

IN THE MATTER OF  
ATLANTIC EQUITIES COMPANY, ET AL.\*

*File No. 8-8415. Promulgated July 11, 1967*

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

**BROKER-DEALER PROCEEDINGS**

**Grounds for Revocation of Requisition**

**Grounds for Suspension or Expulsion from Registered Securities Association**

**Grounds for Denial of Registration**

**Fraud in Offer and Sale of Securities**

**Bidding for and Purchasing Securities While Engaged in Distribution**

**Offer, Sale and Delivery of Unregistered Securities**

**Failure to Comply with Net Capital Requirements**

**Failure to Comply with Records Requirements**

**Withdrawal of Registration**

Where registered broker-dealers and applicant for broker-dealer registration variously participated in scheme to defraud and in manipulative activities with respect to offering of stock pursuant to claimed exemption under Regulation A under Securities Act of 1933 in that blocks of such stock were withheld from public investors and thereafter distributed at artificially inflated prices, optimistic and fraudulent representations were made, and bids were quoted for or purchases effected of such stock during distribution; and where one such broker-dealer failed to comply with net capital requirements and made fictitious entries in its books to conceal true financial condition, *held*, in public interest to deny requested withdrawals of registration, to revoke registrations of certain broker-dealers, to expel or suspend members of registered securities association from membership, and to deny application for registration.

**PRACTICE AND PROCEDURE**

Rulings on objections raised by broker-dealers in consolidated broker-dealer and Regulation A suspension proceedings, which among other things admitted

\* Blair F. Claybaugh & Company, 8-2851; First Pennington Company, 8-7626; Lenchner, Covato & Co., Inc., 8-6692; John Randolph Wilson, Jr., 8-6784; John R. Wilson, Jr. Co., 8-6784; Shawe & Co., Inc., 8-9486; Strathmore Securities, Inc., 8-7323; Klein, Runner & Company, Inc., 8-9930; Howard James Hansen doing business as H. J. Hansen and Company, 8-11747.

in evidence record of prior proceedings against same respondents which Commission terminated because of participation of Commissioner who had served as director of staff Division during its investigation of Regulation A offering, and denied motions to sever or dismiss present proceedings or hold evidentiary hearing with respect to any *ex parte* communications between staff and Commission in connection with such termination, institution of present proceedings, and proffer of prior record, and to obtain copy of transcript of testimony during private investigations, *affirmed*, and contention that prior Commission decision permanently suspending Regulation A exemption, based on issuer's offer of settlement, prejudged issues with respect to other respondents, *rejected*.

#### APPEARANCES:

*Alexander J. Brown, Jr., William R. Schief and Thomas H. Monahan*, for the Division of Trading and Markets of the Commission.

*Murray A. Kivitz*, of Kivitz & Robinson, for Atlantic Equities Company, Klein, Runner & Company, Inc., Milton I. Klein and Earle I. Runner, Jr.

*Oliver E. Stone*, of Rotwein and Stone, for Barbara J. Black.

*Edward T. Tait and William D. Matthews*, of Whitlock, Markey & Tait, and *Edward M. Citron*, for Lenchner, Covato & Co., Inc., Nicholas Covato, Joseph S. Lenchner and Norman C. Eisenstat.

*James R. Jones*, for John Randolph Wilson, Jr., doing business as John R. Wilson, Jr. Co.

*William J. Crowe, Jr.*, and *James T. Glavin*, of Havens, Wandless, Stitt & Tighe, for Strathmore Securities, Inc. and Auldus H. Turner, Jr.

*Howard James Hansen*, *pro se*.

*Joseph S. Schuchert, Jr.*, of Porsche, Schuchert & Sapp, for Naomi R. Jezzi and William J. Abbott.

*Walter Ladusky and Irvin B. Shawe*, president and vice president of Shawe & Co., Inc., *pro se*.

#### FINDINGS AND OPINION OF THE COMMISSION

Following extensive hearings in these consolidated proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner recommended that the registrations as brokers and dealers of Atlantic Equities Company ("Atlantic"), Shawe & Co., Inc. ("Shawe Co."), John Randolph Wilson, Jr., doing business as John R. Wilson, Jr. Co., Lenchner, Covato & Co., Inc., formerly Bruno-Lenchner, Inc. ("Lenchner Co."), Strathmore Securities, Inc. ("Strathmore"), and Klein, Runner & Company, Inc. ("Klein Co.") be revoked; that various persons associated with those bro-

ker-dealers and with two others, Blair F. Claybaugh & Company ("Claybaugh") and First Pennington Company ("Pennington"), whose registrations we previously revoked in these proceedings,<sup>1</sup> be found causes of the revocation of their firms' registrations; and that the application for registration as a broker-dealer of Howard James Hansen, doing business as H. J. Hansen and Company, be denied. Exceptions and supporting briefs were filed by Wilson, Strathmore and Auldus H. Turner, Jr., an officer of Strathmore, and a reply was filed by our Division of Trading and Markets. Lenchner Co., and Nicholas Covato, Joseph S. Lenchner, and Norman C. Eisenstat, officers of Lenchner Co., requested review of the recommended decision on the basis of the matters presented in their brief addressed to the hearing examiner. No exceptions were filed by Atlantic, Shawe Co., Klein Co., Hansen, and various associated persons named as causes by the hearing examiner. On the basis of an independent review of the record and for the reasons set forth herein and in the recommended decision, we make the following findings.

On March 23, 1961 Siltronics, Inc. ("Siltronics"), which was engaged in the manufacture of electronic devices, filed a notification and offering circular under Regulation A for the purpose of obtaining an exemption from the registration requirements of the Securities Act of 1933 with respect to a proposed offering of 150,000 shares of its common stock at \$2 per share. Thereafter, Atlantic was named as underwriter, and Claybaugh, which agreed to sell 105,000 shares of the offering for Atlantic, was named as statutory underwriter. Our staff advised Atlantic's president, Milton I. Klein, and its general manager, Earle I. Runner, Jr., who are also respondents in these proceedings, that it had information that Siltronics stock would be a "hot issue" and have a "spectacular" price rise, and that the market might be manipulated, and Atlantic stated it would do everything possible to maintain an orderly distribution of and market for the stock. The offering commenced on June 26, 1961, and according to the Form 2-A report filed by Siltronics, the portion allocated to Claybaugh was sold on the opening day and Atlantic's allotment was not sold until July 5, 1961.

#### FRAUD IN OFFER AND SALE OF SILTRONICS STOCK

The hearing examiner found that Atlantic, Strathmore, Wilson, Shawe Co., Lenchner Co., Hansen, Klein, Runner and certain other associated persons variously participated in a scheme to defraud and in manipulative activities with respect to the offering

<sup>1</sup> Securities Exchange Act Release Nos. 7158 (October 18, 1963) and 7927 (August 4, 1966).

of Siltronics stock in that two blocks—one of 25,000 shares and the other of 5,000 shares—were withheld from public investors and thereafter sold at artificially inflated prices.

(a) *25,000-share block*

Siltronics' proposed offering had first come to the attention of Claybaugh's Pittsburgh Office, but its manager, respondent Ethel I. Weber, believing that her organization was not in a position to underwrite the offering, told Hansen, manager of Atlantic's underwriting department, about it. Hansen, who under his contract as Atlantic's syndicate manager was authorized to distribute 70 percent of any securities underwritten by Atlantic to selling group members at concessions of up to 50 percent of the underwriting discount, promised Weber that Atlantic would confirm 105,000 shares or 70 percent of the offering to Claybaugh. As a condition to allotting those shares to Claybaugh, Weber agreed that 25,000 of them would be earmarked for transfer to persons designated by Hansen. Pursuant to this agreement, Weber on June 26, arranged with Pennington, a member of Claybaugh's selling group, to transfer to Wilson, at the offering price, 25,000 of the 30,000 shares allotted to Pennington.<sup>2</sup> Two customers of Wilson who were friends of Hansen<sup>3</sup> each purchased 12,000 shares through Wilson at 2, plus a commission of 5 cents per share, but a majority of those shares was taken in the names of five persons who were designated by the customers and had no beneficial interest in the stock. Wilson was permitted to retain the remaining 1,000 shares at the offering price as a "bonus," and he sold those shares about June 27 and in July 1961 at 3 to 4<sup>3</sup>/<sub>8</sub>.

On June 27, Hansen arranged the sale by Wilson as agent of 15,000 shares of the stock that had been purchased by the two Hansen friends to Shawe Co. at 3<sup>1</sup>/<sub>4</sub>, and 1,200 shares at 2 as a bonus, although the stock was then being quoted at 4 to 4<sup>1</sup>/<sub>2</sub> bid, and 4<sup>1</sup>/<sub>2</sub> to 5 asked.<sup>4</sup> Shawe Co.'s purchase of the bonus shares was executed on a principal basis, while its purchase of the 15,000 shares from Wilson was effected as agent for Lenchner Co., pur-

<sup>2</sup> Weber's testimony indicates that the 25,000-share block was not transferred directly from Claybaugh to Wilson because Wilson was not a selling group member.

<sup>3</sup> The first customer, a physician, had attended a meeting with Hansen and Weber, among others, to discuss the possibility of establishing a new broker-dealer firm. The second customer was a registered representative of another broker-dealer firm with which Hansen had previously been associated. That customer had inspected Siltronics' plant at Hansen's invitation 2 months earlier with a view to participation by his firm in the anticipated underwriting.

<sup>4</sup> Hansen obtained 2,300 shares, assertedly as a loan, from one of the purchasers through Wilson of the 24,000 shares, with 1,100 of the 2,300 furnished by the other, around July 6, 1961. Hansen at first testified that he did not execute a promissory note for the loan, which was supposed to be repaid with an equal number of shares or \$9,200, but he later changed his testimony, stating that he executed such a note on July 6, 1961, but did not deliver it until after his initial testimony. There was no repayment by Hansen of the asserted loan.

suant to an arrangement by Hansen, at  $3\frac{1}{4}$ , and Shawe Co. charged Lenchner Co. a commission of  $\frac{1}{4}$ . Of the 15,000 shares acquired by Lenchner Co., 14,100 shares were purchased for Claybaugh at  $3\frac{1}{2}$ , and Lenchner Co. charged Claybaugh a commission of  $\frac{1}{4}$ , and 900 shares were retained by Lenchner Co. to cover a short position in the stock. Joseph S. Lenchner, vice president of Lenchner Co., testified that he knew at the time he effected the purchase through Shawe Co. that the latter had acquired 1,200 share at around 2 and he arranged with Irvin B. Shawe, vice president of Shawe Co., for Lenchner Co. to participate in such bonus stock to the extent of 500 shares at  $2\frac{1}{8}$ .<sup>5</sup> On the day of Lenchner Co.'s purchase at  $3\frac{1}{2}$  it submitted quotations on the stock of  $4\frac{1}{2}$  bid and 5 asked to the National Quotation Bureau, Inc.

Strathmore, which had been allotted 6,000 shares out of Claybaugh's 105,000-share block as a member of Claybaugh's selling group and had disposed of them at the offering price on June 26, received a telegram from Claybaugh the following morning, stating that the Siltronics "syndicate (was) closed" and requesting that Strathmore state its position. That afternoon Turner, vice president and principal trader of Strathmore, purchased a total of 5,000 shares from Claybaugh at 4 to  $4\frac{3}{8}$ , and on the same day and the next day Strathmore sold around 5,000 shares at prices generally of  $4\frac{5}{8}$  and  $4\frac{3}{4}$ .

(b) 5,000-share block

Pursuant to a proposal by Hansen to Joel Silverman, an officer of Siltronics, made prior to the Siltronics offering, persons designated by Silverman agreed to purchase a total of 5,000 shares of the offering at the offering price of 2 on the condition, which had been imposed by Runner of Atlantic and of which Hansen was aware or was informed shortly thereafter, that the shares be resold to Claybaugh at 3 upon Weber's request.<sup>6</sup> Silverman, who acquired the beneficial ownership in 1,000 shares of the block, had

<sup>5</sup> Around July 1961, a prospective customer to whom Shawe showed a confirmation of his firm's transaction in Siltronics stock with Lenchner Co. amounting to about \$50,000, asked why Shawe Co. had sold the stock, which was trading at 5, for that amount. Shawe indicated that his firm's transactions in this block had been prearranged and that otherwise it would not have been able to purchase those shares, and stated that Hansen had "more or less masterminded the whole operation."

<sup>6</sup> Similar arrangements were proposed prior to the offering to a part-time securities salesman who had an account with Atlantic. He was told by an Atlantic representative that he could obtain 1,000 or 2,000 shares at the offering price provided he agreed to resell all but about 200 shares at specified prices ranging from 3 to 4, and that he should use nominees in placing his order. A friend of Weber told the salesman that, because of his close association with her, he would control a block of 30,000 or 40,000 shares, and that he wanted the salesman to sell shares at 5 with the condition that the buyers resell at 10. The salesman did not accept either proposal.

prior to the offering tendered \$10,000 in payment of the 5,000 shares to Runner. Runner rejected the tender, stating that each of the purchasers should write a letter to Atlantic requesting that a trading account be opened in his name and enclose a check in an odd amount, with the total of such checks being about \$10,000. In May 1961, such letters, base upon a draft prepared by Hansen, were sent enclosing checks totaling \$10,535. The apparent purpose of this arrangement was to make it seem that the accounts were ordinary customer accounts not opened for the express purpose of purchasing a portion of the offering. On June 27, Claybaugh purchased the Silverman group's shares at 3 pursuant to the condition of their purchase without informing the group that such purchase was being effected.

(c) *Optimistic and Fraudulent Representations*

Prior to and at about the time of the commencement of the Siltronics offering, representatives of Claybaugh and of Atlantic stressed to customers the potential demand for and shortage of Siltronics stock and the fact that the offering would be a "hot issue," and in addition made general and specific predictions of price increases. A customer of Atlantic who had ordered 100 shares at the offering price was later told that he could not purchase more than 25 shares at that price but could have additional shares at  $4\frac{3}{4}$ . A Claybaugh customer was dealt with similarly and was told that the firm was "not making too much money" selling the stock at 2. Weber told another customer prior to the offering that the price would reach 10, and the customer, who subscribed for 1,000 shares of the stock at the offering price and whose subscription was later reduced to 500 shares thereafter received confirmations reflecting sales to him of 200 shares at 2 on June 26 and 100 shares at  $4\frac{1}{4}$  on June 28. Following the customer's complaint that the latter transaction was unauthorized, Weber sold him an additional 100 shares at  $3\frac{1}{2}$ . Another Claybaugh representative stated to a customer prior to the offering that demand for the stock exceeded the supply, that the offering price would be 4, and that the price would go to 8 as soon as trading opened, and following the customer's order for 500 shares at 4, further represented that persons who had ordered 500 shares would receive 100 shares at 2 and 400 shares at 4. The customer thereafter received confirmations reflecting sales to him of 100 shares at 2 and 400 shares at  $3\frac{1}{2}$ .

Not only did the above representations stimulate demand for the stock and serve to inflate the market price, but a number of them were false and misleading. Thus, Weber's prediction of a

price rise to 10 and the Claybaugh salesman's prediction of a price rise to 8, as well as the price predictions by other representatives of probably 7 within a week, or 7 or 8 after around 30 days, were without a reasonable basis, even in the context of a hot issue and apart from any unlawful manipulative activity.<sup>7</sup> And the representation that the offering price would be 4 was clearly false.

(d) *Conclusions*

Hansen of Atlantic and Weber of Claybaugh were the architects of a scheme to defraud in the sale of the Siltronics "hot issue," which involved the stimulation of demand by optimistic and fraudulent representations and reductions in the number of shares order at the offering price, the withholding of two blocks of stock from the offering and the transfer of most of the shares involved to Claybaugh, directly at a price higher than the offering price and indirectly through a number of broker-dealers at successively higher prices, purchases and the insertion in the pink sheets of bids higher than the offering price before the distribution was completed, and the distribution of those blocks to the public at the artificially inflated prices. We further conclude that various respondents participated in different stages of that scheme.

The manipulative pattern used in disposing of the Siltronics "hot issue" was not a novel one. In 1959, 2 years before the Siltronics distribution, we issued a public release discussing the results of an inquiry into certain practices in connection with the distribution of "hot issues" which might involve violations of the securities laws, with a view to alerting the financial community to those practices in order that violations might be avoided.<sup>8</sup> The practices employed in the instant case were substantially similar in intent and purpose to those we had described.

Wilson, Lenchner Co., Strathmore, and the individual respondents associated with Lenchner Co. and Strathmore assert that they did not knowingly participate in any scheme to defraud with respect to the distribution of the 25,000-share block. However, in the absence of proof of actual knowledge, participation in a scheme may be shown from the surrounding circumstances if they should have alerted respondents to the existence of such scheme.<sup>9</sup> We discuss the positions of these respondents in turn.

Wilson states that he knew the offering was a "hot issue," which is usually sold in 1 day and heavily traded in the after-market, and

<sup>7</sup> See *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 872 (1965), *aff'd* 366 F.2d 446 (C.A. 2, 1966).

<sup>8</sup> Securities Exchange Act Release No. 6097 (1959). See also S.E.C. Special Study of Securities Markets, 88th Cong., 1st Sess. H. Doc. No. 96, Part 1, pp. 502, 514-16, 522-23 (1963).

<sup>9</sup> See *Sidney Taper*, 42 S.E.C. 132, 136 (1964), *aff'd* 344 F.2d 5 (C.A. 2, 1965).

that it is not unusual for large blocks to turn up in the after-market. Accordingly, he asserts, he was entitled to conclude that the 25,000-share block he acquired from Pennington was not part of the Regulation A offering, particularly since he assumed that Pennington, being a member of the National Association of Securities Dealers, Inc. ("NASD"), would not do anything improper, and Pennington's president assured him that his purchase was not improper. He further asserts that he merely effected the transactions in the stock at the request of his two customers, and was not aware of discussions between them and Hansen, their relationship to him, any improper motives on their part, or that dummy accounts were being used by them.

Enough red flags were present, however, to put Wilson on notice that the offering was not over, or at least to alert him to inquire as to the source of the stock. Pennington's sale of the block to him on the first day of the offering at the offering price and his retention of 1,000 shares at that price, were obviously inconsistent with an assumption that the offering was over and with the fact that the offering was a hot issue and in great demand. Similarly inconsistent was Wilson's sale to Shawe Co., which was secured as a buyer by Hansen in a telephone conversation from Wilson's office in which Wilson participated, of 1,200 shares of his customers' stock at the offering price, in addition to 15,000 shares at a price substantially below the prices being quoted for the stock. Under these circumstances neither the fact that Pennington was an NASD member nor the assurance of its president was sufficient to justify a belief that the transactions were not improper.

The Lenchner Co. respondents contend that Lenchner, on behalf of the firm, exercised due diligence to ascertain that the offering had been completed and in checking the origin of the shares purchased from Shawe Co. before he effected such purchase. They assert that, since the firm was interested in trading in Siltronics stock, Lenchner on the afternoon of June 26, had obtained verbal assurance from Claybaugh that the offering was closed and on the morning of June 27, had determined that other firms had begun trading in the stock, whereupon Lenchner Co. commenced trading in the stock and developed a short position; that late that morning Shawe Co. offered to sell 15,000 shares to the firm at  $3\frac{1}{2}$ , which offer was kept open to permit Lenchner to look into the matter; that he communicated with Claybaugh as a possible purchaser because it was the "principal underwriter"; and that upon Claybaugh's agreement to purchase 14,100 shares at  $3\frac{1}{2}$ , he agreed to purchase the shares from Shawe Co. but only after he inquired of



Shawe Co. as to the source of those shares and was informed that they were "registered and unrestricted" and had been acquired from customers of Wilson, who he knew was not a member of the selling group. They also assert that a \$50,000 transaction was not unusually large for Lenchner Co.

The fact, however, that other firms may have been trading in the stock, as was Lenchner Co., did not explain the existence of such a large block of stock in the hands of Shawe Co. or Wilson one day after the purported completion of the offering, nor explain how Wilson's customers acquired so many shares of a hot issue even though Wilson was not a member of the selling group. Moreover, no satisfactory explanation is offered as to why, in view of the fact that the offering was a hot issue and the stock could command premium prices and was being quoted by others at 4 to  $4\frac{1}{4}$  bid and  $4\frac{1}{2}$  to 5 asked, and at  $4\frac{1}{2}$  bid, 5 asked by Lenchner Co. itself, Shawe Co. was able to purchase, as Lenchner knew, 1,200 shares at 2, or why Shawe Co. would be willing to sell 500 shares to Lenchner Co. at  $2\frac{1}{8}$ , and was able to buy 15,000 shares for Lenchner Co. at  $3\frac{1}{4}$ , a price substantially below Lenchner Co.'s own same-day bid of  $4\frac{1}{2}$  in the sheets. Under the circumstances, we reject Lenchner Co.'s contention that it made adequate inquiry before effecting the transactions in question.

The position of the Strathmore respondents is that they acted in accordance with well established custom and practice in the industry, and were not on notice to make any greater inquiry. They refer to the record which shows that Strathmore acquired the total of 5,000 shares from Claybaugh on June 27, at not less than double the offering price in order to meet customer demand and any demand generated by its salesmen, and point out that the purchases were effected only after they were notified that the offering had been completed, checked whether other dealers were trading in the "after-market," and ascertained that Claybaugh was the only source of supply. Strathmore made no inquiries of Claybaugh, however, as to the source of such a large block in the hands of an underwriter on the day following the claimed completion of the offering, but assertedly merely assumed that purchasers of the offering at 2 would have an incentive to double their money by selling the stock.

As previously mentioned, Klein and Runner, president and general manager, respectively, of Atlantic, had been cautioned by our staff prior to the Siltronics offering as to the problems posed by the "hot issue" nature of the proposed offering, and against engaging in any manipulative activity in connection therewith. Despite such admonition, and the assurances given by Atlantic that

an orderly distribution and market would be maintained, Atlantic and Claybaugh, through Hansen and Weber, respectively, engineered the manipulative scheme we have described and through their representatives made fraudulent representations with a view to stimulating further the demand for the offering and inflating the market price of the stock. Shawe's participation in the scheme was with the knowledge and acquiescence of the president of Shawe Co., Walter Ladusky, who was present when Shawe arranged the firm's purchase from Wilson as agent for Lenchner Co. and must have been aware of his firm's acquisition of bonus stock. Nicholas Covato, president of Lenchner Co., and Norman C. Eisenstat, who was secretary-treasurer and assisted Lenchner in the trading department, learned of the transactions effected by Lenchner later that same day. They should have been alerted to inquire into the propriety of their firm's transactions and to take corrective action.

On the basis of the foregoing, we find, as did the hearing examiner, that Atlantic, Hansen, Weber, Wilson, Shawe Co., Lenchner Co., Strathmore, Klein, Runner, Shawe, Covato, Lenchner, Ladusky, Eisenstat, and Turner acted in furtherance of a scheme to defraud, and that they thereby willfully violated or aided and abetted willful violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c) (1) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder.<sup>10</sup>

As we have seen, at least 30,000 shares of Siltronics stock were diverted from the public offering. Accordingly, the distribution continued until those shares were sold to public investors.<sup>11</sup> In the course of the distribution of such shares, bids were entered in the sheets by Lenchner Co. and Strathmore, who were underwriters with respect to the offering within the meaning of Section 2(11) of the Securities Act.<sup>12</sup> Moreover, Weber, Lenchner, Covato, Eisenstat, and Turner were or should have been aware of their

<sup>10</sup> Pennington's secretary-treasurer, Naomi R. Jezzi, and vice president, William J. Abbott, were also charged with participation in the scheme to defraud and violations of Section 5 of the Securities Act of 1933 hereinafter discussed. The record, however, does not establish that Jezzi, who was on vacation at the time Pennington's president effected the purchase of Siltronics shares for Wilson, or Abbott who was primarily a retail salesman, knew of their firm's participation in the transactions until after they were consummated or should have been alerted to inquire into any impropriety in such transactions. Charles E. Klein, Strathmore's president, and Edward G. Griffiths, a Claybaugh salesman, who were charged with violations of the securities acts, died during the proceedings. Accordingly, the proceedings will be dismissed as to these individual respondents.

<sup>11</sup> *Lewishon Copper Corp.*, 38 S.E.C. 226, 234 (1958); A distribution of a public offering comprises "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public."

<sup>12</sup> Cf. *S.E.C. v. Chinese Consolidated Benevolent Assn.*, 120 F.2d 738 (C.A. 2, 1941), cert. denied 314 U.S. 618; *S.E.C. v. Culpepper*, 270 F.2d 241 (C.A. 2, 1959); *S.E.C. v. Mono-Kearsarge Consolidated Mining Co.*, 167 F. Supp. 248 (D. Utah, 1958).

firms' participation in the distribution and Weber, as charged, must be held responsible for the purchases that were effected by Claybaugh, and the others for the bids entered by their firms during such distribution. Accordingly, we find that Lenchner Co., Strathmore, Weber, Lenchner, Covato, Eisenstat and Turner willfully violated or aided and abetted willful violations of the anti-manipulation provisions of Rule 17 CFR 240.10b-6 under Section 10 (b) of the Exchange Act.<sup>13</sup>

#### VIOLATION OF REGISTRATION PROVISIONS

On the basis of the record before us, we find that no Regulation A exemption was available for the Siltronics offering.<sup>14</sup> The record establishes that the terms and conditions of the regulation were not complied with in that, among other things, the aggregate amount at which the securities were offered to the public exceeded the \$300,000 limitation prescribed in Section 3(b) of the Securities Act and Rule 17 CFR 230.254 of the regulation to the extent that purchasers paid more than \$2 per share for the shares withheld from the offering.

No exemption under Regulation A being available and no registration statement having been filed or being in effect with respect to the Siltronics offering, we conclude that in the offer, sale and delivery of Siltronics stock, including the withheld shares, the respondents now before us who participated in the scheme to defraud and the manipulation of the market—Atlantic, Wilson, Shawe Co., Lenchner Co., Strathmore, Hansen, Weber, Klein, Runner, Shawe, Ladusky, Lenchner, Covato, Eisenstat, and Turner—willfully violated Sections 5(a) and (c) of the Securities Act.<sup>15</sup> These respondents knew or should have known that purchasers paid more than the offering price for shares which were part of the offering.

#### FAILURE TO COMPLY WITH NET CAPITAL AND RECORD-KEEPING REQUIREMENTS

The record establishes that from January 31 to February 9, 1961, in transactions unrelated to the Siltronics offering, Atlantic, aided and abetted by Barbara J. Black, then president, willfully violated the net capital and record-keeping requirements of Sec-

<sup>13</sup> See *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 876 (1965), *aff'd* 366 F.2d 446 (C.A. 2, 1966); *Shearson, Hammill & Co.*, 42 S.E.C. 811, 821 (1965).

<sup>14</sup> On June 4, 1964, we entered an order permanently suspending Siltronics' Regulation A exemption pursuant to an offer of settlement in which Siltronics neither admitted nor denied the allegations set forth in our order temporarily suspending such exemption (Securities Act Release No. 4700). Our findings herein are made entirely apart from such order and solely on the record presented.

<sup>15</sup> *Shearson, Hammill & Co.*, *supra*, at 820.

tions 15(c) (3) and 17(a) of the Exchange Act and Rules 17 CFR 240.15c3-1 and 17a-3 thereunder.

Atlantic effected securities transactions during the above period although it had net capital deficiencies, as computed under Rule 15c3-1, of \$10,937 and \$7,672 as of January 31 and February 9, 1961, respectively. Having ascertained that Atlantic was not in compliance with our net capital requirements as of the end of January, Black made or caused to be made fictitious entries in Atlantic's books in order to conceal its true financial condition from our inspector. Thus, Atlantic's records reflect a sale on February 6, of 2,000 shares of a certain stock from Atlantic's trading account for \$9,500, which in fact did not occur, and the repayment to Atlantic on February 7, of a \$5,000 loan previously made to an officer of Atlantic, which in fact had not been repaid. In order to show an increase in Atlantic's cash position reflecting the fictitious repayment of the loan, an Atlantic check for \$5,000 was issued to and endorsed by Black and deposited in Atlantic's bank account, and such deposit was entered on Atlantic's records. The purported disbursement was not entered on the books and the cancelled check was destroyed by Black.

#### ALLEGED PROCEDURAL IRREGULARITIES

Wilson and the Lenchner Co. and Strathmore respondents urge that the proceedings be dismissed because of assertedly erroneous and prejudicial rulings by us and the hearing examiner.

In prior consolidated proceedings against the respondents, Wilson and Lenchner Co., among others, moved, on the basis of the decision in *Amos Treat & Co. Inc. v. S.E.C.*, 306 F.2d 260 (C.A.D.C., 1962), that the proceedings as to them be terminated because of the participation in those proceedings of Commissioner (now Chairman) Cohen, who had served as Director of our Division of Corporation Finance during its investigation of the Siltronics offering. Those proceedings were terminated as to movants, but "without prejudice to the subsequent institution of new proceedings as to the respondents based upon the same or other charges."<sup>16</sup> Subsequently, without the participation of Commissioner Cohen, new proceedings were instituted based on the same and other charges, and were consolidated with the prior proceedings against the nonmoving respondents which had not been terminated, and substantially the entire record of the prior proceedings, consisting of around 4,500 pages of transcript and over 300 exhibits, was admitted into evidence on the issues relating to the

<sup>16</sup> Securities Exchange Act Release No. 6981 (December 21, 1962).

respondents as to whom the earlier proceedings had been terminated.

Wilson and the Lenchner Co. respondents object to our rulings sustaining the admission in evidence of the record of the prior proceedings proffered by the Division, and denying respondents' motions to sever or dismiss the proceedings as to them or hold an evidentiary hearing with respect to any *ex parte* communications between the staff and us, in connection with the termination of the prior proceedings, the institution of new proceedings, the inclusion of additional charges, the consolidation of the new with the unterminated proceedings, and the proffer of the prior record.<sup>17</sup>

We reaffirm the views expressed in our prior rulings that in considering the institution of new proceedings and consolidation we were no longer acting in an adjudicatory capacity as to the moving respondents, that since Commissioner Cohen had withdrawn from participation in the instant consolidated proceedings movants no longer had any possible basis for objection with respect to consolidation, that there was no constitutional or statutory prohibition of *ex parte* communications between us and the staff concerning the institution and consolidation, that no "taint" attached to the record of the prior proceedings since it was made without Commissioner Cohen's participation, and that full opportunity for cross-examination was accorded to movants.

Wilson and the Lenchner Co. and Strathmore respondents further contend that they did not receive a fair hearing because our decision permanently suspending Siltronics' Regulation A exemption, based on its offer of settlement in which they did not participate, prejudged the issues with respect to them, and that they were prejudiced by the Commission's summary of that decision for the press. In our opinion, the claim of "prejudgment" is without substance. Aside from the fact that Siltronics consented to the entry of a permanent suspension order without admitting or denying the allegations contained in the temporary suspension order and solely for the purpose of the suspension proceedings, our acceptance of the offer of settlement and the severance of the issues with respect to Siltronics were "without prejudice to the issues relating to the other parties or persons involved in the consolidated proceedings."<sup>18</sup> The press release expressly stated that our findings were based on an offer of settlement by Siltronics. Moreover, as previously mentioned, our determination of the issues with respect to the respondents now before us is based solely on the record developed in these broker-dealer proceedings.

<sup>17</sup> 41 S.E.C. 658 (1963).

<sup>18</sup> Securities Act Release No. 4700, p. 3.

Wilson and the Lenchner Co. respondents also raise objections to our denial in March 1962, during the prior proceedings, of their motions to obtain a copy of the transcript of movants' testimony during the private investigation preceding the institution of those proceedings. We reaffirm our previous ruling that a witness may for "good cause" be limited to inspection of a transcript of his testimony given in a nonpublic investigatory proceeding, and that, according to the legislative history of Section 6 (b) of the Administrative Procedure Act, "good cause" exists where the circulation of copies of such transcripts might nullify the enforcement of the statutes.<sup>19</sup>

Finally, we find no substance in Wilson's contention that the examiner, who admitted in evidence on the question of public interest as to him the first of a series of newspaper articles on the need for investor protection in Washington, D. C. which article referred to actions instituted against a number of broker-dealers including Wilson, erred in excluding the remaining articles which did not relate to or mention Wilson.

#### PUBLIC INTEREST

In view of the willful violations we have found we must determine whether it is necessary or appropriate in the public interest or for the protection of investors to impose sanctions upon respondents.

Wilson and the Lenchner Co. respondents urge that it is not in the public interest to impose sanctions, and that withdrawal of the broker-dealer registrations of Wilson and Lenchner Co. should be permitted. They point to the time that has elapsed since the prior proceedings were instituted in November 1961, and assert that the adverse publicity caused declines in the businesses of those registrants and led to the closing of Wilson's business and the sale of Lenchner Co. In addition, Wilson notes that the NASD censured him and fined him \$1,000 in a proceeding arising out of his transactions in Siltronics stock, and argues that any additional sanction with respect to his NASD membership would constitute double punishment. He also points to his good reputation prior to his going into the securities business. The Lenchner Co. respondents further claim that no investor suffered any loss, asserting that the market price of the stock subsequent to the offering was in excess of the "trade price" of 3 1/2 of the Siltronics block purchased by Lenchner Co. for Claybaugh.

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<sup>19</sup> We pointed out that counsel for each objecting respondent had been allowed to inspect the portions of the transcripts applicable to the witnesses involved in each motion, and that appropriate portions of the investigative transcript would be available for further examination at our offices.

The lapse of time since the original proceedings were instituted, however, was largely due to the vigorous contest of the complex factual and legal issues involved.<sup>20</sup> Publicity attending the institution of the proceedings is of course a consequence of making the proceedings public in the interest of investors.<sup>21</sup> Nor can we agree that the imposition of a sanction with respect to Wilson's NASD membership would be tantamount to double punishment. In rejecting a similar contention in *Shearson, Hammill & Co.*,<sup>22</sup> we stated that "this Commission, in carrying out its responsibilities under the Securities Acts, is not precluded from pursuing its administrative remedies merely because other regulatory action has been taken where it deems its own proceedings are necessary for the adequate protection of investors." Indeed, the NASD complaint against Wilson was filed during the pendency of our own prior proceedings. As to the assertion that investors suffered no loss, it ignores the fact that the purchasers by paying more than the offering price during the offering in effect sustained an immediate loss to the extent of the overpayment, and, depending on the market price obtainable at the time of resale,<sup>23</sup> such loss would reduce the profit or increase the loss the purchasers would otherwise realize.<sup>24</sup> Further, any investor who purchased stock in the after-market at prices inflated as a result of the manipulative activities similarly sustained a loss. Moreover, the public interest is adversely affected since such activities undermine investor confidence in the securities markets. We have also considered the other factors presented, but in our opinion they are not sufficient to overcome the willful violations found.

On the basis of our findings, we conclude that it is in the public interest to deny withdrawal of the broker-dealer registrations of Wilson, Lenchner Co. and Atlantic; to revoke their registrations of well as that of Shawe Co.; to expel Wilson from membership in the NASD; and to deny registration to Hansen, doing business as H. J. Hansen and Company.<sup>25</sup> We do not, however, deem it neces-

<sup>20</sup> Cf. *Russell L. Irish*, 42 S.E.C. 735, 743 (1965), *aff'd* 367 F.2d 637 (C.A. 9, October 19, 1966), *cert. denied* 386 U.S. 911.

<sup>21</sup> See *J. H. Goddard & Co., Inc.*, 41 S.E.C. 964, 965-66 (1964); *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 879, n. 25 (1965), *aff'd* 366 F.2d 446 (C.A. 2, 1966).

<sup>22</sup> 42 S.E.C. 811, 852, n. 88 (1965).

<sup>23</sup> While, according to the National Stock Summary, the bids in the sheets between November 1962 and December 1965, exceeded the price of  $3\frac{1}{2}$  in Lenchner Co.'s transaction, in the period between August 1961 and September 1962, the bid price on a number of days was lower than that price and declined to  $1\frac{1}{2}$  in March 1966.

<sup>24</sup> See *W. H. Keller*, 38 S.E.C. 900, 907 (1959); *Sidley Tager*, 42 S.E.C. 132, 137 (1964), *aff'd* 344 F.2d 5 (C.A. 2, 1965); *Russell Maguire & Company, Inc.*, 10 S.E.C. 332, 351 (1941).

<sup>25</sup> Atlantic, Shawe Co., and Lenchner Co. are no longer members of the NASD. Atlantic was expelled by the NASD in April 1962, for unfair pricing and net capital violations and the registrations as registered representatives of Klein and Black were revoked. Shawe Co.'s membership was terminated by the NASD in October 1964, for failure to file an assessment

sary in the public interest that Strathmore's registration be revoked, as recommended by the hearing examiner. The extent of Strathmore's participation in the scheme to defraud was not as great as that of the other registrants. We find it consistent with the public interest to suspend Strathmore from membership in the NASD for 90 days.<sup>26</sup> We further conclude that Hansen, Klein, Runner, and Black of Atlantic; Shawe and Ladusky of Shawe Co.; Lenchner, Covato, and Eisenstat of Lenchner Co.; and Turner of Strathmore are each a cause of the sanctions imposed upon their firms. In addition, it is appropriate in the public interest to revoke the registration of Klein Co., which became effective in September 1961, because Klein is president and Runner is vice president of that firm, and we find that Klein and Runner are causes of such revocation.<sup>27</sup> We also find that Weber is a cause of the revocation of Claybaugh's registration heretofore ordered by us.<sup>28</sup> The hearing examiner, although recognizing that Hansen "played a leading role" in the fraudulent scheme and committed other violations of the securities laws, recommended that he should be permitted to become associated with a broker-dealer upon a showing of appropriate supervision. He refers to Hansen's prior clean record and to the damaging impact of the proceedings upon Hansen who despite his "exceptional knowledge of the securities business," was compelled to accept a job as a house-to-house book salesman." On the record before us, we cannot accept the hearing examiner's recommendations as to Hansen who was one of the principal architects of the schemes to manipulate the market in Siltronics stock.

Although the examiner found Covato and Eisenstat to be causes of the sanction imposed upon Lenchner Co., he recommended that the findings in these proceedings should not constitute a bar to these respondents engaging in the securities business. We agree. The basis of the cause findings as to Covato and Eisenstat was their failure to act after a transaction had been consummated in

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report. We further note that in 1963, the NASD suspended Shawe Co.'s membership for 6 months and fined Shawe \$2,000 based on their transactions in Siltronics stock. Lenchner Co.'s membership was terminated in April 1965, for failure to pay a fine and costs.

<sup>26</sup> We note that on April 18, 1966, Strathmore was suspended from the NASD for 90 days and fined \$1,000, and Turner's registration as a registered representative was suspended for a like period and he was fined \$1,000, based on findings of unfair pricing in the sale of securities and improper extension of credit. 42 S.E.C. 993 (1966), *aff'd* C.A.D.C., No. 20, 175, January 3, 1967, *cert. denied* 35 U.S.-L. Week 3412 (U.S. May 22, 1967). Such suspension, which had been stayed, commenced on June 19, 1967), and our order herein will provide for the commencement of the instant suspension upon the termination of the prior suspension.

<sup>27</sup> Klein Co. resigned as a member of the NASD in 1962.

<sup>28</sup> We note that in September 1966, in another proceeding, Weber was suspended from association with a broker-dealer for 12 months for willful violations of the registration provisions of the Securities Act. *Strathmore Securities, Inc.*, File No. 8-7323.



which they personally played no part and of which they had no knowledge until later in the day. Eisenstat's future employment by a broker-dealer is, however, subject to the finding we made in March 1966 that he was a cause of the revocation of the registration of another firm which had acquired Lenchner Co. subsequent to the events involving the Siltronics offering.<sup>29</sup>

We are aware that some gradations exist in the culpability of the remaining respondents, but these can be given appropriate recognition in the event any of such respondents should in the future seek to reenter the securities field.<sup>30</sup>

An appropriate order will issue.

By the Commission (Commissioners OWENS, BUDGE and WHEAT), Chairman COHEN and Commissioner SMITH not participating.

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<sup>29</sup> *Crow, Brouman & Chatkin, Inc.*, 42 S.E.C. 938 (1966).

<sup>30</sup> The exceptions to the recommended decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.