ADMINISTRATIVE PROCEEDING
FILE NO. 3-2601

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
MARTIN CIMENT d/b/a CROWN TRADING CO. MARTIN CIMENT JOHN WELLS	INITIAL DECISION
File No. 8-14730	(Private Proceedings)

Sidney L. Feiler
Hearing Examiner

Washington, D.C.
January 10, 1972

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APPEARANCES: Dennis J. Block, Marc N. Epstein, Stephen D. Oerstreich, Esqs.
of the New York Regional Office of the Commission,
for the Division of Trading and Markets

William Spilky, Esq., 11 Park Place, New York, New York 10007
for Martin Ciment and Martin Ciment d/b/a Crown Trading Co.
Wishod and Fisch, by Jerome Fisch, Esq., 225 Broadway,
New York, New York 10007, for John Wells

BEFORE: Sidney L. Feiler, Hearing Examiner

I. THE PROCEEDINGS

These are private proceedings instituted by order of the Commission pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, as amended ("Exchange Act") to determine whether certain allegations set forth in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.

The order for the proceedings sets forth allegations of the Division of Trading and Markets that during the period from on or about September 1969 through December 1969 Martin Ciment, a registered broker-dealer, doing business as an individual proprietor, under the firm name and style of Crown Trading Co., and John Wells, then employed as a registered representative and trader by Ciment, willfully violated and willfully aided and abetted violations of Sections 5(a) and (c) of the Securities Act of 1933, as amended ("Securities Act") in that they offered to sell, sold and delivered after sale, shares of the common stock of Control Metals Corporation ("Control Metals") when no registration statement was filed or in effect as to these securities pursuant to the Securities Act.1/

It is further alleged that on or about May 5 and May 6, 1970, Ciment and Wells, directly and indirectly, by placing a bid quotation with respect to the common stock of Select Enterprises, Inc., ("Select") in the daily quotation service of the National Quotation Bureau, Inc. ("pink sheets") willfully aided and abetted Select and others to engage in the offer and sale of securities of Select and by placing an ask quotation in these sheets offering shares of Select, for which no registration

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1/ Section 5 of the Securities Act provides, in pertinent part, that it shall be unlawful to make use of the instruments of transportation or communication in interstate commerce or of the mails to offer to sell or to sell a security unless a registration statement is in effect as to it.

statement had been filed, willfully violated section 5(a) and (c) of the Securities Act in connection with the offer and sale of securities of Select. It is also alleged that Ciment and Wells willfully violated and willfully 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 by means of their activities in the offer and sale of Select stock.[2/] Additionally it is alleged that Ciment failed reasonably to supervise Wells with a view to preventing the violations set forth in the order. The Respondents filed answers in which the material allegations of the order were denied.

Pursuant to notice a hearing was held in New York, New York. All parties were represented by counsel.[3/] After the conclusion of the evidentiary hearing, the Division and Wells filed proposed findings of fact, conclusions of law, and briefs in support thereof. Ciment submitted a memorandum in support of his contentions which the undersigned accepted for the record.

On the basis of the entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

2/ The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of material facts, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

3/ Ciment was represented by counsel at the evidentiary hearing only.

II. FINDINGS OF FACT AND LAW

A. The Respondents

Martin Ciment, doing business under the firm name and style of Crown Trading Co., a sole proprietorship, has been registered with the Commission as a broker-dealer, pursuant to Section 15(b) of the Exchange Act since May 21, 1969. He is a member of the National Association of Securities Dealers, a national securities association registered pursuant to Section 15A of the Exchange Act.

By letter dated May 21, 1970, Ciment informed the Commission that he had ceased doing business a week earlier and requested that his registration be "terminated." This matter is pending before the Commission. Prior to his registration, Ciment had eight months experience with another broker as trainee and registered representative.

According to Ciment, at the height of his firm's activities, he employed a total of 9 or 10 persons, 6 of whom were registered representatives and traders. Towards the end of the business of Crown Trading, there were 3 traders left. Ciment exercised supervision over all the employees, but devoted most of his time to "cage" or back office work.

John Wells was employed as a trader and representative at Crown Trading from July, 1969 until May, 1970. He is currently employed by a registered broker-dealer.

B. Activities of the Respondents with respect to the stock of Select

1. Background[4/]

4/ The findings in this section are derived in the main from an injunctive court proceeding which will be referred in more detail later.

Select, formerly known as Goldfield Candelaria Cooperative Mining Company, a Nevada corporation was incorporated in 1917. As of December, 1969 it had no assets, liabilities or business activities and was in fact a corporate shell. It had 1,156,603 shares authorized and outstanding, but its stock had never been registered with the Commission and was not publicly traded.

In early January, 1970 Joseph T. Boyd, a promoter, purchased a substantial majority of the Goldfield shares from another person who had accumulated them, and changed the name of the company to Select.

On January 22, 1970, Boyd transferred 90,000 shares of Select stock into the names of his associates. These associates, including a J. J. Joiner, all assumed managerial roles in Select.

Within a few days, Boyd had made an arrangement with a broker whereby in exchange for 100,000 shares of Select, this broker would start and maintain a market in Select stock at a price of approximately $15 a share, the price Boyd wished to see established so that pending acquisitions negotiated in exchange for Select stock could be completed.

Other brokers were enlisted in the scheme and quotations were inserted in the pink sheets by the participants commencing on February 6. Nominee accounts were used in furtherance of the plan and there was activity, both buying and selling by the group. A high of 17 3/4 was achieved in late February.

Financial statements were issued which were used to further the plan to inflate the price of Select stock. Boyd and an associate prepared and released a financial statement dated January 27, 1970 which substantially overstated the assets of Select and which was false and

misleading. A certified statement, dated March 5, 1970, was also released to the public. Assets were set forth as worth 49 million. In fact this statement was false and misleading in that over half the dollar value of the assets indicated therein was for land in California, a large part of which was owned by the United States Government.

On April 2, 1970 the Commission issued an order suspending trading in Select for 10 days (Sec. Exch. Act Rel. No. 8857). It noted the lack of adequate and accurate information concerning the operations and financial condition of Select, the fact that its shares had not been registered, and the recent market activity in these shares. It warned broker-dealers to carefully consider the information noted in the order. It then stated:

> "The Commission cautions broker-dealers that before effecting transactions in the securities of Select, they have the obligation of assuring themselves that such transactions do not involve a violation of the anti-fraud provisions and are in compliance with the registration and other applicable provisions of the Federal securities law . . . .In addition, brokers and dealers who publish quotations and trade in such securities should assure themselves that they are not engaging in activities which make them participants in violation of the registration provisions of the Securities Act or the anti-fraud and anti-manipulative provisions of the Securities Act and the Securities Exchange Act." (Div. Exh. 3)

2. The Barker Order[5/]

No quotations for Select appeared in the pink sheets between April 2, 1970 and May 5, 1970. A short time prior to May 5 Wells received a telephone call from a Virgil Barker in Denver. Wells had never met Barker, but the latter told him he had been referred by a promoter whom Wells had met socially in Las Vegas.

5/ These findings are based on the testimony of Wells and Ciment since they involve internal office procedures at Crown Trading.

Barker gave Wells an order to purchase 500 shares of Select at $12 per share. Wells prepared an order ticket and a new account card for the files.[6/] Wells checked the pink sheets and could not find any current quotations for Select. He did find that Select had been quoted in February by two brokers.

Wells told Barker that he would have to place a quotation in the pink sheets to complete his order and would need a balance sheet for Select before he would do that. Barker mailed Wells a list of Officers, directors, and agents of Select (Div. Exh. - 16A), a letter to Select stockholders from its president, dated March 28, 1970 (Div. Exh. - 16B), and a certified financial statement, dated the same date (Div. Exh. - 16C). He also told Wells that he could check with Boyd whom he described as "close" to the company for further information. Wells telephoned Boyd and was told that there were ten million shares authorized of which two million shares were issued and outstanding, and 300,000 shares were "free trading." Wells, after receiving permission from Ciment submitted quotations to be published in the pink sheets. The issues for May 5 and 6[7/] show Crown Trading listed as the sole broker dealing in Select and at $12 bid and $15 asked (Div. Exhs. 2-A & B).

6/ The account card was unsigned. Wells and Ciment both maintained that a signed card was received from Barker later. However, it was not produced at the hearing. No investigation was made of Barker's credit reference or other background personal information he gave Wells in opening his account.

7/ These issues would have been distributed on the day following the publication date.

Wells testified at the hearing that his filing of quotations for a two-sided market was a mistake, that he, as a matter of practice, submitted such bids in other stocks in which he was dealing for Crown Trading (Tr. 175 - 178). However, on May 6, 1970 Wells was called to the New York Regional Office of the Commission and testified under oath. At that time he stated in response to the question why he entered bids on both sides of the market, "Well, I thought if I could sell 100 shares at $15.00 then I could be a market maker and possibly have a profit for the firm," (Div. Exh. 23 p. 20). He gave similar testimony at an injunctive court proceeding on October 9, 1970 (Div. Exh. 1D p. 531 - 533). The undersigned concludes from this evidence and his evaluation of the complete testimony of the witness, that the two-sided bid and ask on Select stock entered by Wells in the pink sheets was deliberate and intentional.

3. The Transaction with Essex Securities

When Wells was examined at the New York Regional Office of the Commission on May 6, 1970 the Barker order and Wells' knowledge of Select were the main subjects of the inquiry. Wells learned that Select had been previously suspended from trading by the Commission. The next day, May 7, Wells received a telephone call from another broker, Essex Securities, in Denver, Colorado offering 200 shares of Select. Wells made a purchase at the price of $11 per share. The next day Essex requested that the trade be cancelled. Wells conferred with Ciment and the latter directed that this be done. No further transactions were made in Select stock by the Respondents nor were there any further

quotations for Select placed by them in the pink sheets.

4. Other Contemporaneous Activities in Select Stock.

At or about the time that the Barker order was being processed at Crown Trading an Ernest Mullenax was busily engaged in using Select stock to his financial advantage.

Mullenax had obtained three loans from the Home State Bank of McPherson, Kansas. These loans totalling $45,000 which were due in April, June, and July 1969 were in default as of May 8, 1970. The bank had been pressing for repayment without success. On May 8, 1970 Mullenax telephoned Richard Nichols, president of the bank, gave him an optimistic report of his financial condition and prospects, and promised to pay off his loans by May 16. He also asked whether Nichols would like some additional security (the loans made to him were only partly secured). When Nichols said that he certainly would, Mullenax replied that he would bring in 10,000 shares of Select which, he stated, were valued at $12 a share. The next day, Mullenax gave Nichols one 10,000 share certificate registered in the name of J.J. Joiner (one of the associates of Boyd) with a stock power affixed signed by Joiner. He stated that Select was actively traded in a number of different markets and that the price was 12 bid, 14 asked. He produced a news release from Select, dated March 28, 1970. On the back of this document he wrote a list of brokers whom, he said, were making a market in Select. The first name was that of Crown Securities and also included the name, "John Wells."

The following week Nichols attempted to reach the brokers mentioned by Mullenax. One broker told him he was not making a market in Select, but that he understood that only Crown Securities was making a market. Nichols then telephoned Crown and asked for Wells after stating who he

was and that he had some Select stock and wanted to "know about it." After a long pause he was told they were busy and he should call back. Nichols made no further effort to reach Crown or Wells. Nichols was informed on May 18 that no one was making a market in Select stock then. Nichols further testified that Mullenax told him that the Select stock was actively traded and that it was listed in the pink sheets. The aforementioned loans continued in default and Mullenax is now bankrupt.8/

William Collins is a senior vice-president of the State National Bank of Alabama, Decatur, Alabama. He testified that he first met Mullenax approximately three months prior to May 8, 1970 when a Donald Rouse introduced him. Rouse was chairman of the Board of an investment concern known as the Joint Talent Group which controlled an insurance company, Continental General Insurance Company. They were clients of the bank. Collins was told that Mullenax was going to make an investment in Continental and become its president.

A few days before May 8, Mullenax asked Collins for a bank loan of $60,000 offering Select stock as collateral. He gave Collins two 10,000 share certificates with powers attached, one in the name of Boyd and one in the name of Joiner, a personal financial statement showing a substantial net worth, and some material on Select, including the certified financial statement previously referred to. He told Collins that Select was listed in the pink sheets. According to Collins, Mullenax gave him a list of brokers whom he said were making a market in Select (Div. Exh. 36). Four names were typewritten and a fifth was handwritten, "Crown Securities - N. Y. City - John Wells, Broker." He suggested that Collins check with Crown. Collins told Mullenax that he would need

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8/ The above findings are based on the testimony of Nichols which the undersigned concluded was candid and clear and has been credited.

time to do some checking.

Continuing his testimony, Collins stated that he checked credit references submitted by Mullenax and was satisfied with the information he received. He asked a local broker to find out what he could about Select and received a report that the stock was listed in the pink sheets and was quoted at $12 - $14. Collins further testified that he telephoned Crown, asked for Wells, identified himself to the person who responded and said he understood Crown was making a market in Select and asked what the price of the stock was and whether the sale of a 10,000 share block would affect the price. He was told that the market was $12 - $14 and that the sale of a large block would affect the price. Collins declared that he was influenced to make the loan by the two reports that there was a market for the stock and there was a possibility of trading in it (Tr. 414).

On May 8, 1970, the loan of $60,000 to Mullenax was made by Collins on behalf of the bank secured by the 20,000 shares of Select. Later in the month Mullenax was given a $5,000 unsecured loan. Of the $60,000 Mullenax received, $20,000 was used to pay off a loan of the then president of Continental which was then in default and the collateral securing it was turned over to Mullenax. Mullenax also agreed that one of the 10,000 Select certificates he turned over could be used as cross-collateral on a bank loan to Joint Talent. Mullenax never made any payments on the $60,000 loan which is currently in default.

Wells testified that while he did receive some telephone calls during the time Crown Trading was quoting Select those were from brokers and that no others made any inquiries of him about that stock nor specifically did he receive any calls on Select from persons who identified

themselves as bankers. He further testified that he had had no dealing with Boyd prior to telephoning him at Barker's suggestion a few days after receiving material on Select from Barker and first met Boyd personally in May or June. He also identified a Tony Lay as a Canadian promoter he had met briefly in Las Vegas and with whom he had had some telephone discussions later. He denied that he had even discussed Boyd or Select with Lay nor did he send the latter a telegram (Tr. 179 - 183). However, evidence introduced at the hearing establishes that on May 24, 1970 Wells, while staying at a Boston hotel sent a telegram to Lay stating, "PLEASE CONTACT ME OR JERRY ROSEN OR GEORGE FRYER. GEORGE FRYER TALKED TO THE SEC AND EVERYTHING IS ALRIGHT. ALSO JOE BOYD FROM TEXAS WANTS TO SEE US THIS WEEK IN TEXAS . . ." (Div. Exh. 21).

The undersigned concludes from this evidence, which obviously refutes the testimony of Wells; as well as other testimony of Wells which the undersigned has not credited, that the credibility of his entire testimony is in serious question.

The testimony of Collins has been attacked on a number of grounds. It is urged that there were discrepancies in his testimony as to the dates when he had discussions with Mullenax or other persons, that he was not sure whether the call made to Crown was person-to-person or station-to-station[9/] and that there is doubt that the person he claimed he spoke to was Wells. Additionally, it is pointed out that Collins

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9/ Telephone Company records show only one station-to-station call from the bank to the Crown number on the date the loan was made. (Wells Exh. 15 and 17)

testified that during a conversation he had with Mullenax on May 8, 1970 during which Mullenax suggested he telephone Crown Trading to check on Select, Mullenax said he was then going to telephone Crown Trading and went into another room to do so. There is no record of two telephone calls on that day to Crown. It also is contended, in substance that Collins did not make a careful check of the personal financial information supplied by Mullenax nor the market information he received on Select and did not rely on the Select stock as collateral, but made the loan to obtain payment on a $20,000 loan then in default and in the hope that Mullenax would be able to meet his obligation out of his other assets.

The undersigned, from his observation of the witnesses and from his evaluation of their testimony credits the testimony of Collins that he did telephone Crown Trading and spoke with Wells with reference to Select and that he relied on the information he received on the market for Select in making the loan. While Mullenax told Collins on May 8 that he was going to telephone Crown Trading, the alleged call was supposedly made from another office and there is no proof it was actually made. Indeed, the Respondent Wells relies in part on the contention that no link from him to Mullenax has been established. Collins admitted freely that he was not sure of the dates when some of the discussions with Mullenax and others he testified to took place. However, Mullenax had never done business with Collins before. The Select stock was the only collateral he offered. The undersigned credits Collins' affirmation that he did rely, in part, on the value of the Select stock to secure the loan. His testimony as to the substance of his telephone call to

Wells was clear and candid and included information helpful to Wells. His identification of Wells as the person he had spoken with gains credence from the fact that at the time the telephone call was made there were only two traders employed by Crown.[10] According to Ciment, he devoted his time to back office work and each trader took care of a specific list of stocks. It is highly unlikely under those circumstances that anyone at Crown would have spoken with Collins about Select, except Wells. Also Wells merely reiterated information he had placed in the pink sheets.

5. The Injunction Proceeding

In September 1970, the Commission instituted proceedings against Select and other defendants seeking to enjoin them from further violations of the registration, anti-manipulation, and anti- fraud provisions of the federal securities laws in connection with the offer, or purchase and sale of Select stock. Among those named were Boyd, Joiner, Crown Trading, Wells, and Barker. Ciment consented to a final judgment of permanent injunction (Div. Exh. 5-E). After a formal hearing a preliminary injunction was issued against other defendants, but not against Wells (Div. Exh. 1-E). Subsequently final judgments of permanent injunction were issued against many of the defendants in the above action, including Boyd, Joiner, and Barker. These were obtained on default.[11] No further hearing was held with reference to Wells. Mullenax was not a party to the action.

10/ Div. Exh. 1-D, p. 37

11/ See SEC Litigation Releases 4742, 4834, 4946, and 4993.

6. Contentions of the Parties; Conclusions

a. Effect of the Injunction Action.

Respondent Wells argues that his conduct with respect to the stock of Select was fully examined and litigated in the injunction action instituted by the Commission and he was found innocent of any wrongdoing. In any event, it is further urged, that even if the doctrines of res adjudicata or collateral estoppel do not apply, there should not be a re-litigation of his alleged misconduct.

The hearing on the application for a preliminary injunction, while of some length did not focus on the activities of Wells, but rather on that of the promoters. Wells testified briefly, but no further evidence was presented with specific regard to the effect of his activities. The record merely established that he placed bids in the pink sheets and made one trade which was cancelled (Div. Exh. 1-E, p. 12 - 13).

In his decision, Judge McLean stated:

> "My problem is what to do with its employee, Mr. Wells. The evidence is not very strong about Wells. As I said before, he participated only at the end. He did get in the Pink Sheets at the end, and he did it by putting an offer to sell as well as an offer to buy. He did act perhaps somewhat strangely. But he didn't actually do anything. As soon as the SEC complained, he stopped. And I think I will give Mr. Wells a break, if you want to call it that. And we will say that so far he hasn't violated the 10B(5) ruling. . . ." (Div. Exh. 1-E p. 33 - 34)

He also observed,

> " . . .Whether some of the people that I have let off from preliminary injunction will find themselves permanently enjoined at the trial is something that will have to wait for the trial and the evidence offered."(supra, p. 36).

It is clear that the injunction action was not intended to and does not constitute a bar to a further inquiry into the conduct of Wells and its effect. The contention is rejected.

b. Violations of the Registration Provisions of the Securities Act

It is alleged in the order for these proceedings that:

"During the period on or about May 5th and 6th, 1970 Ciment and Wells directly and indirectly, by placing a $12 bid quotation for Select securities in the daily quotation service of the National Quotation Bureau ("the pink sheets"), wilfully aided and abetted Select and others to engage in the offer and sale of securities of Select and by placing an ask quotation in the pink sheets offering shares of Select at $15, wilfully violated Section 5(a) and (c) of the Securities Act in connection with the offer and sale of securities of Select . . ." (Par. B)

Section 5 of the Securities Act provides in pertinent part that it shall be unlawful for any person to make use of the facilities of interstate commerce or of the mails to sell or offer to sell or offer to buy any security unless a registration statement has been filed as to such security. No registration statement was ever filed as to the securities of Select. It also is undisputed that Wells on behalf of Crown Trading entered bid and ask quotations of $12 bid and $15 ask for Select stock which quotations appeared in the pink sheet issues of May 5th and 6th 1970.

The ask quotations submitted by Wells were offers to sell Select stock and were clearly violative of Section 5.[12/] The two-sided quotations also aided Mullenax in his activities. It is contended on behalf of Wells however that a pledge of stock such as Mullenax made in his dealings with the two banks is not within the terms of "offer and sale of securities" as used in Section 5. The Division takes the opposite position. Counsel on both sides of the issue rely on the Guild Films case in support of their contentions.[13/]

12/ The testimony of Wells that his entry of the ask quotations was inadvertent has been rejected.

13/ SEC v. Guild Films Co., 178 F. Supp. 418 (S. D. N.Y. 1959), affirmed, 279 F. 2d 485 (2d Cir. 1960), cert. den. 364 U.S. 819 (1960)

The Guild Films case has been the object of much discussion in the courts[14] and by legal scholars.[15] However, it is unnecessary to consider the holdings in that case in detail in the context of the question at issue here. Section 2(3) of the Securities Act defines the terms "sale" and "offer to sell" as follows:

> "(3) The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell", "offer for sale", or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."

Mullenax did part with an interest in the Select stock when he pledged it to the banks.[16] Thus his activities come within those included under Section 5. The undersigned concludes that Wells violated and aided and abetted violations of Section 5 of the Securities Act.

The Division contends that the violations of Section 5 by Wells were willful within the meaning of the Securities Act. In opposition to this contention, it is urged that intent to defraud is an essential element in a violation of the provisions of the Securities Acts and that such intent has not been established. It is further asserted that this contention gains corroboration from the fact that Wells, himself, did not stand to gain any profits or any other benefits from the sale of Select stock. The term "willful" has been the subject of detailed definition by the Commission and the courts. The general standard applied by the Commission and approved by the courts is that "willful"..."...means

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14/ For example, see Fox v. Glickman Corporation, 253 F. Supp. 1005, 1011-12 (1966); American Bank and Trust Company in Monroe v. Joste, 323 F. Supp. 843, 845-46 (1970).

15/ Loss, Securities Regulation, 2d ed. vol. I p. 645-651, Supp. vol. IV p. 2623-2625.

16/ Loss, supra, vol. I p. 649

intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.[17] The undersigned, therefore, concludes that the aforementioned violations of Wells were willful within the meaning of the Securities Acts.[18]

Ciment was in sole charge of the operations of Crown Trading. He approved Wells' entering quotations on Select in the pink sheets. According to his own testimony he exercised little supervision over his traders in this regard and permitted his traders to fix the bid and ask prices for stocks they traded. While he occasionally checked their order slips to the National Quotation Service, he was primarily interested in whether they were exceeding the number of quotations available to Crown Trading. The undersigned concludes that Ciment also willfully violated and willfully aided and abetted violations of the registration provisions of the Securities Act. The facilities of interstate commerce and of the mails were made use of by the Respondents in the aforementioned violations.

17/ Tager v. SEC, 344 F. 2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. SEC, 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co. 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959). See generally Loss, Securities Regulation, (1961 Ed.), Vol. II, pp. 1309-1312 (1969 Supp.), Vol. V, pp. 3368-3374.

18/ No proof of financial gain is required to support a charge of Section 5 violation (S.E.C. v. North American Research and Development Corp. (424 F. 2d 63, 81 (1970).

c. Violations of the Anti-Fraud Provisions of the Securities Acts

It is alleged in the order for these proceedings that the Respondents willfully violated and aided and abetted violations of the anti-fraud provisions of the Securities Acts. Specific conduct of the Respondents alleged to be violative of these provisions is that they did:

> (1) Place quotations for the securities of Select in the pink sheets at the arbitrary price of $12 bid and $15 ask and thereby create the appearance of a fair and bona fide market for Select securities;
>
> (2) place quotations for the securities of Select in the pink sheets at such arbitrary prices and thereby create the appearance that Select was a viable corporate entity with valuable assets and securities and with favorable business operations;
>
> (3) place such quotations for the securities of Select in the pink sheets pursuant to an arrangement with Select and others to aid Select and others to offer and sell securities of Select, to pledge Select stock for loans, and in order to induce others to make loans to Select and others;
>
> (4) engage in the activities described in subparagraphs 1, 2 and 3 without making a reasonable inquiry into or in complete disregard of information or lack of information concerning Select, its financial condition, operations, products, prospects, and information and warnings contained in the news release issued in connection with the Commission's suspension of trading in Select securities and termination thereof, and
>
> (5) make untrue statements of material facts and omit to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made not misleading concerning among other things the activities set forth in subparagraphs 1 through 4 above.

It is contended in defense to these allegations that the alleged misconduct with respect to Select stock does not fall within the purview or scope of the anti-fraud provisions of the Securities Acts. It is argued that the banks who were alleged to be defrauded were not "purchasers" or "sellers" of securities and Wells' alleged misconduct was not "in

connection with" the "purchase" or "sale" of securities as required under Rule 10b-5 of the Exchange Act.[19]

The legislative history of Section 10(b) of the Exchange Act makes plain that neither it, nor Rule 10b-5 which implements it, are to be narrowly construed. The legislative purpose was broad; the wording of the section is correspondingly broad; and the scope of the rule adopted by the Commission to enforce it should be held to be equally broad. One authority has stated of the "in connection with," clause it "is plainly and--one must assume--intentionally the loosest linkage, in any of the federal anti-fraud provisions, between a proscribed act and a security transaction".[20] Thus it has been held that the "in connection with" requirement in Section 10(b) and the Rule is satified when "- - -the device employed- - -be of a sort that would cause reasonable investors to rely thereon, and in connection therewith, so relying, cause them to purchase or sell a corporation's securities."[21]

Respondent Wells relies on the so-called, "purchaser-seller doctrine," as enunciated in Birnbaum v. Newport Steel Corp., 193 F.2d 461 (C.A. 21 1952). However, many decisions since then; including the Texas Gulf Sulphur decision, supra, have cast doubt on the scope or validity of that doctrine. It is hardly applicable where, as here charged, action is taken which reasonably can influence a substantial segment of the investing public and the Commission, seeking to protect the public

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19/ This Rule, in pertinent part, prohibits fraudulent conduct "in connection with the purchase or sale of any security."

20/ Bromberg, Securities Law: Fraud-SEC Rule 10b-5, Sec. 7.6(1), p. 190.21

21/ SEC v. Texas Gulf Sulphur Company, 401 F.2d 833, 860 (1968), cert. den. 394 U.S. 976 (1969); see also, Supt of Insurance v. Bankers Life and Casualty Company, et al. U.S. Supreme Court, CCH Securities Law Service ¶92, 724, 93262 (1971).

interest, takes appropriate action. ". . .Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media. . .if such assertions are false and misleading or are so incomplete as to mislead. . ." (Texas Gulf Sulphur, supra, p. 862).

It is concluded the conduct alleged in the order falls within the ambit of the anti-fraud provisions set forth above.

It is argued on behalf of Wells that, in any event, there has been a failure of proof that Wells committed any fraudulent acts. It is maintained that the entire case against him is based on his acceptance of an order from Barker to buy 500 shares of Select, his insertion of bid and ask prices in the pink sheets for two days,the alleged conversation with a bank official on the market price for Select, and his purchase of 200 shares of Select from another broker for Barker, which trade was cancelled at the request of the selling broker. This does not prove any fraudulent conduct, it is contended. These activities, it is claimed, differ from cases where manipulation occurs in a pattern of bids or transactions which should place a broker-dealer on inquiry. Other grounds urged are that a broker-dealer is not required to be an arbiter of the price or worth of a security, expecially when a customer fixes the price he is willing to pay, no relationship between Barker and Mullenax (who was not named in the civil injunction proceeding) has been established, and the obligation of a broker-dealer to make an investigation differs when he is acting as agent for a buyer from his responsibility when he is acting for a seller. . .In the former instance he need not be concerned with the registration of the stock, prospectus

requirements, etc. Here, it is argued, Wells owed no duty to investigate and, in any event, Wells did make an investigation. Finally, it is urged that the testimony of an expert witness produced by the Division refuted its own contentions.

The Division contends that the essence of the fraud committed here was the placing of fictitious quotations for Select in the pink sheets which bore no relation to the intrinsic value of Select stock or to the natural laws of supply and demand as they existed.

It is true, as has been pointed out, that many cases involving violations of the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Acts relate to conduct of broker-dealers in the distribution of unregistered securities and their use of the quotation sheets to further such a plan.[22/] However, this does not exhaust the misuses of quotation sheets to further illegal plans.

It has been pointed out in the Special Study of the Securities Markets that, "the"sheets" published by the National Quotation Bureau, Inc. . . .are the primary medium for the dissemination of wholesale or "inside" quotations among professionals. They are of crucial importance to the over-the-counter markets. . . .Professionals use the sheets to find and communicate buying and selling interests in securities and to judge activity."[23/] These quotations are affected with a public interest (Exchange Act, Sec. 2) and have been held to constitute proof of prevailing

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22/ See, e.g., "Distribution By Broker-Dealers of Unregistered Securities," Sec. Act Rel. No. 4445 (Feb. 2, 1962) and "Application of the Securities Act of 1933 and the Securities Exchange Act of 1934 to Spin Offs of Securities and Trading in the Securities of Inactive or Shell Corporations," Sec. Act Rel. No. 4982 (June 2, 1969), for a summary of Commission policy.

23/ Report of Special Study of Securities Market, Part 2, p. 585.

market prices.[24/]

Thus quotations may be used to establish apparent market prices bearing no relation to the intrinsic value of the security and for the purpose of deceiving others. The field of bank loans based on pledges of stock seems to be a fertile field for this activity.[25/] It is not necessary to carry out such a plan that actual trading activity take place. What is sought is the publication of quotations, either as bid or ask prices, or both, which can be pointed to as evidence of market price and value.

Broker-dealers have the obligation to take precautions to avoid aiding such frauds by inserting bid or ask prices[26/] or indicating a two-sided market. The Commission has pointed that the amount of inquiry which should be made depends on the circumstances.[27/]

A most important fact which emerges from the evidence is that the investigation conducted by Wells was not designed to obtain accurate information on Select stock. He received an order from a person whom

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24/ Merritt, Vickers Inc. v. SEC 353 F. 2d 293,296(C.A.2,1965)

25/ See, e.g., Franklin National Bank v. L.B. Meadows & Co., Inc., 318 F. Supp. 1339 (1970). Further details are contained in the Initial Decision in Alessandrini & Co. an administrative proceeding pending before the Commission. (Adm. Proc. 3-2391)

26/ See, Sales of Unregistered Securities by Broker-Dealers, Sec. Act Rel. No. 5168 p. 3 (June 7, 1971). While this release was issued after the dates of the transactions involved here, it merely restates existing requirements.

27/ See releases cited in footnote 22

he had never met who mentioned the name of another person Wells had met briefly and known only as a promoter. The order was for a stock unknown to Wells and which he could not find currently quoted. He made no effort to find out if the stock was registered nor did he attempt to find out why brokers who were actively quoting the stock previously had discontinued this activity. He would have thereby learned of the suspension order issued by the Commission[28/] which he claimed not to have known of, the questionable validity of information issued by the company, and possible violations of registration provisions.[29/] Instead he obtained material issued by the company and spoke with Boyd, a principal in Select. The Commission in the aforementioned releases and in numerous cases has stressed that the duty of inquiry is not satisfied by checking with persons who would have an interest in concealing true facts. The financial information Wells obtained from Barker was not accurate nor was the information he purportedly obtained from Boyd valid.

It is argued that no link from Mullenax and Boyd or Select to Wells has been established. However, Mullenax was using stock powers obtained from Boyd and another principal in Select, he referred to Wells by name as someone with whom the value of Select could be checked

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28/ Div. Exh. 3

29/ When he did learn of the suspension order this did not deter him from making a trade in Select the next day without making any further inquiry.

and he timed his loan requests to coincide with the insertion of quotations by Wells in the pink sheets. There was thus the precise timing and execution so characteristic of successful fraudulent stock activity.[30/] While Wells denied having any dealings with Boyd until well after the Select matter, the aforementioned telegram he sent to Tony Lay (see p.11) establishes that he was in close touch with Boyd a short time after he inserted quotations in the pink sheets and that that relationship had to have been in existence for some time before that.

Although a buyer is entitled to try to buy a security in the market place at as low a price as possible and to charge as high a price as possible in selling, quotations sheets may not be used to further a fraudulent plan. The quotations for Select inserted by Wells in the pink sheets gave the appearance of a bona fide two-sided market. They did not reflect the fact that Select had assets of dubious value and transactions had taken place in the stock which were questionable. The undersigned concludes that the quotations were inserted in the pink sheets as part of a plan to enable others to obtain loans on pledges of Select stock by fraudulent misrepresentations of the value of Select stock and that Wells willfully aided and abetted that scheme by his conduct and thereby willfully violated and aided and abetted violations of the anti-fraud provisions of the Securities Acts. Ciment had approved placing the quotations in the pink sheets and was aware of developments from the time Wells took the Barker order. Under these circumstances he is also found to have willfully violated the anti-fraud provisions of the Securities Acts by both approving Wells' conduct and failing to

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30/ See, SEC v. North American Research and Development Corp., 424 F. 2d 63, 68 (C.A. 2, 1970).

take appropriate preventative action as the person in charge of the operations of the Registrant.[31/]

C. Violations of the Securities Act in the Offer and Sale of the Common Stock of Control Metals, Inc.

It is alleged in the order for the proceedings that from on or about September 1969 through December 1969, Ciment and Wells willfully violated Section 5 of the Securities Act in that they offered to sell, sold, and delivered after sale, shares of the common stock of Control Metals when no registration statement was filed or in effect as to said securities pursuant to the Securities Act. The evidence on this issue relates to transactions by the Registrant on behalf of a customer, Harold Rothman.

In early September 1969, Wells received a telephone call from Jay Rapp, the principal of another broker-dealer firm, J.H. Rapp and Co. Rapp stated that he had a customer who had a large block of stock (Control Metals may or may not have been mentioned at that point) which he wanted to sell, but who wanted immediate payment on settlement day. Rapp said he could not do this and inquired whether Wells could handle the transaction. Wells suggested that the customer come to the office

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31/ The Division produced as an expert witness the manager of the over-the-counter trading department of a large broker-dealer firm. However, this witness did not have any experience in retail transactions with individuals. He could only speculate as to what would be appropriate in hypothetical situations proposed to him by counsel. Both sides have relied on bits of his testimony, but the undersigned has not found it of value in resolving the issues presented here.

of Crown Trading.[32/]

Rothman came to the offices of Crown and produced certificates for Control Metals stock in relatively small denominations totalling 200 to 300,000 shares (Tr. 118, 365). These certificates were issued in the name of Gardner Securities. He told Wells and Ciment that he had obtained the stock for his services as a promoter and putting companies together (Tr. 125, 366). He also produced two opinion letters from attorneys and stated that some of the stock was covered by those letters (Div. Exhs. 14A & B).

Ciment told Rothman that the signatures on the certificates had to be guaranteed. Rothman brought them back in a few hours in approved form. Ciment also checked with Gardner Securities and was told that Rothman owned the certificates and that his stock was "free trading." Ciment also checked with the tranfer agent of Control Metals and received the same assurance. Ciment then agreed to sell stock for Rothman.

Rothman opened an account with Crown Trading on September 10, 1969. He supplemented the original group of certificates by bringing in additional batches. Ultimately 530,000 shares were sold for his account at prices varying from 35¢ to 22¢ per share during September and October (Tr. 132-135) (Div. Exh. 28). In every instance Ciment checked with the transfer agent and was assured the stock could be sold. He usually had the stock transferred into the name of Crown before it was sold (Tr. 651). Wells made all the trades for the Rothman account, except perhaps in one instance, selling the stock in the over-the-counter market

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32/ The factual recital of the transactions between Crown Trading and Rothman is based primarily on the testimony of Wells and Ciment.

At that time approximately 20 to 25 broker-dealers were trading the stock.

Pursuant to the arrangement with Rothman, Ciment gave him checks in payment for the sales or mailed them to him as each trade was completed. A very substantial sum was involved. (checks issued to Rothman, almost all for Control Metals stock, totalled $124,856.25, Div. Exh. 29). The mails and the facilities of interstate commerce were used to complete the transactions.

Ciment and Wells made no effort to obtain more information from Rothman on the so-called "deals" he had made for which he had obtained the stock. Nor did they attempt to obtain more information on the background behind the opinion letters Rothman had produced. They made one unsuccessful attempt to telephone the offices of Control Metals. According to Ciment, he relied primarily on the assurances from the transfer agent (Tr. 378, Ciment Exhs. 1-4) and Rothman's assurance that he was not a member of a management or control group of Control Metals.

The aforementioned opinion letters dealt with the legal consequences flowing from a transaction whereby a corporation, Fountainhead International, Inc. sold certain Arizona mining interests to Control Metals in exchange for 3,000,000 of its authorized but unissued shares.

Background information on Fountainhead and the above transaction was supplied by Joseph Gold who worked as office manager from July to November 1969 for International Marketing Corporation, a corporation with offices in Washington, D.C. and controlled by a Seymour Pollack as sole stockholder. His testimony is credited.

In August 1969, Gold, on Pollack's instructions, picked up two men at a Washington airport and brought them to the office. One of the men was counsel to Control Metals; the other was a stockholder in

that company. They met with Pollack and his attorney out of the presence of Gold. Two documents were prepared and Pollack asked Gold to sign them.

One document headed, "Realty Purchase Agreement" was an agreement whereby Fountainhead International, Inc. a District of Columbia corporation agreed to sell its interest in certain Arizona mining claims to Control Metals in exchange for 3,000,000 authorized, but unissued shares of Control Metals. This document was signed by another office employee as president of Fountainhead and by Gold as secretary, (Div Exh. 7). Gold acted pursuant to the request of Pollack who told him he owned Fountainhead. The date of this transaction was August 1, 1969, according to Gold. Gold also signed a stock purchase agreement for Control Metals stock on behalf of International, but this document is not in evidence.

On August 6, Gold signed documents prepared by Pollack's counsel purporting to be a report of minutes of a meeting of the Board of Directors of Fountainhead authorizing the sale to Control Metals (Div. Exh. 11), minutes of a joint meeting of stockholders and directors of Fountainhead where a vote was allegedly taken to dissolve the corporation (Div. Exh. 9), and a document purporting to list the names of the stockholders of Fountainhead (Div. Exh. 10). These names were supplied by Pollack. Gold signed these documents as secretary of the corporation and testified no formal meeting as stated was held.

Continuing his testimony, Gold stated that sometime in August or September Pollack telephoned him and asked him to come to Phoenix immediately and meet him there. Pollack gave him a pile of Control Metal certificates and arranged by telephone with the Control Metals transfer

agent to break the certificates, which Gold would bring, into smaller denominations and to reissue them in the name of Gardner Securities. This was done (Tr. 47-48). Later Gold met Pollack and Rothman at the offices of Gardner Securities and drove Rothman to a bank where a pile of Control Metals certificates 3 or 4 inches thick in the name of Gardner Securities were guaranteed as to signature (Tr. 27-28). Gold was not sure of the date when this occurred.

Contentions of the Parties; Conclusions

No registration was ever filed with the Commission for Control Metals stock. Therefore there was a violation of Section 5 of the Securities Act in the offer and sale of the Rothman stock unless some exemption from the registration provisions can be established. The burden of proof is on the party seeking to establish the availability of an exemption.[33/] The exemption relied on must be strictly construed against the person claiming its benefit,[34/] as public policy strongly supports registration.[35/]

It is asserted on behalf of Wells that the stock sold for Rothman was exempted under Section 4(1) of the Securities Act and

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33/ SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953); Pennaluna & Co., Inc. v. SEC, 410 F. 2d 861 (C.A. 9, 1969), cert. den. 396 U.S. 1007 (1970); SEC v. Culpepper, 270 F. 2d 241, 246 (C.A. 2, 1959).

34/ U.S. v. Custer Channel - Wing Corp., 376 F. 2d 675, 678, cert. den. 389 U.S. 850 (1967); SEC v. Sunbeam Mines, 93 F. 2d 699 (C.A. 9, 1938).

35/ Garfield v. Strain, 320 F. 2d 116, 119 (C.A. 10, 1963).

Rule 133 promulgated by the Commission thereunder, and also Section 4(4).[36/] The Division maintains that Rothman was an underwriter within the meaning of the Securities Act and thus no exemption was available.[37/]

Control Metals in agreeing to issue its stock to Fountainhead was an issuer within the meaning of Section 2(4) of the Securities Act. The evidence establishes a definite link from it to Pollack and through Gold, to Rothman, Gardner Securities, and Crown Trading. While Pollack was not listed as a shareholder of Fountainhead, the evidence of his negotiation of the sale of the Fountainhead assets to Control Metals and the use of his employees as dummy officers of that corporation all point to the fact that he was in control of the operations of Fountainhead and made all important decisions concerning it. It also is evident that he controlled the disposition of the Control Metals stock issued to Fountainhead. Once he obtained a block of the stock he took prompt action to transfer it and the testimony of Gold establishes that Rothman was another link in the chain.

36/ Section 4 exempts certain transactions from the provisions of Section 5. Section 4(1) exempts "transactions by any person other than an issuer, underwriter, or dealer." Section 4(4) exempts broker's transactions executed upon customers' orders. Rule 133 deals with mergers and consolidations and will be discussed in detail later.

37/ The term "underwriter" is defined in Section 2(11) as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking. . . ."

It is evident that there was a sale of Fountainhead assets in exchange for Control Metals stock obtained from the issuer and that this stock was obtained with a view to its distribution. Pollack by his activities became an underwriter within the meaning of Section 2(11).[38/] It is not necessary to find that Pollack was a control person of Control Metals or that the amount of stock sold was a substantial portion of the Control Metals outstanding stock.[39/] The statutory definition of "underwriter" includes those who participates in a distribution, whether or not they are controlling persons or even stockholders.[40/] Therefore, Rothman, who actually sold the shares was a statutory underwriter. The exemption under Section 4(1) was not available.[41/]

Similarly, the exemption under Section 4(4) for brokers transactions was not available. This section was intended to exempt trading transactions subsequent to a distribution, but was not intended to exempt transactions by underwriters as part of a distribution.[42/]

38/ Quinn and Company, Inc. v. SEC --F. 2d. --(C.A. 10, Dec. 17, 1971), affirming Sec. Exch. Act Rel. No. 9062, (Jan. 25, 1971); Gilligan, Will & Co. v. SEC, 267 F. 2d. 461 (C.A. 2, 1959), cert. den. 361 U.S. 896.

39/ Quinn and Company, Inc., supra.

40/ SEC v. Chinese Consolidated Benevolent Association 120 F. 2d. 738 (C.A. 2, 1941), cert. den. 314 U.S. 618, "Distribution by Broker-Dealers of Unregistered Securities," Sec. Act Rel. No. 4445, p. 2 (Feb. 2, 1962).

41/ The exemption under Section 4(1) is also not available to dealer transactions. It is unnecessary to consider its application here. See, SEC v. Arco Industries, Inc. Fed. Sec. Law Rep. ¶ 92,972.

42/ Ira Haupt & Co., 23 SEC 589, 604, fn. 23 (1946).

It is further urged that Section 5 of the Securities Act does not apply to the activities of the Respondents because under the terms of Rule 133, issued by the Commission pursuant to the Securities Act, where an issuer acquires the assets of another corporation in exchange for such assets, and the selling corporation dissolves and distributes the issuer's stock to its shareholders, such transactions are exempt from registration and subsequent sales of such unregistered stock by the shareholders of the dissolved corporation are not violations of the Securities Act. This contention is without merit.

Under Rule 133(a) no sale for purposes of Section 5 is deemed to take place where the stockholders of a corporation vote for a merger or transfer of assets to another corporation in exchange for stock. However, it is further provided that if these securities are thereafter used for the purposes of making a statutory distribution the liability of an underwriter within the meaning of Section 2(11) would result (b and c). The Commission has defined the limits of Rule 133 as follows:

> ". . . .The theory of Rule 133 is that no sale to stockholders is involved where the vote of stockholders as a group authorizes a corporate act such as a transfer of assets for stock of another corporation, a merger or a consolidation because there is not present the element of individual consent ordinarily required for a "sale" in the contractual sense. However, this does not mean that the stock issued under such a plan is "free" stock which need not be registered insofar as subsequent sales are concerned. Unless the Securities Act provides an exemption for a subsequent sale of such non-registered stock, registration would be required. Of course, subsequent casual sales of such stock by non-controlling stockholders which follow the normal pattern of trading in the stock would be deemed exempt from the provisions of Section 5 of that Act as transactions not involving an issuer, underwriter or dealer under the first clause of Section 4(1) of the Securities Act. However, if the issuer or persons acting on its behalf participate in arrangements for a distribution to the public of any of the stock issued to stockholders or have knowledge of a plan of distribution by, or concerted action on the part of, such stockholders to effect a public distribution in connection with the transaction, a Section 4(1) exemption would not be available

since an underwriting within the meaning of the statute would be involved.

Where there is a pre-existing plan, as in this case, to use stockholders merely as a conduit for distributing a substantial amount of securities to the public, Rule 133 can not be relied upon by the issuer. As stated by the United States District Court for the Southern District of New York in Securities and Exchange Commission v. Micro-Moisture Controls, Inc., Rule 133 is not applicable to an "exchange" of assets for stock which is "but a step in the major activity of selling the stock.". . In any event, where the persons negotiating an exchange, merger or similar transaction have sufficient control of the voting stock to make a vote of stockholders a mere formality, Rule 133 does not apply. In such case the transaction is not corporate action in a real sense, but rather is action reflecting the consent of the persons in control, and consequently results in a "sale" as to them. Therefore, if an exemption from registration is available it must be found in the statute and can not be based on Rule 133." (footnote omitted)[43/]

Rule 133 was not intended to and cannot be used to validate a distribution as part of a stock-selling scheme. The evidence indicates that the stock transaction between Fountainhead and Control Metals was used to funnel unregistered stock in substantial amounts into the public market.[44/]

The corporate action allegedly taken by Fountainhead authorizing this merger was of the type criticized by the Commission in the Great Sweet Grass case. Regardless of the paper record, it is clear that Pollack was in complete control of Fountainhead and did whatever he wanted to do with it by the use of dummy officers and other devices.[45/]

43/ Great Sweet Grass Oils, Ltd., 37 SEC 683, 690 (1957), Aff'd per curiam sub. nom., Great Sweet Grass Oils, Ltd. v. SEC, 256 F. 2d. 893 (C.A.D.C. 1958). Accord, Operator Consolidated Mines Company, 39 SEC 580, 586 (1959); Consolidated Virginia Mining Company, 39 SEC 705, 709 (1960).

44/ On December 4, 1969, the Commission issued an order temporarily suspending trading in Control Metals stating that certain persons might be selling its shares in violation of the registration provisions of the Securities Act. (Exch. Act Rel. No. 8766)

45/ See also, Strathmore Securities, Inc., Sec. Exch. Act Rel. No. 8207 (1967), Aff'd on other grounds. 407 F. 2d. 722 (C.A.D.C. 1969), Sec. Act Rel. No. 4982 (Ju. 2, 1969).

It is also provided in Rule 133(d) that a person shall not be deemed to be an underwriter or to be engaged in a distribution with respect to securities acquired in a merger or sale of assets which are sold in broker's transactions within the meaning of Section 4(4) of the Act. As previously pointed out, these transactions were not the type of trading transactions covered by the Rule.[46/] Also, the sub-section notes a 1% rule of securities outstanding applicable to such trades in a six months period. This limit was exceeded in the Rothman trades since at the relevant time there were thirteen or fourteen million Control Metals shares outstanding. It is therefore concluded that Rule 133 does not afford the Respondents any exemption from Section 5.

It is further asserted that even if no exemption from registration was available for the stock sold by Respondents, there was no willful violation committed since Wells (and the same argument would apply to Ciment who did not file a brief) did everything possible to check the exempt status of the Control Metals stock he sold, made diligent inquiry, received opinion letters from counsel stating the stock was exempt, and went further by checking with the transfer agent from whom the same advice was received. It is also pointed out that at that time and later a substantial number of brokers were trading in the Control Metals stock.

The Commission has in many decisions stressed the duty of broker-dealers to make very careful investigation to make sure they do not participate in distributions of unregistered stock. It has summarized

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46/ Quinn and Co., supra

applicable principles in the special releases, previously referred to.[47/]

In Sec. Act Rel. No. 4445 it stated:

> ". . . .Section 4(1) exempts trading transactions between individual investors with respect to securities already issued. It does not exempt distributions by issuers or control persons or acts of other individuals who engage in steps necessary to such distributions. Consequently, a dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."
>
> The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.
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> The problem becomes particularly acute where substantial amounts of a previously little known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933. In such situations, it must be assumed that these securities emanate from the issuer or from persons controlling the issuer, unless some other source is known and the fact that the certificates may be registered in the names of various individuals could merely indicate that those responsible for the distribution are attempting to cover their tracks."

Rothman was not known to the Respondents. He gave them a highly suspicious story of acquiring the large block of shares he presented plus additional batches as a result of "deals" he allegedly arranged. Respondents made no effort to check for more details, but accepted assurances from those who would have an interest in arranging for the disposition of the shares. Under these circumstances, reliance on

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47/ See footnote 22

assurances from the transfer agent was insufficient.[48/] The transfer agent could furnish information on the state of the transfer records; he was not an arbiter of the validity of transactions of which he did not have full information.

If the Respondents had examined the opinion letters submitted to them, they would have had reason to pause. The first letter was a communication from counsel for Control Metals to its Board of Directors (Div. Exh. 14-A). In it, the counsel pointed out that he had made no independent investigation of the underlying facts, but relied on facts and documents supplied him. He pointed out there might be a Great Sweet Grass problem, but concluded there was none. He also dealt with the "underwriter" problem and concluded, "therefore, Rule 133(d) and (e) (and Rule 154) which permits sales without registration if it involves relatively small amounts of securities and is made in brokers houses (sic) as a casual sale of such shares by ■ noncontrolling stockholders, is applicable to them." Of course no casual sale was being attempted by Rothman, as Respondents could easily conclude from facts they knew. The writer of the second opinion letter (Div. Exh. 14-B) reached the same result as the writer of the prior letter with respect to casual sales of stock by non-controlling stockholders and the applicability of Rule 154.

The Commission has pointed out in the release quoted above and elsewhere that attorneys' opinions based upon hypothetical facts are

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48/ Stead v. SEC (C.A. 10, Jn. 2, 1971), CCH Fed. Sec. Law Rep. ¶93106.

worthless if the facts are not as specified, or if unspecified but vital facts are not considered (p.3). The Respondents made no independent investigation of the factual assumptions in the letters and, in fact, disregarded statements in them that should have alerted them to the necessity for further checking. It is concluded that both Ciment and Wells[49/] willfully[50/] committed violations of Section 5 of the Securities Act in the offer and sale of the stock of Control Metals.[51/]

D. Failure of Supervision

It is alleged in the order for these proceedings that Ciment failed reasonably to supervise Wells, who was subject to his supervision, with a view to preventing the violations of the Securities Acts and applicable rules committed by Wells (Section 15(b)(5)(E) of the Exchange Act).

Ciment had sole supervision over Wells. He knew what Wells was doing in both the Select and Control Metals securities. Under these circumstances the undersigned concludes that Ciment failed reasonably to supervise to prevent the violations by Wells.

49/ Wells directly participated in the violations. Although the Control Metal sales were authorized by Ciment, his employer, Wells had full knowledge of all the background circumstances and was under a duty not to join in the violations, Strathmore Securities, Inc., Sec. Exch. Act Rel. No. 8207, P.8 (1967)

50/ Where the circumstances are such as to impose a duty to investigate, a violation of that duty brings such conduct within the term, "willful" (Dlugash v. SEC, 373 F. 2d 107, 109 (C.A. 2, 1967).

51/ The fact that Control Metals was being actively traded on the over-the-counter market at the time of the Rothman sales does not validate the conduct of the Respondents. There is no general exemption for any and all transactions in a security. An exemption, if available, applies to a particular transaction. Respondents were under an obligation to make sure that an exemption was available for the stock they sold expecially under all the circumstances known to them.

III. CONCLUDING FINDINGS, PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(5) of the Exchange Act, so far as it is material herein, is required to censure, suspend for a period not exceeding twelve months or to revoke the registration of any broker or dealer if it finds that such action is in the public interest, and such broker or dealer, subsequent to becoming such, has willfully violated any provision of the Exchange Act, the Securities Act, or any rule or regulation thereunder. It also may, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, censure, bar, or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer if it finds that such sanction is in the public interest and that such person has willfully violated any provisions of the Exchange Act, the Securities Act, or any rule or regulation thereunder, or has failed reasonably to supervise, with a view to preventing violations of the Securities Acts or rules. Furthermore, pursuant to Section 15A of the Exchange Act, it may expel or suspend a member of a registered securities association who has violated any provision of the Securities Acts or rules and regulations thereunder.

It has been found that Martin Ciment, d/b/a Crown Trading Co., a sole proprietor, and John Wells, a registered representative and trader for Crown Trading Co., willfully violated the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Acts, and applicable rules thereunder, in the offer and sale of the common stock of Select Enterprises, Inc. It has also been found that Ciment and Wells further violated the registration provisions of the Securities Act in the offer and sale of the stock of Control Metals, Inc.

In addition, Ciment failed reasonably to supervise Wells with a view to preventing the violations by him of the Securities Acts and rules.

The Division urges that in view of the serious nature of the violations, it is in the public interest to revoke the registration of Ciment and to bar him and Wells from association with any broker-dealer. It maintains that the Respondents acted irresponsibly in the sale of Control Metals stock and have shown an inability to comply with the standards required in their quotations of and dealing in Select stock. It asserts that there has been shown a close relationship between Wells and Boyd in conjunction with the activities of Mullenax which compels the conclusion that Wells had actual knowledge of the fraudulent scheme to defraud banks.

On the other had, it is contended, on behalf of Wells, that with respect to the Select transaction, his alleged wrongdoing consisted of a single isolated act, which did not result in any security transaction, and which was minor, inconsequential and remote. With respect to Control Metals, it is argued that Wells did everything that could reasonably be expected of a careful and prudent man and was totally unaware of any connection between his customer and any control party and no further investigation would have led him to discover any connection. A bar order would be unjust, unfair, and not in the public interest, it is asserted.

Ciment, in a memorandum filed in his own behalf, stated that he took all possible precautions to comply with applicable rules and regulations; that he had checked Rothman's stock as free trading and saw that others were trading the stock; and that he did not know of the Select suspension order and stopped trading in that stock when he learned of the order.

The violations found were most serious and go to the heart of the Securities Acts.[52/] Under the best construction of the evidence for the Respondents, the records shows that they were guilty of gross carelessness and inefficiency in failing to take proper steps to see to it that they did not offer to sell and sell unregistered stock and thereby they aided and participated in schemes to defraud others and to unload unregistered stock in the over-the-counter market without taking steps necessary to see to it that there would be compliance with the registration provisions of the Securities Act and other statutory requirements. While the Respondents maintain that they took steps to carry out their responsibilities, their efforts were ineffective and incomplete under the circumstances. Such conduct constitutes a threat to the integrity of the securities markets and to the public interest. The activities of the Respondents in Select stock were not minor, inconsequential and remote, as it has been argued, but are directly related to the fraudulent bank loans negotiated by Mullenax based on the quotations inserted by the Respondents in quotation sheets. The investigations made of Rothman's Control Metals stock and of the Select stock were not designed to develop the complete facts.

On the other hand, there is no record of any other violation of the Securities Acts by either of the Respondents and there is evidence of their recognition of the obligations required of them in the public interest even though they did not carry them out fully in this case.

52/ "To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof. . ." (preamble, Securities Act); "To provide for the regulation. . .of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such. . .markets." (preamble, Exchange Act)

The undersigned concludes that under the circumstances a substantial period of suspension of the Respondents would be sufficient to deter future violations by the Respondents and others and would be appropriate in the public interest for the violations found. Accordingly,

IT IS ORDERED that the registration of the Registrant, Martin Ciment, d/b/a Crown Trading Co., as a broker-dealer is hereby suspended for a period of six months. After such period of suspension, the notice of withdrawal from registration previously filed by him shall be permitted to become effective.

ALSO ORDERED, that Martin Ciment is suspended from membership in the National Association of Securities Dealers and from association with any broker or dealer for six months.

FURTHER ORDERED that John Wells is suspended from association with any broker or dealer for six months.[53/]

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. This initial decision pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review

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53/ It is maintained on behalf of Wells that in a number of cases involving much more serious violations than are involved in this case, the Commission imposed either no sanctions or relatively minor ones. It is well established that the remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be determined by comparison with action taken in other cases. (Edward Sinclair, et al. Sec. Exch. Act Rel.No. 9115(1971), p.7 and cases cited in footnote 15 thereof, affd (C.A. 2, 1971), CCH Fed. Sec. Law Rep. ¶93094.)

pursuant to Rule 17(b) or 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 to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.[54/]

Sidney L. Feiler
Hearing Examiner

Washington, D.C.
January 10, 1972

54/ All contentions and proposed findings and conclusions have been carefully considered. This initial decision incorporates those which have been accepted and found necessary for incorporation therein.