altschuler then spoke to a highly regarded aerospace analyst who said he had heard the rumor about Douglas earnings, and, at the conclusion of their discussion, stated that he agreed that the rumor, though possible of truth, was unlikely to be factual. Altschuler returned to Martin's office and in the presence of Healey reported to Martin that he remained of the same mind concerning the accuracy of the luncheon remarks. Martin then stated that he had spoken to Bilbao, and that Van Strum should "step aside" with respect to Douglas stock.

While Altschuler was making his calls, Martin telephoned Muriel Siebert. She told him that she had heard from Robert Edwards, a portfolio manager at the Manhattan Fund, that Douglas lost 35¢ per share in May, that the first half of FY 1966 would show earnings of 50¢, that Douglas would break even for FY 1966, and that $5 per share was a reasonable estimate for FY 1967. Miss Siebert also told Martin that Edwards had obtained that information from Merrill Lynch, and in response to Martin's inquiry as to why the Douglas figures had changed, said that she intended to call Douglas to verify the numbers. Martin then telephoned Bilbao who, repeating the news Neves had received from Woodman that morning, told Martin that Douglas would be reporting earnings of 43¢ for the first six months, that the outlook for FY 1966 was little or no profit, and that $6 per share was expected for FY 1967.

After speaking to Miss Siebert and Bilbao, and before receiving Altschuler's report, Martin told Healey that in his view Van Strum should discontinue buying Douglas stock and sell its existing 1,500 share position. Healey concurred in that view. Approval for the sale of the Douglas stock was quickly obtained and a few minutes before the closing of the New York Stock Exchange on June 22, 1966 Van Strum sold the 1,500 shares of Douglas stock that had been purchased for the Growth Fund two days earlier.

The next day Miss Siebert called and informed Martin that she believed the numbers that Edwards had given to her the day before were basically correct. Martin then told her that Channing had sold its Douglas stock after he had confirmed the information she had given to him.

The record sufficiently establishes that Martin and Healey, as agents of Van Strum, knew at the time of the sale of the Growth Fund's 1,500 shares of Douglas stock that Merrill Lynch was managing underwriter of the forthcoming Douglas debenture offering and that Merrill Lynch would have access to inside information regarding Douglas earnings and prospects. It is further evident that on June 22 Martin turned to Bilbao of Merrill Lynch for the purpose of obtaining confirmation of unverified material information about Douglas earnings and prospects, and that Van Strum sold the 1,500 shares of Douglas stock without disclosing to the purchasers thereof the information that Martin had obtained from Bilbao. The circumstances

surrounding the purchase and sale of the 1,500 shares indicating, as they do, that Van Strum was a recipient and made use of inside information on June 22, 1966 and knew or should have known the quality of that information, it is concluded that Van Strum had an obligation of disclosure at the time it sold the Growth Fund's holding of Douglas stock. By failing to disclose that material inside information to the purchasers of the stock, Van Strum failed to meet its obligation under the securities laws, thereby wilfully violating and wilfully aiding and abetting violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

On the critical issue of whether Van Strum received inside information on June 22 prior to its sale of Douglas stock, respondent's argument in the negative is rejected. The weight of the evidence strongly favors the findings set forth above.

That Martin spoke to Bilbao on June 22 and received confirmation of the rumors about Douglas he had heard at the Brimberg luncheon can readily be pieced out from the record exhibits and testimony. Altschuler's testimony was unequivocal with respect to Martin's statement on June 22 prior to Van Strum's sale of Douglas stock that he had spoken to Bilbao, and the notes kept by Bilbao of his telephone conversations relating to Douglas on June 22 and 23 also indicate that Bilbao talked with Martin on June 22. The disinterested testimony of Muriel Siebert that Martin told her on

June 23 that Channing had sold its stock after confirming the information that she had given him on June 22 also supports the finding that Bilbao and Martin spoke to each other on June 22. This part of her testimony also resolves the ambiguity in her later response that Martin "said that he had talked to someone at Merrill Lynch on Thursday [June 23]," making it evident that she was referring to the fact that on June 23 Martin told her that he had spoken to someone at Merrill Lynch prior to speaking to her.

Inasmuch as Martin could not have confirmed Miss Siebert's information except through Merrill Lynch or Douglas, and did not receive any information from Douglas, it follows from Miss Siebert's credible testimony that the confirmation came from Merrill Lynch prior to Martin's decision to sell the Douglas shares held by Growth Fund. Further, since Miss Siebert had disclosed to Martin that Merrill Lynch was the indirect source of the specific data she had, it is only reasonable to assume that he would immediately turn to Bilbao for the confirmation he sought.

That the confirmation that Martin received from Bilbao on June 22 involved both material and non-public corporate information is readily apparent from Martin's desire to have the Brimberg luncheon rumors and Miss Siebert's information confirmed. Until speaking to Bilbao, Martin had no more than unverified information on which he could not act. He needed the assurance that only Bilbao could give, and having received it, immediately sold the Growth Fund's

Douglas stock.

Additional evidence that Martin received and used inside information in deciding to sell Douglas is the admission of Altschuler in November, 1966 while attending an aerospace conference in California. He there told another analyst that Channing had sold its entire Douglas position on June 22, 1966 and that the decision was based on information from the "Merrill Lynch underwriting department that Douglas would have no earnings in fiscal 1966." That admission is neither "incompetent triple hearsay" nor "otherwise unreliable and without probative value," as contended by Van Strum. It has considerable probative value, coming as it did from a person in a position of responsibility in the Van Strum organization, and reinforces the conclusion that Martin had access to Douglas inside information on June 22.

The foregoing is also dispositive of Van Strum's argument that it was ignorant that the information in question might have emanated from an insider. While knowing that Merrill Lynch was the proposed underwriter of the Douglas debenture issue would not, standing alone, suffice to show actual or constructive knowledge of the character of the information being furnished by a member of that brokerage firm, such is not the case here. Not only was Martin aware of the underwriting relationship but also of the non-public nature of the information that he received from Bilbao. Further, he knew that Altschuler and independent aerospace analysts

were not satisfied that Douglas earnings had suffered the rumored decline. Those facts, taken with the decision to sell the Douglas holdings which had been so lately purchased, are enough to warrant a finding that Van Strum knew or should have known that it had become a beneficiary of inside information.

Fleschner Becker Associates

Malcolm Fleschner and William Becker are the general partners in the limited partnership of Fleschner Becker Associates which was formed in April, 1966 for the purpose of investing monies of members of the Fleschner and Becker families. The partnership operated in 1966 as a hedge fund under the supervision of Fleschner and Becker. They were solely responsible in 1966 for the investment decisions and transactions of the partnership.

Prior to June 7, 1966 when the preliminary prospectus on the Douglas debenture offering became available to the public, Lawrence Zicklin, the Merrill Lynch representative servicing the partnership account, discussed the Douglas earnings reflected in the prospectus with Becker. Zicklin informed Becker that Douglas earnings would be bad, with the first five months earnings 85¢ per share. On June 8 or 9, Fleschner read the Douglas preliminary prospectus and advised Zicklin that the partnership would have an interest in about $2,000,000 of the Douglas debentures.

After giving the indication of interest, Fleschner and Becker spent additional time stydying the Douglas prospectus, reading

aerospace research reports relating to Douglas, and discussing the company with about ten people, including analysts, who were familiar with Douglas and the aircraft industry. One of the research reports read by Fleschner on or about June 16 estimated Douglas earnings for FY 1966 in the neighborhood of $3 per share and mentioned that the analyst would "consider any weakness in the stock as a result of near-term earnings disappointments, a buying opportunity."

In the afternoon of June 21, Zicklin telephoned Fleschner and told him that Douglas earnings would be disappointing, that its six month earnings would be less than for the first five months.

Next morning Fleschner and Becker read the bullish aerospace industry article that appeared in the June 22 edition of the Wall Street Journal. Having Zicklin's information, they decided that if Douglas stock opened higher as a result of that article, they would sell short 3,000 shares of Douglas stock. At the time of making that decision Fleschner and Becker were aware that Merrill Lynch was the managing underwriter of the Douglas debenture offering, and in reaching their decision took into account Zicklin's information of June 21.

When the broker for Fleschner Becker Associates reported about 10:00 A.M. on June 22 that the market for Douglas stock would, as they had anticipated, open higher, Fleschner placed the order to sell short 3,000 shares of Douglas stock. A delay in the opening

of trading in Douglas stock on June 22 because of an influx of buy orders held up execution of the short sale until 10:58 A.M., at which time the shares were sold at a price of 90. Fleschner and Becker then decided to sell short another 2,000 shares and arranged that sale off the New York Stock Exchange with a California brokerage house at about 11:30 A.M. The next day, June 23, Fleschner Becker Associates sold an additional 3,500 shares of Douglas short at prices ranging from 87-3/4 to 88-1/2, and later that day covered a part of its short position by purchasing 3,000 Douglas shares at 84¼. On June 24, the day that Douglas issued its press release, Fleschner Becker Associates covered its remaining short position of 5,500 shares with purchases at prices of 75 to 76½.

Prior to the first short sale of Douglas stock on June 22, and at the time of Zicklin's call on June 21, Fleschner and Becker knew that Merrill Lynch was managing underwriter of the Douglas debenture offering and knew that Zicklin had provided inside information about Douglas five-month earnings before those earnings became public on June 7, 1966. When Zicklin thereafter related the information he had about Douglas earnings to Fleschner on June 21, Fleschner and Becker knew, as the short sales of Douglas on June 22 and 23 indicate, that they were again receiving inside information. Their action in selling short further indicates that they were well aware of the importance that attached to Zicklin's disclosure, as

does the $3,000 give-up[48/] which Fleschner Becker Associates directed to Zicklin's credit on June 28 in recognition of his assistance on Douglas. Additionally, the inferences drawn from the succession of short sales and the $3,000 give-up are supported by Fleschner's own admission that Zicklin's information was one of the factors considered in reaching their decision to sell Douglas short.

Under the circumstances, Fleschner Becker Associates is found to be a tippee required under the securities laws to make a disclosure of the information received from Zicklin on June 21 in connection with its sales of Douglas stock on June 22 and June 23. The appropriate disclosure not having been made to the purchasers of the Douglas stock that it sold on those days, it is concluded that Fleschner Becker Associates wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent's assertion that on June 21 Fleschner was told only that Zicklin had heard Douglas earnings for six months could be less than for the five month period is inaccurate. While the limit of Zicklin's recollection was to that effect, Fleschner on cross-examination testified that Zicklin also in effect told him that Douglas earnings would be disappointing, a statement which necessarily

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48/ A give-up is in effect a splitting of the commission received by the executing broker with another broker designated by the customer to receive a certain portion of that commission.

would carry considerable weight in assessing the probable reaction of the investment community once the earnings became known.

The suggestion that Zicklin's information was merely rumor already known to Fleschner from other sources cannot be accepted. There is considerable evidence that Douglas problems were well known and that aerospace analysts were successively lowering their estimates of Douglas earnings during the first half of 1966, but those were simply estimates of outsiders and there is no evidence that any one of them had concrete information from Douglas regarding its six-month earnings or whether the earnings to be reported would be regarded as disappointing. Respondent's reliance on the reports of aerospace analysts as evidence that Zicklin did not provide information not previously known is, therefore, misplaced.

Moreover, the record indicates that Fleschner recognized the difference between the rumors and analysts' views on the one hand and Zicklin's information on the other, realizing that Zicklin was giving them not only confirmation that Douglas was in trouble but that troubles were far more serious than had been generally expected. The short sales of respondent on June 22 and 23 depending upon a drop in the price for a profit, reflect more clearly than anything else how confident Fleschner was in Zicklin's information. Such confidence can be reasonably attributed only to an appreciation that Zicklin had received and was relaying to customers who could make use of it, inside information that had been received by Merrill Lynch through

its underwriting relationship with Douglas. It may well be, as respondent suggests, that the short sales would not have taken place absent the bullish Wall Street Journal article of June 22 on the aerospace industry, but accepting that proves nothing more than that respondent found itself with the opportunity that made profit from use of Zicklin's information a certainty. Without the appearance of the Wall Street Journal article with the resulting higher opening of Douglas on June 22, Fleschner and Becker might well have considered the risk of a short sale too great to assume in view of the general pessimistic attitude on Douglas' future, but the rally in aerospace stocks on June 22 cannot be taken as evidence that the tip provided by Zicklin was not used to respondent's advantage. Nor is the fact that respondent covered part of its short sales by purchases on June 23 at odds with the conclusion that the sales of Douglas stock were made on the basis of inside information. Respondent had a substantial profit at the time it began covering its short position, and as Fleschner testified, "We thought we would book some of that profit and reduce our short position." Such covering purchase, when considered in the light of respondent's subsequent short sales on the same day, is no more than evidence of a conservative assessment made in regard to the impact that Zicklin's news when published would have on the Douglas market.

Additionally, the $3,000 give-up directed by respondent on June 28 to Merrill Lynch for Zicklin's benefit supports the conclusion

that Zicklin had been of material service. As respondent points out, the give-up did not carry with it an identification of the service rendered. Nevertheless, a fair inference to be drawn from the size of the give-up and its timing is that recognition was being given to the substantial role that Zicklin's call of June 21 played in respondent's decision to sell Douglas stock short, a move that brought respondent an $81,000 profit within three days. The explanation of the June give-up offered by respondent to the effect that the give-up represented compensation at a rate of $50,000 for 1966 for Merrill Lynch services and to establish a good relationship with Zicklin cannot be credited under the circumstances. Further, the uneven monthly amounts shown in respondent's schedule of direct commissions and give-ups as credited to Zicklin during 1966 belie the claim that respondent had decided on or before June 28 to allot a total of $50,000 to Merrill Lynch in 1966.[49/]

A. W. Jones & Co.
A. W. Jones Associates

Jones & Co. and Jones Associates, each a limited partnership operating during 1966 as a hedge fund, had identical general partners but differed as to their limited partners. Individuals having lower tax brackets were in Jones & Co., which was more likely to take short-

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49/ Direct commissions and give-ups directed in 1966 to Merrill Lynch for Zicklin's credit were:

Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
$1,050	12,600	4,650	1,100	4,900	2,300	2,000	2,000	16,250	$46,850

term gains than Jones Associates. Banks Adams was an associate managing partner, equivalent to a junior general partner, in both partnerships and during 1966 his primary responsibility was the management of a $5,200,000 segment of the partnership equity in Jones & Co. and a $3,600,000 portion of Jones Associates. Other managers, including Hartwell & Co., were designated by the partnerships to manage other portions of varying amounts. As a regular practice the managers present in the partnerships' offices would hold a daily morning meeting at which investment possibilities, among other topics, would be discussed, but each manager decided for himself the transactions which would be effected in his particular segment. An element of competition amongst the managers was introduced by a method of compensation that was calculated in part upon the performance of one manager as compared with that of the others.

Adams had followed the performance of the aircraft manufacturers for about two years prior to June, 1966 chiefly through reading research reports put out by various brokerage houses and speaking to two aerospace analysts on a fairly regular basis. One of the companies Adams became acquainted with in that fashion was Douglas, and in June, 1966 he knew that the first half of a Douglas fiscal year ended as of May 31.

About June 15, 1966 Adams read the preliminary prospectus on the Douglas debenture offering and became aware that Merrill Lynch was managing underwriter. Around that time Adams indicated to Zicklin

that the partnerships were looking at the offering but had not reached any decision.

The afternoon of June 21 Zicklin called Adams on the direct wire that had been installed between their desks a year or so earlier and gave him the news that Douglas earnings would be disappointing and that the first six months of FY 1966 would show earnings of less than the reported five-month period. Adams realized at the time he concluded his conversation with Zicklin that the information when published would adversely affect the market price of Douglas stock, and he decided to exploit his advance knowledge by making short sales of Douglas stock before the market discounted the poor earnings. Shortly before noon, June 22, he placed orders to sell short 2,000 shares of Douglas stock for the account of Jones & Co. and 2,000 shares for Jones Associates, which were executed at prices from 88-7/8 to 89-1/4.

It is clear from Adams' own testimony that the information Zicklin furnished would have material bearing upon investment judgments exercised in connection with Douglas stock, and also that Adams knew Zicklin's information about Douglas earnings had not become publicly known at the time he effected his short sales on June 22. While Adams denies awareness that Zicklin had given him inside information on June 21, the knowledge Adams had that Merrill Lynch as a managing underwriter of the Douglas debenture offering would have access to non-public corporate financial data, and the swift action

that Adams took to take advantage of the Zicklin information, indicate otherwise. It is concluded that Adams knew or should have known that he was the beneficiary of inside information on June 21, and that the partnerships through him thereby had the duty of a Douglas insider to disclose the inside information in connection with the sale of Douglas stock effected on June 22. Since the requisite disclosure was not made, it is further concluded that Jones & Co. and Jones Associates, by Adams' actions, wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The afternoon of June 22, William Fissell, another portfolio manager of Jones & Co. and Jones Associates, also attempted to sell short 2,000 shares of Douglas stock, but succeeded only to the extent of selling 900 shares for the account of Jones & Co., and 800 shares for Jones Associates. There is an absence of evidence of any communication of inside information about Douglas to Fissell prior to the sales that he effected, and in the light of the competitive factor existing between portfolio managers and of Fissell's denial that he heard anything about Douglas from Adams on June 21, it is reasonable to credit his testimony that his sales were based upon his analysis of the market action of Douglas stock.

Since Fissell lacked knowledge of the inside information Adams had received, the partnerships cannot be found to have effected the Fissell sales of Douglas stock on the basis of inside information.

It follows, therefore, that although the knowledge of Adams, a general partner of both Jones & Co. and Jones Associates, may be imputed to the partnerships, they did not in connection with the Fissell sales derive personal benefit from the inside information. Since neither Section 17(a) of the Securities Act nor Rule 10b-5 requires a tippee to disclose his inside information where no advantage is taken of that information by the tippee, it is concluded that the Fissell sales of Douglas stock on June 22 did not involve a violation of the securities laws.[50/]

The arguments of Jones & Co. and Jones Associates are found too stringent with respect to the essential elements needed to establish a violation of Rule 10b-5 and unpersuasive in regard to the weight of the evidence.

As noted earlier, neither a special relationship with a corporate inside source of a kind advocated by respondents nor actual knowedge of an underlying breach of fiduciary duty by Merrill Lynch is required in order to find that Rule 10b-5 has been violated. The "essence of the Rule" is a prohibition against anyone's using inside corporate information for personal benefit, and the traditional fiduciary concept is but one route, the "special facts" doctrine being the other, by which anyone may be brought within the purview

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50/ Cf. SEC v. Texas Gulf Sulphur Co., supra at 848. Bromberg, Securities Law Fraud -- SEC Rule 10b-5, § 7.5(6)(f) at 190.18 (Supp. 1969).

of the Rule.[51/] While Adams' reliance upon Zicklin as a continuing source of information would not satisfy the Rule, that fact, in conjunction with Adams' knowledge of Merrill Lynch's relationship with Douglas and his sales of Douglas stock suffices for a conclusion that Adams knew or should have known that he had received inside information from Zicklin on June 21. Such actual or constructive knowledge may be deemed to have imposed a fiduciary obligation upon the Jones respondents to the degree required for Section 17(a) of the Securities Act and Rule 10b-5 to become applicable. The fact that the Jones respondents had direct telephone lines to other brokers and the fact that Adams spoke to a number of them on a daily basis do not indicate that Adams did not have reason to believe that Zicklin was giving him an insider's tip. Each facet of Adams' conduct and relationship with Zicklin over the relevant period viewed separately may be insufficient premise for a finding of actual or constructive knowledge of the nature of Zicklin's information, but collectively considered support such finding.

Moreover, the testimony of Adams tends to refute the arguments that he was unaware of the nature and importance of Zicklin's information. When asked for his opinion of the effect that the Zicklin information would have on Douglas stock, Adams stated that

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51/ SEC v. Texas Gulf Sulphur, supra at 848.

it would adversely affect the price. In further testifying, he affirmed that one of the factors in his selling short was to take advantage of Zicklin's information before the market had discounted that information. In the light of that testimony it is difficult to understand how the Jones respondents can seriously argue that the information was not material, was not non-public, and was not relied upon by Adams. It is quite obvious that if Adams felt that Zicklin's information would adversely affect the price of Douglas stock, that he must have attached importance to it in reaching his decision to effect short sales of that stock on June 22. It is equally obvious that Adams knew that the Zicklin information was non-public, for he wished to take advantage of it before effective disclosure of that information caused the market to discount it. Adams' opinion of the non-public nature of the information is, of course, affirmed by other evidence indicating that effective disclosure had not taken place on June 22.

In sum, the only area in which the facts permit substantial argument is that concerning whether Adams knew or had reason to believe that Zicklin was furnishing inside information. On that question, the preponderance of the evidence weighs against the Jones respondents.

Fairfield Partners

The limited partnership of Fairfield Partners was formed in 1965 to operate as a hedge fund and in 1966 managed about $31,000,000. Richard Radcliffe and Barton Biggs, two of the five general partners, were the portfolio managers for the partnership in 1966, with joint authority over investment decisions. Customarily these decisions were reached through discussions between Radcliffe and Biggs but on occasion, if Biggs were absent from the office, Radcliffe could and did make independent investment decisions.

By 1966 Radcliffe had followed Douglas fortunes for some years, and in 1965 had developed skepticism about Douglas' ability to improve its earnings. This skepticism persisted and on March 31, 1966 the partnership commenced to take a short position in Douglas stock with a sale of 1,000 shares. During April the partnership increased its short position to 3,500 shares and then covered all but 1,000 shares of the position between May 13 and 17, when the market on Douglas dropped.

Around the middle of May, Radcliffe became convinced from his reading of research reports that serious delays in deliveries of engines and landing gear to Boeing and Douglas would occur and that Douglas would be the more seriously affected because of the assembly line nature of its production. In keeping with this view, the partnership resumed its short selling of Douglas and by June 2 reached a short position of 7,100 shares after a short sale of 600

that day.

Between June 2 and June 20, 1966 Fairfield Partners had no further transactions in Douglas stock, but Biggs placed an order on June 6, which was not executed, to sell short 2,000 shares of Douglas at a price of "about 80," a direction that gave the broker discretion to sell at a price 1/2 to 3/4 above or below 80. The attempted short sale on June 6 and that accomplished on June 2 were partially induced by a conversation late in May between Radcliffe and an analyst who had lowered his earnings estimate for Douglas upon returning from a visit to the company. Another factor discussed between Radcliffe and Biggs prior to placing the June 6 order was an article published that day in Barron's which Biggs felt indicated Douglas earnings were "falling apart and that financing was imminent."

Further information about Douglas earnings was received by Radcliffe when Zicklin of Merrill Lynch telephoned about June 15, 1966 to inquire if the partnership had an interest in the Douglas debenture offering. Radcliffe told Zicklin that the partnership not only had no interest but that they didn't like the offering. Zicklin nonetheless read aloud the five-month earning figures appearing in the preliminary prospectus and suggested that other information in the prospectus would be of interest. Radcliffe asked that a copy of the prospectus be sent, and it was sent and received within a day or so after the request.

The next and critical question bearing upon the issues is whether Zicklin informed the partnership around 1:30 to 2:00 P.M. on June 21, 1966 of the information about Douglas earnings that he had received a few minutes earlier from Catapano. Zicklin recalled that he did telephone Fairfield Partners at that time and gave that information to someone in the partnership's office. Although he was unable to recall to whom he spoke, Zicklin customarily spoke to either Radcliffe or Biggs whenever he wished to convey investment information. Radcliffe could not recall a conversation with Zicklin on June 21, and when pressed, denied that he spoke to him on that date. Weighing Zicklin's testimony against that of Radcliffe's in the light of the latter's short sale of 900 shares of Douglas stock within minutes after the time Zicklin would have called, the absence of sales or orders to sell Douglas stock during the intervening period after June 6, and the give-up of $2,800 directed by Fairfield Partners for credit to Zicklin on July 15,1966, it appears that Radcliffe's recollection of the events of June 21 was faulty.

The record establishes that Zicklin called Fairfield Partners a bit after 1:30 P.M. on June 21 and told Radcliffe that Douglas earnings for six months would be less than for its first five months. Upon hearing that news, Radcliffe turned on his office ticker tape covering transactions on the New York Stock Exchange. At close to 2:00 P.M., he observed a string of trades in Douglas stock at prices

higher than those earlier reported, and called the partnership's broker. Radcliffe inquired about the activity in Douglas stock, learned that trading had been halted for a time but had resumed, and without discussing the matter with Biggs other than to mention Douglas was up a couple of points, placed an order to sell short 900 shares at 89-1/2, the price last noted on the ticker tape. The order, placed at 2:09 P.M. on June 21, 1966 was executed approximately seven minutes later at a price of 89-3/4. In the sale of that stock, no disclosure was made of the information Radcliffe had received a few minutes before from Zicklin.

The evidence educed and the reasonable inferences drawn therefrom establish that prior to June 21, 1966 Radcliffe became aware of the fact that Merrill Lynch was the managing underwriter of the Douglas debenture offering, and at the time of Zicklin's call on June 21 fully realized the implications of that relationship to be that Merrill Lynch had access to inside information about Douglas financial results and that information about Douglas operational results coming from Merrill Lynch was as factual as if the company had spoken. It is concluded that Radcliffe knew or should have known that Zicklin had given inside information about Douglas on June 21, and that the information, if generally known, would have materially and adversely affected the market price of Douglas stock. The failure by Fairfield Partners to disclose the inside information received from Zicklin in connection with its sale of 900 shares of

Douglas stock on June 21 was unfair to purchasers who were without access to the same information, and a wilful violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Fairfield's argument that the discarding of its Douglas research file in 1967 cannot be regarded as a deliberate destruction of damaging evidence is accepted. There is no indication that Fairfield had reason to believe in 1967 that the Division was conducting an investigation involving possible violations by the partnership nor had it been requested by the Division to preserve documents in its files relating to Douglas. Radcliffe's explanation for the disposal of the Douglas file to the effect that filing room was needed, and that because of the Douglas merger with McDonnell the research material on Douglas was of no further use is credited, and no inference is drawn from Fairfield's disposal of the Douglas file.[52/]

52/ Fairfield considers that the Division's proposed finding that Fairfield destroyed its file on Douglas knowing that the Division was investigating Fairfield's sales of Douglas suggests that the Division viewed Fairfield as a prospective respondent in 1966. Fairfield therefore resubmits in its Brief in Support of Proposed Findings and Conclusions of Law a motion to dismiss that was denied in the course of the prehearing conference held in this matter. The motion raises questions of the fairness and due process accorded Fairfield in the course of the Division's investigation that preceded the institution of these proceedings. The questions were decided adversely to Fairfield's contentions on the basis of the information then available for consideration, and the proposed finding in question is not viewed as additional evidence warranting a reversal of the denial.

But Fairfield's contention that Fairfield did not receive information from Zicklin prior to its sale of Douglas stock is contradicted by the weight of the evidence. Its further argument that the record contains a reasonable explanation for the short sale in question absent receipt of the Zicklin information is also rejected.

As urged by respondent, Fairfield's pessimism about Douglas was of long standing and its views had support in the information available during April to June, 1966 in financial publications and from respected aerospace analysts. The continuing pessimism is also reflected in the short sales of Douglas stock which were effected by Fairfield in 1966, but it is significant that the last before the June 21 sale in question was on June 2, nearly three weeks earlier.

Fairfield's bearish view of Douglas prospects does not suffice to explain the decision to make a further short sale of 900 shares on June 21. Radcliffe testified that his decision was triggered on that day by Douglas trades he happened to see being reported about 2:00 P.M. on the New York Stock Exchange ticker in Fairfield's office, but he had no explanation of why he did not act during the period of June 10 to June 20 when Douglas stock was trading at prices substantially higher than the 80 level at which he believed Douglas stock to represent a good short sale. Nor did Radcliffe have an explanation for his unilateral decision to effect the June 21 short

sale, a departure from the usual practice of Radcliffe and Biggs to arrive at investment decisions in joint discussions.

Of course, the questions raised about the credibility of Radcliffe's testimony would not be enough without evidence that Zicklin had called Radcliffe on June 21 before he ordered the short sale. As pointed out by Fairfield, there is no direct testimony regarding the precise time on June 21 that Zicklin telephoned Fairfield to relay the news about Douglas, but from reasonable inference, it is concluded that Zicklin spoke to Radcliffe shortly before 2:00 P.M. and conveyed the information received from Catapano. Unlike Radcliffe, Zicklin had a recollection that he had called and spoken to someone at Fairfield after speaking to Catapano on June 21 and so reported to his superior in the late afternoon of the same day. Zicklin testified that his practice was to speak to either Radcliffe or Biggs regarding investment information, that it was after he had returned from lunch on June 21 that he talked to Catapano, that the latest he would have returned from lunch was 2:00 P.M., and that he considered the information he received from Catapano important enough to transmit to his hedge fund customers as quickly as possible. These circumstances, added to Radcliffe's recital of the occurrences at the partnership offices at about 2:00 P.M. on June 21, indicate that the key to Radcliffe's otherwise inexplicable sudden sale of Douglas stock on June 21 is the receipt of Zicklin's call. With that in the picture, it would have been normal for Radcliffe to look

at the ticker for Douglas trades, check with the partnership's broker to find out what was happening in Douglas, and without more than a brief comment to Biggs, order a sale of the 900 shares of Douglas stock. Further, the June give-up of $2,800 which the partnership directed to Zicklin's credit on July 15, 1966 tends to indicate from its size that Fairfield had been rendered valuable service by Zicklin, and suggests, in the absence of any evidence indicating the services rendered or the method of computing the appropriate compensation to be paid Zicklin, that in the give-up was a recognition of the value of the information given to Fairfield on June 21.

William A. M. Burden & Co.
Burden Investors Services, Inc.

The portfolio of Burden & Co., a limited partnership formed in 1949 to invest monies of certain members of the Burden family, was actively managed in 1966 by Robert Barker and Donald Moriarty, two of the general partners, assisted by John Holman, then a salaried associate. Moriarty and Holman were also vice-presidents and directors of Burden, Inc., a corporation which acted in 1966 as investment adviser to members of the Burden family not general or limited partners in Burden & Co.[53/]

53/ The identification "Burdens" will be used to refer to Burden & Co. and Burden, Inc., collectively.

The consistent objective of the Burdens has been to find and make long-term investments in companies having above-average growth, and considerable time has been spent by them in assessing growth prospects of various industries with a view of concentrating investments in those best meeting the Burdens' objective. Sources of information consulted by Barker, Moriarty, and Holman in reaching an investment decision include economic experts, political analysts, company managements and their reports, trade journals and other publications, brokerage firm and investment banking house reports, and any other information available.

The Burdens followed the aircraft industry for some years prior to 1966 and were thoroughly familiar with its background and with that of Douglas, which they had under consideration as an investment possibility for at least six months prior to June, 1966. The Douglas debenture offering came to Holman's attention early in June, 1966 and in the week before June 14 he received and studied the preliminary prospectus covering that offering. Holman also discussed Douglas with Barker and Moriarty several times during that week and on June 14 all agreed that the Burdens should indicate an interest of $5,000,000 in the Douglas debenture offering. Moriarty then telephoned McCarthy of Merrill Lynch, known by the Burdens to be the managing underwriter, and told him of the Burdens' interest in the debentures.

Six days later, June 20, Melvin Seiden, president of the brokerage firm of Seiden & de Cuevas, Inc., had a fifteen minute conversation with Holman at a dinner sponsored by Seiden's firm. Seiden voiced the opinion that Douglas was a good speculation and told Holman that Douglas had a "tremendous backlog of orders," that the small equity capitalization of the company provided great leverage, and that anticipated plane deliveries indicated large profits in FY 1967. Seiden further pointed out that interest in the Douglas offering was very high and that he suspected that many persons unable to purchase the quantity of debentures desired would buy Douglas stock, with the result that the stock price would go higher. He suggested that a hedge against dependency on price and availability of Douglas debentures would be an immediate purchase of Douglas stock.

Influenced by Seiden's views, Holman called a meeting next morning, June 21, which Moriarty attended initially and which continued between Holman and Barker after Moriarty had to leave to keep an appointment. Holman, concerned about the possibility that the Burdens might not be allotted a full $5,000,000 of Douglas debentures, presented Seiden's reasoning to Barker and Moriarty, and expressed his own opinion that investor interest in Douglas and the rising price of its stock indicated that a purchase of Douglas stock was desirable. Barker felt Holman's recommendation made sense, but Moriarty was not in favor of such investment. However, after

Moriarty left the meeting, further discussion with Holman led Barker, the senior partner, to agree that the Burdens should buy $1,000,000 of Douglas stock. Holman placed the Burdens' order with Seiden that morning before 11:00 A.M., and during the course of the day 7,100 shares of Douglas stock were purchased at prices from 86-3/8 to 88-5/8 per share for accounts serviced by Burden, Inc., and 3,900 shares at prices of 86-3/4 to 88 were bought for Burden & Co.

When Moriarty returned to his office around 2:30 P.M., Barker informed him that Holman's arguments had been persuasive, and that it had been imperative to proceed with the purchase. A few minutes later the call from McCarthy came to Moriarty advising him that Douglas earnings for May were very disappointing, that Douglas second quarter earnings would be lower than those of its first quarter, and that its earnings for FY 1966 would be "flat." Shortly thereafter Moriarty called an informal meeting at which he advised Barker and Holman of the information from McCarthy. Both Barker and Holman greeted that news with surprise and disbelief. Holman, the more knowledgeable about Douglas, also viewed the information, if true, as raising the possibility that Douglas would have no earnings for FY 1966, and as being unfavorable to the point of representing a disaster. Because of their doubts about the information, the three agreed that the plausibility of the McCarthy information should be explored through conversation with outside aerospace

analysts.

One of the consultants relied upon by the Burdens was Dr. Robert Christensen, an officer of a technological consulting firm retained by the Burdens, who made a presentation of a report on Boeing Aircraft Corporation at the Burden offices on the morning of June 22. Neither he nor either of two aerospace analysts, Benjamin Rosen of Coleman and Company and Stuart Feick of Baker Weeks & Co., with whom Moriarty and Holman talked, gave the Burdens the same information given by McCarthy. At noon, Moriarty left the Christensen briefing to attend the luncheon for institutional investors sponsored by Brimberg & Co. where he overheard, and later repeated to Barker and Holman, rumors to the effect that Douglas earnings were going to be very disappointing.

About 9:30 A.M. on June 23, Holman had an unannounced visit from Seiden. He was anxious to give the Burdens his reaction to a remark made by Gerald Tsai, president of Manhattan Fund, regarding Douglas. Earlier that morning Seiden had met Tsai for breakfast and before they sat down or had any preliminary conversation on the subject, Tsai suggested that if he were Seiden he would "really check into this Douglas situation." Without disclosing Tsai's identity, Seiden informed Holman that a source worth listening to had caused him to be very worried about Douglas. Holman and Seiden discussed various aspects of Douglas for another half hour, at which point Holman asked Seiden what he would do. Seiden, reversing his

recommendation of June 20, replied that he would sell the Douglas stock.

The Seiden discussion was reported by Holman to Barker and Moriarty a few minutes later in a meeting in which the information and opinions that the Burdens had gathered from Rosen, Feick, and Christensen were also reviewed. After the meeting had gone on for about an hour, Barker made the decision to sell the Douglas stock purchased on June 21, and this was accomplished before the close of the New York Stock Exchange on June 23 at prices ranging from 88 down to 84-1/4. The Burdens admit that no disclosure of the information received from McCarthy on June 21 was made to purchasers of the Douglas stock sold by them on June 23.

The evidence marshaled on the issues affecting the Burdens establishes that the Burdens knew or should have known that "access, directly or indirectly,to information intended to be available only for a corporate purpose" had been obtained by them through McCarthy's tip on June 21 regarding Douglas unreported earnings and its earnings prospect for FY 1966. Any doubt that may have been present in the minds of Barker, Moriarty, and Holman on June 21 about the "plausibility" of McCarthy's information must have been dissipated by Seiden's visit to Holman on June 23, and the realization certainly brought home to them that McCarthy had given them the benefit of inside information Merrill Lynch had received as a managing underwriter. Having received inside information about Douglas, the Burdens

as tippees acquired and then failed to discharge the responsibility imposed upon them to disclose that information to those purchasing Douglas stock from them. It is therefore concluded that the Burdens wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The Burdens' position that the record is inadequate to prove that they received inside information required to be disclosed in connection with their sales of Douglas stock on June 23 cannot be accepted. As of the time that those sales were made, the Burdens knew or should have known that McCarthy had given Moriarty a tip on Douglas non-public corporate information. Such actual or constructive knowledge is enough to impose an obligation of affirmative disclosure of the information received in connection with the Burdens' sales of Douglas stock without a showing of a greater "special relationship" between Merrill Lynch and the Burdens.[54/] To require more would be to defeat the intent of Section 17(a) of the Securities Act and Rule 10b-5 that "all investors . . . have relatively equal access to material information, ..."[55/]

The further argument that the McCarthy information was not material is rebutted not only by the actions taken by the Burden

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54/ See SEC v. Texas Gulf Sulphur Co., supra.

55/ Id.

managers to verify the McCarthy information, but by Holman's reaction to that information. It is true that the evidence does not reflect that the Burdens received specific figures for the Douglas second quarter or six-month earnings, but Moriarty was also told that "the year as a whole would be flat." That the term "flat" was considered by the Burdens as meaning zero earnings is reflected by Holman's description of McCarthy's information as a "disaster." Holman's view clearly reflects an immediate recognition of the materiality of McCarthy's information, as does Moriarty's testimony that it caused the Burdens to reevaluate the Douglas situation. Realization of the impact of the McCarthy information upon their investment judgment alone can account for a need to review the carefully considered decision to purchase $1,000,000 of Douglas stock reached by the Burdens but hours earlier.

Nor does the record sustain the Burdens' assertion that "the entire financial community by June 23 knew more" than the information McCarthy provided. The opposite is the fact. By June 23 a portion of the financial community, primarily a small number of institutional investors, had the benefit of surmise and speculation about the drop in Douglas earnings and its prospects, but even that had not been so widely disseminated as to be considered effective disclosure of the inside information in question. Indeed, the aerospace analysts that Holman and Moriarty spoke to on June 21 and 22 apparently had no inkling of the "disaster" that the McCarthy information

represented, and it was not until the morning of June 23 that the Burdens received an indication from Seiden that others were aware of the same information they had. But the fact that a few in the financial community had the same knowledge is not the effective disclosure of corporate information that is required before a tippee is excused from his obligation of disclosure.

The Burdens' contention that McCarthy's telephone call of June 21 was not a factor in their decision to sell their Douglas stock on June 23 is also rejected. The materiality of the information McCarthy gave was recognized immediately and considerable effort made to obtain what Holman referred to as "documentation" of it. The only reasonable inference that can be drawn from the circumstances is that the McCarthy information was a factor that played a material role in the decision of the Burdens to sell their Douglas stock on June 23. Holman and Moriarty's testimony to the contrary is not credible.

The Dreyfus Corporation

The Dreyfus Corporation has been for a number of years the investment adviser of The Dreyfus Fund, an investment company registered under the Investment Company Act of 1940. The net asset value of the Fund was approximately $1.5 billion in 1966, and during that year hundreds of decisions affecting the Fund's portfolio were made by six investment officers who had the responsibility for

attaining the Fund's objective of long-term capital gains. Two of the Fund's investment officers at that time were Allan Pratt and Howard Stein, the latter also being president and a director of Dreyfus Fund and president of The Dreyfus Corporation.

A staff of securities analysts was employed by Dreyfus Fund to assist the investment officers by supplying them with information and analyses on a spectrum of investment areas. Stephen Swid was one of the Fund's junior analysts in 1966, with responsibility for following certain high technology industries, including aircraft manufacturers.

In February, 1966 Swid recommended that the Dreyfus Fund take a position in Douglas stock, and that recommendation, which entailed a long-term investment of $5,000,000, was reviewed by three of the investment officers and then approved. Purchases of Douglas stock pursuant to Swid's recommendation commenced on May 9, 1966; three days later Stein ordered buying to cease when he learned from a partner of Coleman and Company that Douglas was having problems. Because of his understanding that the problems might be temporary, Stein decided that the Fund should retain the 21,300 shares it had acquired, but a few days later, following discussions with other aerospace experts, he decided that the Fund should not add to its Douglas stock holdings.

When the Douglas debenture offering was announced in late May or early June, 1966 Swid, in the absence of Pratt, advised Bilbao

of Merrill Lynch that Dreyfus Fund had an interest in those debentures. A few days later and before publication of the earnings figures in the Douglas debenture prospectus of June 7, Bilbao informed Swid that Douglas had earned 85¢ per share in its first five months. In the same conversation Bilbao also disclosed that the estimate on Douglas earnings for FY 1966 had been reduced to a range of $2 to $3 per share, with Merrill Lynch leaning toward the $2 figure, and gave Swid other information about Douglas production problems.

Swid attended the June 22 luncheon that Brimberg & Co. sponsored for institutional investors, and while there overheard comments about Douglas having production problems and not being able to meet its delivery schedule. He then questioned the airline executive, the principal speaker at the luncheon, about the Douglas delivery schedule of airplanes to the speaker's company for the latter half of 1966 and early 1967, and was told that Douglas had not revised its schedule.

Not satisfied with the answer given by the luncheon speaker, Swid made further attempts when he returned to his office to check on whether Douglas was having delivery problems. He first called the offices of United Aircraft Corporation, the supplier of the jet engines for Douglas aircraft, and using a dissemblance that concealed his actual interest in Douglas, learned from a United Aircraft official that deliveries of engines to Douglas were not on schedule but would

improve in the last half of 1966. Swid next spoke to Lawrence Vlaun, an aerospace analyst at the brokerage firm of Auchincloss, Parker & Redpath; receiving nothing in the way of factual information from him, Swid then placed a call but could not reach Melvin Scott of Douglas.

In hopes of speaking to Scott, Swid waited until after 5:00 P.M. on June 22 before deciding to talk to Stein about Douglas. He called Stein at home, related the rumors he had heard at the Brimberg luncheon, spoke about his inability to obtain information about the rumored production difficulties except to the extent of his conversation with United Aircraft, and recommended that Dreyfus Fund sell its Douglas stock. Stein's response was that comments about Douglas production problems had been circulating for a month or so, and that Swid should do more work on the situation. Next morning, June 23, Swid noted in the New York Times that 50,000 shares of Douglas had traded on the Pacific Coast Exchange at a price higher than its closing on the New York Stock Exchange, and persuaded Pratt to relay that information to Stein. Stein, unimpressed by the trade, had Pratt tell Swid to continue with his checking.

The confirmation Swid was seeking came to him later in the morning of June 23 when Bilbao repeated in a telephone conversation, the information that Catapano had acquired from Woodman the day before to the effect that Douglas had lost money in May and in its

second quarter and would have little, if any, profit for FY 1966. Convinced that Douglas stock would decline when those earnings were publicized, Swid bypassed Pratt to again call Stein at home. Without disclosing that he had received inside information on Douglas from Bilbao,Swid insisted that his recommendation to sell Douglas stock be accepted, and went so far as to state that if his advice were not taken, he should not be working for Stein. After that conversation, Stein received a call at about 1:00 P.M. from the Dreyfus Fund trader alerting him to the fact that Douglas stock had dropped substantially during the morning. Stein consulted a chart of the price movements on Douglas stock, saw that the chart indicated a probability of a severe decline with a breakthrough of a support level at a price of 83 or 84, and having in mind Swid's call of the previous day as well as earlier knowledge that Douglas was encountering difficulties, decided to sell the Dreyfus Fund's holdings of Douglas stock. An order to sell Dreyfus Fund's 21,300 shares was placed at 2:19 P.M., a few minutes after Stein advised Pratt that the Douglas stock should be sold, and that afternoon the stock was sold at prices of 80-1/4 to 81-3/4.

The thrust of the charges against The Dreyfus Corporation is that inside information regarding Douglas was unfairly used to obtain an advantage over purchasers of the 21,300 shares of Douglas stock sold for Dreyfus Fund's account on June 23. While it is clear from the evidence that Swid received material inside information

about Douglas earnings and its prospects during his telephone conversation with Bilbao on June 23, the Division has failed to prove that Swid acquainted Stein with that same information. It is found, therefore, that although on June 23 Dreyfus Corporation possessed inside corporate information regarding Douglas earnings, no use was made of that information in connection with the sale that day of the Dreyfus Fund's holdings of Douglas stock. Disclosure of inside information not being required of a tippee unless some use is made of that information, it is concluded that Dreyfus Corporation did not commit the violations charged and that these proceedings against it should be dismissed.

The Division's contentions that Swid passed on to Stein the inside information received from Bilbao and that Stein was in possession of inside information information at the time he caused the sale of the Fund's 21,300 shares of Douglas stock are not sustained by the record. As recognized by the Division, its contentions rely upon inferences to be drawn from the actions of Swid and Stein. But contrary inferences which appear more reasonable are as readily drawn from those actions. Thus, Swid might well, as the Division argues, not have called Stein a second time unless he had something significant to report, but it does not follow that he would have passed on Bilbao's information. Swid appeared on the witness stand to be a person who would not hesitate to withhold that news as a means of leading Stein to believe that the extremely timely "sell"

recommendation evidenced superior analytical ability. Swid had no hesitation in resorting to deception to achieve his ends when speaking to United Aircraft, and it is unlikely that he would have more scruple in advancing his interests in talking to Stein. Moreover, Swid's misjudgment of an investment situation on an earlier occasion indicates that he had need to reestablish his ability in the eyes of Stein by giving the appearance of calling the decline on Douglas with precision. Under the circumstances, Stein's denials that he had received information on June 22 or 23, 1966 concerning Douglas earnings and prospects of the nature received by Swid from Bilbao, and his testimony regarding the bases upon which he ordered the sale of the Douglas stock on June 23 are credited.

PUBLIC INTEREST

Pointing to the record as justification for stern remedial action, the Division urges that those respondents not registered with the Commission under the Exchange Act or Advisers Act be barred from association with a broker or dealer, and that the registrations of the registered respondents be permanently revoked. Respondents, on the other hand, argue that sanctions are not required in order to serve the public interest. In support, they refer to the novel issues presented in these proceedings, the surrounding circumstances, respondents' state of mind at the time of the sales in question,

the remedial purpose of Section 15(b) of the Exchange Act, and the prior unblemished records of the respondents together with their cooperation with the Division during the investigation which led to the institution of these proceedings.

While the sanctions advocated by the Division are found to be inappropriate as too severe, the position of the respondents that no sanctions be imposed is also unacceptable. Under all the circumstances, it is concluded that censure is necessary and appropriate in the public interest as to respondents other than Anchor, Hartwell, Inc., and Dreyfus. With respect to the latter, it does not appear that remedial action against Anchor and Hartwell, Inc., is required in the public interest, and as noted earlier, the proceedings should be dismissed with respect to Dreyfus.

Consideration has been given to the mitigating factors advanced by respondents, but the fact that these proceedings are the first in which tippees have been charged with violations of the securities laws does not excuse the commission of those violations, nor can they be condoned. The concept of unfairness inherent in respondents' sales of Douglas was not novel in 1966; neither was the condemnation of the use of corporate information for personal benefit unstated; nor the aim of Section 17(a) of the Securities Act and Rule 10b-5 to place investors trading in securities on a relatively equal footing unknown. The respondents' blindness toward their obligations to the investing public must be attributed to

undue self-interest.

Mitigating respondents' offenses is the fact that the record does not evidence deliberate intent by respondents to flout the law for financial gain, nor does it appear that respondents engaged in previous misconduct. Moreover, as respondents suggest, the unusual amount of publicity attendant upon the institution and later stages of these proceedings and that which will probably further attend until final determination of these issues will serve as a further sanction and, in like manner to that found in Cady, Roberts, 56/ "induce a more careful observance of the requirements of the anti-fraud provisions in the area in question."

With respect to Anchor and Hartwell, Inc., there appears no need to impose sanctions simply because of their control relationship to persons found to have wilfully violated Section 17(a) of the Securities Act and Rule 10b-5. Anchor was not acting in a supervisory capacity in its control of IMC in 1966, and the public interest does not require imposition of sanctions against Anchor for violations arising out of IMC's conduct. Similarly, it does not appear necessary to impose sanctions against Hartwell, Inc., which did not come into existence until after the Douglas sales in question had been effected by the other Hartwell respondents. 57/

56/ Supra at 917.

57/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

Accordingly, IT IS ORDERED that Investors Management Co., Inc., Madison Fund, Inc., J. M. Hartwell & Co., Hartwell and Associates, Park Westlake Associates, Van Strum & Towne, Inc., Fleschner Becker Associates, A. W. Jones & Co., A. W. Jones Associates, Fairfield Partners, Burden Investors Services, Inc., and William A. M. Burden & Co. be, and they hereby are, censured;

IT IS FURTHER ORDERED that these proceedings be, and they hereby are, discontinued as to Anchor Corporation and J. M. Hartwell & Co., Inc.; and

IT IS FURTHER ORDERED that these proceedings be, and they hereby are, dismissed with respect to The Dreyfus Corporation.

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

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

for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Warren E. Blair

Warren E. Blair
Hearing Examiner

Washington, D. C.
June 26, 1970