ADMINISTRATIVE PROCEEDING
FILE NO. 3-4981

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
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SECURITIES & EXCHANGE COMMISSION

In the Matter of

DOUGLASS AND CO., INC. et al.

INITIAL DECISION

Washington, D.C.
May 27, 1977

David J. Markun
Administrative Law Judge

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APPEARANCES: Thomas E. Boyle, Keith G. Galitz, Harold M. Golz, attorneys, Denver Regional Office, for the Division of Enforcement.

Gilbert L. McSwain, D. Elizabeth Wills, and William T. Hart of Keller, McSwain, Wing & Maxfield, Denver, Colorado, represented Respondents at the hearings and otherwise until January 10, 1977; proposed findings, conclusions, and supporting brief were filed on behalf of Respondents by Nelson, Harding, Marchetti, Leonard & Tate, Denver, Colorado, and Hanes & Gage, Cheyenne, Wyoming.

BEFORE: David J. Markun, Administrative Law Judge.

THE PROCEEDING

This public proceeding was instituted by an order of the Commission dated March 3, 1976 ("Order") 1/ pursuant to Sections 15(b) (15 U.S.C. §78o) and 19 (h) (15 U.S.C. §78s) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Respondents Douglass and Co. Inc. ("DOUGCO"), Donn Charles Douglass ("Douglass"), and six others 2/ wilfully violated or aided and abetted violations of various provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act and of regulations promulgated thereunder, whether Respondents DOUGCO, Douglass, and another failed reasonably to supervise others with a view to preventing violations allegedly committed by such other persons, and, lastly, to determine the remedial action, if any, that might be appropriate in the public interest.

In view of the settlements mentioned in footnote 2 above, this initial decision has applicability only to Respondents DOUGCO and Douglass ("Respondents"). The principal charges against these Respondents arise out of their trading the unregistered securities of Polaris Mining Company ("Polaris") in alleged violation of the registration requirements of the Securities Act and the antifraud provisions

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1/ In the course of the hearing the undersigned granted the Division's motion to amend the order for proceedings in various particulars, including various new charges and the inclusion of additional charges of net capital violations. ALJ Ex. #3.

2/ Settlement offers were accepted by the Commission from Robert Byron Stanat, Andrew P. Geiss, Stanley Roger Semin, Nolan Twibell, General Bond and Share Co., and Sam Clarence Pandolfo.

of the Securities Act and the Exchange Act and rules and regulations thereunder and their alleged failure to comply with net capital requirements at various times and with related notice requirements.

The evidentiary hearing was held in October and November, 1976, after which proposed findings of fact, conclusions of law, and supporting briefs were filed by the parties. 3/

The findings and conclusions herein are based upon the record and upon observation of the demeanor of the various witnesses. Preponderance of the evidence is the standard of proof applied.

FINDINGS OF FACT AND LAW

The Respondents

The Respondent DOUGCO, a Colorado corporation, has been registered as a broker-dealer under the Exchange Act since February of 1973. Its office is in Denver.

At all times material to the charges against Respondents (October, 1973 to October, 1976, the "revelant period") Respondent Douglass was the president, a director, principal trader, and owner of at least 25% of the outstanding stock of DOUGCO.

3/ On January 10, 1977, following Respondents' decision to engage substitute counsel, counsel who represented Respondents at the hearing withdrew and new counsel prepared Respondents' proposed findings, conclusions, and supporting brief. See "appearances" at p. 1 above.

Among the former Respondents who have entered into settlements with the Commission (see footnote 2 above) and to whom reference will need to be made in the course of this initial decision are: Robert B. Stanat ("Stanat") who had been at various times since February 9, 1973 and until about October 24, 1975, vice president, a director, and (directly and indirectly) the beneficial owner of more than 25% of the outstanding stock of DOUGCO; Nolan Twibell ("Twibell"), a minor stockholder of DOUGCO shares from November, 1974 and a registered representative of the firm at times material herein; Andrew P. Geiss ("Geiss"), a vice president and director of DOUGCO from October 1973 until June 1974, a minor shareholder of DOUGCO from February 1973 until June 1974, and a part-time registered representative of the firm at times material herein; and Stanley Roger Semin ("Semin"), a minor shareholder of DOUGCO from March 1973 until June 1974 and a part-time registered representative of the firm at times material herein.

Violations Involving Quotation and Sale of Polaris Stock

In late October of 1973 DOUGCO initiated a market in the common stock of Polaris by entering the stock in the "pink sheets" with the National Quotation Bureau, Inc. From that time until February 21, 1975, when trading in Polaris was suspended by the Commission, DOUGCO was the

principal market maker in Polaris, effecting numerous transactions in the stock both with other broker-dealers and its own, individual customers. The Division of Enforcement charges and contends that DOUGCO's activities with respect to Polaris caused Respondents, among other things to wilfully violate: (a) Section 15(c)(2) of the Exchange Act and Rule 15c2-11 [4/] thereunder, in that

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4/ 15 U.S.C. §78o(c)(2); 17 CFR §240. 15c2-11. Rule 15c2-11 provides in pertinent part as follows:

Rule 15c2-11. Initiation or Resumption of Quotations without Specified Information

(a) It shall be a fraudulent, manipulative and deceptive practice within the meaning of Section 15(c)(2) of the Act, for a broker or dealer to publish any quotation for a security or, directly or indirectly to submit any such quotation for publication, in any quotation medium (as defined in this rule) unless:

* * * *

(4) Such broker or dealer has in his records, and shall make reasonably available upon request to any person expressing an interest in a proposed transaction in the security with such broker or dealer, the following information (which shall be reasonably current in relation to the day the quotation is submitted), which he has no reasonable basis for believing is not true and correct or reasonably current, and which was obtained by him from sources which he has a reasonable basis for believing are reliable: (i) the exact name of the issuer and its predecessor (if any); (ii) the address of its principal executive offices; (iii) the state of incorporation, if it is a corporation; (iv) the exact title and class of the security; (v) the par or stated value of the security; (vi) the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year; (vii) the name and address of the transfer agent; (viii) the nature of the issuer's business; (ix) the nature of products or services offered; (x) the nature and extent of the issuer's facilities; (xi) the name of the chief executive officer and members of the board of directors; (xii) the issuer's most recent balance sheet and profit and loss and retained earnings statements; (xiii) similar financial information for such part

the information in DOUGCO's files concerning Polaris as required by the Rule was not reasonably current and that Respondents had no reasonable basis for believing the information in DOUGCO's possession to be true and correct and reasonably current and to have been obtained from reliable sources 5/; (b) the registration requirements of Sections 5(a) and 5(c) 6/ of the Securities Act, in that they offered and sold substantial quantities of unregistered shares of Polaris for which no exemption from registration was available; and (c) the anti-

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(Footnote 4/ continued)

4/ of the 2 preceding fiscal years as the issuer or its predecessor has been in existence; (xiv) whether the broker or dealer or any associated person is affiliated, directly or indirectly with the issuer; ... and (xvi) whether the quotation is being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person, directly or indirectly the beneficial owner of more than 10 percent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person ....

5/ The Division urges it was error to exclude Respondents' Wells Committee submission (Exh. 1D for identification) which it urges contains admissions of violations of Rules 15c2-11 and 15c3-3 under the Exchange Act. In view of the findings of violations of those Rules made herein the point would appear to be moot. In any event, the ruling made at the hearing (R. 133-149, 1078-1082) is adhered to.

6/ 15 U.S.C. §77e(a) and (c).

fraud provisions of Section 17(a) 7/ of the Securities Act and Section 10(b) 8/ of the Exchange Act and Rule 10b-5 9/ thereunder by (1) making false and misleading statements of material facts to purchasers of Polaris stock concerning the financial condition of Polaris and the value of its assets, (2) omitting to state to such purchasers various material facts necessary to keep various statements that were made from being misleading, (3) initiating and maintaining a market in Polaris stock without making reasonably diligent inquiry as to the financial condition of Polaris and as to its products, offices, officers and principals, and (4) maintaining, controlling and manipulating the market for Polaris stock and failing to disclose such facts to the purchasing investors. In addition, the Division charges and contends that Respondents failed reasonably to supervise others subject to their supervision with a view to preventing violations by such others of the statutes and rules mentioned above that are alleged to have occurred in connection with DOUGCO's transactions in Polaris.

Polaris was incorporated in Utah on June 24, 1937, and as of March 25, 1971 its authorized capital was 30,000,000 shares of common stock at $.01 par value. Polaris has never filed a registration statement with the Commission.

7/ 15 U.S.C. §77q(a).

8/ 15 U.S.C. §78j(b).

9/ 17 C.F.R. §240.10b-5.

In 1972 Polaris was a shell corporation, with no meaningful assets, liabilities, or operations. In that year control of Polaris was purchased from Richard Brown ("Brown") by Russell H. Twiford ("Twiford") and Jack D. Hill ("Hill") for about $6,000, for which consideration Twiford received approximately 3,000,000 shares of Polaris and Hill about 1,000,000 shares. In connection with the acquisition of control Twiford received from Brown all of the books and records of Polaris, including its stock-transfer records and blank stock certificates.

During the period covered by the charges respecting transactions in Polaris stock, Twiford was general manager of certain mining properties held or worked by the company in Arizona, ostensibly for mineral exploration. In September 1973 Robert J. Paul ("Paul") became vice president of Polaris and within two months he became president. Within the meaning of the pertinent securities laws, both Twiford and Paul were "control" persons of Polaris during the times material to the charges respecting transactions in Polaris stock.

On February 21, 1975, the Commission temporarily suspended trading in the stock of Polaris for a ten-day period, based upon the unavailability of current, accurate information as to the financial condition and assets of Polaris. On June 27, 1975, the Commission filed a civil action in the United States District Court

at Denver, Colorado, charging Polaris and certain individuals, including Twiford and Paul, with sale of unregistered Polaris securities and fraud in the sale of such securities. Thereafter, Polaris, Twiford, and Paul consented to the entry of permanent injunctions against them as sought in the complaint.

Polaris had no established trading market for its securities at the time Twiford and Hill acquired control of the corporation. In the fall of 1973 Twiford delivered the stock-transfer records of Polaris, which acted as its own stock transfer agent, to Paul. These records were incomplete in that, among other things, they did not show reliably the total number of shares outstanding or which shares were restricted and which were free-trading. Much of the stock held beneficially by Twiford and Hill had been placed in the names of their nominees.

Shortly after Twiford and Hill had purchased control of the Polaris shell from Brown they, along with Robert F. Wilkinson ("Wilkinson"), an associate of Twiford's who had advanced certain funds to Twiford on behalf of Polaris and had received Polaris stock from Twiford as consideration, met in Denver with Nolan Twibell ("Twibell"), a registered representative at DOUGCO, to obtain Twibell's assistance in finding a broker-dealer to make a market in the stock of Polaris. Twibell said he would try to get DOUGCO to initiate a market in Polaris but that it would cost Twiford about $1,500 to cover "expenses."

In connection with persuading DOUGCO to initiate a market in Polaris, Twiford provided DOUGCO through Twibell an instrument called a Disclosure Statement (Ex. 20A-1) that had been prepared by Polaris's attorney and a short unaudited financial statement (balance sheet) of Polaris dated June 1, 1973 (Ex. 20A-3). Another Polaris financial statement or "balance sheet", also dated June 1, 1973 (Ex. 20A-2) was also in DOUGCO's "due diligence" file prior to the time DOUGCO commenced making a market in the stock, but the source of this other statement, which differs in certain respects from Ex. 20A-3, is not established by the record.

On October 11, 1973, DOUGCO filed a notice signed by Douglass, with the National Quotation Bureau, Inc. seeking to insert an initial quotation on the stock of Polaris, which was not then being quoted. On October 17, 1973 DOUGCO entered its first bid and ask quotes on Polaris and continued to quote the stock until trading was suspended on February 21, 1975.

During the relevant period Douglass was the principal securities trader at DOUGCO and was responsible for its market making functions. It was he who decided to initiate a market in Polaris and to continue trading it during the mentioned period even after information came to his attention that should have prompted him to cease such trading flatly or at least, as respects some information that came to Douglass's attention, until further inquiry could be

made or until further information concerning Polaris could be obtained. Douglass had approximately 20 years of experience in the securities business and as a securities trader as of late 1973.

After DOUGCO commenced making a market in Polaris stock, a number of additional items were added to the "due diligence" file that DOUGCO kept on Polaris, but, as to most such items, the record does not indicate when they were received. This has no significant bearing on the charged Rule 15c2-11 violations, however, since such documents, whenever received, would not have justified a continuation of DOUGCO's trading of Polaris under the Rule.

On the basis of Twiford's representation to Twibell that Polaris lacked cash with which to pay the $1,500 "expenses" for DOUGCO's listing of Polaris in the pink sheets, Twibell agreed to accept instead 150,000 shares of Polaris stock. Twibell kept 75,000 of these shares, unknown to Douglass until considerably later, and the remaining 75,000 shares were divided equally by Douglass and Stanat as individuals, rather than inuring to DOUGCO. Douglass and Stanat testified they kept these shares personally because the two of them shared in the profits and losses of the trading account and that since there was not at the time an "errors account" in the trading department at DOUGCO it was convenient for them to personally absorb errors in the trading account and to reimburse themselves indirectly on an ad hoc basis by personally accepting the Polaris stock. This after-the-fact rationalization of their conduct was nowhere reflected on DOUGCO's

books nor was it made known to Edward Jedd Roe, Jr. ("Roe"),who was at that time an officer and major stockholder of DOUGCO. Nor does the record show the magnitude or nature of any alleged "adjustment" that needed to be made. Based on these considerations, the demeanor of the witnesses, and the entire circumstances as found herein, this testimony by Douglass and by Stanat is not credited.

The payment of fees or "expenses" by an issuer to a broker-dealer for listing the issuer's stock in the pink sheets is not customary. Retention of the Polaris stock personally by Douglass and by Stanat was further evidence of that. The fact that there was such a payment here was a warning flag that should have made Douglass especially cautious about making a market in or having transactions in Polaris stock both in terms of possible Rule 15c2-11 violations and possible violations of the registration requirements of Section 5(a),(c).

Twibell and Douglass both knew that the 75,000 shares of Polaris stock paid for "expenses" of "pinking" and split by Douglass and Stanat were received from Twiford, known to both to be a control person of Polaris.

In addition, on or about October 31, 1973, Twiford opened an account at DOUGCO, through which he proceeded to sell 75,000

shares of Polaris stock. Douglass personally had a hand in processing this sale order even though he then knew Twiford to be a control person of Polaris (among other things, Douglass had had several telephone conversations with Twiford prior to DOUGCO's entering Polaris quotations in the pink sheets). Thus, Respondents' argument that they were victims of deception on the part of Twibell, Geiss, and Semin, their own agents, insofar as the sale of unregistered Polaris stock is concerned, certainly is not true as to the shares sold <u>for</u> Twiford or as to the shares obtained by Douglass and Stanat <u>from</u> Twiford for "pinking" the stock and later sold by them. These circumstances should clearly have alerted Douglass to the need for making proper inquiry as to the tradability of other large blocks of unregistered Polaris stock that later came to be sold through DOUGCO, as found herein at a later point, of which activity Douglass, as the chief trader of DOUGCO, was well aware. He chose, instead, to close his eyes to what was going on. Nor did his knowledge of these circumstances prompt him, as it should have done, to make diligent inquiry in terms of Rule 15c2-11 compliance.

In his testimony at the hearing Douglass conceded that in the light of hindsight the information DOUGCO had on Polaris was inadequate to meet the requirements of Rule 15c2-11. Respondents

urge, however, that at the time Douglass had no reasonable basis for believing the information he had to be other than true and correct and reasonably current and that he obtained the information from sources he had a reasonable basis for believing were reliable. The record does not support these contentions.

The financial statements ("balance sheets") contained in DOUGCO's due diligence file when it initiated a market in Polaris stock (Exhs. 20A-2 and 20A-3) were deficient and contradictory on their face. The two balance sheets, both dated June 1, 1973, had various differences in presentation, and Respondents never bothered to establish why there were two balance sheets extant or what accounted for the disparities. Both sheets improperly valued certain mined but unprocessed ores at the estimated eventual selling price even though significant processing work remained to be done. Also, a 1/8th interest in certain mining properties and some unprocessed ores were improperly listed at figures derived by attributing to them values equal to the par value of the Polaris stock that had been exchanged for them. Listed liabilities were inordinately low, a fact that should have put any reasonable viewer on notice that Polaris could not have been particularly active. One of the statements showed property valued at $35,000 in Arizona without specifying the location. One statement had an item for capitalized expenses and the other did not. The former showed no retained

earnings or accumulated deficit, suggesting that the figure for capitalized expenses was an arbitrary one designed to make assets and liabilities balance out.

It is undisputed that the due diligence files of DOUGCO for Polaris did not contain the required financial statements for the preceding two fiscal years when DOUGCO commenced trading Polaris. Such statements, even as respects a company like Polaris that had been inactive for a considerable time and that may not therefore have had either significant assets or operations, may nevertheless provide useful information on such matters as the issuer's capitalization. Gotham Securities Corporation, 10 SEC DOCKET 895,896 (1976).

Notwithstanding these patent deficiencies in the financial statements for Polaris in DOUGCO's due diligence file, Respondents did not review or analyze the statements with care or make any attempt to verify the data contained therein by contacting Polaris officers or by other appropriate means.

In or about November of 1973 DOUGCO's then cashier advised Douglass that information concerning the listing of officers of Polaris in DOUGCO's due diligence file did not conform with corresponding information on file with the Utah State authorities and that the Utah records showed Polaris as not current in its payment

of annual state franchise taxes.

In late 1973 and early 1974 the cashier advised Douglass a number of times of problems she was having in the transfer of Polaris stock and that large-denomination certificates were being hand delivered to her by Twibell, Semin, and Geiss, the three salesmen at DOUGCO responsible for almost all the DOUGCO trading in Polaris. She also advised Douglass late in 1973 that she had been advised by persons associated with Polaris that they were unable to certify reliably what stock of Polaris was restricted and could not furnish DOUGCO with a list of its shareholders owning restricted shares.

In or about November, 1973, Douglass acknowledged to Roe, then a principal and the largest shareholder of DOUGCO (Roe pulled out of DOUGCO at the end of January, 1974, because of disagreements with the other owners, principally Stanat), that he, Douglass, was aware that Polaris was a shell corporation. Roe suggested, after discussions with John Kanouff, then legal counsel to DOUGCO, that they cease trading the stock of Polaris until a proper due diligence file was obtained and until Polaris was properly investigated. Douglass did not heed this suggestion.

On February 28, 1974, after a number of problems concerning Polaris had been called to Douglass's attention, and after Douglass's suspicions had concededly been aroused by the fact that there seemed to be an almost unlimited supply of Polaris stock available out of Salt Lake City, a meeting concerning Polaris and its stock was held

at the DOUGCO office at which Douglass, Stanat, Geiss, Semin, Kanouff, and Paul, the last representing Polaris, were present. DOUGCO's cashier was also present during some portions of that meeting. At the February 28 meeting Paul advised Respondents that he could not then furnish accurate, complete, or reliable figures as to the amount of stock of Polaris outstanding at the time or as to the amount or holders of Polaris stock that was restricted. On that date in the course of that meeting Kanouff also made it clear that in his view DOUGCO's due diligence file on Polaris was insufficient to meet the requirements of Rule 15c2-11 for the reasons stated in Kanouff's letter to Paul of March 1, 1974 (Ex. 20A-21). Kanouff's letter to Paul on behalf of DOUGCO called upon Polaris to provide numerous items Paul had undertaken to provide in the course of the meeting, e.g. lists of restricted shareholders, updated financial statements and statements showing operating results, and in addition requested Paul to furnish information concerning the origin of cash flow being used to conduct certain exploratory mining operations in Arizona and certification concerning examination by counsel as to legal title concerning such Arizona properties. Finally, Kanouff's letter included a flat statement that unless Polaris filed a registration statement under Section 12(g) of the Exchange Act within 120 days DOUGCO would cease trading Polaris stock.

Neither Paul nor any other representative of Polaris ever provided DOUGCO with the numerous, significant items called for by Kanouff's letter, with the single exception of an April 13, 1974 balance sheet. No results of operations were furnished and to subsequent oral inquiries Paul never gave any satisfactory explanation for failing to furnish the information or taking the actions that had been called for.

Notwithstanding these failures by Polaris, Respondents continued to trade Polaris for almost a year more until trading in the stock was suspended by the Commission on February 21, 1975. Douglass testified that he continued to trade Polaris so as not to jeopardize the position of customers who had bought the stock through DOUGCO, implying that if DOUGCO discontinued making a market in Polaris the price of the stock would have collapsed. This kind of concern would clearly afford no legal justification for continuing to trade Polaris stock in the face of all that Douglass knew or suspected about Polaris by February 28, 1974. Apart from that, the record establishes that one of the major reasons why Douglass knowingly continued to violate Rule 15c2-11 was his concern about losing the income generated by trading the stock 10/ in light, particularly, of the net-capital problems DOUGCO was having during a significant portion of the period, as found below.

10/ DOUGCO's gross trading profit in trading Polaris stock from October 1973 through April 1975 was $78,029.02.

Under the circumstances disclosed by this record, Douglass had no reasonable basis for believing the information he had concerning Polaris to be either true and correct or current or for believing that the sources from which limited information had been obtained were reliable. He had, in fact, substantial reasons for knowing otherwise.

Returning to the matter of trading unregistered Polaris stock, the record shows numerous transactions by DOUGCO in violation of Section 5(a), (c) of the Securities Act in addition to those already found above with respect to stock sold for Twiford or which was given by him to Douglass and to Stanat for entering Polaris in the pink sheets.

On January 11, 1974 Hill sold 200,000 shares of Polaris to DOUGCO in the name of his nominee, Randall J. Hill. Hill also sold shares of Polaris stock to DOUGCO in the name of another nominee, Dennis L. Harms, as follows: 10,000 shares on 4/26/74; 50,000 shares on 5/31/74; 50,000 shares on 6/17/74; 50,000 shares on 6/24/74; 10,000 shares on 7/2/74; and 30,000 shares on 12/11/74. These 200,000 shares were delivered to DOUGCO on 4/8/74.

Hill further sold shares of Polaris stock to DOUGCO in the name of yet another nominee, Jack E. Cameron, as follows: 100,000 shares on 8/14/74; and 110,000 shares on 8/16/74. Payment of a total of $6,550 on these sell transactions was made in the name of Randall Hill, a nominee of Hill's, as earlier noted.

On or about 8/14/74 DOUGCO was on notice through its cashier that Polaris was unable to determine whether shares held in the name of Randall Hill were restricted.

The sale transactions by Hill referred to above were effected through Twibell at DOUGCO. Twibell was fully aware prior to such sales that Hill acquired the Polaris shares sold at DOUGCO in connection with the purchase of control of the Polaris shell, that the shares had been placed in the names of nominees of Hill, that Hill had caused customer accounts to be opened at DOUGCO in the respective names of his nominees for the purpose of selling Polaris stock and that Hill was selling such stock because of pessimistic views of Polaris' future prospects.

In connection with the foregoing sale transactions in Polaris shares at DOUGCO by Hill the stock certificates were initially delivered by Hill to Twibell outside the offices of DOUGCO, at Twibell's direction, and Twibell in turn delivered them to cage personnel at DOUGCO. Twibell solicited and received additional compensation for these transactions in cash ($300 - $500) from Hill, on at least two occasions. Douglass was told by his cashier that Twibell was delivering to her Polaris certificates in the names of Harms, Cameron and Randall Hill.

The DOUGCO customer account cards for Jack E. Cameron, Dennis Harms and Randall Hill did not disclose that Hill had a beneficial interest or control over those accounts.

At the time Paul became president of Polaris he received 250,000 shares of Polaris stock from Twiford, which shares were placed in the names of nominees.

On or about October 2, 1974 Paul opened a brokerage account at DOUGCO in the name of his nominee, Richard Schraeder, and through that account, on October 2, 1974, sold 50,000 shares of Polaris stock. Douglass and Twibell knew prior to this sale by Paul that Paul was President of Polaris.

Twibell was the registered representative at DOUGCO to whom Paul supplied information to open the account in Schraeder's name and through whom Paul sold the 50,000 shares of Polaris stock. Twibell was aware that Paul was using Schraeder as his nominee and neither he nor anyone else made any inquiry as to the source of the stock delivered by Paul nor as to any restriction on the sale thereof.

The customer new-account card at DOUGCO for Richard L. Schraeder does not disclose that Paul had any control or beneficial interest in the account.

Robert F. Wilkinson sold shares of Polaris stock that he had obtained from Twiford to DOUGCO, as follows: 30,000 shares on 10/15/73; 10,000 shares on 1/30/73; 10,000 shares on 2/13/74; 10,000 shares on 2/14/74; 10,000 shares on 2/21/74; 10,000 shares on 3/13/74; 10,000 shares on 3/20/74; 10,000 shares on 3/21/74; 30,000 shares on 11/19/74; 25,000 shares on 1/7/75; 25,000 shares on 1/20/75; and 10,000 shares on 1/30/75.

Twibell made no inquiry of Wilkinson as to the source of any of the Polaris stock being sold by Wilkinson to DOUGCO. Wilkinson obtained Polaris stock directly from Twiford. Twiford was originally introduced to Twibell by Wilkinson, and Wilkinson participated in the meeting that included Twiford, Hill, and Twibell at which Twibell's help was sought and obtained to assist in getting DOUGCO to make a market in Polaris stock.

The shares of Polaris stock purchased by DOUGCO from Twiford, Paul, Hill, Wilkinson and their respective nominees were subsequently offered and sold through the mails in the over-the-counter market by DOUGCO. DOUGCO used the mails and means and instruments of transportation and communication in interstate commerce to offer and sell Polaris stock to the public.

Respondents urge that the above transactions in Polaris stock in which they participated were exempt from the registration requirements under the dealer exemption contained in Section 4(3) [11/] of the Securities Act. This reliance is misplaced. The Section 4(3) exemption is not available to Respondents since that exemption is not available to one who participates , as the record here shows, in a distribution of shares

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11/ 15 U.S.C. §77d.

by the issuer or by control persons or persons who in law are statutory underwriters. Quinn and Co., Inc., 44 SEC 461, 466-7 (1971), affirmed Quinn and Company v. S.E.C., 452 F. 2d 943,946 (C.A. 10, 1971),cert den. 406 U.S. 957; Gilligan, Will & Co. v. S.E.C., 267 F.2d 461, 466 (C.A. 2d 1959) cert. den., 361 U.S. 896.

In terms of volume of Polaris shares traded between October 17, 1973 and January 18, 1974 DOUGCO was by far the most active trader with purchase trades involving in excess of 10,000,000 of the 16,000,000 shares purchased; the next closest market maker had trades of 1,015,400 shares. With respect to quotations DOUGCO was listed on 70 days with the next closest market maker listing quotations on only 60 days. Thereafter DOUGCO continued to trade the stock actively until trading in it was suspended.

It is likely that significant amounts of the (unregistered) shares of Polaris traded by DOUGCO other than those specifically found above to have emanated from the issuer, control persons, or statutory underwriters were also shares for which no exemption was available; however, the record does not establish that and accordingly no finding is made on that point, even though it is generally held that the person claiming the availability of an exemption from registration requirements bears the burden of establishing entitlement to the exemption. S.E.C. v. Ralston-Purina Company, 346 U.S. 119 (1953).

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Respondents contend that they relied on the advice of their then legal counsel, Jack Viders, who orally advised Douglass that Rule 15c2-11 did not preclude DOUGCO's initiating a market in Polaris just prior to the time DOUGCO entered Polaris in the pink sheets. Viders testified he could not recall giving such advice or examining the few documents that then comprised DOUGCO's due diligence file on Polaris. Douglass testified flatly that such advice was received. On the basis of the thrust of the testimony, the demeanor of the witnesses, and surrounding circumstances, the conflict in the testimony on this point is resolved in Respondents' favor. Nevertheless, Respondents had no rational basis for relying on Viders' advice since the data they gave him to review were patently defective and insufficient, and Douglass did not give Viders all relevant information that came to his attention either at the time he sought and got the legal advice or shortly thereafter, e.g. that Douglass and Stanat received free stock for initiating a market in Polaris from Twiford, a control person of Polaris, or that Polaris stock was unregistered and that DOUGCO was participating in a distribution of unregistered stock emanating from the issuer, control persons, or statutory underwriters. Thus, even as respects Rule 15c2-11 compliance Viders' advice, which in any event could not excuse failure to comply with the Rule, cannot be relied on even in

mitigation since Respondents failed to place known, relevant facts before Viders.

Moreover, as the Division's reply brief correctly points out, nothing in the record, not even Douglass's testimony, indicates that the legal advice sought from Viders went to anything other than Rule 15c2-11 compliance. There is nothing in the record to suggest that Viders was asked about the propriety of any of the numerous transactions in Polaris involving control persons and statutory underwriters.

Lastly, Respondents contend that their Section 5(a), (c) violations should be excused because they were the victims of deception on the part of Twiford, Hill, Twibell, Semin, and Geiss, who are characterized as having made a "concerted effort" to keep the "true facts" respecting Polaris from Respondents. If this argument had any validity, it would be germane only to sales made by Hill and Paul through nominees, since in other cases, i.e. the sale of Douglass's and Stanat's shares that were obtained from Twiford, and the sale of other shares for Twiford, Douglass was personally well aware of what was going on. And, this last being the case, it was inexcusable for Douglass not to have made diligent inquiry into the source of the large quantities of Polaris stock that were readily available and that were being sold to DOUGCO customers. Particularly since Twiford had to hand out free shares of Polaris to have it "pinked", Douglass should have been especially care-

ful to make the necessary inquiries to assure that he was not violating Section 5(a), (c). Here Douglass's failure to make proper inquiry stands out in even bolder relief in light of the fact that he initiated a market in Polaris without meeting the requirements of Rule 15c2-11 and thereafter, after his own counsel made it clear that DOUGCO was in violation of the Rule, Respondents continued almost a full year to make a market in Polaris after their demands to Polaris for information and other action went unheeded. Rule 15c2-11 was designed especially to cope with the problems incident to trading in companies like Polaris, having little or no assets. The rule was not made to be broken.

In the offer and sale of Polaris stock by use of the jurisdictional means, and in recommending the stock to customers, DOUGCO salesmen (principally Geiss, Semin, and Twibell) made false and misleading representations regarding Polaris and its securities in violation of the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. They represented, among other things, that Polaris had valuable mining properties and that Polaris was mining and shipping valuable ore from such properties. The fact is that Polaris' mining properties were unproven and the sale of ore taken from such mining properties generated no net revenues. DOUGCO's salesmen had no basis in

fact for making such representations. Baseless opinions and projections, recklessly made, are violative of the antifraud provisions. U.S. v. MacKay, 491 F.2d 616, 623 (C.A. 10, 1973), cert. den. 416 U.S. 972; Alexander Reid & Co., 40 SEC 986, 989-990 (1962).

DOUGCO salesmen further stated that Polaris stock was underpriced and the market price was expected to reach $.50 per share in a short time. This representation was made about a security that had never sold for over $.10 per share. Such prediction about price rises, especially with respect to an obscure, long dormant shell corporation like Polaris, has long been held by the Commission to be a "hallmark of fraud". Alexander Reid & Co., 40 SEC 986, 991 (1962); Billings Associates, Inc., et al., 43 SEC 641, 645 (1967).

In the offer and sale of Polaris stock, DOUGCO salesmen failed to disclose to potential investors that DOUGCO had incomplete and insufficient information concerning Polaris' management, assets and financial condition and that they were recommending the purchase of Polaris in the absence of such information.

Polaris was in poor financial condition and it had negligible revenues from operations. The sale of ore by Polaris resulted in a net loss. At no time did DOUGCO have sufficient information about Polaris nor had it conducted a reasonable investigation. Failure to so advise customers

violated the antifraud provisions.

Furthermore, DOUGCO's customers who purchased Polaris stock were not told that Douglass and two other persons associated with DOUGCO had received, at no cost to them, stock of Polaris for initiating the over-the-counter market for Polaris. Neither were such customers advised of the source of such free stock. In addition DOUGCO customers purchasing Polaris stock were not advised that salesmen of DOUGCO (Semin and Geiss) were deeply involved personally in the affairs of Polaris and were raising capital from the investing public for Polaris, which capital Polaris was relying on almost totally for its continued operation and life. Nor were DOUGCO customers advised that control persons of Polaris were selling unregistered Polaris stock through DOUGCO. Such omissions were material and violated the antifraud provisions of the securities laws.

Even apart from the above misrepresentations and omissions, DOUGCO violated the antifraud provisions in that it recommended the purchase of Polaris by investors without having a reasonable basis for such recommendations. Hanly v. S.E.C., 415 F.2d 589, 596.

DOUGCO is of course responsible for the conduct of its salesmen under the doctrine of respondeat superior — Armstrong Jones & Co. v. S.E.C., 421 F. 2d 359, 362 (C.A.6, 1970), cert. den. 398 U.S. 958; H.F. Schroeder & Co., 27 S.E.C. 833 (1948); Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961);

Sutro Bros. & Co., 41 SEC 470, 479 (1963) — and is also subject to the imposition of sanctions predicated upon violations by the salesmen under Section 15(b)(4)(D) of the Exchange Act. In addition, and with particular reference to misrepresentations and failures to state material facts respecting Polaris by Semin, Geiss, and Twibell, DOUGCO must be held to have failed reasonably to supervise them with a view to preventing violations by them of the antifraud provisions, since the record fails to disclose any effective system for or actual supervision of such persons. And, lastly, DOUGCO is also responsible for Douglass's acts or reckless omissions insofar as they caused or contributed to the fraud found above since a corporate entity, acting through its principals, must be held responsible for the misconduct of such principals.

Douglass personally participated in, aided or abetted, or was personally aware of much of the conduct that constituted fraud. Thus, he knew that Polaris was being recommended by DOUGCO without there existing a reasonable basis for the recommendations. He knew that the salesmen were not disclosing that Douglass and Stanat received free Polaris stock for entering Polaris in the pink sheets. He knew that Polaris was being recommended while DOUGCO was in violation of Rule 15c2-11.

To the extent that Douglass may not have known of some of the violative conduct on the part of his salesmen, e.g. specific predictions of price rise for Polaris or failure to disclose Geiss's and Semin's personal involvement with Polaris, no findings holding Douglass responsible are made herein.

In view of the intentional participation by Douglass in antifraud violations as found above, establishing scienter as a matter of fact, it is unnecessary to consider whether, as Respondents contend, the scienter requirement of Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), applies as a matter of law to this administrative proceeding. The finding of scienter is of course more than enough to meet the established requirements of wilfulness 12/ under Section 15(b) of the Exchange Act.

12/ All that is required to support a finding of wilfulness is proof that a respondent acted intentionally in the sense that he was aware of what he was doing and either consciously, or in careless disregard of his obligations, knowingly engaged in the activities which are found to be illegal. Hanly v. Securities and Exchange Commission, 415 F. 2d 589, 595-6 (C.A. 2d, 1969); Nees v. Securities and Exchange Commission, 414 F. 2d 211, 221 (C.A. 2d 1969); Dlugash v. Securities and Exchange Commission, 373 F. 2d 107, 109-10 (C.A. 2d 1967); Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8 (C.A. 2d 1965).

The Division also charged and urges that Respondents dominated, controlled, and manipulated the market for Polaris stock and that they failed to disclose that to the purchasing public. It is concluded that the record does not support these charges. While there are bits and pieces of testimony or other evidence that tend to support a conclusion that DOUGCO's making a market in Polaris was an essential element in allowing Polaris to commence and to continue to be traded during the relevant period, the evidence falls far short of establishing manipulation, domination, or control by Respondents of the market for Polaris, which involved numerous market makers over most of the relevant period.

The Division also charges that Respondents violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by making a market in Polaris at prices ranging from $.01 to about $.095 without having made diligent inquiry as to the past and present financial condition of Polaris, its products, offices, officers and employees. It is concluded that this charge essentially duplicates elements of the Rule 15c2-11(a)(4) charge and aspects of the Rule 10b-5 charge and therefore need not be treated separately.

Violations of Net Capital Provisions

Section 15(c)(3) of the Exchange Act[13/] forbids a broker-dealer to effect transactions when its capital position is below the minimum requirements established by the Commission. The capital requirements established by the Commission are set forth in Rule 15c3-1. [14/] The order for public proceedings alleged violations of this Section and Rule occurred between August and October 1974 and again in October 1976. [15/] The Division presented evidence that further violations of the net capital rule occurred in November and December, 1974, as bearing on the question of the sanctions, if any, that should be imposed in the public interest.[15a/]

13/ 15 U.S.C. 78o(c)(3).

14/ 17 CFR 240.15c3-1.

15/ Paragraph M, Order for Public Proceedings as amended during the course of the hearing. See footnote 1 above and ALJ Exh. #3.

15a/ While deficiencies occured in November and December of 1974, as found below, these have not been considered for any purpose, including sanctions. See International Shareholders Services Corporation, Exchange Act Release No. 12389, April 29, 1976. Findings on this point have been made only for use in the event it should become an issue on any appeal that may be taken.

The term "net capital" is defined as the net worth of a broker-dealer, i.e., the excess of total assets over total liabilities subject to certain adjustments.[16/] Deducted are fixed assets and assets which cannot be readily converted into cash, including furniture and fixtures, unsecured advances, and other specified assets.[17/] Additionally, inventory securities that have no independent market are excluded and the value of other inventory securities is reduced by an appropriate "haircut" set forth in the Rule.[18/]

As of the following dates DOUGCO was subject to a minimum net-capital requirement of $25,000 except for October 21, 1976, when, because of its then aggregate indebtedness, its required net capital was $28,782. Its actual net worth (deficit), net capital, and resulting capital deficiency on such dates were as follows:

Date	Net Worth	Net Cap.	Cap. Deficiency
Aug. 30, 1974	($54,319)	$ 7,199	$18,800
Sept. 27, 1974	($37,981)	$ 8,696	$16,303
Oct. 25, 1974	($45,837)	$14,149	$10,850
Nov. 29, 1974	($31,750)	$14,455	$10,544
Dec. 27, 1974	($42,651)	$21,220	$ 3,779
Oct. 15, 1976	$99,488 [19/]	($6,257)	$31,257
Oct. 21, 1976	$120,297 [19/]	$27,466	$ 1,315

16/ 17 CFR 240.15c3-1(c)(2).

17/ 17 CFR 240.15c3-1(c)(2)(ii).

18/ 17 CFR 240.15c3-1(c)(2)(iii)

19/ Net worth in these two instances includes subordinated capital whereas on prior dates above it does not.

Respondents offered no net capital calculations of their own for October 15, 1976. As to the other dates, Respondents calculations show DOUGCO to be within net capital ratio. However, these purported results as respects the 1974 dates are achieved by Respondents as a result of a combination of error, misapplication of the net capital rules, and outright improper practices designed to misrepresent the net capital position of DOUGCO.

One of such improper practices involved the so-called "Blankenheim transaction." George Blankenheim was a registered representative at DOUGCO and sales manager from February 1974 through May 1976.

In computing DOUGCO's net capital for August 30, 1974, Respondents included a "cash trade as of 8-30-74" reflecting a purported purchase by Blankenheim from DOUGCO's trading account of 1100 shares of Discovery Oil, Ltd. for $1100, 2,000 shares of International Monetary Corp. for $1500, and 800 shares of Dakota Graphics for $2400, the purchases totaling $5,000. By reducing the firm's inventory of securities, the "haircut" it was obliged to take on its inventory of securities for net capital computations was reduced _pro tanto_.

The purported transaction was in actuality not entered into as of 8-30-74, but at a later date, and was, in fact, a sham transaction entered into in order to "park" the secu-

rities with Blankenheim and thus remove them, temporarily, from the firm's inventory.

Douglass asked Blankenheim for help in reducing inventories in late August, 1974. Lacking funds, Blankenheim agreed to borrow $5,000 from the United Bank of Denver. On 9-10-74 he obtained a 90 day loan of $5,000 which was used to "purchase" the 3 securities mentioned above, which were selected by Douglass, not Blankenheim. Blankenheim's understanding was that he would not have to take any loss on the transaction and that he was doing it as an accommodation to the Respondents. Custody of the 3 securities actually remained with DOUGCO and they were used by Douglass, without Blankenheim's knowledge or consent, to secure loans and advances to Douglass, Stanat and others at DOUGCO in September, October and November of 1974.

On 12-9-74 DOUGCO gave Blankenheim a check for $5,000 which Blankenheim endorsed over to the United Bank in payment of his 90 day loan. The securities were thus "repurchased" from Blankenheim at the same prices at which they were "sold" though the market prices of two of these securities had dropped by about one half meanwhile, without an offsetting gain in the third security.

In addition, DOUGCO paid directly the interest on Blankenheim's loan by issuing a check to United Bank for $184.93.

Although Douglass knew that Blankenheim had no funds to pay for the securities unless he got a bank loan, which was not obtained until 9-10-74, Douglass instructed his employee Kathy Simons, sometime after September 6, 1974, to book the Blankenheim transaction "as of 8-30-74". In fact, the check from Blankenheim was not received until on or after September 5, 1974, and Douglass was told there would be insufficient funds in the account unless and until the loan was obtained. The Blankenheim check was not deposited by DOUGCO until 9-11-74 though it was its established practice to deposit checks on the day of receipt or the next business day.

The sham Blankenheim transaction thus had the effect of materially overstating DOUGCO's net capital for the period from August 30, 1974 through December 8, 1974.

Another sham transaction Respondent engaged in to overstate the firm's net capital in 1974 was a purported sale of its furniture to Douglass in exchange for his personal note for $5,000, purportedly secured at least in part by the securities involved in the Blankenheim transaction. Although there was testimony that a note had been prepared, no note, either executed or unexecuted, could be located, and the auditors in the 1975 audit of the firm consequently reversed the transaction. Further, DOUGCO's records and the testimony of its cashier established that the purported sale of DOUGCO's furniture

occurred after August 30, 1974, but was reflected on the books and records as having occurred on August 30, 1974. Further evidence that this was not a bona fide sale of the furniture is the fact that Douglass, not having taken possession of the furniture, made no attempt to collect rentals. Moreover, Douglass made no effort to legitimize the purported sale by obtaining board of directors approval, as required by the Articles of Incorporation, nor, so far as appears, did he interpose objection to the auditors' reversal of the "sale" in the course of the 1975 audit.

The record also establishes that Respondents improperly reflected on the firm's books a $2,500 check from HemoTec Corporation as having been received as of August 30, 1974, whereas in fact it was not received and deposited until September 6, 1974.

The additional overstatements of DOUGCO's net capital for the relevant periods on the 1974 dates arose from failures properly to accrue various liabilities. These included compensation due Geiss on the Colt Oil underwriting, commissions due the firm's salesmen on the Oxford Exploration underwriting, and the 1-1/2% override on salesmen's commissions due Blankenheim as sales manager. As to this last item, Respondents defend on the ground that on October 7, 1974, the board of directors, with Blankenheim's assent, deferred payment of the override

Respondents dispute various aspects of the computation of net capital for October 21, 1976. Each of their arguments has been considered and found to be not persuasive.

On and about the dates of the net capital deficiencies found above, DOUGCO engaged in securities transactions.

Miscellaneous Violations

The record establishes various additional violations of the securities laws and rules by Respondents.

Rule 15c3-3 20/ requires every broker or dealer to maintain with a bank, separate from any other bank account of the broker or dealer, a "special reserve bank account for the exclusive benefit of customers." The evidence establishes that DOUGCO's special reserve account was deficient by in excess of $20,000 for the months of September through December 1974. This violation is undisputed. Respondents contend this resulted through a clerical employee's error in depositing funds intended for the special reserve account in an "otherwise dormant account". But depositing such funds in the "otherwise dormant account" did not render them available exclusively for the benefit of customers. Therefore this circumstance involving error can only be considered on the question of sanctions, not existence of a violation.

20/ 17 CFR 240.15c3-3.

DOUGCO was also charged with violations of Rule 15c3-3(m) (customer buy-in-rule) and Douglass with failure reasonably to supervise. Exhibit 18J establishes 28 instances wherein customer transactions were not closed within ten business days after the settlement date and DOUGCO failed to buy in for customers securities of like kind and quality as required by the Rule. The sales manager, when questioned about it, testified ". . . a lot of them were overdues, I'm sure." Some of such open transactions were carried for as many as 105 days.

DOUGCO also violated Rule 15c3-3(d)(2) (fail to receive from a broker-dealer) during October 1976. Three securities, Wyoming Coal, Soltray, Inc., and Discovery Oil, Ltd., were all included in DOUGCO's books as failed-to-receive for more than 30 dalendar days.

Section 17(a) of the Exchange Act 21/ requires brokers and dealers to make and keep such records as the Commission by its rules may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Commission has adopted Rule 17a-3 22/ which prescribes the records to be made and kept. The requirement that records be made and kept embodies the requirement that such records be true and correct. Merritt, Vickers, Inc. et al, 42 SEC 274, 278 (1964). As found above, a number of records of DOUGCO

21/ 15 U.S.C. 78q(a).

22/ 17 CFR 240.17a-3.

were not made and kept accurate and current. DOUGCO customer account cards for Cameron, Harms, Randall Hill and Schraeder failed to disclose that anyone else had a beneficial interest or control over those accounts. DOUGCO's records did not disclose liabilities to Blankenheim, firm salesmen for commissions on underwritings, and other liabilities. DOUGCO's trial balances and computations of net capital were likewise false and inaccurate. Except for the deficiencies on the cards of Cameron, Harms, Randall Hill, and Schraeder, Douglass participated in or was aware of the deficiencies in the records mentioned in this paragraph. He therefore aided and abetted these violations by DOUGCO to the extent indicated.

Section 17(a) of the Exchange Act [23/] imposes upon brokers and dealers the requirement to make and file certain reports with the Commission. Under that provision of the Act, the Commission has adopted Rule 17a-11.[24/] This rule was adopted to provide the Commission and the self-regulatory bodies with an adequate and timely flow of information concerning the operational condition of broker-dealers. [25/] Among other things, the Rule provides that when the net capital of a broker or dealer is less than required by any capital rule to which it is subject, immediate telegraphic notice must be given to the Commission and self-regulatory organization to which it belongs and a report setting forth the

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23/ 15 U.S.C. 78q(a).
24/ 17 CFR 240.17a-11
25/ Securities Exchange Act Release No. 9268 (July 30, 1971)

firm's financial condition must be filed with them within 24 hours after such net capital deficiency occurs. 26/

DOUGCO gave no telegraphic notice and filed no follow-up report during the month of October 1976 when it had a capital deficiency. It thereby violated Rule 17a-11.

Other violations of Section 17(a) and Rule 17a-11 thereunder occurred as a result of filing false and misleading X-17a-11 reports. The evidence establishes that from August 30, 1974 through December 27, 1974, net capital deficiencies existed at DOUGCO and reoccurred on October 15, 1976 and October 21, 1976. Between September 20, 1974 and December 20, 1974 DOUGCO filed five X-17A-11 27/ reports with the Denver Regional Office of the Commission.

The reports filed on Form X-17A-11 during the summer and fall of 1974 contained false statements concerning the net capital of DOUGCO during that period. The evidence establishes that DOUGCO had net capital deficiencies during the period August 30, 1974 through December 1974. These deficiencies were concealed through the use of improper and fictitious bookkeeping entries.

Since Douglass was instrumental in falsification of DOUGCO's books and records, as previously found, he must bear responsibility for the false Form X-17A-11 reports for this 1974 period. He therefore aided and abetted DOUGCO's 1974 violations of Section 17(a) and Rule 17a-11.

26/ 17 CFR 240.17a-11(a). This rule was applicable to the 1976 net capital violations but not to those in 1974.

27/ Three of these reports were not filed within the time specified in Rule 17a-11.

Failure Reasonably to Supervise; Respondeat Superior

The Exchange Act provides that the Commission may sanction a person associated with a broker-dealer if he

> "has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such violations, if such other person is subject to his supervision." 28/

Under the doctrine of respondeat superior a principal is liable for the acts of its agents. Armstrong, Jones and Co. v. S.E.C., 421 F.2d 359, 362 (C.A. 6, 1970), cert. den. 398 U.S. 958 (1970). The Commission has stated the rationale for respondeat superior, and noted a statutory application, in principle, of it, as follows:

> "Registrant as a firm can only act through its employees and agents, and the willful violations of its employees in the course of their employment must be considered the willful violations of the firm. Moreover, in any event disciplinary action against a registered broker-dealer under Section 15(b) may be founded not only on a willful violation by the registered broker-dealer itself, but also on any willful violation by any employee of such broker-dealer." Sutro Bros. and Co., 41 SEC 470, 479 (1963)

The application of failure to supervise and of respondeat superior to the antifraud violations has been treated separately above at pp. 28-30 in conjunction with a consideration of Respondents' urging of a scienter requirement.

28/ Section 15(b)(4)(E), 15 U.S.C. 78o(b)(4)(E).

As to the remaining violations found herein to have been committed by principals, agents, or employees it is clear that DOUGCO bears responsibility under the concept of _respondeat superior_. Were the law otherwise, as contended by Respondents, i.e. that the doctrine "has no place" in the Commission's administrative proceedings because it imposes a form of strict liability, 29/ DOUGCO would still be subject to imposition of sanctions for such violations because of its failure reasonably to supervise. The record shows that DOUGCO did not have in effect adequate procedures for supervision and that adequate supervision was in fact not carried out.

It is concluded, as argued by Respondents, that the concept of _respondeat superior_ is inapplicable to Douglass (the Division cites no authority for their contrary position) and that Douglass's responsibility for such violations by others as to be judged under the requirement of reasonable supervision. See _Mississippi Valley Investment Company et al_, Exchange Act Release No. 12683, August 2, 1976. As to whether that requirement was met by Douglass, the record is less than satisfactory. While Douglass was the principal trader and in charge of trading functions, it appears that Stanat was in charge of back office personnel and in charge of "compliance" matters. And there was also a sales manager,

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29/ As noted above at p. 29, Section 15(b)(4)(D) of the Exchange Act imposes a form of statutory "strict liability."

who had certain supervisory duties. In view of these factors it is concluded that the Division has failed to sustain its burden of proving that Douglass failed adequately to supervise in connection with the violations of 15(c)(3) and 17(a) of the Exchange Act and of rules thereunder.

Conclusions

In general summary of the foregoing, it is concluded that within the relevant period, extending from about October, 1973 to October, 1976, Respondents DOUGCO and Douglass committed violations of the following provisions of law or regulation as a result of the following acts, practices, omissions, or failures to disclose relevant facts, all as more particularly found above:

(1) Within the period from about October 17, 1973, to about February 21, 1975, DOUGCO wilfully violated and Douglass wilfully aided and abetted violations of Section 15(c)(2) of the Exchange Act and Rule 15c2-11(a)(4) thereunder by initiating and maintaining a market in the stock of Polaris Mining Company by submitting quotations to the National Quotations Bureau, Inc. at a time and at times when Respondents were not in possession of the information required by the Rule that was

reasonably current and at a time and at times when Respondents had no reasonable basis for believing that information concerning Polaris in the possession of Respondents was true and correct and reasonably current.

(2) Within the period from about October 17, 1973 to about February, 1975, DOUGCO wilfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in effecting transactions in Polaris stock by making false and misleading statements of fact concerning Polaris and by omitting to state about Polaris material facts necessary to make the statements that were made, in light of the circumstances under which they were made, not misleading. To the extent found herein, Douglass wilfully aided and abetted these violations.

(3) During the period from on or about October 17, 1973, to on or about February 21, 1975, DOUGCO wilfully violated, and Douglass wilfully aided and abetted violations of, Section 5(a), (c) of the Securities Act in offering, selling, and delivering unregistered Polaris stock for which no exemption was available.

(4) During the period from August, 1974 through October, 1974, and in October, 1976, DOUGCO wilfully violated, and Douglass wilfully aided and abetted the 1974 violations, of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, the net capital rule. Respondents also likewise wilfully violated and aided and abetted violations, respectively, of Section 17(a) of the Exchange Act and Rule 17a-11 thereunder in that DOUGCO filed with the Commission reports on Form X-17a-11 that were false and misleading in respect of DOUGCO's assets and liabilities.

(5) During the months of September through December, 1974, DOUGCO wilfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder by failing to maintain sufficient funds in a special reserve account for the protection of customers.

(6) As of August 1, 1975, DOUGCO wilfully violated Section 15(c)(3) of the Securities Act and Rule 15c3-3(m) thereunder by failing to take action immediately to close transactions with its customers in twenty-eight instances in which customers failed to deliver securities to DOUGCO within 10 business days after they sold such securities.

(7) In October, 1976, DOUGCO wilfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-3(d)(e) thereunder by failing to obtain physical possession of securities included on its books and records as failed-to-receive for more than 30 calendar days.

(8) Within the relevant period DOUGCO wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by failing to keep a number of required records current and accurate. Douglass wilfully aided and abetted certain of these violations.

(9) In and shortly after October,1976, DOUGCO wilfully violated Section 17(a) of the Exchange Act and Rule 17a-11 thereunder in that it failed to give telegraphic notice to the Commission that it was experiencing net capital difficulties and failed to file the necessary follow-up reports.

(10) DOUGCO failed reasonably to supervise persons subject to its supervision with a view to preventing certain of the violations found herein to have been committed by such persons.

PUBLIC INTEREST

The violations committed by Respondents were numerous, varied and serious, and some of them continued over substantial periods of time.

Significantly, DOUGCO allowed itself to fall into net capital violation on two dates in October, 1976, even while this proceeding charging the earlier 1974 violations was pending. Parking securities to falsify net capital has been held to violate Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and rules thereunder. 30/

But the most egregious aspect of the net capital violations is the fact that to cover up the charged 1974 net capital violations, in an effort to falsify DOUGCO's true financial condition, Douglass engaged in falsifications including parking of securities, sham purchase of the firm's furniture, backposting the receipt of assets, and failure to record liabilities when they accrued or were incurred. These actions by Douglass evince a cavalier disregard for the central protections intended to be afforded to customers by the net capital rule.

30/ In re Jay Rutledge (Stephenson, Leydecker & Co.), CCH Federal Securities Law Reports, August 19, 1976, ¶80,692 (Initial Decision declared final, Exchange Act Release No. 12841, September 29, 1976)

The multiple and varied violations in connection with Respondents' trading of the essentially worthless Polaris stock are equally serious. Douglass attempts to portray himself as the victim of deception by others, including three of his salesmen and representatives of Polaris. But the record, as found above, belies such attempted portrayal. As found above, Douglass had personal knowledge of numerous facts that should have served as warning flags, not the least of which was the fact that Polaris had to "induce" him to initiate a market in that long-dormant shell by giving him Polaris shares for doing so.

Douglass makes much of his reliance on the legal counsel of Jack Viders. However, as already noted, this advice was limited to the question of compliance with Rule 15c2-11, and even on that issue the advice was necessarily faulty since Douglass withheld from Viders certain highly relevant information that Douglass had when he sought the advice and failed to seek a new opinion when, shortly thereafter, additional relevant information came to his attention.

The overwhelming weakness, however, in Douglass's reliance-upon-counsel plea is that, as found above, Respondents continued to trade Polaris for almost a full year after they had been advised by other counsel that to do so was in violation of Rule 15c2-11 and after numerous demands made by Respondents' counsel of Polaris representatives, designed to rectify the situation, went ignored. To urge, as Douglass does, that he couldn't stop trading Polaris stock because to do so would have destroyed the market for Polaris stock and thus injured his customers is to demonstrate a fundamental lack of awareness of the underlying purposes of the laws and regulations violated by Respondents in connection with their trading of Polaris.

The record strongly suggests Douglass's lack of interest in or respect for proper supervisory procedures, and his argument that supervision has now been strengthened is not reassuring in the light of the entire record.

The Division urges strongly that maximum sanctions, revocation and bar, are called for. Respondents urge that no public purpose would be served by revocation and that Douglass's sanction ,

if any, should be limited to suspension in line with suspensions imposed upon other respondents who entered into settlements with the Commission.

The sanctions applied must be of sufficient severity to deter misconduct of the kind found in the future, by Respondents and by others, as well as to apply appropriate sanctions for the instant violations.[31/]

The strongest point in mitigation for Douglass is the fact that he had been engaged in the securities business for some 20 years without prior violations. This consideration warrants his re-entry into the business in a supervised, non-proprietary capacity after an appropriate period.

Taking into account the number and gravity of the violations, mitigating circumstances, and the entire record as a whole, it is concluded that the sanctions ordered below both for remedial and deterrent purposes are necessary, appropriate, and adequate in the public interest.

31/ The purpose of sanctions must be to demonstrate not only to respondents but to others that the Commission will deal harshly with egregious cases. Arthur Lipper Corp. v. S.E.C., 547 F. 2d 171, 184 (1976).

ORDER

Accordingly, IT IS ORDERED as follows:

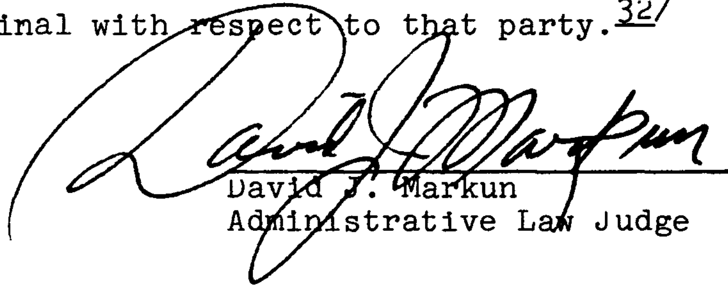
(1) the registration as a broker or dealer of Respondent Douglass and Co. Inc. is hereby revoked and the firm is hereby expelled from membership in the National Association of Securities Dealers, Inc.

(2) Respondent Donn Charles Douglass is hereby barred from association with a broker or dealer with the proviso that after a period of ten months he may apply to become associated with a broker or dealer in a non-proprietary, non-supervisory capacity upon satisfactory showing to the Commission that he will be adequately supervised.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR §201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review this initial decision

as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.[32/]



David J. Markun
Administrative Law Judge

Washington, D.C.
May 27, 1977

32/ All proposed findings, conclusions, and supporting arguments of the parties have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues presented. To the extent that the testimony of various witnesses is not in accord with the findings herein it is not credited.