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UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of

VICTOR R. REDSTONE d/b/a
VANGUARD INVESTMENT COMPANY
590 South San Vicente Boulevard:
Los Angeles 48, California

File No. 8-7989

RECOMMENDED DECISION

Warren E. Blair,
Hearing Examiner

New York, N.Y.

April 17, 1964

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BEFORE:

Warren E. Blair, Hearing Examiner

APPEARANCES:

Ronald P. Kiefer, Esq. and J. Joseph
Kennedy, Esq. of the Los Angeles Branch
Office of the Commission for the Divi-
sion of Trading and Markets.

Ernest Kuhn, Esq., 9171 Wilshire Boulevard,
Beverly Hills, Calif. for Registrant.

Cyon J. Gibson, pro se

Nature of Proceeding

Proceedings in this matter were instituted by the Commission on November 13, 1963 by its Order for Private Proceedings pursuant to Sections 15(b) and 15 A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether allegations of the Division of Trading and Markets ("Division") that Victor R. Redstone ("Redstone"), doing business as Vanguard Investment Company ("registrant"), Harvey Sterman ("Sterman"), and Cyon J. Gibson ("Gibson"), wilfully violated and aided and abetted wilful violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b), 15(b), 15(c)(1), and 17(a) of the Exchange Act, and Rules 10b-5, 15b-2(b), 15c1-2, and 17a-3 thereunder, are true; whether remedial action is appropriate under Sections 15(b) and 15A of the Exchange Act; and whether, pursuant to Section 15A(b)(4) of the Exchange Act, Sterman and Gibson, or either of them, should be found a cause of any order of revocation, expulsion or suspension.

The Division alleges in substance that registrant, Sterman, and Gibson wilfully violated and aided and abetted

wilful violations of the anti-fraud provisions of the Securities Act and Exchange Act in the offer and sale of common stock of National Growth Corporation ("National Growth") by failing to amend registrant's application for registration so as to disclose the control of registrant by Sterman and the change of registrant's address; opening a fictitious customer's account on registrant's books; offering, selling, and delivering after sale National Growth stock that had not been registered under the Securities Act; charging commissions on principal transactions; and making false and misleading statements and omitting statements of material facts concerning National Growth, National Growth stock, and registrant's investment advice at a time when customers were being required to make hasty decisions to purchase. The Division further alleges that the conduct alleged also involves wilful violations of Sections 5(a) and 5(c) of the Securities Act and Sections 15(b) and 17(a) of the Exchange Act and Rules 15b-2(b) and 17a-3 thereunder.

Counsel for registrant filed an answer on November 26, 1963 which contained a general denial and a disclaimer of sufficient information upon which to base an answer to any of the Division's allegations.

Sterman appeared after the hearing had begun, pursuant to a subpoena and without counsel. After the Examiner explained to Sterman his right to participate in the proceeding he had under the Commission's Rules of Practice, he declined to participate. His appearance was therefore limited to that of a witness at the hearing.

Gibson also appeared some time after the hearing was under way, pursuant to a subpoena and without counsel. The Examiner advised him of his right to participate in the proceeding, after which Gibson filed a notice of appearance. He took an active part in the cross-examination of witnesses and later testified on his own behalf. No answer to the Division's allegations has been filed by Gibson.

Upon completion of the hearing, registrant, Gibson, and the Division were given an opportunity to file proposed findings of fact and conclusions of law and briefs in support thereof. The registrant and the Division have made such filings, but Gibson has not availed himself of the opportunity to do so.

The following findings, conclusions and recommendations are made on the basis of the record in this proceeding, including the testimony of the witnesses and the exhibits introduced at the hearing.

Registrant

1. Redstone, a sole proprietor doing business as Vanguard Investment Company, became registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act on November 30, 1959. An amendment to registrant's Form BD application for registration was filed by registrant on August 8, 1960 in which registrant reported a change of address to 590 South San Vicente Boulevard, Los Angeles 48, California. Registrant has filed no other amendment to the application for registration.

2. Registrant was primarily engaged in selling mutual funds, but had become dormant in July, 1960.

3. About March, 1961, Joseph Landau ("Landau"), who was a securities salesman for registrant and associated with Redstone in an insurance agency, introduced Sterman to

Redstone for the purpose of discussing the formation of a corporation to engage in a securities business. Following a preliminary discussion in which the three of them agreed to form a corporation under the name of Vanguard Investment Company, Redstone engaged an attorney to draw up the necessary papers.

4. About April 1, 1961, Sterman opened an office at 1150 South Beverly Drive, Los Angeles, California ("Beverly Drive office") in the name of Vanguard Investment Company. Landau was present in that office, as well as in a later one to which Sterman moved in July, 1961, to act "as sort of a watchdog" for Redstone. Redstone visited these new offices on two or three occasions, but the evidence is not persuasive that he personally effected any sales of securities during the period in question.

5. It appears that Sterman set about putting registrant back into active business almost as soon as he moved into the Beverly Drive office. He employed a secretary-receptionist and three salesmen, one of whom was Gibson, on a

full-time basis for registrant, and engaged part-time an accountant to take care of registrant's books and records. Telephone service in registrant's name was also obtained by Sterman, and a bank account opened by him under the designation "Vanguard Investment Co. - Clients Account", which was used as a general checking account by registrant.

6. During the period in question, registrant, Sterman, Landau, Gibson, and the two other salesmen confined their sales efforts to the stock of National Growth, which they offered and sold by use of the mails. According to registrant's records, registrant, as principal, sold 36,625 shares of National Growth stock in that time, while purchasing 31,500 shares, leaving registrant with an apparent short position of 5,125 shares. No registration statement had been filed pursuant to the Securities Act covering National Growth stock. As will be seen, Sterman was instrumental in finding the source of supply for the National Growth stock which was offered and sold by registrant.

National Growth Corporation

7. National Growth, a Colorado corporation formerly named Yucca Mining and Petroleum Company, Inc., was primarily engaged in the development of oil, gas and uranium claims until September, 1960. At that time, National Growth exchanged 480,000 of its shares, representing 46% of its outstanding stock, for real estate and other assets owned by a closely held corporation named Albaro Corporation.

8. According to the National Growth financial reports introduced into evidence, National Growth had suffered losses which resulted in its having, as of June 30, 1960, a so-called "accumulated deficit" of \$1,324,770. During the next two months, it had a net operating loss of \$5,557, which raised the "accumulated deficit" to \$1,330,327 as of August 31, 1960. National Growth's "capital deficit" as of the latter date was \$3,097,090, and its "total deficit" amounted to \$4,427,418.

9. Following the acquisition of Albaro Corporation assets, National Growth was able to realize a small profit

from its operations. For the four month period ending December 31, 1960, National Growth had a net income of about \$10,000, and for an eleven month period ending May 31, 1961, net income was \$93,163, or about 9¢ per share.

10. The 480,000 shares of National Growth stock were held by Albaro Corporation until April, 1961, when the latter corporation was dissolved. As part of the dissolution, 432,000 shares of National Growth stock were divided among the Albaro stockholders, and the other 48,000 shares, representing the finder's fee payable in connection with the acquisition of the National Growth stock by Albaro Corporation, were placed in the name of Louis Jaffee ("Jaffee").

11. Although Richard Davis, in testifying, denied that he knew who received the finder's fee and also denied that he directed that the 48,000 shares be issued in Jaffee's name, the preponderance of the evidence indicates that the 48,000 shares were placed in Jaffee's name at the instance of Davis who, with his two partners, was entitled to the finder's fee.

12. Davis was first introduced to Gibson in 1956 by the then president of National Growth, and Gibson has been a casual acquaintance of Davis since then. Davis and Sterman have been friends since 1959 and on occasion Davis has helped Sterman in connection with financial matters. Davis knew that Sterman was going into business as Vanguard Investment Company and that Sterman was going to handle National Growth stock.

13. The principal source of the National Growth stock sold by registrant was the Jaffee shares. Registrant's books reflect that 26,500 shares of the 31,500 shares purchased during the period in question were purportedly purchased from Jaffee between April 13, 1961 and May 12, 1961. Another 4,000 shares were repurchased by registrant as principal on May 9, 1961 from a customer who had bought them a few weeks before. Registrant charged the customer a commission, although it appears from registrant's records that the 4,000 shares were bought as principal for its own account.

Responsibility of Registrant

14. Registrant's position throughout the proceeding

has been that Sterman's acts and the acts of those he employed could not be laid at registrant's doorstep because Sterman had not been authorized by registrant to effect securities transactions in its name. Redstone, in testifying, categorically denied authorizing anyone to engage in business as Vanguard Investment Company during the period in question.

15. While there is no explicit contradiction of Redstone on this point, there is considerable circumstantial evidence introduced by the Division for the purpose of showing that registrant did, in fact, authorize, acquiesce, and participate in Sterman's activities. At the outset, Redstone made registrant's general ledger available to Sterman through Landau, and did not attempt to retrieve it until late in July, 1961. Redstone became aware of the fact that Sterman had opened an office early in April, 1961, when the telephone company asked him to sign an application for telephone service at the Beverly Drive office. Shortly after that he learned that the telephone was being answered in registrant's name and, upon going to the Beverly Drive office, found registrant's

name on the door. Redstone did nothing about stopping either practice beyond making a possible objection to the use of the sign on the door. At least two other visits were made by Redstone to the Beverly Drive office and the later office to which Sterman moved, without any attempt by Redstone to determine what was going on in those offices other than directing a question or two to Sterman and Landau.

16. Of even greater significance than Redstone's apparent inaction are the facts indicating that Redstone knew of and shared in registrant's activities which were being directed by Sterman. In the early part of April or May, 1961, Elmer J. Goodman, the accountant engaged by Sterman, was informed by Sterman that Redstone was the owner or actual head of the business being conducted at the Beverly Drive office, and a little later Redstone was introduced to Goodman as the owner or a partner, without dissent by Redstone as to that identification. In addition, Redstone received a check in the sum of \$350 from Sterman on or about May 18, 1961 which had imprinted on its face "Vanguard Investment Co. - Clients Account."

Redstone's denial that he noted the name of the account against which that check was drawn is scarcely credible under the circumstances. Nor does the record lend credence to Redstone's explanation that the check represented payment by Sterman of a share of the incorporation expenses. In an attempt to conceal the nature and purpose of the payment to Redstone, Sterman caused an apparent false entry to be placed on registrant's books charging the \$350 to a "Rent-Custodial" account. This deception would have been entirely unnecessary if the payment were for legitimate incorporation expenses as claimed by Redstone. A telling fact also is the presence of Landau at the Beverly Drive and later office for the purpose of protecting Redstone's interests. It would not be realistic to assume, in the absence of a showing to the contrary, that Landau would suddenly become disloyal to Redstone, with whom he had a long association, and would deliberately deceive him as to what was taking place under Sterman's direction.

17. The record shows, and the Hearing Examiner finds, on the basis of the record, that Redstone, Landau, and Sterman entered into an agreement to engage in the securities

business together as principals of a corporation to be formed by them for that purpose. The Examiner further finds that an express or tacit agreement was entered into to the effect that, pending formation of the corporation, Redstone would devote his time to his other business interests, while Sterman and Landau would conduct a securities business in registrant's name. The Examiner also finds that by virtue of the foregoing, Sterman was a person in control of registrant and that in consequence of Sterman's control registrant is responsible for the acts, practices and conduct of Sterman and of persons employed by Sterman while he was directing registrant's business during the period in question.

Failure to Amend Application for Registration

18. In view of the above findings, the Examiner concludes that amendments to registrant's application for registration should have been promptly filed disclosing registrant's change of address, and that Sterman was a person in control of registrant. Registrant's failure to file such amendments was a wilful violation of Section 15(b) of the

Exchange Act, and Rule 15b-2(b) thereunder, that was aided and abetted by Sterman.

Bookkeeping Rules

19. During the course of the hearing, several persons testified who would normally have known Jaffee if such a person existed. All denied such knowledge, although the further denial by Richard Davis that he had anything to do with the National Growth stock being issued in Jaffee's name is not worthy of belief. Sterman, who would have been able to shed light on the identity of Jaffee, did not choose to testify, and an inference can be drawn from his failure to do so that his testimony, if produced, would have been adverse.^{1/}

20. The Hearing Examiner finds that the name Jaffee is fictitious, that no person of that name sold National Growth stock to registrant or received payment therefor, and

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1/ N. Sims Organ & Co. v. S.E.C., 293F.2d 78, 80-81 (C.A., 1961), cert. denied 82 S. Ct. 440; Heft, Kahn & Infante, Inc., Securities Exchange Act Release No. 7020, p. 7, (1963).

that the identity of the beneficial owner or owners of the National Growth stock purchased by registrant in the name of Jaffee was known to Sterman and deliberately concealed on the books and records of registrant by the use of the name Jaffee.

21. The use of a fictitious name in entries made on registrant's books and records caused those entries to be false, misleading and inaccurate.^{2/} The Hearing Examiner concludes that registrant wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder and that Sterman aided and abetted that violation.

Sale of Unregistered Stock

22. As noted before, the Jaffee shares of National Growth stock that were offered and sold by registrant were part of the finder's fee received by Richard Davis and his partners. Since the finder's fee came from the 480,000 shares issued by National Growth to Albaro Corporation, through which the Albaro group controlled National Growth, it follows that

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^{2/} Morris Luster, 36 S.E.C. 298, 302.

the Jaffee shares should not have been distributed by registrant to the general public, as they were, without registration under the Securities Act. Aside from the evidence which affirmatively indicates that no exemption from registration under the Securities Act was available for the Jaffee shares, the burden of establishing the existence of such an exemption would be upon registrant.^{3/} Registrant in no way attempted to carry that burden.

23. Gibson in his own defense denied that he was a salesman for registrant and that any sales of National Growth stock were made by him. The record of his association with Sterman and registrant, the activities in which he engaged during the period in question, the testimony of disinterested witnesses, and his receipt of sizable checks drawn against registrant's bank account and recorded by registrant as payments of "commissions" or "draws against commissions" establishes the contrary to be the truth. Accordingly, the Hearing Examiner

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3/ N. Pinsker & Co., Inc., 40 S.E.C. 285,287 (1960); S.E.C. v. Ralston Purina Company, 246 U.S. 1192 (1953).

finds that Gibson also offered and sold unregistered National Growth stock, and that Gibson did so in the capacity of a salesman for registrant.

24. The Hearing Examiner concludes, by reason of the foregoing, that registrant, Sterman, and Gibson, singly and in concert, wilfully violated Sections 5(a) and (c) of the Securities Act.

Fraud in the Offer and Sale of National Growth Stock

25. Seven investors testified concerning their purchases and the representations that induced those purchases. In six instances, investors who paid 1 5/8 to 2 1/8 per share were told that the price of National Growth stock would enjoy a rapid rise in an extremely short time. Such statements included representations by Gibson to a woman who purchased 500 shares at 1 5/8 that the stock "would go to \$4 or \$5 a share in about 30 or 40 days";^{4/} by Landau that the price would "double within a short time"; and by Sterman to one customer

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^{4/} Gibson's customer later gave him two more orders of 500 and 100 shares on behalf of two other investors.

who paid 1 3/4, that "the price of the stock was certainly going to go to \$3 a share" and to another customer who also paid 1 3/4, that within a week or two "the stock would go up to \$3 a share."

26. Other representations which appear to have had no bases in fact and which were made to prospective investors included a statement by Sterman that an earnings report would be released within two or three weeks after April 17, 1961 showing earnings by National Growth of a dollar or better per share and that he had millionaire friends in Philadelphia who were going to buy the stock.

27. It does not appear that any of the investors received a financial statement relating to National Growth, although one investor requested such statement from Sterman, nor does it appear that any of them were informed by Sterman, Landau, Gibson, or the other salesmen regarding National Growth's financial condition.

28. In addition to the oral representations referred to, registrant mailed a printed, undated memorandum to

about 400 people, the names of whom were supplied by Landau or Stermen. The memorandum, on registrant's letterhead, referred to registrant as "really Big League" and when taken as a whole, gave the impression that registrant had extensive facilities for financial research and analysis and in one paragraph represented that registrant's recommendations were "the result of QUALITY analysis". In fact, registrant did not have even the usual well-known financial manuals in the office, and registrant was not, as Redstone testified and as the record otherwise shows, "Big League".

29. Daniel C. Heyman testified that shortly after receiving registrant's memorandum, he purchased 500 shares of National Growth stock in the course of a number of telephone conversations with a person identifying himself as Redstone. The person calling represented, among other things, that National Growth had great prospects and "should double within a few months." However, Heyman had never met Redstone and at the hearing was unable to identify the voice of Redstone as that of his caller. In the light of Heyman's inability to

connect Redstone with the voice of his caller, Redstone's denial that he sold National Growth stock, and the absence of evidence such as existed in the N. Sims Organ case, supra, indicating otherwise, the Division has not proved that Redstone was, in fact, the salesman to whom Heyman spoke and through whom he made his purchases.^{5/}

30. It is eminently clear from the testimony and exhibits in the record that National Growth was a highly speculative venture with enormous risks for the investor. In order to avoid the possibility of fraud and to meet the standards of conduct expected of a broker-dealer and its representatives, it was incumbent upon registrant, Sterman, and Gibson in offering and selling National Growth stock, to make known these risks by giving prospective purchasers all available information on the company, and to refrain from expressing opinions which had no reasonable basis.^{6/}

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^{5/} It should also be noted that another investor witness, William Poders, did not identify Redstone at the hearing as the person of that name whom he had met.

^{6/} Leonard Burton Corporation, 39 S.E.C. 211 (1959).

31. Instead of acting in a responsible manner, registrant, Sterman, and Gibson chose to dispose of the National Growth stock by deluding purchasers into the belief that quick, sure profits would come from a rapid rise in the price of National Growth stock, and by omitting any reference to the large previous losses suffered by National Growth and the slight profit that current financial statements showed the company could expect. By holding out the lure of an unusual increase in the price of the stock in a matter of weeks, purchasers were forced to make hasty decisions in complete reliance upon representations made to them, with no opportunity afforded for them to reach an informed judgment. That no basis in fact existed for the quick price rise predictions becomes apparent from a reading of the National Growth financial reports. The record clearly indicates that those same reports, as well as information of similar nature, were readily available to registrant, Sterman, and Gibson, if they did not actually have such information when they were selling the stock.

32. The Commission has repeatedly condemned sales techniques of the ilk resorted to by Sterman, Gibson and registrant's other salesmen. Most pertinent is the view expressed in Heft, Kahn & Infante, Inc., supra, p. 4, that:

"... There is inherent in the dealer-customer relationship the implied representation that the customer will be dealt with honestly and fairly and that representations respecting a stock which the dealer recommends are reasonably made on the basis of knowledge and careful consideration."

In the same vein is the Commission's observation in Alexander Reid & Co., Inc., 40 S.E.C. 986,990 (1962), that:

"A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a stock which he had undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration. Without such basis the opinions and predictions are fraudulent," 7/

33. The Hearing Examiner finds that registrant and Sterman used misleading literature and that they and Gibson made use of fraudulent oral misrepresentations in the offer and sale of National Growth stock. The Hearing Examiner further finds that the written and oral misrepresentations,

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7/ See also Barnett & Co., Inc., 40 S.E.C. 1 (1960); Leonard Burton Corporation, supra, p. 214.

together with the violations of Section 5 of the Securities Act and of Sections 15(b) and 17(a) of the Exchange Act and Rules 15b-2(b) and 17a-3 thereunder, were parts of a fraudulent scheme and course of business conceived and carried out by registrant, Sterman, and Gibson to defraud purchasers.

34. The Hearing Examiner concludes that by reason of the foregoing, registrant, Sterman, and Gibson, singly and in concert, wilfully violated and aided and abetted wilful violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder.

Public Interest

35. In view of the serious nature and number of the wilful violations committed by registrant, the Hearing Examiner finds that it is in the public interest to revoke registrant's registration as a broker-dealer.

Recommendations

36. The Hearing Examiner recommends, on the basis of the foregoing, that the Commission enter an order finding

that it is in the public interest to revoke registrant's registration as a broker-dealer.

37. It is further recommended that Sterman and Gibson be found to be causes within the meaning of Section 15A(b)(4) of the Exchange Act of any order of revocation entered herein against registrant.^{8/}

Respectfully submitted



Warren E. Blair
Hearing Examiner

New York, New York

April 17, 1964

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^{8/} To the extent that the proposed findings and conclusions submitted by the parties are in accord with the views set forth herein, they are sustained and to the extent that they are inconsistent therewith, they are expressly overruled.

