UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 45-69

DON D. ANDERSON & CO., INC., and
DON D. ANDERSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order of
the Securities and Exchange Commission

ANSWERING BRIEF OF RESPONDENT SECURITIES AND EXCHANGE COMMISSION

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ANSWERING BRIEF OF RESPONDENT SECURITIES AND EXCHANGE COMMISSION

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether there is substantial evidence that a broker-dealer in securities and its president violated the net capital rule of the Securities and Exchange Commission, by failing to maintain the minimum net capital required by the rule because they included in their computation of net capital, contrary to the rule, stock which could not be "readily converted into cash," when the record shows that during the relevant time period they included in their net capital computation certain closely held stock for which there was admittedly no independent professional market and in which there was little trading at any time and none during the relevant time period.

2. Whether a broker-dealer and its president were denied due process of law, when the Commission, on the basis of substantial evidence, found that they had violated the Commission's net capital rule by including in the computation of net capital stock which failed to meet the test of ready convertibility into cash set forth in the rule, by reason of the claimed uncertainty and indefiniteness of the test even though, prior to the time of the violation, the test had been interpreted in a long line of cases to require evidence of an independent professional market for the stock and they have conceded that no such market existed.

3. Whether a broker-dealer and its president were denied due process of law because the Commission required them to submit "clear proof" that certain stock, which they included in their computation of net capital, was readily convertible into cash, when it had been shown and conceded that the stock was closely held, that there was no independent professional market for the stock and that there was little trading in the stock at any time and none during the relevant time period.

4. Whether the Securities and Exchange Commission abused its discretion in sustaining, as not "excessive or oppressive," the sanctions imposed by the National Association of Securities Dealers, consisting of the suspension of a broker-dealer's membership in the Association and its president's registration as a registered representative for a period of 15 days and the assessment against them jointly and severally of a fine in the amount of $1,000, together with costs, when the Commission found, upon a review of the record, that the broker-dealer and its president had committed serious violations of the Association's Rules of Fair Practice consisting of failure to comply with the free-riding and withholding interpretation of the Association and repeated failures to comply with the Commission's net capital rule.

COUNTERSTATEMENT OF THE CASE

Don D. Anderson & Co., Inc. ("the firm") and Don D. Anderson ("Anderson"), its president, have petitioned this Court, pursuant to Section 25(a) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78y(a), to review an order of the Securities and Exchange Commission dismissing an application to review disciplinary action taken against them by the National Association of Securities Dealers, Inc. ("NASD").[1/] Pursuant to petitioners' request, the Commission, on January 28, 1969, granted a stay of its order pending petitioners' appeal to this Court (R. 226).[2/] The NASD is a national securities association registered with the Commission as such under Section 15A of the Exchange Act,[3/] 15 U.S.C. 78o-3. The firm is a broker-dealer in securities registered with the Commission as such and is a member of the NASD (R. 40). The facts underlying the findings of the Commission are not in substantial dispute.

1/ Section 25(a) provides in pertinent part as follows:

> Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain review in the Court of Appeals of the United States . . . by filing in such court . . . a written petition praying that the order of the Commission be modified or set aside in whole or in part. . . . Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. . . . The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.

2/ Pursuant to Rule 12 of the Rules of this Court, petitioners are required to file with this Court three copies of the record in this case. Accordingly, citations to the record in this brief are made to the official record, consisting of 226 pages, as certified by the Commission to this Court by Certificate, dated March 10, 1969.

3/ The form of "cooperative regulation" established by the Exchange Act and involved in the instant case was set forth by this Court in Handley Investment Co. v. Securities and Exchange Commission, 354 F.2d 64 (1965).

The action taken by the NASD and, in effect, sustained by the Commission was based upon two violations by petitioners of Article III, Section 1 of the NASD's Rules of Fair Practice (R. 221-224). The first violation found by the NASD consists of the firm's effecting securities transactions while not in compliance with the net capital requirements of the Commission. The second violation consists of the firm's failure to comply with the free-riding and withholding interpretation of the NASD. The petition for review contests only the finding of the net capital violation and the appropriateness of the sanction imposed for both violations. The NASD ordered the suspension of the firm's membership in the NASD and Anderson's registration as a registered representative for a period of 15 days, the fining of petitioners jointly and severally in the amount of $1000.00 and the assessing of costs in the amount of $203.95.[4/] Petitioners admitted violating the free-riding and withholding interpretation and did not contest that finding in the proceeding before the Commission (R. 168, 171).

The Commission found that the firm violated the Commission's net capital rule[5/] and Article III, Section 1 of the NASD's Rules of Fair

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4/ The proceedings before the NASD included a decision on September 7, 1967, by the NASD's District Business Conduct Committee for District No. 4, after a full hearing on the merits, in which it found that petitioners had violated the Commission's net capital rule and the NASD's free-riding and withholding interpretation (R. 91-98). The District Committee imposed the sanctions referred to above (R. 97, 98). The District Committee's findings, opinion, and sanction were sustained by the Board of Governors of the NASD on February 21, 1968 (R. 155-157). On March 21, 1968, petitioners applied to the Commission, pursuant to Section 15A(g) of the Exchange Act, 15 U.S.C. 78o-3(g), for review of the decision of the NASD's Board of Governors (R. 161-162).

5/ Rule 15c3-1, 17 CFR 240.15c3-1, promulgated under Section 15(c)(3) of the Exchange Act, 15 U.S.C. 78o(c)(3). The rule provides that a broker-dealer must not permit his aggregate indebtedness to all other persons to exceed 2,000% of his net capital computed as specified in the rule, and, in the absence of specified conditions, must maintain net capital of at least $5,000.

Practice[6/] by effecting securities transactions while failing to maintain the required minimum net capital of $5000 during the accounting period ended November 30, 1966. Specifically, the Commission found that in computing net capital the firm and Anderson improperly included 1500 shares of stock of American National Bank of Midwest City ("ANB"), which they valued at $40 per share. In this connection, the Commission found that the stock should have been excluded from the computation of net capital as not "readily convertible into cash"[7/] because it was a "closely held local issue, transfers of which were few and far between" and because "[t]he stock was not listed on any securities exchange, nor did quotations appear for it in the sheets published by the National Quotation Bureau, Inc. or in local newspapers" (R. 222-223). Petitioners did not dispute the absence of a professional market. In fact, Anderson admitted that he had never had a transaction in the stock nor to his knowledge had any other broker (R. 137).

The Commission also found that the firm had violated the NASD's Rules of Fair Practice when it purchased 100 shares of stock of an issuer from a member of a selling group engaged in a public offering at the public offering price of $4.50 per share and, on the following day, sold the stock to another member at a price of $8.00 per share. The NASD found and petitioners conceded that the firm had violated the NASD's interpretation with respect to free-riding and withholding, which states that members "have an obligation to make a bona fide

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6/ Article III, Section 1 of these rules requires NASD members to "observe high standards of commercial honor and just and equitable principles of trade."

7/ Under Subsection (c)(2)(B) of the net capital rule, net worth is adjusted by deducting "assets which cannot be readily converted into cash (less any indebtedness secured thereby)."

public offering, at the public offering price, of securities acquired by participation in any distribution, whether acquired as an underwriter, a selling group member, or from a member participating in the distribution as an underwriter or selling group member," and that it is inconsistent with that obligation, among other things, to sell securities thus acquired to another broker-dealer at or above the public offering price. 8/

STATUTE AND RULE INVOLVED

Section 15(c)(3) of the Exchange Act and Rule 15c3-1(c)(2)(B), promulgated thereunder, are set forth in the statutory appendix (p. 1a, infra).

ARGUMENT

I. Petitioners Violated the Net Capital Rule of the Commission and the NASD's Rules of Fair Practice. 9/

The net capital rule of the Commission provides that a broker-dealer, in the absence of certain specified conditions, must have and maintain net capital of not less than $5,000. The rule was adopted to provide safeguards for public investors by setting standards of financial responsibility to be met by broker-dealers. 10/ The term "net capital" means

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8/ CCH NASD Manual ¶ 2151, pp. 2018-2021 (1967).

9/ Since petitioners have not contested the finding that a violation of the Commission's net capital rule is a violation of Article III, Section 1 of the NASD's Rules of Fair Practice, further discussion focuses on the net capital rule.

10/ As the Court of Appeals for the Fifth Circuit stated in Blaise D'Antoni & Associates, Inc. v. Securities and Exchange Commission, 289 F.2d 276-277 (1961):

> "The net capital rule is one of the most important weapons in the Commission's arsenal to protect investors. By limiting the ratio of broker's indebtedness to his capital, the rule operates to assure confidence and safety to the investing public."

net worth (the excess of total assets over total liabilities) adjusted in accordance with the provisions of the rule. As noted, supra, n.7, one of the adjustments for which the rule provides is that there shall be deducted from net worth "assets which cannot be readily converted into cash." Rule 15c3-1(c)(2)(B).

The backbone of the rule is "liquidity"; its object being to require broker-dealers to have at all times sufficient liquid assets to cover their current obligations. Securities Exchange Act Release No. 8024, pp. 1-2 (Jan. 18, 1967). The requirement that assets "which cannot be readily converted into cash" must be excluded from the assets of the firm is in keeping with the object of the rule. As the Commission recognized over twenty-five years ago in In the Matter of Guy D. Marianette, 11 SEC 967, 970-971 (1942):

> "Customers do not open accounts with a broker relying on suit, judgment and execution to collect their claims — they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position."

Accordingly, the Commission has consistently held that stock which cannot be "readily converted into cash" must be excluded from the computation of net capital. In the Matter of C. A. Benson & Co., Inc., Securities Exchange Act Release No. 7856 (April 8, 1966); In the Matter of Midwest Planned Investments, Inc., Securities Exchange Act Release No. 7564 (March 26, 1965); In the Matter of John W. Yeaman, Inc., Securities Exchange Act Release No. 7527 (February 10, 1965); In the Matter of Pioneer Enterprises, Inc., 36 SEC 199 (1955). See also, In the Matter of George A. Brown, Securities Exchange Act Release No. 8160 (September 19, 1967); Guy D. Marianette, supra, 11 SEC at 970-971. Where securities are not

sufficiently liquid, they must be excluded as not readily convertible into cash, irrespective of whether they may have substantial intrinsic value. In the Matter of John W. Yeaman, Inc., supra, Securities Exchange Act No. 7527 (February 10, 1965). Similarly, the Commission, with the concurrence of the federal courts, has traditionally held that securities are not readily convertible into cash where there is no existing independent professional market for such securities such as on a national securities exchange or in the over-the-counter market. See e.g., In the Matter of Pioneer Enterprises, Inc., supra, 36 S.E.C. at 207; In the Matter of Whitney-Phoenix Co., Inc., 39 S.E.C. 245, 249 (1959); In the Matter of John W. Yeaman, Inc., supra, Securities Exchange Act Release No. 7527 (February 10, 1965); In the Matter of Charters & Co. of Miami, Inc., Securities Exchange Act Release No. 7991 (November 16, 1966); and Securities and Exchange Commission v. C. H. Abraham & Co., Inc., 186 F. Supp. 19 (S.D. N.Y., 1960).

In the absence of demonstrating liquidity, by establishing that an independent professional market for a particular stock exists, the Commission has not accorded a value to stock for net capital purposes unless, under "special circumstances," a broker-dealer submitted "clear proof" that the stock was otherwise readily convertible into cash as of the date of the net capital computation. In the Matter of George Brown, supra, Securities Exchange Act Release No. 8160, p. 8 (September 19, 1967).

In the instant case petitioners concede that there was no independent professional trading market for the stock in question (R. 60, 137). This

concession is dispositive of the issue of ready convertibility in the absence of the clear proof required by the Brown case. In their brief in this Court, petitioners make no effort to demonstrate that there exists such clear proof of ready convertibility or, for that matter, any proof whatsoever on this issue. In the proceedings below the petitioners did attempt to show ready convertibility. However, they submitted no specific evidence that the stock had ever been actually traded at $40 a share,[11/] and, indeed, they conceded that the stock was closely held (R. 124), that it was not actively traded (R. 43, 60) and that there was no trading during the accounting period in which the deficiency occurred (R. 121-122). In fact, as noted, supra, p. 5, Anderson admitted that the firm had never had a transaction in the stock nor to his knowledge had any other broker.

In their effort to demonstrate ready convertibility, petitioners did submit a letter written by Anderson, dated July 18, 1967, to the effect that certain of the ANB directors would have been willing to purchase the firm's ANB stock at $40 per share on November 30, 1966, the date of the net capital deficiency (R. 85). In addition, petitioners submitted two affidavits of ANB directors describing offers received "in early 1966" to purchase shares of ANB stock at $40 per share (R. 149, 150). Petitioners also submitted letters and affidavits, indicating as of dates other than the date of the deficiency, that certain persons would bid or would quote the stock at specified prices ranging between $35 and $40 per share (R. 15-18).

11/ In their brief petitioners suggest that there was evidence of certain "small trades" of ANB stock at $46 per share which were "later referred to as $36.00 trades." (Br. p. 5). In fact, however, it was Anderson who mentioned these trades in the course of his testimony and once referred to them as $46 trades (R. 118) and on another occasion as $36 trades (R. 120). Moreover, he conceded that the trades were private and in small amounts, and he was unable to provide any dates, specific amounts or the names of any parties (R. 118-120).

The values suggested by these letters and affidavits are not, however, evidence of any actual trading in the stock and are mere declarations of intention of doubtful probative value in demonstrating ready convertibility, particularly when the NASD found that the last bid in the sheets published by the National Quotation Bureau, Inc. for ANB stock prior to November 30, 1966 was at $28 per share. The publication of that bid appeared on August 3, 1966 (R. 95). Certainly, the self-serving statements submitted by petitioners could not constitute the "clear proof" required by Brown.[12/] It should be noted that some of the evidence submitted by petitioners purports to establish a value for the ANB stock of between $35 and $39 per share which value would, if accepted for net capital purposes, still result in a net capital deficiency. In light of the insubstantial evidence submitted by petitioners, it is clear that the ANB stock was not readily convertible into cash at $40 per share or at any other value.[13/]

12/ Although there was no independent professional market for the questioned stock in Brown, the Commission allowed it to be included in the net capital computation at book value finding that the standard of "clear proof" of ready convertibility into cash was satisfied by uncontested and uncontroverted evidence adduced by Brown. In Brown the stock in question had actually been traded in substantial amounts by the issuing company at its current book value, the value at which the broker-dealer had carried the stock for net capital purposes. In the instant case the ANB stock was carried at approximately twice book value even though, as petitioners have conceded, there was very little trading in the stock and no evidence of a trade at that price. In addition, in Brown, unlike the instant case, the issuing company had during the accounting period in question offered to purchase the stock from the broker-dealer at book value at any time.

13/ Contrary to petitioners' assertions that the NASD made a finding that there was a private market for the ANB stock at $40 per share (Br. p. 11, 14), the NASD Board of Governors found, on the basis of the evidence submitted by petitioners, that "there was and is no ready market for the shares. . . ." (R. 157). In addition, the NASD District Committee, referring to petitioners' evidence, stated "we cannot accept this as any sort of substantiation that a $40 market existed." (R. 96).

It is apparent from the foregoing discussion that the Commission was justified in finding that petitioners violated the net capital rule and Article III, Section 1 of the NASD's Rules of Fair Practice, which as noted supra n. 6, requires NASD members to "observe high standards of commercial honor and just and equitable principles of trade." Certainly, the Commission's finding is supported by substantial evidence as required by Section 25(a) of the Exchange Act, noted, supra, n. 1. As this Court pointed out in Associated Securities Corp. v. Securities and Exchange Commission, 293 F.2d 738, 741 (1961);

> "The balancing of private detriment against public harm requires the fair and proper exercise by the Commission of its discretionary powers. The evaluation of facts and the exercise of judgment for the protection of investors dealing in over-the-counter securities is a function assigned by Congress to the Commission rather than the courts and the exercise by the Commission of its discretionary powers will not be upset by the courts except for cogent reasons." [Footnote omitted.] 14/

14/ See also, e.g., Keele Hair & Scalp Specialists, Inc. v. Federal Trade Commission, 275 F.2d 18, 21 (C.A. 5, 1960); Steelco Stainless Steel, Inc. v. Federal Trade Commission, 187 F.2d 693, 694-695 (C.A. 7, 1951); Law Motor Freight, Inc. v. Civil Aeronautics Board, 364 F.2d 139, 144 (C.A. 1, 1966), certiorari denied, 387 U.S. 905 (1967); Standard Distributors, Inc. v. Federal Trade Commission, 211 F.2d 7, 12 (C.A. 2, 1954); National Labor Relations Board v. Bird Mach. Co., 161 F.2d 589, 590 (C.A. 1, 1947); Archer v. Securities and Exchange Commission, 133 F.2d 795, 799 (C.A. 8), certiorari denied, 319 U.S. 767 (1943); Keller v. Federal Trade Commission, 132 F.2d 59, 60 (C.A. 7, 1942); see Hartford Gas Co. v. Securities and Exchange Commission, 129 F.2d 794, 796 (C.A. 2, 1942). The function of the reviewing court is to determine whether, in fact, there is substantial evidence to support the Commission's findings. Consolo v. Federal Maritime Commission, 383 U.S. 607, 619-620 (1966). Decisions by the Federal Trade Commission, Civil Aeronautics Board, National Labor Relations Board and Federal Maritime Commission are subject to court review under virtually the same "substantial evidence" standard governing review of Securities and Exchange Commission decisions.

II. Petitioners Were Not Denied Due Process of Law.

Petitioners' contention that they were denied due process of law because sanctions were imposed upon them for violating "a rule too uncertain to afford a guide" and because a "changed interpretation of the Net Capital Rule" was applied "retroactively" (Br. p. 9) is simply incorrect.

The rule is not uncertain or imprecise as claimed by petitioners (Br. p. 9, 13). It is difficult to conceive of language more definite than that contained in Rule 15c3-1(c)(2)(B), which, as noted supra n.7, requires that net worth be adjusted by deducting "assets which cannot be readily converted into cash. . . ." Cf. Handley Investment Co. v. Securities and Exchange Commission, supra, 354 F.2d at 66. Nor was there any retroactive application of a changed interpretation of the rule as asserted by petitioners. Petitioners appear to concede (Br. p. 12) that they violated the rule as "interpreted" in Securities Exchange Act Release No. 8024 (January 18, 1967). They contend, however, that prior to that release a different standard was employed and under that standard they were not in violation of the rule. In this connection petitioners are in error in that they ignore the numerous decisions on this point handed down prior to the issuance of the release.

In a series of cases ranging over a period of years prior to the date of the violation in this case it has been made clear that stock may not be included in computing net capital where, as in this case, there is no independent professional trading market,[15/] the stock is closely held and

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15/ See e.g., Securities and Exchange Commission v. C. H. Abraham & Co., Inc., supra, 186 F. Supp. 19; In the Matter of Pioneer Enterprises, Inc., supra, 36 SEC 199.

not actively traded,[16] and there is no actual trading in the stock during the accounting period in question.[17] Petitioners' assertion (Br. p. 12) that "[p]rior to this release, no standard such as an independent market had been established" [emphasis added] ignores Judge Ryan's statement in Abraham, decided in 1960, supra, 186 F. Supp. at 21:

> "The Commission's rule requires an independent quotation and we need not labor the point that purchases by an interested party do not constitute an independent market. The Commission's requirement of independence is both logical and reasonable. . . ."

Moreover, the Commission's issuance of the release, which petitioners mistakenly perceive as making new law, was for the express purpose of assisting brokers and dealers in complying with the net capital rule and in no way indicates a departure from prior case law. In fact, with respect to ready convertibility, the release specifically cites certain of the cases, decided well before the violation in this case, from which the test set forth therein was taken. Securities Exchange Act Release No. 8024, supra, p. 9 (January 18, 1967). The release does not purport to promulgate any new law in this area. The fact that petitioners did not have the benefit of the release but only of the case law in no way relieves them of their obligation to comply with the net capital rule. Since the relevant case law in existence at the time of petitioners' violation of the net capital rule clearly indicates that petitioners were required to exclude the ANB stock from their computation of net capital, there was no application of an uncertain

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16/ In the Matter of John W. Yeaman, Inc., supra, Securities Exchange Act Release No. 7527 (February 10, 1965).

17/ Securities and Exchange Commission v. C. H. Abraham & Co., Inc., supra, 186 F. Supp. 19.

rule and no retroactive application of a changed interpretation of the rule. Hence, there was no violation of petitioners' right to due process of law.[18/]

Petitioners, without the citation of authority, also contend (Br. p. 9) that they were denied a "presumption of innocence" in violation of their right to due process of law. They argue that this denial consists of placing upon them the obligation to offer "clear proof" of ready convertibility into cash in the absence of evidence of a professional market for stock in question. In keeping with the principal purpose of the net capital rule of requiring broker-dealers to maintain a capital position sufficiently liquid to permit them to meet their obligations to customers on reasonable demand, the Commission has "viewed securities for which no exchange or over-the-counter market exists as prima facie lacking the expectation or capability of liquidity contemplated by the rule." In the Matter of George A. Brown, supra, Securities Exchange Act Release No. 8160, p. 8 (September 18, 1967). To require "[c]lear proof of ready convertibility into cash . . . to overcome the absence of a professional market" (ibid.) is not at all inconsistent

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18/ Petitioners assert that the NASD acted unfairly in that it had not previously put petitioners on notice that there was a net capital violation (Br. p. 13). They asserted before the Commission that for a period of 20 months the NASD and the staff of the Commission were aware from submitted financial statements that the firm was ascribing value to the ANB shares for net capital purposes, and were apparently satisfied with such valuation. The NASD stated that it did question the valuation but did not inform the firm prior to the time it discovered the net capital deficiency at issue here because, as it computed the firm's net capital making an adjustment with respect to such shares, there was no deficiency. In any event, petitioners cannot shift their responsibility for compliance with net capital requirements to the NASD or to the Commission. A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation. Cf. In the Matter of L. B. Securities Corporation, Securities Exchange Act Release No. 7806, p. 4 (January 28, 1966); In the Matter of H. C. Keister & Company, Securities Exchange Act Release No. 7988, p. 7 (November 1, 1966).

with notions of fairness and due process. Petitioners contend that the requirement of "clear proof" is contrary to Section 7(c) of the Administrative Procedure Act, 5 U.S.C. § 556(d) (Br. p. 10). The section provides that the proponent of an order has the "burden of proof." Apparently petitioners understand the section to preclude imposing upon them the obligation to prove anything. In fact, however, the section "means not only that the party initiating the proceeding has the general burden of coming forward with a prima facie case but that other parties, who are proponents of some different result, also for that purpose have a burden to maintain." S. Doc. No. 245, 79th Cong., 2d Sess. 208, 270 (1946). Cf. N.L.R.B. v. Mastro Plastics Corp., 354 F.2d 170, 176 (C.A. 2, 1965).

Thus, in the instant case, once it had been shown and had been conceded that there was no professional market for the stock, petitioners had the obligation to submit clear proof of ready convertibility. They failed to meet that obligation. Such an obligation does not constitute a denial of due process. It merely places on the party with a knowledge of the facts the duty of going forward. Ibid.

Petitioners further contend that the charge against them was changed "in mid-stream" from "over-valuation" to "non-convertibility" (Br. p. 14) and that they were denied the right to address themselves to the issue of whether the stock was readily convertible into cash. An examination of the record reveals, however, that at all times in the proceedings below the ready convertibility of the stock was an issue. In both the proceeding before the Commission and the proceedings before the NASD petitioners did address themselves to the issue of "convertibility." Specifically, at the hearings

before the District Committee of the NASD and before the Board of Governors of the NASD, petitioners, while conceding the absence of an independent professional market, did attempt to establish that the stock was readily convertible into cash. Indeed, at the District Committee hearing Anderson indicated his understanding of the issue stating: ". . . I hope I can submit enough facts to you, that this stock, though it is inactively traded, has a ready cash value." (R. 47). The fact that the NASD in determining that there was no ready market for the stock at $40 per share ascribed a value of 26 5/8 per share does not in any way indicate that petitioners were deprived of an opportunity to present evidence, were misled as to the issue or otherwise deprived of a fair hearing. Whether the NASD ascribed to the stock a value per share of zero or 26 5/8, the fact remains that in order to establish compliance with the net capital rule, petitioners would have to prove that the stock was readily saleable at the price of $40 per share. As noted, supra, p.10, the use of a value of even $39 per share for net capital purposes would have resulted in a net capital of under the required $5000 minimum. Furthermore, it is appropriate to note that it is the Commission's findings which are the subject of the instant petition for review and not the findings of the NASD. R. H. Johnson & Co. v. Securities and Exchange Commission, 198 F. 2d 690 (C.A. 2, 1952), certiorari denied, 344 U.S. 855 (1952). Moreover, if petitioners felt the charges against them had been unfairly shifted in the proceeding before the Commission, they were free to seek to adduce additional evidence at that time. No such effort was made. Nor do petitioners suggest now that they could adduce such evidence. Cf. Merritt, Vickers, Inc. v. Securities and Exchange Commission, 353 F. 2d 293, 297 (C.A. 2, 1965).

III. The Sanctions Imposed Were Not Excessive and Were Well Within the Commission's Discretion.

Petitioners contend (Br. pp. 9, 10 and 16-17) that the sanctions imposed were "purely punitive" and were excessive. Petitioners, however, misunderstand the nature of the proceedings and try to ignore their own past misconduct.

The sanctions imposed in broker-dealer proceedings, whether initiated by the NASD or by the Commission, are remedial devices, consistent with the statutory intent to protect investors; they are not punitive measures imposed on the broker. Associated Securities Corp. v. Securities and Exchange Commission, 283 F. 2d 773, 775 (C.A. 10, 1960); Associated Securities Corp. v. Securities and Exchange Commission, 293 F. 2d 738 (C.A. 10, 1961); and Blaise D'Antoni & Associates, Inc. v. Securities and Exchange Commission, supra, 289 F. 2d at 277. The sanctions imposed are designed to deter future violations of the federal securities laws by petitioners and others and to protect the investing public. Such a deterrent is particularly important in connection with violations of the net capital rule which, as noted, supra, n. 10, "is one of the most important weapons in the Commission's arsenal to protect investors." Ibid. The legislative history of the Maloney Act, which created the form of self-regulation involved here, makes clear that Congress contemplated cooperative regulation of brokers and dealers who do business over-the-counter, along the lines existing with respect to the exchange market, "to include the proscription not only of the dishonest, but also of those unwilling and unable to conform to rigid standards of financial responsibility, professional conduct and technical proficiency." S. Rep. No. 1455 at p. 3-4 and H.R. Rep. No. 2307 at p. 4, 75th Cong., 3d Sess. (1938).

In addition, petitioners in their brief make only a fleeting and inaccurate reference to their previous violations of the net capital rule (Br. p. 3). In July 1966, just a few months prior to the net capital violations involved in the instant case, the NASD's Board of Governors in another proceeding found that the firm and Anderson had committed violations of the net capital rule and Regulation T of the Federal Reserve Board, 12 CFR 220 et seq., and imposed suspensions and a fine (R. 157). Contrary to petitioners claim (Br. p. 3), some of the net capital violations found in that proceeding, like the one in the instant case, involved valuing securities for net capital purposes where there was no evidence of a ready market (R. 97).

Furthermore, petitioners' admitted violation of the free-riding and withholding interpretation is not a matter of small concern. In addition to the notice that NASD members were given of its promulgation by the NASD and its publication in the NASD Manual, the Commission has on several occasions pointed to the concern which the interpretation reflects as to sales practices that contribute to artificial increases in the price of securities by restricting the supply available for distribution to the public, forcing customers to acquire securities at prices higher than the offering price and giving the firms participating in the distribution an unfair advantage.[19/]

19/ See Securities Act Release No. 4150 (October 23, 1959); In the Matter of First California Company, 40 S.E.C. 768 (1961); L. H. Rothchild & Co., 41 S.E.C. 729 (1963); In the Matter of Jerome Goldberg, Securities Exchange Act Release No. 7619 (June 3, 1965); Report of the Special Study of the Securities Markets of the S.E.C., H. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. (1963), pp. 528-533.

Under the circumstances, the sanctions imposed were clearly reasonable and well within the Commission's discretion. Compare, Blaise D'Antoni & Associates, Inc. v. Securities and Exchange Commission, supra, 289 F. 2d 276. Moreover, it is difficult to conceive of a lesser and yet meaningful sanction which could have been imposed on petitioners for the violations found in this case. Petitioners attempt to minimize the serious nature of the violations in this case (Br. p. 9-10) and would have this Court ignore the important regulatory purpose to be served by these rules. Ibid. Moreover, as the Court of Appeals for the Second Circuit pointed out in Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8-9 (1965):

> Registration of broker-dealers is a means of protecting the public . . ., and the determination of the sanctions necessary to protect the public rests primarily within the competence of the Commission. . . . The Commission must have a very large measure of discretion in determining what sanctions to impose at a particular time in particular cases. Failing a gross abuse of discretion, the courts should not attempt to substitute their untutored views as to what sanctions will best accord with the regulatory powers of the Commission. 20/

See also, Associated Securities Corp. v. Securities and Exchange Commission, 293 F. 2d 738 (C.A. 10, 1961); and Handley Investment Co. v. Securities and Exchange Commission, 354 F. 2d 64, 66 (C.A. 10, 1965).

20/, Accord, e.g., Marketlines, Inc. v. Securities and Exchange Commission, 384 F. 2d 264 (C.A. 2, 1967), certiorari denied, 390 U.S. 947 (1968); Berko v. Securities and Exchange Commission, supra, 316 F. 2d at 141-42; see American Power and Light Co. v. Securities and Exchange Commission, 329 U.S. 90, 112-113 (1946); cf. Wright v. Securities and Exchange Commission, 112 F. 2d 89, 95 (C.A. 2, 1940).

CONCLUSION

For the foregoing reasons the order of the Commission should be affirmed.

Respectfully submitted,

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STATUTORY APPENDIX

Securities Exchange Act of 1934

Section 15(c)(3)

(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers.[1]

Rule 15c3-1(c)(2)(B), 17 CFR 240.15c3-1

Rule 15c3–1. Net Capital Requirements for Brokers and Dealers

* * *

(*c*) **Definitions.** For the purpose of this rule:

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(2) The term "net capital" shall be deemed to mean the net worth of a broker or dealer (that is, the excess of total assets over total liabilities), adjusted by

* * *

(B) Deducting fixed assets and assets which cannot be readily converted into cash (less any indebtedness secured thereby) including, among other thing, real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and expenses; good will; organization expenses; all unsecured advances and loans; customers' unsecured notes and accounts; and deficits in customers' accounts, except in bona fide cash accounts within the meaning of section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System;