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'Boiler Room' Tactics

High Pressure Phone Sales Condemned

"We are shocked with the telephonic solicitation system to sell highly speculative securities to individuals not known to the firm or its salesmen . . ."

This is an extract from a recent decision by a District Business Conduct Committee in which a member was expelled.

"Recommendations were made to customers to purchase specific speculative securities without knowledge of the particular accounts," the Committee emphasized. Lack of supervision of salesmen was also cited.

The Committee also said: "The course of conduct and sales practices engaged in by these Respondents could only result in violation of our Section 2 of Article III of the Rules of Fair Practice . . ."

The section referred to by the Committee is known as the "suitability" rule. It reads:

"In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

Use of "boiler room" tactics in telephonic solicitation of business has always been a difficult problem in the securities business. It has been an increasing headache for business conduct committees in recent months. Lack of proof clearly establishing the employment of such selling methods, and the traditional reluctance of customers to give evidence, make the task of enforcement

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COMMITTEE HEAD



Donald L. Patterson, Boettcher and Company, Denver, chairman of the important National Business Conduct Committee for 1958. The National Committee has the assignment of reviewing all disciplinary decisions by District Business Conduct Committees and recommending final action to the NASD Board of Governors.

Branch Office Fined

A branch office of a member firm and the resident manager have been fined and censured for violations of the Rules of Fair Practice.

The member was fined \$1,000 on two findings of violations and the resident manager \$100. In addition, total costs of the complaint proceedings, amounting to \$1,166.52, were assessed against the firm.

Failure to supervise the activities of both the branch office and its personnel was at the root of the complaint. Also involved were findings that, in a number of its transactions with customers, the office did not obtain the best market for the securities.

Uranium Maze

Dealer Expelled; Two Others Fined

A Salt Lake City member, Empire Securities Corporation, has been expelled and assessed \$6,800 in costs growing out of complaint proceedings which the member initiated against four other dealers in that area.

The questions the Association was called upon to resolve stemmed from a series of "buy-in" transactions by the complaining member against those who filed cross-complaints. In lengthy hearings before the District Business Conduct Committee and the National Business Conduct Committee on appeal, much confusing and contradictory evidence was heard. Methods of doing business peculiar to uranium issue underwritings and trading and the crucial part played by parties not connected with the proceedings had to be examined and evaluated.

Empire's complaint was directed at the refusal of the respondents to reimburse Empire for the amounts the firm paid to "buy in" certain stock of York Oil and Uranium Company. Each of the respondents had sold York Stock to Empire in separate transactions, but they allegedly failed to deliver the shares.

Respondents in counter claims alleged that Empire had violated NASD rules by its own conduct in the same transactions.

A summary of facts, findings and conclusions of the NASD Business Conduct Committees which heard the proceedings follows:

"York was incorporated in Wyoming in February, 1955. By May, it had issued approximately 5,000,000 shares of stock for \$8,000 and mineral claims and leases, most of which were acquired from the officers and directors. Be-

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tween that time and June, there were a number of transfers and exchanges of stock on the part of the company, officers and directors. In one such exchange, old certificates which were 'black in color' were exchanged for new 'reddish-brown' ones stamped 'Investment Shares.'

"In the summer of 1955, York made a public offering of 10,000,000 shares of its common stock at a price of 2 cents per share. This offering was underwritten by Empire on a 'best efforts' basis, with commissions to the underwriter of 12½ per cent on sales in Utah and 20 per cent on sales made outside Utah; allowance for expenses of \$4,000 and options to the underwriter to purchase 1,000,000 shares at 2 cents per share, exercisable at the rate of one share for each ten shares sold.

"The financing was intended to net York \$200,000, less commission and expenses. The underwriting was not successful, about 1½ million shares being sold, with proceeds of \$19,980 to the company. The public offering was terminated in March, 1956.

"Trading in York stock began March 27. Empire immediately took a substantial short position. From March 29 to April 24, each of the respondents sold York stock to Empire in separate transactions at prices ranging from 2 to 7½ cents per share.

"Empire claims that delivery was not made properly because the certificates tendered did not represent stock which had been sold in the public offering or stock which was derived from stock thus sold and asserted its purchases were specifically limited to that particular class of stock. Empire served notice it was going to 'buy in' the respondents on these trades. It did 'buy in' 181,000 shares from brokers at prices ranging from 7½ to 9½ cents. Empire demanded reimbursement of \$8,822 from the respondents, the claimed difference between prices on the original sale and the 'buy-ins.'

"No facts relating to the Company, the business or the general market account for the rise in mar-

ket price of York. Ordinarily, broker-dealers transacting business with other broker-dealers are, whether expressly so or not, trading in securities that are acceptable in every way. It is apparent that all parties to this controversy were aware, or should have been aware, of circumstances surrounding these transactions which made them highly suspicious.

"It seems likely that both Empire and the respondents had some scheme in mind when entering into these transactions whereby they might take advantage of the other. For example, Empire bought from the respondents at prices ranging from 2 to 7½ cents, with the majority of purchases at about 4 cents, having reason to believe that the only stock available to respondents would be stock not acceptable to Empire. Respondents' failure to make good delivery would then warrant 'buy-ins' at prices which would damage the respondents severely, or make substantial profits for existing holders of free-trading stock . . .

"It is well recognized that short selling is an ordinary and customary current practice among certain brokers in the Salt Lake City area. During the so-called uranium boom, the customary and ordinary practice of completing offerings was to increase prices through the rapid trading of such stocks. Customers and unknowing broker-dealers were damaged thereby. Customers lost and became fearful of the uranium market. Other brokers discontinued trading in such securities. Consequently, the field was narrowed to a few brokers who played a 'game' among themselves.

"In this atmosphere it is also clear that the respondents were not acting blindly when they undertook to sell York stock at about 4 cents in the transactions in controversy. They may have intended to sell to Empire as much York stock as possible, regardless of the source for delivery. It is also possible that the respondents may have intended to take advantage of Empire's higher market, thereby insuring their customers a substantial profit whether

such customers were holders of free-trading stock or not."

Two other members involved in the complaints were fined \$500 each and, in addition, assessed costs of \$850 each.

Branch Offices

Board Interpretations Clarify Definition

Interpretations clarifying the definition of a "Branch Office," as contained in Article I, Section 11 of the NASD By-Laws, have been adopted by the Board of Governors.

Local offices now are required to be separately registered with the Association if they meet the following specifications:

1. When a member or representative maintains desk space other than in his residence;
2. When a member or representative has a local phone listed or advertised in any business establishment (other than a phone answering service);
3. When a representative of a member operates out of his residence and lists his phone number under the firm name;
4. When any office is listed in a financial publication or professional dealer's digest as a branch office.

Branch office assessment is \$10 a year. Each branch is supplied a Manual and receives all communications issued by the Association.

Investment "Major"

Georgetown University, Washington, D. C., announces that the school is offering a fully integrated program based on "the needs of the financial community for graduates soundly educated in the functions of investment banking and the marketing of securities."

The degree of Bachelor of Science in Business Administration, major in investment banking, is provided through full-time day programs, in four years, or, in part-time evening study, in five years.

MID-WINTER MEETING OF THE BOARD OF GOVERNORS



Left to right, rear: Thomas G. Foster, Edward J. McKendrick, Earl F. Waterman, Assistant to the Executive Director Donald H. Burns, Edward H. Austin, Frank L. Reissner, Executive Director Wallace H. Fulton, Earl K. Bassett, Counsel John W. Lindsey, Counsel Marc A. White, Joseph J. Muldowney, Lee H. Ostrander, Alexander Yearley, IV, and Treasurer Dale F. Linch. *Front:* Edmond E. Hammond, Vice Chairman Richard W. Simmons, J. Gordon Hill and Howard H. Fitch. Mr. Lindsey died suddenly a short time after the meeting (for story see Page 4).



Left to right, front: James F. Jacques, Public Relations Counsel James P. Conway and Chairman Charles L. Bergmann. *Rear:* Albert C. Purkiss, Curtis H. Bingham, Ernest W. Borkland, Jr., and Allen J. Nix.



Left to right, front: Glenn L. Milburn, Arthur A. Christophel, Secretary of Investment Companies Committee Ray Moulden and Donald L. Patterson. *Rear:* Francis M. Brooke, Jr., Ralph C. Sheets, Glenn E. Anderson and James G. Dern.



Albert C. Purkiss, Walston & Co., Inc., New York, chairman of the National Quotations Committee, largely instrumental in working out the expanded NASD system of quotations on over-the-counter securities.



Thomas B. MacDonald, of Blyth & Co., Inc., New York, heads up the National Uniform Practice Committee, the group that oversees the "back office" phases of the business through the Uniform Practice Code.



Robert L. Cody, of North American Securities Company, San Francisco, new chairman of the Investment Companies Committee, which supervises selling practices and other activities in the expanding investment company field.

Over-Counter Book

McGraw-Hill Puts Out Comprehensive Study

"The Over-the-Counter Securities Market" has just been issued by McGraw-Hill Company. One of the most comprehensive and detailed reviews of the market ever assembled, it is the result of extensive studies, to which the NASD contributed much assistance. The project was underwritten by the Merrill Foundation.

The book brings together a series by the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania. It presents a comprehensive picture of the magnitude, structure and operation of the over-the-counter market in all of its aspects. The book covers certain areas of the market to an extent never undertaken before.

Volume of activity, pricing and price differentials, characteristics of transactions, position practices, and the relationship between over-the-counter securities markets and exchange markets are among the major topics covered by the book.

Professors Irwin Friend, G. Wright Hoffman and Willis J. Winn, all of the Wharton School, collaborated in the research and are the authors of the book. It is priced at \$12.50.

"This book is a must for reference purposes in every investment banking office and for every student of the capital market," according to one authority on the project.

Copies of the book may be obtained from McGraw-Hill Publishing Co., 330 W. 42nd Street, New York 36, N. Y.

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ment in this area more than ordinarily difficult.

The Association's Board of Governors and District Committees are conscious that much of the business done by members is carried on by telephone. The legitimate and proper use of the telephone is recognized as being inherent to the business of selling securities.

There was nothing legitimate or proper in the practice cited here, however, and the Business Conduct Committee's decision is considered a significant step forward in the control of "boiler room" operations.

"We also find," the Committee said, "that the conduct involved

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constituted conduct contrary to high standards of commercial honor and just and equitable principles of trade, and constituted a course of conduct and practice of business which could only result in the violation of our rules.

"There almost appears to be a studied endeavor to act contrary to important and responsible requirements of the Association's rules.

"We are impressed by the fact that none of the persons who should have been responsible appeared to have taken any of the responsibility required in the securities business in dealing with members of the public . . .

"This clearly is contrary to supervision inherent in our rules and a violation of the most serious kind."

John W. Lindsey

John W. Lindsey, partner of the law firm of Blum, Lindsey and Powell, counsel for the Association, died February 12, at Redington Beach, Fla., where he was vacationing with his family. Mr. Lindsey was 44. A resident of Rockville, Md., he was born in Yonkers, N. Y. He was first employed by the Association in 1941, shortly after graduating from Ohio State University Law School. He is survived by his widow, Palmeta, and three children, John, Pamela and Howard.