UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 33287

MELVYN HILLER,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF ORDERS
OF THE SECURITIES AND EXCHANGE COMMISSION

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

COUNTERSTATEMENT OF THE ISSUES PRESENTED

1. Did petitioner, the president of a registered broker-dealer in securities as well as one of its principal shareholders and the person primarily responsible for its sales activities, violate antifraud provisions of the federal securities laws (1) by actively encouraging salesmen of his firm to solicit customers to purchase a speculative security on the basis of false, unconfirmed and extravagant reports and rumors and (2) by himself making false and misleading representations to customers of his firm concerning that security?

2. Where the Securities and Exchange Commission, after making an independent review and evaluation of the record in an administrative proceeding, found that petitioner had committed serious and willful violations of antifraud provisions of the federal securities laws, is its order subject to reversal as an abuse of its discretion merely because the Commission, in determining the sanction to be imposed in the public interest, barred petitioner from being associated with any broker or dealer rather than imposing a lesser sanction thought to have been appropriate by its hearing examiner?

COUNTERSTATEMENT OF THE CASE

The Proceedings Before the Commission

Melvyn Hiller has petitioned this Court, pursuant to Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y(a), to review two orders of the Securities and Exchange Commission. The first order, dated April 30, 1968, barred Hiller from being associated with any broker or dealer in securities (Grs. App. 206a-207a).[1/] The second order, dated December 24, 1968, denied Hiller's petition for rehearing, leave to adduce additional evidence and leave to make oral argument (Grs. App. 242a-263a). The orders were entered at the conclusion of a private administrative

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1/ The Commission's order of April 30, 1968, was based upon its findings and opinion of the same date (Grs. App. 185a-205a).

The appendix filed by Hiller is cited as "Hil. App. ____." Hiller's brief in this Court is cited as "Br. ____." The transcript of the proceedings before the hearing examiner is cited as "Tr. ____." Pursuant to an order of this Court, entered on December 15, 1969, the parties have also been permitted to refer to the appendix to briefs filed in Gross v. Securities and Exchange Commission, C.A. 2, Docket No. 33159 (see fn. 4, p. 5, infra). That appendix is cited as "Grs. App. ___a."

proceeding conducted by the Commission pursuant to Sections 15(b) and 15A of the Securities Exchange Act, 15 U.S.C. 78o(b), 78o-3. The respondents in the proceeding were Richard Bruce & Co., Inc. ("Bruce & Co."), which had been registered with the Commission as a broker and dealer in securities, the three individuals who owned and ran the company--Hiller, George Granat and Stanley Gross--and three of the company's salesmen.

With respect to Hiller, the Commission's order instituting the proceedings presented the issues of (1) whether he had willfully violated the antifraud provisions of the Securities Act of 1933 and of the Securities Exchange Act[2/] in the offer and sale of stock of Transition Systems, Inc. ("Transition"), and (2) whether he had willfully violated those antifraud provisions and the registration provisions of the Securities Act[3/] in the offer and sale of stock of Honig's Parkway, Inc. ("Honig's") (Hil. App. 172-175). The hearing examiner found that Bruce & Co. had willfully violated the antifraud provisions in the offer and sale of Transition's stock and that Hiller and certain other respondents had willfully aided and abetted these violations (Grs. App. 178a); that Hiller and certain other respondents had violated the antifraud provisions in failing reasonably to supervise

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2/ Section 17(a) of the Securities Act, 15 U.S.C. 77q(a); Sections 10(b) and 15(c)(1) of the Securities Exchange Act, 15 U.S.C. 78j(b), 78o(c)(1), and Rules 10b-5 and 15c1-2, 17 CFR 240.10b-5, 15c1-2, promulgated by the Commission under the Securities Exchange Act.

3/ Sections 5(a) and 5(c) of the Securities Act, 15 U.S.C. 77e(a) and 77e(c).

Bruce & Co.'s activities with a view to preventing violations of the securities laws during the period that Bruce & Co. was selling Transition's stock (Grs. App. 178a); that Bruce & Co. had willfully violated the antifraud provisions in the offer and sale of Honig's stock and that each of the individual respondents had willfully aided and abetted these violations (Grs. App. 177a); and that all respondents had willfully violated the registration provisions of the Securities Act in the offer and sale of Honig's stock (Grs. App. 178a). The hearing examiner ordered that Hiller be barred from association with a broker or dealer in a supervisory capacity, and that he be suspended from any association with a broker or dealer for a period of six months (Grs. App. 181a).

Hiller and certain other of the respondents filed with the Commission petitions to review the decision of the hearing examiner, and the Commission on its own initiative, pursuant to Rule 17(c) of the Commission's Rules of Practice, 17 CFR 201.17(c), ordered review of the initial decision "with respect to the issues which were before [the hearing examiner] concerning all the respondents."

The Commission made an independent review of the entire record (Grs. App. 188a). It concluded that "Hiller was primarily responsible for and himself participated in making fraudulent representations to customers and he as well as Granat actively encouraged the dissemination of the unconfirmed reports concerning Transition," and determined that in light of this "serious fraud upon . . . [Bruce & Co.'s] customers," it was

in the public interest to bar Hiller from association with any broker or dealer (Grs. App. 204a).[4/] The Commission stated that it was unable to make adverse findings with respect to Hiller or the other two principals of Bruce & Co. in connection with the transactions in Honig's stock (Grs. App. 203a).

Hiller filed with the Commission a Petition for Rehearing, For Leave to Adduce Additional Evidence, and For Leave to Make Oral Argument. In a Memorandum Opinion and Order dated December 24, 1968 (Grs. App. 263a), the Commission denied the petition. This appeal followed.

Transition Systems, Inc

Transition was incorporated in December of 1960 (Tr. 1059) (Hil. App. 17) to develop a "correlator," an electronic device to improve signal detection systems (Tr. 1257; 1267-1269). In February 1961, a meeting was arranged with Bruce & Co. to discuss a possible public stock offering (Tr. 1266, 1330, 1340) (Grs. App. 104a, 108a, 110a). Hiller, who was president of Bruce & Co., attended this

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4/ In addition, the Commission revoked the registration of Bruce & Co. and imposed sanctions on the other individual respondents. Gross and one of the salesmen, Aaron Fink, also petitioned this Court for review of the same orders of the Commission challenged by Hiller. Gross' appeal (Docket No. 33159) concerned similar facts and issues of law to those in Hiller's appeal. On October 27, 1969, a panel of this Court composed of Judges Waterman, Moore, and Kaufman rendered an opinion affirming the Commission's order as to Fink (Docket No. 33275). On November 10, 1969, a panel of this Court composed of Judges Moore, Hays and Anderson rendered an opinion affirming the Commission's order as to Gross.

meeting, at which the president of Transition discussed his company and the possible uses of the correlator (Tr. 1266-1269) (Grs. App. 104a-106a), but pointed out that Transition had not yet developed such a machine (Tr. 1269-1270) (Grs. App. 106a). It was decided that Bruce & Co. would underwrite a public issuance of Transition stock (Tr. 1270) (Grs. App. 106a-107a). A registration statement for that stock became effective in June 1961 (Commission File No. 2-18007-1, officially noticed at Tr. 6, 8) and the offering was completed in July 1961 (Tr. 2875) (Hil. App. 82). At the time of the public offering the company had not commenced operations and had no employees (Grs. App. 105a); its office was in the law office of one of the company's officers (Grs. App. 154a). By the terms of the underwriting agreement Bruce & Co. was entitled to have one representative on Transition's board of directors, and in September 1961, Hiller became its representative on Transition's board (Tr. 1287) (Hil. App. 18-19).

After the public offering of Transition's stock was completed, the flow of information concerning the company and its activities ceased. Despite persistent efforts on the part of Bruce & Co., it was unable to acquire any information concerning Transition's progress in the development and marketing of the correlator (Tr. 1565; 1854-1856; 1916-1917; 2442; 2816; 2829) (Hil. App. 20-21; 25-28; 31-32; 66-67; 69-72).

Commencing in about October 1961, and continuing into May 1962, a number of "rather wild stories" concerning Transition and the correlator began to circulate (Tr. 2662; 1995, 3058) (Hil. App. 68-69; 37-38; 102-104).

The stories concerned the application of the correlator to various fields (Tr. 1928-1930, 2216-2217, 2351, 3060-3063) (Hil. App. 33-37; 44-48; 59-61; 105-109) and were to the effect that Transition had made a scientific "breakthrough" (Tr. 2219, 2351-2352) (Hil. App. 47; 59-61); that the correlator was fully developed (Tr. 1494-1495, 2217) (Grs. App. 32a-34a; Hil. App. 45) and was being produced (Tr. 3060) (Hil. App. 105-106); that there had been a great deal of interest shown by potential purchasers (Tr. 1494, 2217, 2361) (Grs. App. 32a-33a) (Hil. App. 45, 62); that the company had contracts with the government (Tr. 2251, 2253, 2361) (Hil. App. 50, 52, 62) and a backlog of orders from private concerns (Tr. 1495, 2263, 2265-2267, 2390-2391) (Grs. App. 33a) (Hil. App. 53, 57-59, 64-66) and that Transition would have increased earnings for its fiscal year ended September 30, 1962 (Tr. 1912, 2226, 2367) (Hil. App. 30, 49, 63) and substantially increased earnings in the succeeding fiscal year (Tr. 2367, 3065) (Hil. App. 63-64, 111).

These rumors and extravagant claims were contradictory to the published information concerning Transition which was then available to Bruce & Co. This information consisted of the registration statement filed in connection with Transition's public offering and Transition's first annual report to stockholders, which was received by Bruce & Co. in January 1962 (Tr. 2816, 2819-2820, 2658). (Hil. App. 69-70, 166-167, 163-164). The Introductory Statement of the prospectus contained in the registration statement recited, among other things, that Transition had not yet commenced operations and had made no arrangements for the sale of any products or services,

that the proceeds of the offering might not be sufficient to meet its needs for the period required to develop a practical correlator, that the company to a large extent would be dependent upon government contracts for the development and production of a correlator, and that there was no assurance that the government would make funds available for such purpose or that Transition would obtain any, or, if it did, that it would be able to develop a correlator or manufacture and sell it at a profit. Transition's annual report (received in evidence as Division's Exhibit 19 at Tr. 1195), which covered the period from the corporation's formation in December 1960, to the end of its first fiscal year (September 30, 1961), showed a net operating loss of $11,417, representing pre-production costs and expenses. The report noted that Transition had been inactive from its inception until July 1961, and that the premises it had recently leased (which would contain an electronics laboratory) would not be ready for occupancy until December 1961. The first page of the report, the president's letter to stockholders dated January 9, 1962, indicated that by that date the electronics laboratory had been equipped and stated that the "critical research and development program for [Transition's] general purpose correlator is being conducted" (Hil. App. 179).

The chief source of the optomistic rumors had been a brother of the president of Transition, who had been retained by the company as a "financial consultant" (Tr. 1664) (Hil. App. 22-23). He apparently was

not considered a reliable source of information by Hiller, who considered the reports to be of "poor quality" (Tr. 2910) (Hil. App. 98) and characterized the rumors as "a lot of garbage" (Grs. App. 75a).[5/] Indeed, during the period that the rumors were circulating there was "absolutely no proof" of their truth (Tr. 2662) (Hil. App. 69). Even though he was on Transition's board, Hiller had been unable to confirm the accuracy of the rumors, and he finally quit the board in May 1962 (Grs. App. 194a; Tr. 2892) (Hil. App. 90) because of his inability to secure any information (Tr. 1876, 2890-2893) (Hil. App. 29, 87-91).

Solicitation of Transition Stock During the October 1961-March 1962 Period

Prior to the time that Hiller finally quit Transition's board because of his inability to get reliable information, and notwithstanding the lack of proof and the discrepancy between the rumors and the available published information, Bruce & Co.'s sales representatives were allowed to solicit purchases of Transition's stock based on the rumors then circulating. The sales representatives were instructed by Hiller, as well as by the other principals of the firm, that they could sell this stock to persons "able to handle a speculative, extremely speculative situation of this kind" (Tr. 2623-2624) (Grs. App. 126a).

5/ This comment was in response to a report that Transition "had perfected or developed an all-purpose correlator that would detect 97 percent of all conceivable types of cancer . . ." (Grs. App. 66a-67a; 73a-75a).

Hiller also told them to sell to persons "not susceptible to weeping in their beer if they lost money" (Tr. 3160) (Hil. App. 112), and not to sell it to "any crybabies, [who] can't take their losses" (Tr. 1564) (Hil. App. 20); they were further instructed to disclose that the information they were passing on to their customers was unpublished and "not in many cases directly from the company" (Tr. 2965) (Hil. App. 101-102).[6/]

Various customers of Bruce & Co., testified that they were solicited within the period of October 1961 to March 1962, to purchase Transition's stock by means of representations that Transition was engaged in highly secret operations and had a government contract (Tr. 375-376; 735) (Hil. App. 133, 142); that its correlator would be used to transmit information on the bodily condition of Col. John Glenn during his orbital flight around the earth (Tr. 258; 275; 279; 297-8) (Hil. App. 117, 123, 124, 128); that the senior United States Senator from the State of New York was going to be highly influential in obtaining government contracts for the company (Tr. 791, 802-3, 817) (Hil. App. 144, 146, 148); that the correlator would detect cancer and "almost anything in the human body," and the American Medical Association was interested in it (Tr. 653, 297) (Hil App. 140, 128), and that Transition's

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6/ Although Bruce & Co.'s sales representatives had at one point been told that they could give no information except what appeared in Transition's prospectus, the supervisor of the sales representatives testified that he recalled ". . . only that perhaps we were no longer reminded of this . . ." once the salesmen learned of the rumors (Grs. App. 127a-128a).

stock was "terrific" and that it "was unquestionably going to go up" (Tr. 374; 664) (Hil. App. 132, 140), and would "skyrocket" (Tr. 751) (Grs. App. 96a), unquestionably go up about 30 points (Tr. 791) (Hil. App. 144) and rise to about $40 per share in six months (Tr. 375, 390-392) (Hil. App. 133, 135-138). Indeed, Hiller himself told a customer that he thought Transition would be another Calvar, a company "which had had a remarkable rise in price" (Tr. 262, 292-293) (Hil. App. 121, 125-127).

In fact, the rumors and the representations and predictions based upon them were false. Transition never received a single order for its correlator, never got a government contract and was not engaged in secret or classified operations (Tr. 1308-1309; 1311, 1625) (Hil. App. 150-151, 153, 158). The correlator was never used on the orbital flight (Tr. 1309, 1310) (Hil. App. 151-152). It had no application for cancer detection (Tr. 1332) (Hil. App. 157); Transition had not communicated with the American Medical Association concerning the device, nor had the Association expressed an interest in it (Tr. 1310) (Hil App. 152). New York's senior United States Senator was in no way involved with the company (Tr. 1309) (Hil. App. 150-151). Transition's federal income tax return for the fiscal year ending September 30, 1962, showed a new loss of $69,650 (Divisions Exhibit 17, received in evidence at Tr. 1080).[7/]

7/ In April 1962 (after the fraudulent activities found by the Commission had occurred), Transition issued a news release announcing that its correlator was available for sale at $10,000 per unit (Grs. App. 191a-192a). Shortly thereafter, a large manufacturer offered a similar product for half Transition's price, and Transition was unable to compete (Grs. App. 192a).

STATUTES AND RULES INVOLVED

Pertinent statutes and rules are set forth in the statutory appendix to Hiller's brief (pp. 1c to 4c).

ARGUMENT

I. THE COMMISSION CORRECTLY DETERMINED THAT PETITIONER WILLFULLY VIOLATED ANTIFRAUD PROVISIONS OF THE SECURITIES LAWS

It should be noted initially that Hiller does not contest the Commission's finding that he was primarily responsible for and participated in the representations to Bruce & Co.'s customers which the Commission held to be false and misleading. Nor does he contest the finding that he actively encouraged the dissemination of the unconfirmed reports and rumors concerning Transition and that he authorized the salesmen to solicit customers to purchase that stock on the basis of these reports and rumors. As we have seen (pp. 7, 9-11 supra) they are supported by substantial evidence and accordingly are conclusive.[8/] What Hiller does appear to argue, however, is that the

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8/ Section 25(a) of the Securities Exchange Act, which confers jurisdiction on this Court, provides that "[t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." And Section 10(e)(B) of the Administrative Procedure Act, as codified, 5 U.S.C. 706(2), provides that a reviewing court may "set aside agency action, findings, and conclusions found to be . . . (E) unsupported by substantial evidence . . . ." Thus, it has been recognized that in proceedings such as this "[t]he scope of . . . [the Court's] review is to determine if the Commission's findings are supported by substantial evidence." Pierce v. Securities and Exchange Commission, 239 F. 2d 160, 162 (C.A. 9, 1956). Accord, e.g., Vickers v. Securities and Exchange Commission, 383 F. 2d 343 (C.A. 2, 1967).

solicitation of orders for a speculative security on the basis of false, unconfirmed and extravagant reports and rumors does not constitute fraud under the federal securities laws.[9] This argument is without merit.[10]

This Court has long held that a broker or dealer in securities, is ". . . under a special duty, in view of its expert knowledge and proffered advice . . . ," and the fact that "[i]t holds itself out as competent to advise in the premises . . . ," to deal fairly with its customers in accordance with the standards of the securities profession. Charles Hughes & Company, Inc. v. Securities and Exchange Commission, 139 F. 2d 434, 436-437 (C.A. 2, 1943), certiorari denied, 321 U.S. 786 (1944).[11] Citing the Charles Hughes case, the Commission has stated:

> We believe . . . that the making of representations to prospective purchasers without a reasonable basis, couched in terms of either opinion or fact and designed to induce purchases, is contrary to the basic obligation of fair dealing borne by those who engage in the sale of securities to the public. (Footnotes omitted.)

9/ Hiller also argues that the false and misleading representations which he himself made to a customer of Bruce & Co. were not made "in connection with" the purchase or sale of Transition stock (Br. 26,55). This contention is dealt with at pages 22-23, infra.

10/ Hiller devotes one portion of his Brief (pp. 37-41) to the agrument that his supervision of Bruce & Co.'s employees should not be the basis for the imposition of a sanction upon him. Since the Commission specifically stated that its "findings of fraud violations did not rest on any failure of supervision" (Grs. App. 249a), this is not an issue on this appeal.

11/ In that case this Court pointed out (id. at 437):

> "The law of fraud knows no difference between express representation on the one hand and implied misrepresentation or concealment on the other."

In the Matter of Mac Robbins & Co., Inc., 41 S.E.C. 116, 119 (1962), aff'd sub nom. Berko v. Securities and Exchange Commission, 316 F. 2d 137 (C.A. 2, 1963).[12/]

The most recent reaffirmation of this principle of implicit representation of fair dealing and its relationship to the antifraud provisions of the securities laws is found in this Court's decision in Hanly v. Securities and Exchange Commission, 415 F. 2d 589 (1969). Citing the Charles Hughes case, this Court pointed out at page 596: "A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicity represents he has an adequate basis for the opinions he renders" (footnotes omitted). Furthermore, this Court stated that the usually strict standards governing the conduct of persons selling securities become even stricter where the sales involve over-the-counter securities (as were the sales of Transition's stock here). Id. at 597. This Court concluded in Hanly that such persons "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation." Ibid.[13/]

12/ Accord, e.g., Charles P. Lawrence, Securities Exchange Act Release No. 8213 (Dec. 19, 1967), aff'd sub nom. Lawrence v. Securities and Exchange Commission, 398 F. 2d 276 (C.A. 1, 1968); A. T. Brod & Co., Securities Exchange Act Release No. 8060 (April 26, 1967); Martin A. Fleishman, Securities Exchange Act Release No. 8002 (December 7, 1966); Arthur Leibowitz, 41 S.E.C. 484 (1963).

13/ See also, Nees v. Securities and Exchange Commission, 414 F. 2d 211, 219-220 (C.A. 9, 1969).

In that case also the argument was made, which Hiller makes here (Br. 19, 21, 35), that these strict standards should not be applied in the absence of a "boiler room" operation. The Court stated "we specifically reject petitioners' argument that absence of boiler room operations here is a defense to a charge of misrepresentation." Id. at 597, n. 14.

Hiller argues, however, that it was "reasonable" for him to believe the "rather wild stories" (p. 6, supra) concerning Transition and the correlator (Br. 13; 17-18), and therefore permissible for him to have solicited customer orders based on them. In support, he argues that the rumors were in accord with the published information concerning Transition (Br. 13, 17-18) and he points to purchases of Transition stock made by two investors who were in the securities business (Br. 15-16, 30, 32, 54). These factual arguments, which were made to and rejected by the Commission, are meritless.

In finding that the representations and predictions were made without a reasonable basis (Grs. App. 190a), the Commission pointed to the facts that Hiller did not consider the chief source of the rumors, the brother of Transition's president, as a reliable source of information concerning Transition's operations; that Hiller considered the reports to be of poor quality and a "lot of garbage"; and that during the period the rumors were circulating, there was "absolutely no proof" of their truth (see p. 9, supra). Additionally, rather than being in accord with the published information concerning Transition, the record is clear that the

rumors were contrary to such information (see pp. 7-8, supra). As pointed out in fn. 7, p. 11, supra, the April press release, which Hiller argues confirmed the rumors (Br. 13) occurred after the fraudulent conduct found by the Commission, and, as Hiller concedes, was itself false (Br. 12-13).

Nor does the purchase of Transition's stock by two investors who were in the securities business suggest that Bruce & Co.'s sales representatives were free to solicit their customers based on the rumors then circulating. The Commission has pointed out that a salesman's willingness to speculate with his own funds without reliable information gives him no license to make false and misleading representations to induce his customers to speculate.[14/] If purchases by Hiller would have been no defense, a fortiori, purchases by third persons are of no help.

Hiller argues that the admittedly false and misleading representations that were made did not constitute a "manipulative, deceptive, or other fraudulent device or contrivance" within the meaning of Section 15(c)(1) of the Securities Exchange Act because subsection (b) of Rule 15c1-2 defines that term to include any untrue or misleading representation made "with knowledge or reasonable grounds to believe that it is untrue or misleading," and that it is irrelevant that he could not verify the truth of the representations made so long as he

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14/ A. T. Brod & Co., Securities Exchange Act Release No. 8060 (April 26, 1967), p. 4; Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965), p. 22.

did not know or have reasonable grounds to believe they were untrue or misleading (Br. 21-23; 30-34). Although Hiller states that the Commission overlooked this definition (Br. 22), in fact this identical argument was made to the Commission in Hiller's petition for rehearing, and was rejected (Grs. App. 244a-247a). In rejecting this argument, the Commission pointed out that, at the least, Hiller's representation to a customer that Transition could be another Calvar (p. 11, supra), the stock of which had had a remarkable rise in price within a short period of time, was in effect a forecast of a spectacular price rise (Grs. App. 195a) and "made with 'knowledge or reasonable grounds to believe,' that it was 'untrue or misleading'" (Grs. App. 246a). In any event, subsection (a) of Rule 15cl-2 defines the term "manipulative, deceptive or other fraudulent device or contrivance" to include "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," and in its decision the Commission concluded that "the use of. . . [unconfirmed] reports as part of a sales pitch was contrary to the basic obligation of a broker-dealer to deal fairly with the investing public" (Grs. App. 197a). In holding that the activities here violated antifraud provisions (Grs. App. 198a), the Commission noted that since broker-dealers and their associated persons "hold themselves out as professionals in the securities business, a report disseminated by them in connection with recommending a security, notwithstanding the fact

that customers are advised that the report is unconfirmed, gains in authority and credibility" (Grs. App. 197a).[15/] In any event, even assuming there were merit to Hiller's argument respecting Section 15(c)(1), Hiller does not deny that the representations found were within the scope of the other designated antifraud provisions of the securities acts (see fn. 2 , p. 3, supra and Grs. App. 198a).

Hiller next argues, as he did unsuccessfully to the Commission, that he had a "duty to pass on to his customers the information which was brought to his attention concerning Transition" (Br. 28), provided that the source of the information and its speculative nature and lack of verification were disclosed. This "duty" is purportedly based upon the general principle of "full disclosure" (Br. 28-29; 34-36) and upon this Court's decision in Securities and Exchange Commission v. Texas Gulf Sulphur Company, 401 F.2d 833 (1968), certiorari denied, 394 U.S. 976(1969) (Br. 50-55). The Texas Gulf case gives no comfort to Hiller. In construing Commission Rule 10b-5, promulgated pursuant to Section 10(b) of the Securities Exchange Act, this Court stated:

> The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i. e., the investing public. Matter of Cady, Roberts & Co., 40 SEC 907, 912 (1961). Id. at 848.

15/ This was especially so in this case since, as the hearing examiner found, Bruce & Co. had acquired among many of its customers a reputation for knowledgibility with respect to Transition because it had been the underwriter of the Transition stock and because its president, Hiller, was sitting on Transition's Board of Directors (Grs. App. 174a).

In the Texas Gulf case, while the insiders who traded could not know the extent of the ore that had been found by their company, they knew facts (i.e., the length, extent, and location of drill holes and the amount of ore in each) that placed them "alone . . . in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; . . . ." Id. at 852. There can be no comparison to the situation here, where, as the Commission pointed out (Grs. App. 196a):

> The picture that emerges from this record is of registrant authorizing, if not encouraging, the solicitation of orders for a speculative stock on the basis of unconfirmed and extravagant reports or rumors, and of sales personnel being instructed to transmit such reports to persons who in the salesmen's judgment could afford to lose money or would not complain if they did, in a situation where losses were or could reasonably be anticipated. **(Emphasis supplied.)**

In any event, as the Commission noted (Grs. App. 195a), there is no indication in the record that any of the customers who testified at the hearing were cautioned as to the unreliable nature of the reports. Indeed Hiller spent about one-half hour with one customer discussing the stories about Transition, and, as far as the record shows, Hiller made no cautionary statements to the customer about the stories (Tr. 304, 258-259) (Hil. App. 130, 116-117).

Hiller also contends that the false and misleading representations made in this case were "mere opinions," and as such argues that an investor relies upon them "at his own risk" (Br. 21). The Commission pointed out in its memorandum opinion that "many of the representations . . . [were] more than mere expressions of opinion" (Grs. App. 247a, n. 5). Moreover, as noted, (supra, pp. 13-14), the Commission has

repeatedly held that representations and predictions made without a reasonable basis and designed to induce purchases violate the antifraud provisions whether such statements are couched in terms of opinion or fact. 16/

Hiller relies on Securities and Exchange Commission v. Macon, 28 F. Supp. 127 (D. Colo., 1939). That case apparently dealt with the opinion of experts contained in an offering circular concerning the sale of oil and gas interests. The court, in granting an injunction, there said:

> I do not believe a salesman has the right to pass the opinion of someone else on to the public, and derive benefit therefrom in selling stock and receiving the proceeds, without being in some way responsible for such statements. Any other construction would open the way to a great many abuses, and permit people to derive profit from letters of experts irrespective of the merits or their standing in their profession, without any responsibility. Id. at 129.

The court there concluded that a person selling securities "cannot pass such information on and escape responsibility by saying 'I believed it.'" Although the court did remark that securities purchasers rely on opinions at their own risk, it went on to point out: "On the other hand, the expression of opinion, coupled with other statements, may amount to a statement of a material fact, although it is disguised and framed

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16/ Mac Robbins & Co., Inc., supra, 41 S.E.C. at 119; Pennaluna & Co., Securities Exchange Act Release 8063 (April 27, 1967) at p. 9, affirmed in part and reversed in part on other grounds, 410 F. 2d 861 (C.A. 9, 1969); certiorari denied, 38 U.S.L.W. 3254 (January 13, 1970); DeMammos, Securities Exchange Act Release 8090 (June 2, 1967) at p. 3, affirmed from the bench, C.A. 2, Docket No. 31469 (October 13, 1967).

technically to be nothing more than a mere opinion." 28 F. Supp. at 129. The case has been cited for the proposition: "It is the impression created by the statements which determines whether they are misleading." In re American Trailer Rentals Company, 325 F. 2d 47, 53 (C.A. 10, 1963), reversed on other grounds, 379 U.S. 594 (1965).

Hiller questions the finding that he "willfully" violated the federal securities laws, and points to the lack of a finding that he had a "deliberate intent to defraud the investing public" (Br. 19). As this Court stated, however, in Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8 (1965):

> It has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

And another court, in approving the same definition of willfulness, commented that the court had been cited to no authority to the contrary and had found none. Gearhart & Otis, Inc. v. Securities and Exchange Commission, 348 F. 2d 798, 803 (C.A.D.C., 1965).[17/] This Court has recently held that "proof of specific intent to defraud is irrelevant . . . in private proceedings such as these . . . ." Hanly v. Securities and Exchange Commission, supra, 415 F. 2d at 596.

17/ Accord, e.g., Nees v. Securities and Exchange Commission, supra, 414 F. 2d at 220-221.

With respect to the representations which Hiller himself made, he raises two arguments. Hiller contends that in comparing Transition to Calvar (p. 11, supra), he intended "to show the customer that he had no verification of any reason why the price of Transition stock rose so spectacularly, since at that time Calvar stock had a spectacular rise in price without any reason whatsoever" (Br. 25-26) (emphasis in original). In rejecting this argument, the Commission noted that the customer testified that the only thing he knew about Calvar was that "it had had a spectacular rise over a short period of time" (Tr. 262) (Hil. App. 121) and that Hiller was giving the customer the impression that Transition "could do the same thing" (Tr. 292-293) (Hil. App. 126). The testimony of a saleswoman who was present was to the same effect (Tr. 3105) (Grs. App. 87a, 246a, n. 3).

Hiller also argues that his statements were not made "in connection with" the purchase or sale of Transition's stock, as required by Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. The record indicates that the customer to whom Hiller made the false statements had entered a purchase order for 200 shares of Transition on February 26, 1962 (Tr. 259-260; Division's Exhibit No. 9)(Hil. App. 117-119). On the settlement date, March 2, 1962, the customer went to Bruce & Co. to pay for his purchase (Tr. 260)(Hil. App. 119).

It was at that time that he spoke to Hiller and Hiller made the false and misleading representations and comparison (Tr. 261-262) (Hil. App. 119-121). The customer subsequently spoke to Hiller once or twice again because "the stock started to drop in value, and I was concerned about it" (Tr. 263)(Hil. App. 122).

As this Court has made clear, the "in connection with" phrase is construed broadly, and does not require that an actual purchase or sale occur. Securities and Exchange Commission v. Texas Gulf Sulphur Company, supra, 401 F. 2d at 860.[18/] The Rule applies as well to misrepresentations which may have induced the investor not to sell securities at the time, with the result that a greater loss may occur when they are ultimately sold. Stockwell v. Reynolds & Co., 252 F. Supp. 215 (S.D. N.Y., 1965). This principle is implicit in this Court's definition of material facts in Texas Gulf to include facts "which may affect the desire of investors to buy, sell or hold the company's securities," 401 F. 2d at 849 (emphasis added), and was further recognized by this Court in its conclusion that the Rule is violated "whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public. . . ." Id. at 862.

Finally, the Commission did not err in denying Hiller's request for a rehearing at which he might adduce additional evidence. He sought

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18/ Accord, Heit v. Weitzen, 402 F. 2d 909, 913 (C.A. 2, 1968), certiorari denied, 395 U.S. 903 (1969)

certainly entitled to establish a policy, based on further experience and the condition of the securities markets, as to the sanction necessary when fraudulent conduct of the character involved in this case has occurred. As stated in Shawmut Ass'n v. Securities and Exchange Commission, 146 F. 2d 791, 796-797 (C.A. 1, 1945):

> Flexibility was not the least of the objectives sought by Congress in selecting administrative rather than judicial determination of the problems of security regulation. [Citation and footnote omitted.] The administrator is expected to treat experience not as a jailer but as a teacher.

CONCLUSION

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

Respectfully submitted,

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