ADMINISTRATIVE PROCEEDING
FILE NO. 3-5031

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

STANTON L. WHITNEY :

:

INITIAL DECISION

Washington, D.C.
March 3, 1977

Warren E. Blair
Chief Administrative Law Judge

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APPEARANCES: Gary S. Matsko, of the Boston Regional Office of the Commission, for the Division of Enforcement.

Steven B. Duke, for Stanton L. Whitney.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

These public proceedings were instituted on May 28, 1976 by Order of the Commission ("Order") pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"). The Order directed that a determination be made whether Stanton L. Whitney ("Whitney") had engaged in the misconduct charged by the Division of Enforcement ("Division"), and what, if any, remedial action is appropriate in the public interest.

In substance, the Division alleged that Whitney wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder during the period from approximately August 1, 1973 to July, 1974 and as part of the violative conduct and activities, Whitney misrepresented his authority to participate in transactions in securities belonging to the pension fund ("Fund") of the Town of Stratford, Connecticut ("Town"). The Division also alleged that, as part of the charged violation, Whitney delivered those securities to the securities firm of Thomson & McKinnon Auchincloss Kohlmeyer, Inc. ("Thomson McKinnon") without authority, concealing the fact that he was acting without authority, and creating the impression that he had authority to make that delivery.

Respondent appeared through counsel, who participated throughout the hearing. As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by the parties.

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

RESPONDENT

Whitney has been a registered representative associated with CNA Investor Services, Inc. ("CNA"), a broker-dealer registered pursuant to the Exchange Act, since 1968. Respondent sells mutual fund shares and variable annuities in that capacity, but that activity is secondary to an insurance business which he has operated in Fairfield, Connecticut for the last seven years.

FRAUDULENT CONDUCT

In June, 1972 the Stratford Pension Board ("Pension Board"), which governs the Fund, voted to change the manager of the Fund from City National Bank of Connecticut ("City National") to Connecticut General Life Insurance ("CG"). Before that decision could be implemented, an injunction against the shift was obtained by the Town employees union, resulting in the placing of a newspaper advertisement for new bids for management of the Fund. Whitney responded to that advertisement by submitting a bid on behalf of CG. With an eye toward a resolution of the dispute with the union, the Pension Board decided in May, 1973 to split the pension

assets evenly between City National and CG with the understanding that there would be a contest between the two managers for about two years.[1/] At the end of the period the manager making the better showing was to receive the entire fund for management. An escrow agreement under which CG was to receive its share of the Fund's assets was executed by CG and the Pension Board on October 16, 1973.[2/]

On or about March 18, 1974 City National prepared an evaluation of the Fund's portfolio and it was determined that the value of the portion to be managed by CG was $2,246,279. In April, 1974 the Town Director of Finance received from City National the securities intended for transfer to CG management and on May 17, 1974 those securities were picked up at the Director's office by Whitney, taken to New York City, and delivered into the possession of Thomson McKinnon.

Prior to his bidding on the Fund, Whitney was instrumental in CG receiving three other pension funds for management. In those instances he dealt with John Elliott,

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1/ In February, 1974 the injunction obtained by the employees union was dissolved.

2/ An escrow agreement is included in management arrangements undertaken by CG when assets other than cash are to be transferred to CG for liquidation and reinvestment.

CG's then New England pension fund manager, and received a commission from CG based upon a percentage of the assets that CG received for management. Whitney also talked to Elliott about the Fund in September, 1972 before entering the bid that led to CG being awarded half of the Fund's portfolio, and was present at a Pension Board meeting in February, 1973 when Elliott advised the Pension Board members that commissions payable to Whitney would be in a range between $700 and $35,000.[3/] Whitney calculated $34,000 to be his commission if CG followed the fee schedule previously used.

The amount of commissions to be paid to an agent out of Fund assets was a matter of some moment to the Pension Board and at some of the Board meetings attended by Elliott and Whitney, Board members expressed their concern on that point. Elliott eventually advised the Pension Board at its meeting on August 14, 1973, which Whitney also attended, that Whitney would be paid a "finder's fee" of $700 out of the Fund assets. At the same meeting the Pension Board voted to split the Fund's assets between City National and CG. Two days later, by letter dated August 16, 1973, Whitney

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3/ According to CG's schedule of fees payable, the lower limit would be payable as a finder's fee in connection with management for portfolio only and the upper end in case the Fund opted for "full service" management under which CG would be compensated for relieving the Pension Board of all management detail.

informed Alvin Rapps, a registered representative of Thomson McKinnon, of that action and wrote that arrangements had been made with Harold Bigler, a CG vice-president, to favor Thomson McKinnon, all other factors being equal, for services relating to the acquisition and disposition of securities. In fact, Bigler had not agreed that Thomson McKinnon should receive CG's favor as stated by Whitney.

In conversations leading up to Elliott's announcement at the August 14, 1973 Pension Board meeting that Whitney's compensation would be $700, Elliott and Whitney agreed during May, 1973 that a $700 fee was unreasonably low and they discussed a number of ways that indirect compensation might be paid to Whitney, the final idea being that payments might come out of commissions paid by CG to brokers on securities transactions. In June, 1973 the possibility of Whitney receiving indirect compensation was still being explored, Elliott contacting Bigler on the subject and Whitney checking with Stanley Hirsch, CNA Regional Director for Equity Sales. It appears that Elliott's inquiry did not receive a favorable reaction from Bigler, but that Elliott indicated the contrary to Whitney. Hirsch advised Whitney during July and August, 1973 in response to his June inquiry that indirect compensation could be generated based upon transactions executed over the major stock exchanges, and asked for the name of a securities firm acceptable to CG. Whitney then

spoke to Elliott and received approval of Thomson McKinnon.[4/]

Elliott and Whitney again discussed problems concerning commissions on securities transactions for the Fund portfolio in October and November, 1973. Elliott informed Whitney in those conversations that CG had decided, after talks between one of their officials and a representative of the Connecticut Insurance Department, that commissions should not be derived from trades effected for liquidation of Fund portfolio assets but that Whitney could still be compensated through commissions rising out of trading transactions for the Fund.

Apparently still concerned about the compensation question, Elliott met on December 7, 1973 with Bigler, Charles Stamm, the CG General Counsel, and Robert Jones, a CG vice-president in group pension operations, to review with the group Whitney's dissatisfaction with the finder's fee, a subject Elliott had mentioned to Jones a few days earlier. Bigler opposed the idea of indirectly compensating Whitney through brokerage commissions paid in connection with liquidation of the Fund portfolio.[5/] Elliott was

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4/ In August, 1973, CNA and Thomson McKinnon entered into a non-member access agreement which provided that CNA would conduct transactions on the New York Stock Exchange through Thomson McKinnon, with the latter retaining 60% of the commissions generated and giving CNA the remaining 40%. CNA would give its registered representative 50% of its share.

5/ Bigler and Jones understood that Elliott was proposing a plan for indirect compensation that Whitney had suggested.

advised before the meeting ended that the others in the group disapproved of providing additional compensation for Whitney through means of directing a broker effecting CG securities transactions to share commissions, and that they felt that commissions on the sale of securities of a pension plan should be a matter of public record, which in Whitney's case had been stated to the Pension Board to be $700. Elliott was instructed by Jones at the conclusion of the meeting to tell Whitney that CG would not be a party to the proposal for sharing commissions and about ten days later Elliott told Jones he had given the message to Whitney.

Elliott died in January, 1974 and in February, 1974 Lawrence English was appointed his successor. Whitney was introduced to English on April 3, 1974 at a meeting attended also by Frederick Castellani, then an underwriter in CG's Group Pension Department, and another CG employee. At that meeting English told Whitney that CG had taken the position that a liquidation of Fund securities by CG would not in any way involve Whitney or provide remuneration for him, and that CG would not utilize Thomson McKinnon. When Whitney indicated his displeasure and said that he had a different understanding with Elliott, he suggested English was in error, and English agreed to check once more with Jones, which he did that afternoon. The same afternoon, or next day, English telephoned Whitney and repeated his

conversation with Jones to the effect that there were no commitments to compensate Whitney beyond the $700 finder's fee. Either in that telephone conversation or at the earlier meeting Whitney asked for English's reaction to the possibility of Whitney's deriving additional compensation by acting on behalf of the Town, and English indicated that CG would have no objection, but that Whitney would have to persuade the Town to retain his services. Subsequently, Castellani sent a letter dated April 10, 1974 to Whitney, at Whitney's request for written confirmation, stating that CG recommended that Whitney "handle the liquidation of the securities for the Town directly," 6/ with cash proceeds of the liquidation to be directed to CG. Castellani went on to write that if the recommendation were found to be satisfactory, the Escrow Agreement would no longer be applicable and would have to be rescinded. He closed with a request that Whitney advise him or English whether the suggested arrangement "is satisfactory to all parties." In April, 1974 English spoke with Whitney on the telephone and asked him about his progress with Stratford and was led to believe that Whitney had been able to sell his services to the Town.

When Whitney picked up the Fund securities on May 17, 1974 from the Town Finance Director, he signed receipts

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6/ Div. Exh. 15.

which bore a typed legend that the securities were being received "For Conveyance To Connecticut General Insurance Company." Because a substantial amount of the securities were in the form of negotiable bearer bonds, Whitney asked for police protection. When such protection could not be arranged, Richard Caraglior, the Pension Board Chairman, accompanied Whitney to the New York offices of Thomson McKinnon. Whitney had called Rapps the day before and he was waiting for delivery of the Fund securities. While the securities were being checked by Thomson McKinnon office personnel, Rapps prepared a new account card in the name of "Town of Stratford Pension Fund Agency" and by entering upon the account card "For the Courtesy of CNA Inv. Serv. Inc." reflected that the account had been introduced by CNA. 7/ Rapps also indicated by entries on the card that the original confirmation should go to the Fund and a duplicate to CNA, and that a triplicate of the confirmation should be mailed to CG, attention of Bigler. But when Rapps had Whitney look the card over for accuracy, Whitney told Rapps that it was not necessary to send a triplicate to CG, causing Rapps later in the day to direct the Thomson McKinnon operations man to cancel the triplicate instructions.

7/ As a result of the credit for introducing the account, CNA would, by reason of its non-access agreement with Thomson McKinnon, receive compensation from commissions generated out of transactions in the account.

The securities that Whitney left with Thomas McKinnon could have been sold within two or three weeks after delivery, but sale was delayed while Rapps awaited instructions Whitney had said would be coming from the Pension Board Chairman. On a contrary note, about a week after delivering the securities to Thomson McKinnon, Whitney advised the Town Finance Director in a letter dated May 20, 1974 that the "[i]nvestment instructions will be forthcoming from Connecticut General's Investment Department next week." 8/

After delivering the securities to Thomson McKinnon, Whitney continued his attempts to induce the town to use his services and to that end asked English for another letter similar to the one dated April 10, 1974 that Castellani had addressed to him but addressed in this instance to the Pension Board Chairman and signed by a CG investment officer. In line with that request a letter dated May 29, 1974 on CG's letterhead was mailed to the Pension Board Chairman over the signature of Bigler. That letter repeated the recommendation for external liquidation and the need for rescission of the Escrow Agreement that were mentioned in Castellani's letter of April 10, 1974 to Whitney. In a letter to Town officials dated May 31, 1974 and also addressed to the Pension Board Chairman, Whitney pursued the recommendation of external liquidation in Bigler's letter of May 29, advising

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8/ Div. Exh. 7.

Caraglior that the draft letter which had been enclosed should be "re-typed verbatim on Town stationary, signed by you as Chairman and The Town seal affixed thereto," and then mailed to Thomson McKinnon, attention of Alvin Rapps.[9/] Upon receipt of Whitney's letter, Caraglior telephoned Whitney and was told that the alphabetical sequence of securities liquidation, scheduled in the draft letter enclosure to commence on June 10, 1974, was a method CG had selected.

Before any instructions were sent to Thomson McKinnon, Caraglior and Whitney met with the Town attorney, Anthony Copertino. In that meeting, held July 3, 1974, Copertino took the position that before external liquidation could go forward the Escrow Agreement would have to be rescinded and also that CG should give affirmative approval to the proposed alphabetical sequence of securities liquidation. Although Whitney assured Copertino that CG was aware of the liquidation formula and that CG had no objection to it, Copertino persisted in his view that a letter of recommendation or approval be forthcoming from CG. At Whitney's suggestion Copertino telephoned English, had a discussion of the matter with him, and was told by English that he would try to arrange to have the requested CG approval letter sent. Shortly thereafter, English, having determined that CG would not approve the proposed liquidation, informed Copertino of CG's

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9/ Div. Exh. 8.

decision.

During conversations with Copertino in July, 1974 English also became aware, contrary to the impression Whitney had created, that the Pension Board had not authorized liquidation of the Fund's securities through Thomson McKinnon and that CG alone was authorized to proceed with that liquidation. A number of other conversations then occurred in July, 1974 amongst Coraglior, Whitney, English, and Copertino wherein agreement was reached by them that the liquidation should proceed under CG's direction pursuant to the Escrow Agreement, but before any action was taken English learned that unless Thomson McKinnon did the liquidation it intended to charge the Fund $5,000 for services rendered.

The possibility of incurring that $5,000 expense resulted in decisions on August 6, 1974 by the Pension Board to rescind the Escrow Agreement and authorize Thomson McKinnon to proceed with the liquidation of the Fund's securities. Thomson McKinnon then sold the securities, charging the normal brokerage fees. Whitney received $3,500 as his share in those fees pursuant to the non-access agreement between Thomson McKinnon and CNA.

Under the circumstances reflected in the record, it is clear that Whitney wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Both his taking

of the Fund's securities on May 17, 1974, which deprived CG of the possession to which it was entitled under the Escrow Agreement, and his delivery of those securities to Thomson McKinnon were unauthorized acts forming part of a scheme to defraud. Both acts, singly and together, operated as a fraud or deceit upon the Pension Board and CG in connection with the sale of the Fund securities by Thomson McKinnon.

While the Division argues that Whitney's scheme had its inception with the letter of August 16, 1973 which Whitney wrote to Thomson McKinnon, the record does not support that contention. Rather it appears that during 1973 and until his death in January, 1974 Elliott may have led Whitney to believe that an arrangement might be worked out with CG's approval whereby Whitney could receive additional payment for efforts which Elliott agreed were worth more than the $700 fee that the Pension Board had been told would be the limit of Whitney's compensation. Elliott's death left available only Whitney's testimony concerning many of their discussions, but although self-serving, as observed by the Division, it remains credible with respect to the understanding that Whitney had with Elliott. Otherwise there would have been no reason for Whitney to insist at the meeting of April 3, 1974 that he had a different understanding with Elliott regarding his compensation and that English check

with his superiors on the accuracy of the $700 fee limitation. Whitney could not have reasonably hoped to accomplish anything by his demand unless Elliott had led him to believe that Bigler had endorsed the concept of indirect compensation.

Further, Elliott had good reason to equivocate in talking to Whitney on the subject. He realized, as did Whitney, that $700 was inadequate compensation and it is very likely that he was hoping to persuade his headquarters office to change its position on indirect payments to Whitney, as well as to eliminate the risk of alienating Whitney, the person the Pension Board was looking to in its negotiations with CG. 10/

But is is also concluded that following the April 3 meeting and the conversation a few days later in which English, after speaking to Jones, affirmed the $700 limitation, Whitney knew that he could not expect to receive indirect compensation from CG nor expect that CG would use Thomson McKinnon. He must have realized then that his remaining hope was to persuade the Pension Board to agree to rescind the Escrow Agreement and allow him to liquidate the Fund securities through Thomson McKinnon. It appears, however, that before he was able to accomplish the change in the liquidation

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10/ Although the Escrow Agreement had been executed in October, 1973, Elliott was interested in obtaining a "full service" contract from the Pension Board for CG.

procedures, Whitney received the call from the Town Finance Director to pick up the Fund securities. It is concluded that it was shortly after that call that Whitney decided to carry out his earlier arrangements with Thomson McKinnon in order to preserve his chance for compensation under CNA's non-access agreement with that firm while at the same time continuing to seek a change in the liquidation procedures.[11/] In keeping with that decision, it appears that Whitney's first overt act in carrying out his scheme was his telephone call to Rapps on May 16, 1974 to arrange for Thomson McKinnon to accept delivery of the Fund securities the next day.

Further evidence of Whitney's scheme is found in the instructions regarding the opening of a new account by Rapps to cover the Fund securities. If, as Whitney urges, the securities were delivered to Thomson McKinnon because he "naturally inferred that CG's decision to liquidate through Thomson was still in effect,"[12/] he would not have had reason to direct that a new account be opened at Thomson McKinnon in the name of "Town of Stratford Pension Fund Agency," nor to instruct Rapps not to send a triplicate confirmation to CG. Those instructions are consistent

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11/ It appears that Whitney would have accomplished his objectives except for Copertino's insistence that CG furnish the Town with a letter approving the alphabetical sequence of securities liquidation contemplated by Thomson McKinnon.

12/ Brief for the Respondent, at 8 (January 24, 1977).

with carrying out the scheme he had devised to delay a turnover of the Fund securities to CG control and inconsistent with respondent's claim that he was acting at least under color of implied authority from CG in taking possession of and delivering the securities to Thomson McKinnon.

Respondent argues extensively that there were no misrepresentations of material facts by him in connection with the purchase or sale of securities, and relying upon numerous cited cases, including Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), takes the position that a violation of Rule 10b-5 has not been proven. But, as the Division counters, the "various misrepresentations and failures to disclose promoted the purpose of the scheme, but . . . are not the essence of the scheme pleaded and proven." 13/ The scheme devised and carried out by respondent being fraudulent in nature in that by deceptive means it deprived the Pension Board and CG of rightful possession and control of the Fund securities, and respondent's acts and practices having operated as a fraud upon the Pension Board and CG, is not necessary to decide whether respondent made misrepresentations of material facts

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13/ Reply Brief for the Division of Enforcement, at 2 (February 11, 1977).

before finding that he violated Rule 10b-5.[14/] Respondent further contends that a Rule 10b-5 violation was not committed because the conduct in question was not in connection with the purchase or sale of any security; there being "no fraud relating to the securities themselves; no decison influenced."[15/] The construction that respondent places upon Rule 10b-5 is not supported by Blue Chip Stamps, supra, Bolger v. Laventhal, 381 F. Supp. 260 (E.D.N.Y. 1974) nor the other cases he has cited. While there is no question that as a necessary element of a Rule 10b-5 violation there be a nexus shown between the alleged misconduct and a securities transaction, it is also true that Rule 10b-5 may be "invoked where the fraud relates not, as in the usual case, to a particular securities

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14/ Rule 10b-5, 17 CFR 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

15/ Brief for the Respondent, at 23.

transaction but to a course of dealing in securities regardless of their identity." 16/ Here, respondent's "course of dealing" was in connection with the delayed liquidation of the Fund securities by Thomson McKinnon, and is sufficient to call Rule 10b-5 into play.

The argument that respondent advances on the question of the "wilfulness" of his violation is also rejected. Whether Ernst & Ernst v. Hochfelder 17/ is applicable to administrative proceedings instituted by the Commission so that scienter is required before a violation of Rule 10b-5 may be found "wilful" need not be determined here. Respondent not only knew what he was doing in the sense of consciousness of the acts that formed the violative course of conduct, but it is concluded that he knew that his actions entailed a deception, and that he intended to deceive within the meaning of Hochfelder, supra.

PUBLIC INTEREST

While the Division proposes that respondent be sanctioned because of his misconduct, the extent of the sanction it considers appropriate is not indicated. Respondent's position is that he was, at the very worst, careless, and that he

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16/ Arthur Lipper Corp. v. S.E.C., __F.2d__, CCH Fed. Sec. L. Rep. ¶95,796 at 90,864 (2d Cir. 1976).

17/ 425 U.S. 185 (1976).

deserves no sanction.

After careful consideration of the factors advanced by the parties on the question of sanctions, including the absence of previous disciplinary action against respondent, the nature and extent of respondent's misconduct, and the circumstances leading up to that misconduct, it is concluded that a suspension of respondent from association with any broker or dealer for a period of nine months is necessary in the public interest.

One of the Division's concerns in this matter is the difference between $1,542,871 realized as proceeds from the eventual liquidation of the Fund securities awarded for management by CG and the $2,021,000 market value of those securities on May 17, 1974, the day respondent delivered the securities to Thomson McKinnon. The Division attributes the erosion in the value of the securities to the delay caused by respondent through his deceptive conduct. However, it is not clear from the record how much blame for the delayed liquidation should be allocated to respondent and how much may be attributable to lack of diligence on the part of CG or Pension Board representatives, and no assessment has been attempted in connection with the consideration of the appropriate remedial action to be taken against

respondent.[18/]

Accordingly, IT IS ORDERED that Stanton L. Whitney is suspended from association with a broker or dealer for a period of nine (9) months from the effective date of this order.

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

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

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

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

Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
March 3, 1977