IN THE MATTER OF

HERBERT L. WITTOW

doing business as

WITTOW & COMPANY

JOHN F. COUGHENOUR

File No. 3-2182. Promulgated August 24, 1971

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

BROKER-DEALER PROCEEDINGS

Fraud in Connection with Sale of Securities

Where registered broker-dealer participated with another broker-dealer in an arrangement under which the latter, in executing customer's orders to sell securities as agent at specified price or better, effected sham sales of such securities to registrant at specified prices, which were below prevailing market prices, and promptly "repurchased" securities at slightly higher prices, and arrangement and resultant profits to broker-dealers were not disclosed to customer, *held*, registrant was participant in a fraudulent scheme and in public interest to impose suspensions on registrant and its sole proprietor.

Sales of Unregistered Securities

Where associate manager of broker-dealer branch office sold securities for customer who had obtained them from controlling person of issuer with a view to distribution and who was therefore statutory underwriter under Securities Act, and associate manager was on notice of facts which should have caused him to inquire regarding customer's status, but failed to make careful inquiry, *held*, no exemption from registration of securities was available under Section 4 of Act, sales violated registration provisions of Act, and in public interest to impose suspension on associate manager.

APPEARANCES:

Joseph F. Krys, Dilworth A. Nebeker and *H. Michael Spence*, of the Denver Regional Office of the Commission, for the Division of Trading and Markets.

Donald P. Shwayder, of Rothgerber, Appel & Powers, for Herbert L. Wittow.

Joseph C. Daley, Thomas B. Bracken and *Edward W. Long*, of Mudge Rose Guthrie & Alexander, for John F. Coughenour.

FINDINGS, OPINION AND ORDER

These were private proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") with respect to Herbert L. Wittow, doing business as Wittow & Company, a registered broker-dealer, and with respect to John F. Coughenour, who during the pertinent period was an associate manager of a branch office of a broker-dealer firm.[1] Following hearings, the hearing examiner submitted an initial decision concluding, among other things, that Wittow's registration and his right to be associated with any broker-dealer should be suspended for 14 days, and that Coughenour should be suspended from association with any broker or dealer for 7 days. We granted petitions for review filed by each of those respondents, and briefs were filed by them and by our Division of Trading and Markets. On the basis of an independent review of the record, and for the reasons set forth herein and in the initial decision, we make the following findings.

The issues with respect to Wittow and Coughenour, while relating to securities of the same issuer, arise out of unrelated transactions and involve different provisions of the securities laws. We therefore deal with them separately, turning first to the issues pertaining to Wittow.

I. WITTOW

VIOLATIONS OF ANTIFRAUD PROVISIONS

We find, as did the examiner, that in April and May 1968 Wittow willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and aided and abetted violations of those provisions by Birkenmayer & Company, Inc. and Arnold L. Greenberg, Birkenmayer's vice-president, in connection with certain sales of common stock of Worldwide Energy Company, Ltd. by Birkenmayer as agent for customers. Wittow participated with Birkenmayer and Greenberg in an arrangement under which sham sales of such stock by Birkenmayer to Wittow, at prices below the prevailing market, and "repurchases" of the same shares by Birkenmayer were effected, with Wittow and Birkenmayer deriving profits that were not disclosed to the customers.

[1] Issues pertaining to other respondents named in the proceedings have been resolved on the basis of offers of settlement submitted by them. *Birkenmayer & Company, Inc.*, Securities Exchange Act Release No. 8884 (May 15, 1970).

Between February and June 1968, Harry A. Trueblood, Jr., president of Consolidated Oil & Gas, Inc., sold a total of about 195,000 shares of Worldwide stock to or through Birkenmayer on behalf of himself, his children and Consolidated. As to the shares which Trueblood instructed Greenberg to sell on an agency basis,[2] he specified limit prices below which they should not be sold.[3] All those shares were sold at the specified limit prices, which were reported as the sale prices to the customers. A large part, 41,900 shares, was sold to Wittow pursuant to an understanding that Birkenmayer would repurchase the shares at a slightly higher price determined by Greenberg, and such repurchases were effected on the same day or at most within two business days. Confirmations were exchanged between Birkenmayer and Wittow, but the latter made no payments and merely received from Birkenmayer the price differential, which ranged from 2¢ to 6 1/8 per share and for all the transactions totalled $1,525.

The examiner found that Birkenmayer did not obtain the best prevailing market prices for its customers, noting that on each of the six days on which Birkenmayer sold the Worldwide stock to Wittow, it also effected sales on a principal basis at higher than the limit prices. Greenberg, in testifying that he could not have obtained more than the limit prices for his customers, claimed that those prices exceeded the contemporaneous bids of other market-makers and that if he offered the shares at higher prices he would risk "missing" sales at the limit prices. However, an analysis of Birkenmayer's transactions, as reflected by its order tickets and confirmations, shows that contention to be without validity. On at least a number of the days in question, Birkenmayer effected sales as principal at prices higher than the limit price specified by Trueblood on that day, very close to the time of the sales to Wittow and in substantial amounts. For example, on one of the days, Birkenmayer executed a 10,000-share agency order for Consolidated, which it received at 12:25, by selling the shares to Wittow at 4 3/6 at 12:26. At 11:49 and 11:56 it had sold for its own account 3,000 and 1,000 shares, respectively, at 4 5/8 to two other dealers, and at 12:47 it sold a total of 1,200 shares to three other dealers at the same price. In the course of the day, it sold over 19,000 shares for its own account, all at prices exceeding the

[2] According to Greenberg, Trueblood, before placing an order, generally asked him for the market quotations, and would place an agency order if he did not like the quoted bid.

[3] A "limit" order is one that may be executed only at the price specified or better. See *George A. Brown*, 43 S.E.C. 490, 495, n. 7 (1967).

4 3/8 realized for Consolidated, and it repurchased the 10,000 shares from Wittow at 4:40.

It is clear that Birkenmayer did not fulfill the obligation which attached to it in executing the agency transactions to obtain the best price for its customers and not to prefer its own interests over theirs.[4] In substance, it executed those transactions as principal despite the express direction by Trueblood to act as agent. While it appears that Greenberg had asked Trueblood whether he cared if Birkenmayer repurchased the stock and Trueblood replied that he did not as long as the shares were sold at the designated limit price, clearly Trueblood's consent was to repurchases following sales executed on an agency basis with proper effort to obtain the best available price, and did not encompass the kind of arrangement Birkenmayer had with Wittow, which was not disclosed to Trueblood.[5]

Wittow was on notice that Greenberg was not making an effort to obtain the best execution for his customers, but admittedly made no independent inquiry regarding the prevailing market prices. Birkenmayer's same-day "repurchases" at higher prices were inconsistent with the representation that Wittow asserts Greenberg made to him that the limit prices at which the shares were being sold to Wittow reflected the "offer side" of the market. Moreover, even aside from the prices at which the transactions were executed, it seems clear that Wittow must have been aware that the manner of execution was improper. While Wittow testified that Greenberg told him that his customer was aware of the repurchase arrangement, Wittow was informed that the customer wanted agency execution and was under an obligation, in light of the highly abnormal nature of the transactions, to ascertain whether full disclosure was being made to the customer concerning all aspects of the transactions.[6] In view of his failure to do so, Wittow must be deemed a participant in a fraudulent scheme.[7]

PUBLIC INTEREST

Wittow urges that the sanctions imposed by the examiner against him and his firm are too severe, particularly when compared to sanctions imposed against other respondents in these proceedings. However, the appropriate remedial action

[4] See *Investment Service Co.*, 41 S.E.C. 188, 198 (1962), *aff'd sub nom. Barnett* v. *U.S.*, 319 F.2d 340 (C.A. 8, 1953); *Opper* v. *Hancock Securities Corporation*, 250 F. Supp. 668 (S.D.N.Y.), *aff'd* 367 F.2d 157 (C.A. 2, 1966); *Thomson & McKinnon*, 43 S.E.C. 785, 788-89 (1968); and cases cited in note 6 of release.

[5] *Cf. Arleen W. Hughes*, 27 S.E.C. 629 (1948), *aff'd* 174 F.2d 969 (C.A.D.C., 1949).

[6] Wittow testified that he had never before engaged in transactions of such nature.

[7] *Cf. Moore & Co.*, 32 S.E.C. 191 (1951).

as to a particular respondent depends on the facts and circumstances applicable to him and cannot be measured precisely on the basis of action taken against other respondents.[8] Moreover, the sanctions with respect to other respondents in the proceedings were imposed in accordance with offers of settlement which we deemed it appropriate to accept, whereas our present determination a to Wittow is based on a resolution of the issues as developed by the record.[9] In reaching his conclusion regarding Wittow, the examiner took into consideration the mitigative factors presented, including the absence of any prior action against Wittow in his 12 years in the securities business, the fact that he did not originate the unlawful scheme and that his participation was apparently motivated more by a desire to accommodate Greenberg than by the expectation of profit. Under all the circumstances, we consider that the 14—day suspensions ordered by the examiner are appropriate in the public interest.

II. COUGHENOUR

VIOLATIONS OF REGISTRATION PROVISIONS

The examiner found that between January 15 and April 15, 1968, Coughenour willfully violated the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933 in connection with the offer and sale of 60,000 shares of Worldwide common stock as to which no registration statement had been filed or was in effect. Those shares were sold by Coughenour and his employer for one Doyle H. Baird in a series of 7 agency transactions, for a total of $253,750. Baird had acquired the shares as partial consideration for his sale on January 12, 1968 of certain oil and gas properties to Consolidated, which the examiner found controlled Worldwide at that time and was with Worldwide under the common control of Trueblood, president of Consolidated and board chairman of Worldwide. The examiner held that under the circumstances Baird was an "underwriter" of those Worldwide shares as defined in Section 2(11) of the Securities Act, in that he purchased the shares from an "issuer" (defined in that Section to include a person controlling or under common control with the issuer) with a view to distribution, and that Coughenour's sales were not, as claimed by him, exempt from the registration requirements. The record supports the examiner's findings.

[8] See *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967).
[9] See *Cortlandt Investing Corporation*, 44 S.E.C. 45, 53–55 (1969).

It is well settled that the burden of proving the availability of an exemption from the registration requirements of the Securities Act rests with the person claiming the exemption.[10] Where as here the critical factor determining the availability of an exemption is whether the shares in question emanated from a person in a control relationship with the issuer,[11] one asserting an exemption must show the absence of control, at least where a secondary distribution of significant proportions is involved.[12] No such showing was made in this case.

"Control" is defined in Rule 405 under the Securities Act as the power to direct or cause the direction of management and policies, and the existence of control is determined by the circumstances of each case.[13] It is undisputed that in 1965 Consolidated had acquired control of Worldwide through the acquisition of Worldwide convertible debentures and the accompanying right to designate three of Worldwide's five directors. Consolidated's designees included Trueblood, admittedly a controlling person of Consolidated, and Robert B. Tenison, a vice-president of Consolidated until July 1, 1967, and from early 1967 until well after the period of the sales of Baird's shares, the board included the Consolidated designees as well as another director of Consolidated who also represented a major shareholder of Worldwide.

Coughenour argues that at the time under consideration it was Tenison and not Consolidated or Trueblood who was in control of Worldwide. He points to testimony of both Trueblood and Tenison to that effect, and to the fact that Trueblood had been succeeded by Tenison as Worldwide's president in December 1966 and had advised Tenison that Consolidated intended to divest itself of its Worldwide stock, which it did thereafter. However, while Consolidated sold the major part of its Worldwide shares in a public offering in November 1967 and a further small amount by January 12, 1968, it still held at the latter date 275,000 shares, representing about 10.6 percent of Worldwide's outstanding stock.[14] Viewing the record as a

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[10] *S.E.C.* v. *Ralston Purina Co.*, 346 U.S. 119 (1943); *S.E.C.* v. *Culpepper*, 270 F.2d 241, 246 (C.A. 2, 1959).

[11] Coughenour's transactions did not come within the exemption provided by Section 4(1) for transactions by any person other than an issuer, underwriter, or dealer. He was at the very least a participant in transactions effected by his employer which was clearly a "dealer." Although those transactions were executed on an agency basis, Section 2(12) of the Securities Act defines the term "dealer" to include both persons who engage in the securities business as principal and those who do so as agent. See *Quinn and Company, Inc.*, 44 S.E.C., 459, 465 (1971), appeal pending (C.A. 10, No. 71-1090).

[12] *Pennaluna & Co.* v. *S.E.C.*, 410 F.2d 861, 865 (C.A. 9, 1969), *cert. denied* 396 U.S. 1007.

[13] See *Rochester Telephone Corp.* v. *United States*, 307 U.S. 125, 145 (1939).

[14] Consolidated thereafter disposed of the balance of the shares through additional sales over a period of four months.

whole, it does not in our opinion show that the November 1967 sales and the expressed intention to dispose of the balance had operated to dissipate Consolidated's control position by January 12, 1968. Consolidated was still Worldwide's largest single stockholder and Trueblood, who with his minor children owned between 3 percent and 4 percent of the outstanding stock, continued as its board chairman and the other directors, at least two of whom had close ties with him or Consolidated, remained unchanged, with the same directors even being reelected at the April 1968 shareholders' meeting. The record shows, as the examiner found, that Tenison, although in charge of the day-to-day operations of Worldwide, was subject to the control of the board of directors which exercised the usual and customary powers of a board of directors.[15]

There is no merit in Coughenour's further contention that regardless of Baird's underwriter status, his transactions were exempt under the brokers' exemption provided by Section 4(4).[16] That exemption is not available when the broker knows or has reasonable ground to believe that his customer is an underwriter, since in that event the broker likewise violates Section 5 by participating in a non-exempt transaction.[17] Here the record shows that Coughenour was on notice of facts which should have caused him to make inquiry regarding the status of his customer. The magnitude of the transactions involved and his lack of familiarity with the issuer should have indicated to him the need for a careful inquiry, notwithstanding that a number of dealers were making a market in Worldwide stock, or the absence of any restrictive legend on the certificates involved.[18] In fact, it appears that Coughenour had some concern as to the saleability of the shares without registration, but accepted the statements of Baird and Baird's attorney, whom he called, that the stock was freely tradeable.[19] Coughenour did not know nor did he inquire as to how many shares Baird owned or how many were outstanding and where Baird

[15] Although, as stressed by Coughenour, Tenison held in his name proxies for about 70 percent of the shares voted at the April 1968 shareholders' meeting, those proxies were expressly solicited on behalf of management.

Control by Consolidated of Worldwide at the time of Baird's receipt of his Worldwide shares is not negated nor control by Tenison demonstrated by the fact that in April and May 1968, subsequent to such receipt, the Worldwide board of directors approved acquisition which brought Worldwide into competition with Consolidated. We also note that Trueblood did not oppose the acquisitions, and merely abstained from voting, and that at the May 1968 meeting the board rejected a proposal by Tenison that Worldwide acquire another company.

[16] Section 4(4) exempts brokers' transactions executed upon customers' orders but not the solicitation thereof.

[17] See *Quinn and Company, Inc., supra*, p. 465.

[18] See *Quinn and Company, Inc., supra*, pp. 467-68.

[19] See *S.E.C.* v. *Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959).

had acquired his shares, and he sought no information from Worldwide itself or from its transfer agent.[20] Under the circumstances it is clear that his transactions were violative of Section 5, and that his violations were willful.[21]

PUBLIC INTEREST

Coughenour urges that the public interest does not require his suspension and that at most his conduct warrants only censure. He asserts that he believed that registration of the Worldwide shares was not required, and argues that his conduct constitutes at most a technical violation of complex provisions and rules. Coughenour points out that the 60,000 shares sold constituted about 2.3 percent of the shares outstanding and states that all were purchased by Birkenmayer & Co., a market-maker, which he asserts did not require the protection afforded by registration, and that Birkenmayer had in its possession the prospectus which had been used in the November 1967 registered offering and which he asserts contained current information concerning Worldwide. He notes that the price of the Worldwide stock increased substantially following the sales in question and claims that no public investors have been damaged. Coughenour further states that he has been engaged in the securities business for 15 years without previously committing any violations and that we have not in the past imposed substantial sanctions on a salesman solely for violations of Section 5.

In our view the factors presented by Coughenour are not sufficient to warrant a reduction of the 7-day suspension imposed on him by the examiner, which appears to us consonant with the nature of the violations and Coughenour's prior good record. We cannot agree with the characterization of the violations of the registration requirements, a keystone of the whole scheme of securities regulation, as technical. Nor is the

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. The attorney testified that he had not himself made a sufficient inquiry to have enabled him to give a legal opinion regarding the tradeability of the stock, but had been told by a Consolidated officer, an attorney who had represented that company in the negotiations with Baird, that it was free for sale, and the examiner found that the attorney merely reported that officer's views.

[20] Coughneour is not aided by his assertion that further inquiry would have failed to disclose any control relationship because in the view of those in a position to know such a relationship did not exist. We need not speculate as to what reasonable inquiry would have disclosed where no such inquiry is made. See *Strathmore Securities, Inc.*, 43 S.E.C. 575, 584 (1967), 407 F.2d 722 (C.A.D.C., 1969).

[21] We do not rely upon the examiner's finding, to which Coughenour has objected, that by Coughenour's sales of Worldwide stock he aided and abetted violations of Section 5 by his employer. That finding was not a material factor in the examiner's decision.

We reject Coughenour's contention that the examiner erred in failing to sever the proceedings as to him after settlement offers submitted by most of the other respondents were accepted during the course of the hearings. There is no indication that the examiner relied on evidence that was not relevant to the allegations against Coughenour and we have not considered any such evidence. *Cf. Clinton Engines Corporation*, 41 S.E.C. 408, 411 (1963).

fact that the price of the shares subsequently appreciated determinative of the seriousness of the violations. And while the interpretation of various exemptive provisions may present complexities, the basic concept here involved—that transactions by an underwriter, including one who has purchased securities from a person in a control relationship with the issuer, are not exempt—is clear and well established. Furthermore, although Birkenmayer was the initial purchaser, it must be presumed that some if not most or all of the shares were resold to public investors,[22] and no prospectus covering those shares was in existence.[23]

Accordingly, IT IS ORDERED that the registration as a broker and dealer of Herbert L. Wittow, doing business as Wittow & Company, be, and it hereby is, suspended for a period of 14 days and that Wittow be, and he hereby is, suspended from being associated with a broker or dealer for the same period.

IT IS FURTHER ORDERED that John F. Coughenour be, and he hereby is, suspended from being associated with a broker or dealer for a period of 7 days.

The suspensions are to commence with the opening of business on August 30, 1971.

By the Commission (Chairman CASEY and Commissioners OWENS, NEEDHAM and HERLONG).

[22] See *D. H. Blair & Co.*, 44 S.E.C. 318, 321 (1970); Op. Gen. Counsel, Securities Act Release No. 1862 (December 14, 1938).

[23] The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.