ADMINISTRATIVE PROCEEDING
FILE NO. 3-5018

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

CHARLES C. CARLSON :

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

March 28, 1977
Washington, D.C.

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: William M. Hegan and James L. Sanders, of the Chicago Regional Office of the Commission, for the Division of Enforcement.

Charles C. Carlson, *pro se*.

BEFORE: Jerome K. Soffer, Administrative Law Judge

On August 25, 1976, the Commission issued an Order for Public Proceedings (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) alleging that respondent, Charles C. Carlson, wilfully violated and wilfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act of 1933 (Securities Act) in the offer and sale of securities issued by Thomas J. Norton Co., Inc., (Norton); and that he wilfully violated Section 15(b)(6) of the Exchange Act in that, without the consent of the Commission, he was associated as a salesman with a broker-dealer. Further, the Order alleges that respondent filed and caused to be filed with the New York Stock Exchange an application containing false and misleading information and that he submitted to the Commission's staff a letter containing false and misleading information.

The Order directed that a public hearing be held before an administrative law judge to determine the truth of the allegations and what, if any, remedial action is appropriate in the public interest for the protection of investors. Such hearing was held in Chicago, Illinois on October 5, 1976, at which respondent appeared and acted as his own counsel in the proceedings. Following the close of the hearing, proposed findings of fact, conclusions of law and supporting briefs were filed respectively by counsel for the Division of Enforcement and by respondent, including a reply brief filed by the Division. The findings and

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

Respondent

Carlson, a graduate of the University of Wisconsin, first entered the securities business as a registered representative in 1957 and was employed by a number of broker-dealers until the imposition of the sanction set forth hereinafter. One of the intervening employments was with a firm known as George M. Baker & Company where he was a salesman and a limited partner. On August 2, 1960, he was censured by the National Association of Securities Dealers and directed to pay a fine of $300 because of the failure of the firm to comply with recordkeeping requirements.

Between December, 1966 and June, 1971, respondent was employed by John A. Dawson and Company, a registered broker-dealer of Chicago, as a registered representative. As alleged in the Order, Carlson had been suspended by the Commission, in an order adopted on June 9, 1971 in Administrative Proceeding File No. 3-2611 (SEA Release No. 9198), from being associated with a broker or dealer for a period of 9 months, and at the conclusion of which period he "may be associated with a broker-dealer in a non-supervisory capacity upon an appropriate showing to the Commission that he will be adequately supervised". The

order revoked the registration of the Company and imposed the same suspension against John A. Dawson, its general partner, as for respondent. These sanctions were imposed by way of settlement of charges of violations of the registration provisions of the Securities Act with respect to the sale of about 4,800,000 shares of the common stock of United Australian Oil, Inc. in the amount of about $1,300,000. At that time, respondent was represented by counsel and understood the requirements of the sanction agreed upon.

After leaving Dawson & Company, Carlson was employed by PEPCOR, a company engaged in selling participations in oil and gas wells, as a salesman and later sales manager, between October, 1971 and early 1973. While so employed, respondent took a part-time job in November, 1972 as a salesman with Goldstein-Samuelson, a dealer in commodity futures options. He worked there for about 2 months, and sold to some ten customers options representing total premiums of between $7000 and $8000. He received about $200 in compensation. An additional earnings check for $1000 was dishonored because of financial difficulties of the company. After leaving PEPCOR, Carlson went into business for himself as a house painter and painting contractor.

For a brief period in 1973 Carlson, at the suggestion of another individual who had worked with him at Goldstein-Samuelson, became associated with Chicago Silver Exchange, Inc. and its sister company, Commodity Investment Associates. Both companies,

located in the same Chicago office, proposed to sell silver bullion to the general public as a hedge against anticipated inflation and depression. With the expectation that there might be general interest in buying silver bullion, Carlson permitted his name to be connected with literature, business cards and a letter distributed by the companies to general mailing lists as well as to some of his own acquaintances. However, there was no affirmative response to these solicitations and within about two weeks Carlson terminated his association with these companies. He earned no remuneration for the brief period with them. He continued conducting his house painting business.

Sometime in February or March 1974, respondent applied for employment in the Trust Department of the First National Bank of Evanston, Illinois. He advised the Bank of his previous sanction by this Commission. He remained at the bank for about 3 days while it was deciding whether to employ him. In view of the sanction, the Bank decided not to do so. Although he performed no duties, the Bank voluntarily paid him for the three days he was there.

In February 1974, Carlson became employed by Norton as a salesman of options on commodity futures contracts, an employment upon which is based one of the charges in the Order. After his initial training, respondent worked on a part-time basis devoting not more than one-half hour per day in attempting to

sell options. He generally worked out of his home while continuing to attend to his painting business. Between March 26 and May 24, 1974, he sold to three individuals a total of 8 options contracts producing premiums of some $16,575, as a result of which he earned net commissions of $1,326. He left Norton because of the demands of his painting business.

He had submitted a written application to Norton at the beginning of his employment in which he failed to show his prior association with Goldstein-Samuleson, the Chicago Silver Exchange, Commodity Investment Associates or the First National bank. He explains that Mr. Norton was not interested in having them listed.

In December, 1974, Carlson went to work as a securities salesman by a Chicago broker-dealer, Heinold, O'Connor and Cloonan, Inc. (Heinold). In his application for employment, he did not indicate his prior employment with Goldstein-Samuelson, Chicago Silver, the Bank or Norton. This information was omitted because Heinold was not interested in any part-time jobs. He did disclose that a sanction had been ordered against him as a result of his employment with Dawson, but the application did not recite that he had been fined $300 by NASD.

Heinold filed on his behalf, an application with the NASD for registration as a representative of the firm. The application required a statement of his employment during the past ten years,

designating which was part-time and which was full time. He did not list his association with the three companies heretofore named, under the belief and with the advice of a Heinold official that it was not necessary to list part-time employment. However, he did advise the NASD of his sanction by this Commission and the fine of $300 while employed at Baker.

In connection with his employment at Heinold, Carlson contacted a staff attorney in the Chicago Regional Office of the Commission and was advised that he would have to obtain approval for the type of supervision over him at this employment. Thereafter, several conversations occurred between a representative of Heinold and the staff attorney in order to work out satisfactory supervisory details. In the meantime, respondent resigned from his employment with Heinold until the matter was resolved. On or about January 28, 1975 proposals by the broker as to supervision were forwarded to the Division's Washington Headquarters with a favorable recommendation. Some two months later, on March 26, 1975, the Director of the Division of Enforcement sent a letter of approval for respondent to work for Heinold. The Chicago attorney advised respondent, who was quite anxious to go to work, by telephone a day or two before that approval was on the way.[1/]

1/ The agreed supervisory procedures with Heinold were assumed by the branch manager and required the following:

1. A review of all customers statements monthly noting any trading pattern repeated in various accounts, and frequency thereof;
2. Review of all solicited transactions for adequacy of research and suitability;

The final relevant employment for Carlson commenced in or about November of 1975 as a registered representative with David Noyes & Company, a Chicago broker-dealer (and member of a number of stock exchanges), and lasted until some time in May or June of 1976. In connection with this employment, he advised a Noyes senior partner, Paul E. Murin, of the sanction order, (although he did not specifically relate that he could not work without clearance) and of the Commission approval of the prior employment with Heinold. It was his belief and apparently that of the Noyes partner that having once obtained approval in a previous employment, it was not required for later work, particularly since an initial application was filed with the New York Stock Exchange, for permission for respondent to work as a registered representative. Mr. Murin recalls having seen the supervision order at some time, but not that it required prior approval for employment. In fact, Noyes never before had to seek such approval for any other employee.

1/ (Continued)

3. Approval prior to mailing of all correspondence by respondent;
4. A review of his personal records kept on account of transactions;
5. A requirement that Carlson maintain a daily register of his telephone calls and personal contacts, whether solicited or unsolicited, indicating name, the nature of the call, and what action taken if any and pertinent information bearing upon the suitability of any recommendation made. This is to be reviewed by Carlson daily.

The application to the New York Stock Exchange required a consecutive statement of business history for the past ten years, including "self-employment, unemployment, part-time securities, commodities, insurance and real estate industry and related positions". In reply, respondent did not include his association with Goldstein-Samuelson, the Silver Exchange, the Bank in Evanston, or with Norton. In his opinion, they did not fall within the categories called for, particularly in view of his belief, (hereinafter discussed) that commodity futures options were not "securities". The application recited the fact of his prior suspension as having resulted from his sale of "some unregistered stock", that he could now assume a non-supervisory position, and that he had, on August 2, 1960, been censured and fined $300 by the NASD for a bookkeeping violation.

The Exchange preliminarily gave temporary approval and then, after reviewing the application, final approval to Carlson's employment at Noyes.

Respondent's initial compensation was a draw of $600 per month beginning in late 1975 and continuing for a total of five months until the termination of his employment. (Carlson states that his last check was given in April.)

Some time in May of 1976, the Chicago Regional Office contacted Murin with respect to the employment of respondent, and advised that prior approval of the Commission was required

as to the supervision he was to receive. The proposals by the Regional Office included not only those previously required of Heinold but, additionally, that respondent's supervisor be familiar with the financial status and investment needs and objectives of respondent's customers, that he examine all transactions before execution, and that all incoming correspondence addressed to respondent be reviewed by the supervisor before being given to him. The name, position and experience of the supervisor was to be stated. At the same time, it was requested that respondent submit an affidavit concerning all of his employment since the Commission's Order of June 9, 1971. Mr. Murin, who has been a Noyes senior partner for more than 43 years, felt that the supervisory procedures already in effect over their staff of registered representatives had been proven adequate and sufficient. On May 25, he so advised the Commission.

Under the procedure at Noyes, all outgoing correspondence is first reviewed by a partner, Standard & Poor's looseleaf sheets are used in all instances where a customer or prospect asks about a security rating, when a new account is opened a partner examines the application and either approves or rejects, and all transactions are checked at the close of each day. It does not check all incoming correspondence or require a representative to keep a daily listing of all telephone calls or personal contacts.

By letter dated June 7, 1976, the Chicago Regional Office advised the broker that it did not consider these procedures to be

adequate and would not recommend the same to the Washington Office. This letter pointed out respondent's failure to submit an affidavit of employment and that his continued employment by Noyes was in violation of the provisions of Section 15(b)(6) of the Exchange Act. The broker was further advised that it could be subjected to an administrative proceeding for employing Carlson and offered the usual opportunity to submit a statement as to why such administrative proceedings should not be instituted (as permitted in SEA Release No. 5310). As a result of these negotiations, Carlson was discharged. The exact time is not established.

Noyes position is that it was too burdensome to provide special supervision over that afforded other representatives, and that as a result of observation and a check with Heinold it believed respondent to be trustworthy and honest, although he did not spend as much time at his work as desired.

In response to the request by the Regional Office for an affidavit of employment, respondent sent an unsworn letter, showing that his employment since June 1971 consisted of his PEPCOR affiliation, his self-employment as a painting contractor and his association with Heinold. No mention is made of his employment with Goldstein-Samuelson, Norton, the Chicago Silver Company or the First National Bank of Evanston. He did not feel that the Commission would be interested in part-time work.[2/]

2/ In a personal resume used by Carlson in seeking employment generally, he similarly does not list his part-time association with those companies.

Since leaving Noyes, respondent has been for the most part unemployed. He does not want to go back into the securities business, but is seeking employment in other fields.

Discussion and Conclusion

The Registration Violation

The first of the two charges against Carlson asserts that during the period from in or about April, 1974 to in or about May, 1974, he wilfully violated and wilfully aided and abetted violations of the registration requirements of the Securities Act in that he offered to sell, sell and deliver after sale, "securities issued by Thomas J. Norton Co., Inc., namely, investment contracts, evidences of indebtedness, and instruments commonly known as a security involving purported options on commodity futures", and that no registration statement was filed or in effect as to said "securities".

According to an investigation by Mr. John Brissman, an investigator employed in the Chicago Regional Office of the Commission, Norton was in business from February until October of 1974, dealing in commodity futures options embracing a number of commodities. During this period, the firm sold approximately 627 options to some 350 customers, with total sales premiums in excess of $1,200,000. In almost all instances the dealing was in "naked" options, with only about four percent of them being covered by actual futures contracts.

As noted previously, Mr. Carlson, during his brief part-time employment sold only 8 options representing $16,575 worth of premiums.[3/] Actually, however, since some of the premiums of his customers involved rollovers of profits made on prior option transactions with the firm the actual amount invested by the individuals through him was much less. Records of Norton show that only one of Carlson's three customers suffered a loss on his investment, one made an actual profit, and the third suffered only a small loss (less any amount he may realize upon distribution in bankruptcy of Norton assets).[4/]

Under the procedures practiced by Norton, a new customer would be given a "Statement of Policy" which included, among other things, an undertaking that the premiums received would be segregated by Norton in a "Trust Fund and Market Position Account" for the expressed purpose of allowing

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3/ None of the option contracts sold by Carlson were covered by actual futures contracts, with one possible exception involving a sugar futures option. Norton customers held a total of 56 1/2 short position sugar options and Norton had held 4 sugar futures contracts in a short position. It is possible that one of these four might have been used to cover the option held by Carlson's customer, although no direct connection therewith is shown.

4/ One of these customers, Edwin M. Curtis, had previously been solicited by respondent in connection with other dealings, including the purchase of silver bullion. On May 20, 1974, as a result of solicitation by Carlson, he agreed to pay $1,000 premium for a long position on a lumber futures option. During the period of the option, the price had reached a profitable position and he had been advised by respondent to exercise it. Curtis did not do so in the hope that the price would go higher. Instead the price eventually dropped and he lost his money. Although Curtis is an experienced and very active trader in commodities, this was the one and only futures option in which he ever became involved.

Norton to use the premiums "to take appropriate market positions . . . to insure the profitability of options when exercisable at a profit by our clients."

In actual practice, however, premiums were deposited in a single unsegregated account from which Norton drew funds for all its business expenses, to pay salesmen's commissions, to purchase futures contracts, to provide for the personal use of the firm's principals, and to pay customers exercising profitable options. In the latter respect, where a customer did exercise a profitable option, Norton would merely cover the profit by a payment to the customer in cash, rather than deliver a futures contract. If the striking price were not reached, then, of course, the premium would be retained by Norton to the customer's loss. Frequently, where a profit was due the customer, he would be encouraged to "rollover" this profit by buying another naked option. Thus, the only appropriate market position taken to "insure marketability" was to endeavor to have enough money left over to pay off a customer enjoying a profitable option.

It is the contention of the Division that the relatively few options sold by respondent represented interests that are "securities" within the definition of that term in the securities laws, and were not registered as required. The lack of registration is admitted. That these options were

securities is not.

It is the position of Carlson that to the best of his knowledge commodities futures options are not securities, and were not considered or declared as such at the time he was selling them. As far back as his part-time employment at Goldstein-Samuelson, he had been advised by one of the officers of that company that options of this type were not securities and did not require registration. He was similarly advised by Mr. Norton when he went to work for him in 1974. He further asserts that at one time he had asked an attorney to research the question for him, and was advised that there were no cases or rules declaring them to be "securities". In his pro se brief, he further draws a distinction between a commodity option "fund", or the sale of an interest in such fund, as properly being a security, as opposed to the sale of a naked individual option to one independent person. Finally, respondent challenges the jurisdiction of this Commission in the field.

The Division contends that the options dealt in by Norton were "securities" within the meaning of the statute (Section 3(a)(10) of the Exchange Act which embraces"investment contracts" and "any interest or instrument commonly known as a security". Its brief set forth accepted fundamental principles to be applied in determining whether any particular situation or interest is a "security," such as, that the term is to be broadly construed in order to carry out the

remedial purposes embodied in the federal securities laws (citing S.E.C. v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1953); S.E.C. v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963); Affiliated Ute Citizens v. United States, 405 U.S. 128, 151 (1972), and Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). These cases also direct us that in searching for the meaning of the term "security", form should be disregarded for substance, with emphasis on "economic reality."

The forms of economic relationships constituting "investment contracts" within the meaning of the federal securities laws have been outlined in a number of Supreme Court and Circuit Court decisions, the most significant of which include S.E.C. v. W.J. Howey Company, 328 U.S. 293 (1946) and United Housing Foundation v. Forman, 421 U.S. 837 (1975). These cases and others set forth four elements which must be found to be present in any economic relationship to give rise to the existence of an investment contract as follows: (1) an investment of money or tender of initial value, (2) in a common enterprise or venture, (3) with a reasonable expectation of profits, (4) to be derived from the undeniably significant or essential managerial or entrepre-nurial efforts of others which affect the failure or success of the enterprise.

It is upon the basis of this test that, in cases cited in Division's brief, multi-level distributorships and pyramid

sales plans contracts were held to involve investment contracts. This result was also found in other cases mentioned in the brief, such as where members of the public invested their money in an oil-drilling enterprise operated by others (Joiner, supra), an orange grove which was to be cared for and marketed by others (Howey, supra), and a money lending operation dependent upon the skill of others in making sound loans (Tcherepnin, supra).

The Division urges that the options dealt in by respondent while employed by Norton embody the elements of an investment contract as defined heretofore, particularly on the basis of "economic reality". It interprets the payment of a premium as an investment of money in a common enterprise, because the premiums were commingled in a common bank account, and because ultimate profits depended upon the efforts, skill and expertise of Norton in covering the options by the purchase of actual futures contracts. Mention is made of Norton's statement of policy specifically representing that the company would take appropriate market positions to insure the profitability of the options. However, in advancing these contentions, the Division has shown the weakness of its position.

As seen, there were very few commodity futures contracts purchased by Norton, and it has not been shown that these were in any way related to the options being sold to customers. The premiums were placed in one company bank account (contrary to the promise in the Statement of Policy) for the convenience of Norton, used for a variety of purposes but not for taking

market positions. The commingling was not part of a common enterprise or venture. As far as any managerial skill being afforded by Norton or others, there was none. The fluctuations of the commodities futures market would determine whether the striking price of the option would be reached, an activity wholly outside any action or skill on the part of Norton, or anyone else. Norton's only contribution to the "venture" was its financial resources in being able to pay off when an option became profitable to a customer. Whether this depended upon its independent resources, or the retention of premiums of customers who suffered option losses, or the ability to generate new premiums, is not clear in this record. What is clear is the lack of any managerial or entreprenurial contribution by Norton.

The question of whether the options here involved are "securities" under the Act has come before the Courts on several occasions. Cases holding commodities futures options contracts to be securities include S.E.C. v. Continental Commodities Corp., 497 F.2d 516 (C.A. 5, 1974), a decision which is mentioned in the Division's brief, S.E.C. v. American Commodity Exchange,et al., CA-10, Number 76-1064, (December 13, 1976), CCH Fed. Sec. L. Rep. (1976-1977 Transfer Binder), ¶95,798; S.E.C. v. Thomas J. Norton, U.S.D.C., N.D. Illinois, No. 75-C-1487 (August 3, 1976) CCH Fed. Sec. L. Rep. (1976-1977 Transfer Binder), ¶95,709.[5/]

5/ The Division, in its brief, also cites S.E.C. v. Commodities Options International, Inc., Civ. No. 73-761, MML (June 27, (continued)

These cases are readily distinguishable from the facts found here.

In Continental Commodities Corp., supra, the defendant undertook to recommend certain commodities futures contracts to its customers. In addition, it undertook to advise a customer of the most opportune moment either to sell or to exercise the option. Finally, it also offered investment counseling as to the most propitious time to sell a specific futures contract. It was thus held that the investors lacking the business acumen possessed by the promoters, inexorably relied upon the promoter's guidance for the success of their investment. This conclusion formed the basis of the Court's opinion that the options purchased from the promoters contained all the four necessary elements heretofore described. However, there is no such situation existing in the instant case. Norton offered no expertise, nor advice when to buy or to purchase nor how long to hold the options. It was merely a repository of the premiums paid, which it would retain if the striking price were not reached and for which it undertook to pay the amount of profits which could have been earned by the exercise of the option.

5/ (Continued)
1974), appeal docketed, C.A. 9 No. 75-2385, a case in the District Court for the Central District of California, which is claimed to determine that the purported offer of commodities options in circumstances similar to the instant case are securities. However, the Administrative Law Judge has been unable to find a report of this decision and to evaluate the applicability thereof to the situation herein.

In the American Commodity Exchange case, supra, the Circuit Court upheld a finding by the District Court that a commodities futures option was a security, but without a discussion as to whether or not it comported with the four elements heretofore spelled out. The Circuit Court was satisfied that the relationship between the parties subjected the investor to a risk over which he had no control. This reasoning is not very satisfying nor sufficient to persuade the Administrative Law Judge.

The decision in Thomas J. Norton, supra, was based upon a motion to dismiss the complaint of the Commission alleging that options sold by Norton (the same Norton by whom respondent was employed) were securities required to be registered. The District Court, in properly deeming the allegations of the complaint to be true for the purposes of the motion,relied upon allegations that the agreement between the parties included the pooling of funds of various investors into a common enterprise in which the fortunes of the investors were interwoven and dependent upon the efforts and success of those seeking the investment or third parties, and also that the success or failure of one investor's contract and of defendant's contracts could have a direct impact upon the profitability of another investor's contract. Finally, the Court stated that:

> "The question of whether a security is involved is a question of fact <u>and will depend upon</u> whether plaintiff can <u>prove the allegations of its complaint</u>". (underling added)

However, from the record in this case, there is no proof that there was a pooling of funds or a common enterprise, and, as seen, no showing that there was any managerial effort on the part of Norton, which would affect the failure or success of the enterprise. Hence, the <u>Norton</u> case is clearly distinguishable.

On the other hand, there are the decisions in <u>Glazer</u> v. <u>National Commodity Research and Statistical Services, Inc</u>., U.S.D.C., N.D., Illinois E.D. (1974), 338 F. Supp. 1341; Aff'd C.A. 7, No. 74-1861 (January 7, 1977), CCH Fed. Sec. L. Rep. (1976-1977 Transfer Binder) ¶95,831. In both the District Court and the Circuit Court, an option arrangement similar to the one in the case at bar was found not to constitute a security, principally because there was no pooling of funds, no common purpose and no discretionary element on the part of the dealer in furtherance of the arrangement. As stated in the Circuit Court:

> "Assuming that NATCOM performs its contracts, profits for a purchaser depends upon the terms of the option, the amount of the premium, the course of the market, and the purchaser's choice of the time to exercise the option. The profit does not depend on the efforts of skill or NATCOM. Exercise of an option would call upon NATCOM to produce and sell to the purchaser a specified commodity future contract or buy one from the purchaser, or as the parties suggest, to settle in cash for the purchaser's profits. NATCOM's ability to perform would depend upon its financial resources."

In the Glazer case, the Commission appeared as amicus to argue that the interests sold were securities within the definition of the federal securities laws, more particularly an investment contract. The foundation of the Commission position appeared to the Court to be that the purchasers of the options were actually buying an interest in NATCOM's assets. The Circuit Court rejected the contentions of the Commission concerning the nature of the commodity futures options.[6/]

In a related situation involving investment by customers, in a broker's "guided commodity account program", giving the broker authority to trade in commodities futures for the plaintiff's account, wherein all funds received from participants in the program were pooled and used by defendant to engage in futures trading, with the program participants sharing pro rata in the contracts which were purchased or sold, the Court found the arrangements and the investments not to be a security under the securities laws. Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., U.S.D.C., E.D. Michigan S.D. Civ. No. 6-70683 (December 27, 1976), CCH Fed. Sec. L. Rep. (1976-1977 Transfer Binder) ¶95,862. The District Court points out that under

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6/ The Circuit Court observes that while contending that the options were investment contracts, the Commission at the same time was ". . . asserting distinctions which we are unable to perceive [when] the S.E.C. says: 'It bears emphasis that the Commission does not suggest that the offer or sale of commodities or commodities futures, (continued)

the definition of what is a security as set down in Howey, supra, one of the important ingredients is the common enterprise. The District Court held that the defendants' financial interest in the transactions was limited to commissions, and that regardless of how many other customers accounts were being handled by defendant under similar a arrangements, it did not involve any common enterprise.

In the opinion of this Administrative Law Judge, the arrangements between Norton and his customers did not involve the creation of a security under the securities laws. Disregarding form for substance and in considering economic reality, it would appear that it more likely partook of the nature of pure gambling rather than an investment. It is true that all investments involve some element of gambling and risk, but here this seems to be the only element. The investor was paying a premium. Whether or not he made a gain or lost his investment depended purely upon the action of the commodities futures market. If he guessed wrong, he lost his money (bet) -- if he guessed right, he was entitled to earn a profit, and was paid off by Norton. If he wanted to parlay the action, he left his profit in, and bought another option on the same basis. This aspect of

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6/ (continued)

or bona fide options on commodities futures, without more, is the offer or sale of securities'". The same language is repeated by the Division in its brief herein, on page 24. The Administrative Law Judge is likewise unable to perceive this difference.

the transaction was quite apparent to the Commission investigator, Mr. John Brissman, who testified (Tr.p. 29):

> "* * * It is, in fact, betting that the option will not appreciate, and the firm will profit by the amount of premium. In the case where the option appreciates, the firm simply loses money, because it has to pay the customer for his option out of its checking account." 7/ (underlining added).

However, for the purpose of this proceeding, it suffices to point out the sharp division in the decisions on the subject and the uncertainty as to whether commodities futures options were in fact securities to be regulated, in order to decide respondent's responsibility for his sale of such options in reliance upon advice and common understanding that there was no need for registration, and whether the imposition of sanctions therefor is in order. Even in Glazer, supra, in discussing the then pending bill to establish the Commodity Futures Trading Commission, the District Court observed, at page 1345 of 338 F. Supp.: "Accompanying the bill is H.R. Rep. No. 957, 93rd Cong., 2d Sess. 48-50 (1974), which indicates the current view that such options are not regulated by any federal statute."

7/ It is interesting to note that in an article in the New York Times of February 27, 1977, Mr. Albert Haas, Jr., a contributing editor of San Francisco Magazine and a former senior vice president of Sutro & Company, a brokerage house, described trading in stock options thusly: "options trading is neither investing nor speculating. Mostly it is gambling -- legal , Federally-regulated gambling." In Business Week for March 7, 1977, in an article entitled "How to Trade Options" (page 77), a customer-investor in stock options says that they "hold the same appeal as betting on horses."

Respondent contends that the jurisdiction of this Commission in this proceeding has been superseded by the creation of the Commodity Futures Trading Commission (CFTC) as established by the Commodity Futures Trading Act of 1973, 7 U.S.C. §1, et seq. (CFT Act). The position of the Division, as expressed in its reply brief (pages 5-7) appears to be that the CFT Act has not deprived this Commission of its jurisdiction with respect to arrangements involving the offer and sale of securities (assuming that futures options are securities) and rely upon statements made by "the floor managers of the Act" supposedly making that clear.

The CFT Act of 1974 went into effect on April 21, 1975. Section 2 of that Act provides that the CFTC shall have exclusive jurisdiction with respect to commodity futures contracts, including any transactions which is of the character of an option. This conferring of exclusive jurisdiction is subject to several provisos, the second of which reads as follows: "and provided further, that except as hereinabove provided, nothing contained in this section shall (1) supersede or limit the jurisdiction . . . conferred on the Securities and Exchange Commission or (2) restrict the Securities and Exchange Commission . . . from carrying out their duties and responsibilities in accordance with such laws." (Underlining added).

The key phrase in this proviso (which is carefully omitted from the Division's brief in its jurisdiction discussion) is the introductory one "that except as hereinabove provided" since that which is "hereinabove provided" is the section granting exclusive jurisdiction to the CFTC with regard to commodity futures trading and options. It has been held that this amounts to a transfer of jurisdiction from this Commission to the CFTC. See SEC v. Univest, Inc., 405 F. Supp. 1057 (1976), and 410 F. Supp. 1029 (1976); and the decisions in American Commodity Exchange Inc., and Thomas N. Norton, supra.

The facts giving rise to the charges against respondent herein occurred prior to the effective date of the CFT Act. However, these proceedings were commenced after that Act, thereby raising the question as to whether this Commission still has jurisdiction in the matter.

In considering this question of overlapping jurisdictions the above three cases, while agreeing that after April 27, 1975, the new agency's jurisdiction supersedes that of this Commission, disagree as to whether this Commission retained jurisdiction over actions, proceedings and investigations commenced prior to the effective date of CFT Act relating to matters falling within the purview of its statutory authority. The Tenth Circuit Court in American Commodity Exchange, Inc. after detailed analysis of Congressional proceedings and

debates leading up to the passage of the CFT Act concludes that "the sensible approach to this would be to hold that Congress intended for the SEC to finish up its work before the exclusive provision of the Commodity Act became absolutely effective" otherwise there would exist a no-man's land in which no sanctions would flow from conduct under either act during the crucial periods involved in that case. Thus, the Court found that all pending proceedings including ongoing investigations should continue unabated by any provisions of the CFT Act. The same general conclusion is reached in Norton case. Contrary to these holdings are the decisions Univest, Inc., which, on the basis of a study of the same background material utilized by the Circuit Court in the American Commodities Exchange case, conclude that although the SEC was entitled to continue any investigation commenced prior to the effective date, any information developed from those inquiries should have been turned over to the proper party for prosecution, i.e. the CFTC.

In this proceeding, the order was served long after the effective date in the CFT Act. But a careful reading of the record does not disclose when the investigation affecting Carlson was initiated. The only indication is found in the memorandum opinion of the District Court in Norton

from which it appears that although the complaint was filed in that case after the effective date of the Act, the case was "allegedly" being investigated prior thereto. Hence, the failure to prove that the investigation of Carlson was commenced prior to the critical date is fatal to the question of jurisdiction, even under the holding in American Commodities Exchange. Of course, a finding that the options are not "securities" would deprive the Commission of jurisdiction in any event.

From the foregoing, it is found that respondent was engaging in an activity, the sale of options on commodity futures contracts, at a time when an existing decision in a District Court in Glaser, supra stated that such options were not regulated by any federal statute, and when subsequent Circuit Court decisions were in disagreement as to whether these options were "securities" under the securities laws; and wherein court decisions have disagreed as to whether this Commission had jurisdiction over such transactions. Under this estate of affairs, it is found that Carlson was well justified in relying upon the opinion of others that he was engaged in an activity not subject to any regulation, even if it would be eventually found that these options were securities and that this Commission had jurisdiction. This is not a situation that would call for sanctioning Carlson.

He was a small part-time operator involved for a brief period in an insignificant volume of transactions who had no relevant impact in his field. No useful purpose would be served by the imposition of any sanction against him. 8/

The "Employment" Violation

The Order further charges respondent with having, during the period from December 1975 to June 1976, wilfully violated Section 15(b)(6) of the Exchange Act, in that, without the consent of the Commission, he was associated as a salesman with a registered broker-dealer which was also a member firm of the New York Stock Exchange. The section under which respondent is charged reads as follows:

> The Commission, by order, shall censure or place limitations on the activities or functions of any person associated, or seeking to become associated with a broker

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8/ The entire question of the legality of options on commodity futures contracts is still fluctuating. Under the former Commodity Exchange Act of 1936 there was a prohibition against trading in options on commodities regulated under that Act (which did not include ccpper, platinum, lumber, cocoa and sugar sold by Carlson). The CFT Act continued the prohibition against trading on these but also left it to the CFTC to decide whether to extend the option trading prohibition to the newly regulated commodities or to subject such option trading to regulation. The CFTC chose the latter course and in November 1976 it adopted interim regulations pertaining to dealers in options. One of these regulations was enjoined in British American Commodity Options Corp. v. Bagley, U.S.D.C., S.D.N.Y. Dec. 21, 1976. As a result, in a commentary in the Securities Regulation and Law Report No. 385 January 12, 1977, at pp. A6-7) the FTC might reconsider its decision to subject option trading to regulation in favor of suspending trading in them entirely or taking some other alternative measure. See also the discussion in S.R.L.R. 370, September 22, 1976, at pp. A20-21, and the comments of vice chairman Rainbolt concerning the manner in which the CFTC is approaching the granting of permission to trade in these options (S.R.L.R. No. 392, p. A-8).

> or dealer, or suspend for a period not exceeding twelve months or bar any such person from being associated with a broker or dealer, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in subparagraph (A), (D), or (E) of paragraph (4) of this subsection, has been convicted of any offense specified in subparagraph (B) of said paragraph (4) within ten years of the commencement of the proceedings under this paragraph, or is enjoined from any action, conduct or practice specified in subparagraph (C) of said paragraph (4). <u>It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with a broker or dealer is in effect willfully to become, or to be, associated with a broker or dealer without the consent of the Commission, and it shall be unlawful for any broker or dealer to permit such a person to become, or remain, a person associated with him</u> without the consent of the Commission, if such broker or dealer knew, or in the exercise of reasonable care should have known, of such order. (underlining added).

This allegation arises from respondent's employment with David Noyes and Co. during a 5 or 6 month period of employment from in or about November, 1975 to some time in May or June of the following year, in asserted violation of the Commission's order of June 9, 1971 imposing sanctions. This order, which was based on a settlement reads, in pertinent part, as follows:

> "IT IS ORDERED that, effective June 30, 1971, * * * John A. Dawson and Charles C. Carlson be, and they hereby are suspended from being associated with a broker or dealer for a period of nine months and, that at the conclusion of such period, each of the individual respondents may be associated with a broker-dealer in a non-supervisory capacity upon an appropriate showing to the Commission that he will be adequately supervised."

The Division interprets this sanction, as it has throughout the events herein, to mean that after the initial period of suspension has expired, Carlson could not thereafter be employed by a broker-dealer in a non-supervisory capacity, without

obtaining the prior approval of the Commission for such employment.[9/] The Division contends that any such employment without the prior approval violates Section 15(b)(6).

Moreover, it would appear that the Division treats the granting of such approval as if it were dealing with a petition to be relieved from a suspension or bar. Thus, Carlson was requested to submit an affidavit (not a mere letter) as to all his employment since June 9, 1971[10/] and in its brief, the Division seeks to apply to Carlson the requirements of the Commission's Release (SEA Rel. No. 11267, February 26, 1975) having reference to "applications from relief from disqualification". However, that Release is concerned with applications for readmission by individuals who have previously been barred from the business or some aspects thereof, and to individuals who have been disqualified but seek to have the disqualification lifted.

As the events herein demonstrate, the logical interpretation to apply to the language of the sanction order would be that Carlson was to be suspended for nine months, and that

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9/ Thus, in a letter (Exhibit 4) on May 13, 1976 to Mr. Murin of the Noyes Company, the Chicago Regional Administrator states:

> "This means that Mr. Carlson may not be employed by your firm until the Commission has given its approval, which approval is firstly based upon 'an appropriate showing to the Commission that he will be adequately supervised'".

10/ In its letters to Mr. Murin and later in its briefs, the Division appeared to be quite incensed over respondent's failure to submit the requested affidavit. Such requirement is wholly unwarranted under the terms of the sanction order.

thereafter he had the right to go to work, but only in a supervised capacity. It did not mean that he first had to get approval, or to have a sanction lifted, or to petition that a disqualification be removed. He did have the burden of making an appropriate showing that in such employment, he would be adequately supervised. This distinction is important. To follow the reasoning of the Division would have the effect of extending the period of suspension imposed upon Carlson far beyond its express nine-month limitation. Carlson's experience when he went to work for Heinold bears this out.

At the commencement of respondent's employment with Heinold, there was a preliminary period of negotiation between the Regional Office and the broker, as to satisfactory terms of supervision. This was then followed by a transmittal to the Division's Washington office of the agreed upon terms. Thereafter, a further period of some sixty-days elapsed before final approval was given. During all of this time Heinold was advised not to employ Carlson. In other words, by making him wait out this procedure, he was effectively suspended for an additional period of at least sixty or more days. Surely, this was not the intent of the original sanction imposed upon him.[11/] Moreover, the terms of supervision could conceivably

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11/ The Division feels that this lapse of time was not excessive. To a person out of work and seeking a job, two months or more of waiting time can indeed induce a severe hardship. As a matter of fact, Mr. Dyhouse, the attorney in the Chicago Regional Office, tells us that he was called a number of times by Carlson to find out when he would be able to go to work, and, when the terms were approved, Dyhouse telephoned respondent at once, rather than have him wait for the formal ruling, so that he could resume his employment that much sooner.

have been rejected in Washington, which would then have involved more negotiations with the prospective employer, followed by a repeat of the described procedures and the effective "suspension" from any employment with a broker or dealer for that many more months.

These procedures are compounded by the fact that there are no established guidelines setting forth what type of supervision would be "adequate", so that an employer would know what would be expected of him if he were to hire respondent. Under these procedures, there is no way for a person who has completed a period of suspension to resume his livelihood conditionally or temporarily pending the making of an "appropriate" showing. The lack of pertinent guidelines creates the anomaly of having more stringent supervision demanded of Noyes than required of Heinold, without apparent reason therefor. It would be sheer folly to expect a prospective employer to first go through protracted negotiations with a Regional Office, then wait for weeks and perhaps months to find out if he can hire a salesman, particularly one like Carlson, who is no proven world-beater. In effect, the existing procedures would result in the extension of the original period of suspension far beyond its stated limits (and perhaps beyond the 12-month statutory limitation).

The provisions of Section 15(b)(6) of the Exchange Act

must also be taken into account. It makes it unlawful for one against whom there is in effect an order barring or suspending him from association with a broker or dealer to become so associated without the prior consent of the Commission. This is clearly directed against a person resuming activities while he is barred or suspended therefrom unless first approved by the Commission, probably after a petition to be relieved from the sanction. But here, Carlson was neither barred nor suspended when he sought to work for Noyes. He was not seeking to remove the restriction against supervisory employment. Nevertheless, the section appears to apply to him since there was "in effect" the continuing proviso of an order suspending him, but whose suspension period had long since expired.

The only way to give any logical meaning to the statute under the involved facts is to read the section together with the terms of the sanction order. In order to avoid a construction leading to unspecified and uncalled for added periods of suspension it must be concluded that respondent had a right to go to work for a broker or dealer in a supervised capacity, but that he had to forthwith make a showing that he would be adequately supervised. Once he attempted such showing, his employment could continue pending an approval of the supervision.[10A/]

On this basis, it is found that Carlson is in violation of the terms of the sanction order and of the statute not for

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10A/ Similarly, a sanction suspending a respondent for a stated period followed by a bar thereafter from being employed in a supervisory capacity may go to work in a non-supervisory capacity without prior Commission approval, even though there is "in effect" an order of suspension or bar.

becoming employed by Noyes, but for failing promptly thereafter to make a showing that he would be adequately supervised. In fact, he never made the offer to do so. This matter arose several months later and was instigated by action of the Chicago Regional Office in entering into negotiations with Noyes. Respondent's excuse that he believed that once having been cleared to work for Heinold he was clear to work for others is rather weak. At the very least, he should have made inquiry of the Commission or his counsel to resolve any doubt.

The failure by respondent to make the required showing was "willful" as that term is understood in proceedings under the securities laws. It is well established that a finding of willfulness does not require an intent to violate the law; it is sufficient that the person charged with the duty consciously performs the acts constituting the violation. See Billings Associates, Inc., 43 SEC 641, 649 (1967); and Hughes v. S.E.C., 174 F.2d 969, 977 (C.A.D.C., 1949).

In mitigation, it is observed that respondent no doubt feared, and rightly so, that had he gone to the Commission, he would have been kept from working (suspended?) for several months as he had experienced with Heinhold. He might not have been hired. Moreover, he may well have been lulled into inaction by the fact that the terms of the sanction order (Murin said he had seen it) did not seem to impel Noyes to

action with respect thereto. 11/

Public Interest

Having been found to have wilfully violated Section 15(b)(6) to the extent heretofore found, the question of a proper sanction must be considered. The sanction: is intended to be remedial only and to protect the public interest (Berko v. S.E.C., 316 F.2d 137, 141 (C.A. 2, 1963), should have a deterrent effect upon others (Richard C. Spangler, Inc., SEA Release No. 12104 (February 12, 1976) 8 SEC Docket 1248, note 71), and must be assessed with due regard to the facts and circumstances of each particular case (Robert F. Lynch, SEA Release No. 11737 (October 15, 1975), 8 SEC Docket 75, 78).

In the light of the foregoing, it is noted that Carlson had been previously fined $300 by the NASD for a bookkeeping violation and sanctioned, as aforesaid, in the Dawson matter. However, the NASD fine seems relatively light, and the limited sanction agreed to in the Dawson case by the Commission appears to be contrary to the extreme seriousness which the Division seeks to attach to Carlson's participation therein.

11/ In its brief, the Division dwells extensively upon the claim that the supervisory conditions demanded of Noyes were proper. However, lesser terms required of Heinold were apparently satisfactory as well. No reasons are advanced as to why the supervision given over many years by Noyes over its other representatives was not adequate. After observing the demeanor of Mr. Murin, the Administrative Law Judge is convinced that he could well take care of his salesmen under the rules he was following. In any event, whether respondent made an adequate showing, or whether the Division was justified in seeking other and different requirements, is not in issue herein.

Also noted are the allegations in the Order for Proceedings concerning the submission of a false employment statement to the Stock Exchange and a false employment statement to the Division. With respect to the latter, as indicated in footnote 10, *supra*, the Division was not entitled to seek such a statement from the respondent. Of course, having submitted it, he should have proceeded with candor. This was likewise incumbent upon him in his application for registration with the New York Stock Exchange. However, he cannot be faulted for omitting from both statements a three-day association with a bank in which he performed no duties although gratuitously paid. He cannot be held to have been deliberately deceptive in not telling of his association with The Chicago Silver Exchange, which lasted only two weeks and resulted in no compensation to him. In fact, other than his employment by PEPCOR, the remaining jobs were part-time affairs, involving no significant earnings or activities. In view of his belief, at the time apparently justified, that the sales of commodity futures options did not involve regulated dealings in securities, the failure to list these jobs is also of minimal significance. Perhaps, for a complete picture of his activities, he should have included at least the Goldstein-Samuelson and Norton connections. But evidently no one was taken in or injured by his failure to do so.

On the positive side, it cannot be overlooked that in seeking employment both from Heinold and from Noyes, Carlson disclosed that he had been sanctioned, a fact that was also made known in his application to the New York Stock Exchange. Despite this, he was approved for registration by the Exchange and engaged as a salesman by these brokers. True, he did not disclose initially the proviso in the sanction about having to make a showing of adequate supervision, but this is not deemed to major significance especially since Heinold acted to comply with this requirement, Mr. Murin had seen the order, and the Exchange can be presumed to have looked into it. The mitigating effect of respondent's prior experience in trying to work for Heinold has been discussed above.

Other factors noted include the failure of the Division to proceed in any way against Noyes, despite its clear and forceful threat to do so. Under the Division's interpretation of Section 15(b)(6), Noyes' violation is of equal quality with that of Carlson. Yet, only he, a minor employee, has been charged in this proceeding.

Also considered in arriving at a proper sanction to be imposed is the fact that respondent has already been kept from employment for several months at Heinold, and dismissed from his employment at Noyes, 12/ primarily because of the efforts

12/ For technical reasons, these periods of unemployment are not being characterized as additional periods of "suspension".

by the Division in its application of the provisions of the sanction order.

To summarize, it has been concluded that no sanction against respondent is warranted as a result of his limited participation in the sale of commodity futures options at a time when it was reasonable to assume that they were not securities; that respondent has been found to have willfully violated the provisions of Section 15(b)(6) of the Exchange Act; and that after weighing and giving full regard to the surrounding facts and circumstances, both favorable and unfavorable, a censure of respondent is in order.

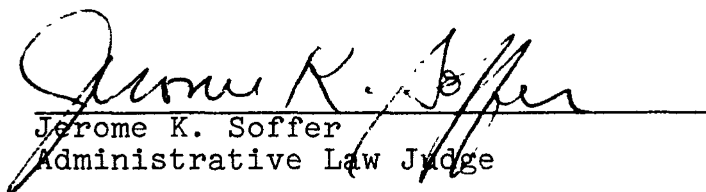
In arriving at the sanction given, it has also been considered that if at any time in the future, Carlson changes his mind and again seeks employment in the securities field, he will have to disclose not only the fine paid to the NASD and the sanction imposed in the Dawson matter, but the fact that he was censured in these proceedings. He will also continue to be subject to the provisions in the Dawson order about being restricted against supervisory positions and the need of making a showing of adequate supervision.13/

13/ In their proposed findings and conclusions and briefs, the parties have requested the Administrative Law Judge to make findings of fact and have advanced arguments in support of their respective positions other than those heretofore set forth. All such requested findings of fact, conclusions, and arguments not specifically discussed herein have been fully considered and the Judge concludes that they are without merit or that further discussion is unnecessary in view of the findings herein.

Accordingly, IT IS ORDERED that respondent, CHARLES C. CARLSON be, and he hereby is, censured.

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

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 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.



Jerome K. Soffer
Administrative Law Judge

Washington,D.C.
March 28, 1977