ADMINISTRATIVE PROCEEDING
FILE NO. 3-1811

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SECURITIES & EXCHANGE COMMISSION

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
	:
M.V. GRAY INVESTMENTS, INC. MAXEL V. GRAY	:
File No. 8-12190	:
	:

INITIAL DECISION

(Private Proceeding)

Washington, D.C.
January 12, 1970

David J. Markun
Hearing Examiner

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APPEARANCES:

Mark A. Loush and Hugh H. Makens, Detroit Branch Office (William D. Goldsberry, then Chief of the Detroit Branch Office, now Assistant Regional Administrator, Chicago Regional Office, appeared at the initial hearings on the question of interim suspension) for the Division of Trading and Markets.

Allen Schwartz, of Miller, Canfield, Paddock and Stone, Detroit, Michigan, and Loren Gray, of Gray and Thompson, Mt. Pleasant, Michigan, for respondents.

BEFORE: David J. Markun, Hearing Examiner

THE PROCEEDING

This private proceeding was instituted by an order of the Commission dated December 16, 1968, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the respondents committed various charged violations of the Exchange Act and the rules thereunder as alleged by the Division of Trading and Markets ("Division") and the remedial action, if any, that might be appropriate in the public interest.

The Commission's order provided that there be determined first the question whether suspension of the registration of M.V. GRAY INVESTMENTS, INC. on an interim basis, pending final determination of the issues presented by the order, was necessary or appropriate in the public interest.

The evidentiary hearing on this preliminary question was held in Detroit, Michigan, on January 7 and 8, 1969, after which the issue of interim suspension was resolved pursuant to registrant's settlement offer as reflected in the Commission's "Temporary Order Limiting Operations" of February 5, 1969.

Thereafter, on motion of the Division, the order for proceeding was amended on March 21, 1969,[1/] to add charges of net-capital

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1/ R. 3*. (Where a reference to the hearings transcript is followed by an asterisk (*) it indicates a reference to the hearings held on July 7 through July 10, 1969. A reference without such asterisk is to the hearings transcripts for January 7 and 8, 1969).

violations and charges of violations of the registration requirements of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and of the anti-fraud provisions of the Securities Act and the Exchange Act in connection with alleged sales by Maxel V. Gray of the common stock of American Monitor Corporation.

The evidentiary hearing resumed on July 7, 1969, and continued until its conclusion on July 10th, after which the parties filed proposed findings, conclusions and supporting briefs. Respondents were represented by counsel who participated throughout the hearing. 2/

The findings and conclusions herein are based upon the record and upon observation of the various witnesses.

FINDINGS OF FACT AND LAW

The Respondents

Respondent M.V. Gray Investments, Inc. ("registrant") has been registered as a broker-dealer with the Commission since December 18, 1964. It was incorporated in Michigan on November 4, 1964, and has its offices in Midland, Michigan.

Registrant is licensed to sell securities only in Michigan. Its business predominantly is the sale of mutual fund shares to its customers. Of some 52 salesmen that registrant had as of January, 1969, about 30 to 35 were part-time.

2/ A motion by respondents to reopen the hearing to permit introduction of further evidence on two points relating to sanctions was denied by the hearing examiner's order of November 14, 1969.

Respondent Maxel V. Gray ("Gray"), 47, has been president and a director of the registrant from the time it was incorporated. Prior to July 26, 1968, Gray owned 75% of the outstanding stock of the registrant and since that date he has owned 69%.

Registrant's Board of Directors includes Gray, Loren E. Gray (a brother), Doris L. Corner and (since about January 7, 1969) Gordon Kloostra.[3/]

Bookkeeping Violations.

The order for proceeding contains allegations that registrant wilfully violated and that Gray wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that registrant failed to accurately make and keep current various books and records.

The evidence establishes that at the time of an inspection of the books and records of the registrant conducted by an investigator of the Commission November 18 through 21, 1968, and on November 25, 1968, a number of deficiencies existed. Thus, the general ledger had been posted only through August 31, 1968. Further, the money balances in customers' ledger accounts had not been posted since August 31, 1968, and receipts and deliveries of securities in such accounts had not been posted since December 1967. About February 1, 1968, Jerry Vollmer ("Vollmer"), who maintained the books and records

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3/ Mrs. Corner owns 23% of the registrant and Kloostra and Loren E. Gray each has a smaller ownership interest.

during his employment by registrant, under Gray's supervision, told Gray that he was not posting receipts and deliveries of securities in customers' ledger accounts, that posting such entries was a "full-time job", and that he was "behind" and did not have the time to post such records himself.

Registrant's records were also deficient in that they did not include any record of the securities pledged by it to secure four banks loans it had outstanding as of September 30, 1968, which loans ranged in amounts from about $14,000 to some $35,000. No record of the securities pledged had ever been prepared by the registrant.

At the time of the inspection in November, 1968, registrant was not maintaining any ledgers or other records reflecting "securities in transfer," and there was no indication that it had previously maintained such a record.

Registrant maintained no "position record", i.e. a securities record or ledger reflecting separately for each security as of the clearance dates all "long" and "short" positions carried by it for its own account or for the account of its customers, from about February 1968 to the time of the inspection in November. In February the employee who had kept such record theretofore informed Gray that she had stopped keeping it on the advice of Vollmer, who had stated it was not necessary to keep such record because the basic data reflected were contained in other records.

Registrant failed to prepare monthly trial balances for the entire period December 1967 through December 1968, with two exceptions.

The exceptions were a balance sheet as of May 31, 1968, 4/ which Vollmer prepared to satisfy requirements of Michigan law and the financial statement as of September 30, 1968, prepared for the registrant by the CPA firm of Osborn & Goodnight at the close of registrant's fiscal year.

While Vollmer worked for registrant he prepared and showed to Gray on a monthly basis, though the reports were frequently tardy, what Vollmer called "tape trial balances". These were figures prepared on adding machine tapes by reviewing the general ledger, adding the credits and debits and determining if they balanced. These tapes were prepared in response to Gray's desire to know how the firm stood financially and were not in response to any specific request by Gray that trial balances be prepared. The tapes contained only numbers, no writing. On their faces the tapes are unintellegible; in his testimony Gray conceeded that they meant "absolutely nothing" to him then. These tapes clearly did not meet the requirement for making and keeping monthly trial balances.

Likewise, registrant did not prepare monthly a record of its aggregate indebtedness and net capital from September 30, 1967 through December 31, 1968.

4/ This balance sheet was in fact false and inaccurate since it failed to reflect the fact that Gray was then indebted to the registrant in the sum of $25,000. At Gray's direction the note was treated as if it had been paid back and the statement thus falsely showed a bank balance of $17,746.57 whereas in fact registrant then had a $7,253.43 overdraft at the bank.

As to each of the record-keeping requirements found above to have been violated, Gray testified that he was aware of the requirements for making and keeping the particular records. Gray's awareness of record-keeping requirements generally is further established by the fact that in connection with an earlier inspection of registrant's books and records, in December 1966, the Commission had occasion to admonish Gray concerning the importance of keeping various records.5/ Appropriate action by Gray would have avoided each of these violations.

Some idea of the magnitude of the record-keeping deficiencies that are involved in this proceeding can be gotten from the substantial work effort that was required in attempting to bring the records into compliance. Gray engaged Wayne Steeves, a registered representative of the registrant who is a C.P.A., to conduct and supervise this work. Steeves, with three other persons, worked full time on the books from December 6, 1968, to about January 8, 1969, averaging about sixty (60) hours per week at the task. Two other persons were used on a part-time basis. Even so, the posting of certain of the records had not been completed as of January 8, 1969.6/

Respondents concede generally that the record-keeping violations found above did in fact occur but they urge that, for two main

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5/ The then Regional Administrator of the Chicago Regional Office of the Commission in his letter to Gray of February 6, 1967, called attention (Ex. 8) to various deficiencies, including many in the same general areas as the deficiencies found above, and emphasized the importance of keeping accurate and complete records. Gray replied by letter of February 14, 1967 (Ex. 9) giving assurances that they were keeping the various records then under discussion, including net-capital computations.

6/ While Steeves, et al. were working on the deficient records, registrant was not doing business, it having been "closed down" by an order of the Michigan Securities Bureau (Ex. 37).

reasons, the violations were not "wilfull".

First, respondents urge the difficulty of employing and retaining experienced and competent personnel in the relatively small city of Midland, Michigan. 7/ Second, respondents urge at great length that their difficulties respecting registrant's books and records are the result of a deliberate effort on the part of Vollmer to make the registrant "look bad" and get it "closed down". Gray had hired Vollmer because of registrant's prior and continuing difficulty with its books and records specifically to take charge of the books and records, on the assumption that Vollmer, 26, would be competent to do so in light of his work in assisting in an audit of the registrant by his then employer, the C.P.A. firm of Osborn and Goodnight. Vollmer's alleged purpose in making the registrant "look bad", respondents contend, was to ease the way for a competing brokerage firm that Vollmer and several registered representatives of the registrant contemplated forming.

The record does not support either of respondents' contentions on the facts, even apart from the question whether such asserted defenses, if they had a basis in fact, would be valid defenses under the laws and regulations involved.

While the record shows that Vollmer was dissatisfied in his work relationships with Gray and the registrant, and that Vollmer did discuss with two of registrant's representatives the desirability and feasibility of forming a new, competing broker-dealer firm, it

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7/ About 30,000 population, situated in a predominantly agricultural area.

does not support respondent's contention that Vollmer deliberately let his work slide or fall behind in order to get the registrant put out of business. Rather, the record suggests that to the extent that record-deficiencies were attributable to Vollmer they were the result of an amalgam of limited experience, laziness, ineptness, and an unwillingness to accept ministerial-type help from others in the office. The idea of forming a competing brokerage firm did not originate with Vollmer and had in fact been entertained by some registered representatives even before Vollmer came to the firm. The idea was prompted at least in part by the belief that the registrant might get into difficulty in connection with Gray's 1967 sales of American Monitor Corporation stock. 8/

Neither does the record suggest that inability to recruit and retain competent bookkeeping personnel was the cause of the record-keeping deficiencies. There is no showing that existing personnel were incapable of keeping the required records or that they did not know how to do so or that additional personnel of equal competence could not have been hired. (Indeed, respondents have recently hired additional personnel who are, in their view, entirely competent). The deficiencies resulted, in fact, from Gray's failure to make elemental checks to ensure that Vollmer was carrying out his duties and to

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8/ See the discussion below of Gray's sales of unregistered AMC stock and of fraud violations connected therewith.

ensure that Vollmer got and utilized any help from others that may have been required.[9/] Gray's testimony on these points has been carefully considered and, to the extent that it conflicts with the findings made above, is not credited.

It is well established that a finding of willfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law and that it is sufficient that a respondent intentionally engaged in conduct which constitutes a violation.[10/] Under this standard the record-keeping violations charged and established by the record were clearly wilfull.

Likewise, it is clear from the record that Gray aided and abetted the registrant's record-keeping violations. Gray was president, a director, the majority stockholder and the person who in effect "ran" the firm as its principal officer. As such he cannot escape his responsibilities for proper conduct of the registrant's business by pleading ignorance of accounting or his visual impairment.[11/]

9/ Vollmer's normal work load and duties were increased during the fall of 1968 when the firm was handling an underwriting (Fund of Letters) and again in October, 1968 when the departure of Gray and most of the sales force to attend a convention left Vollmer with some added duties in tending to customers for about three weeks.

10/ Tager v. Securities and Exchange Commission, 344 F.2d 5, 8 (C.A. 2, 1965); Dunhill Securities Corporation, Sec. Exch. Act Rel. 8653, p. 5 (July 14, 1969).

11/ Gray has a congenital visual defect that has made him color blind and cut his vision to 17% of normal vision. Nevertheless, he is able to read even small print or figures with the aid of a magnifying glass, and, in any event, Gray could have checked the status of books by having particular entries read to him.

Empire Securities Corporation, 40 S.E.C. 1104, 1106 (1962).

Net Capital Violations.

The order for proceeding, as amended, includes a charge that registrant wilfully violated, and Gray wilfully aided and abetted violations of, Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, in that registrant effected securities transactions (through jurisdictional means) while its aggregate indebtedness to all other persons exceeded 2000 percentum of its net capital and while its net capital was less than the $5,000 minimum required by the Rule.

The evidence establishes, without contradiction by respondents, that on April 30, May 31, June 30, September 30 and October 31, 1968, registrant's aggregate indebtedness exceeded 2,000 per centum of its net capital 12/ and that on those dates or the next succeeding day registrant effected transactions in nonexempt securities. Use of the mails and other instrumentation of interstate commerce is also established by the evidence and is not controverted by respondents.

12/ The calculations for the respective dates were as follows:

	April 30, 1968	May 31, 1968	June 30, 1968	September 30, 1968	Oct. 31, 1968
Aggregate Indebtedness	$ 152,360.17	$243,820.50	$218,164.43	$3,001,347.57	$288,837.70
Net Capital	($ 15,106.67)	($ 31,500.81)	($ 27,761.45)	$ 47,412.19	$ 4,973.05
Capital Required	7,618.01	12,191.03	10,908.22	150,067.38	14,441.89
Deficiency	22,724.68	43,691.92	38,669.67	102,655.19	9,468.84

These violations followed an express warning to registrant concerning the importance of complying with the net-captial rule from the then Regional Administrator in Chicago on February 6, 1967, after an inspection of registrant late in 1966 disclosed apparent net-capital violations. Gray had replied on February 14, 1967, giving assurance that "Net capital is computed at regular intervals . . . ." However, as already found above in connection with discussion of the record-keeping violations, registrant did not in fact make regular monthly computations of its aggregate indebtedness and net capital during the period in 1968 when the net-capital violations occurred.

Gray was advised a number of times by Vollmer that registrant might be "undercapitalized" because of the 30 percent "haircut" that had to be taken on securities in the firm's inventory or that the firm appeared to have a "net capital problem". Moreover, in July, 1968, Gray received a letter from the Director of the Michigan Securities Bureau advising him that as of May 31, 1968 registrant was not in compliance with Michigan's net-capital requirements. Nothwithstanding these multiple circumstances putting Gray on notice, he failed to act to have proper computations made and to bring registrant into compliance with the net-capital rule.

Once again, respondents seeks to lay blame and responsibility at the feet of Vollmer. To the extent that Vollmer was responsible for the net-capital violations, registrant is of course responsible.

But Gray must be held to have had primary responsibility. He knew that computations of aggregate indebtedness and net capital were not being made during 1968. He knew or should have known that the adding machine tapes run by Vollmer did not constitute the necessary computations. And he had been warned that registrant had or might have a net capital problem. In these circumstances, it is concluded that Gray willfully aided and abetted registrant's net capital violations and, as its principal officer, was the main instrument through which the wilful 13/ violations by the registrant occurred by failing to take necessary action to assure compliance with the rule. 14/

Regulation T Violations

Respondents concede that during the period January 1968 to at least December 16, 1968, registrant wilfully violated and Gray wilfully aided and abetted the charged violations of Section 7(c)(1) 15/

13/ A finding of wilfulness under Section 15(b) of the Exchange Act does not require a finding of intention to violate, but merely an intent to do the act which constitutes the violation. "Registrant obviously intended to effect securities transactions through the use of the mails and the facilities of interstate commerce on the dates" when its net capital was deficient. Churchill Securities Corp., 38 S.E.C. 856, 859 (1959).

14/ Gray's testimony, to the extent it conflicts with the findings made above on this issue, is not credited.

15/ Section 7(c)(1), in effect, prohibits any broker or dealer who is a member of a national securities exchange or who transacts a business in securities through the medium of such a member from extending credit to customers in violation of regulations prescribed by the Federal Reserve Board under Section 7 of the Exchange Act. Section 4(c)(2) of Regulation T (12 CFR 220), promulgated by the Board of Governors of the Federal Reserve System, requires that a broker or dealer promptly cancel or otherwise liquidate a transaction where a customer purchases a security in a cash account and does not make full cash payment within seven full business days. If exceptional circumstances prevent full cash payment within the (continued on following page)

of the Exchange Act and Regulation T promulgated by the Board of Governors of the Federal Reserve System. 16/

The evidence establishes that during the period January 1968 to about August 31, 1968, there were 121 instances in which customers had not paid for securities within the required time. In 93 cases payment was from 0 to 29 days late; in 20 cases from 30 to 59 days late; and in 8 cases payment in full was not received until 60 days or later after the seventh full business day. During the period September 1, 1968 to December 31, 1968, there were 63 violations of Regulation T in 63 separate accounts. One payment was 55 days late and the others ranged from a day to 20 days late. The accounts in which the violations occurred included those of Gray, Mrs. Corner, and Gordon Kloostra, all officers of the registrant. 17/

In January or February, 1968, employee June Markell, who used to prepare letters to the NASD requesting time extensions, told Gray that she lacked time to prepare the letters and was falling behind in doing so. Gray told her to "let it go", and in that offhand

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15/ (Continued from preceding page) required time, a broker or dealer may apply to any national securities exchange, or to the NASD, for non-exchange members, for a limited extension of time to obtain payment from the customer.

16/ During the relevant period, registrant conducted a business in securities through Watling, Lerchen & Co., a member firm of the New York Stock Exchange, a national securities exchange.

17/ Even after the order for proceeding was issued on December 16, 1968, alleging *inter alia* Regulation T violations, the registrant allowed two additional such violations to occur.

manner the seeking of extensions was discontinued. Gray's attitude, which he conveyed to employees, was that it was just delays in the mail and that sooner or later the customers would pay up.

Gray knew of the requirements of Regulation T; he evidently regarded it as so much red tape.

As conceded by respondents, the violations of Regulation T by registrant were wilfull and Gray aided and abetted in their commission.

Failure to Amend B-D Application

The record establishes the charge, as respondents concede, that registrant wilfully violated and Gray wilfully aided and abetted violation of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder through registrant's failure promptly to file an amendment on Form B-D reflecting a change in its officers.

On February 1, 1968, respondent designated Doris L. Comer, who had been its secretary and treasurer,a vice president and appointed Gordon N. Kloostra the new secretary and Jerry B. Vollmer the new treasurer. The required reporting of these changes on Form B-D "didn't get done" until January 2, 1969, some eleven months later.

Failure to Supervise

The order for proceeding includes a charge that during the periods in question ". . . Registrant and Gray failed reasonably to supervise those persons under their supervision with a view to preventing . . ." the various violations by the registrant that have been found above.

Section 15(b)(5)(E) of the Exchange Act, as added by the 1964 amendments to it, provides an independent ground for the imposition of a sanction against a broker or dealer or a person associated with a broker or dealer who ". . . has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, <u>another person who commits such a violation</u>, if such other person is subject to his supervision." [emphasis added] Although the record contains ample evidence establishing Gray's and the registrant's (through Gray) failure to supervise Vollmer and other personnel of the registrant 18/ subject to such supervision with a view to preventing the mentioned violations, the charge respecting failure to supervise fails to meet the terms of the statute because the order fails to allege the commission of any violation by Vollmer or any other personnel who were subject to supervision. 19/

18/ Gray had supervision of registrant's salesmen, Vollmer, Mrs. Ardis Johnson (who kept the books and records prior to Vollmer's employment) and, generally, "ran" and managed the registrant. Gray had no established procedure for supervising Vollmer. Adequate supervision and/or initiative on Gray's part would have prevented the violations under discussion but Gray failed to carry out such supervision.

19/ The question whether the order might properly have pleaded a failure to supervise the registrant (by failing to supervise its agents and employees) is not here considered since it is concluded that the charge, fairly read, is not susceptible of such a construction and does not give adequate notice of reliance upon any such theory.

Accordingly, the charge respecting a failure to supervise cannot support the imposition of sanctions in this proceeding.

Sale of Unregistered Stock (American Monitor Corporation)

The record establishes the charge, as respondents concede, that during the period from about October 1967 to about December 31, 1967, Gray wilfully violated Section 5(a) of the Securities Act 20/ through the sale and delivery after sale of Class B common stock of American Monitor Corporation for which no registration statement was in effect and as to which no exemption from registration was applicable.

American Monitor Corporation ("American Monitor") is an Indiana company incorporated in that state on June 21, 1966, and has its principal place of business in Indianapolis. Jerry Denny ("J. Denny") is president; his brother Larry Denny ("L. Denny") is secretary; and Jack Simpson ("Simpson") is treasurer. Prior to the sales here involved each of the three officers owned 8,700 shares of the corporation's Class B common stock, for a collective total of 26,100 shares, of the 30,000 shares of Class B then authorized.

On or about August 23, 1967, Gray visited the American Monitor offices in Indianapolis to discuss the possibility of acquiring

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20/ Under Section 5(a), unless a registration statement is in effect, it is unlawful to sell or deliver a security by use of the mails or the facilities of interstate commerce. A charge of violation of Section 5(c) of that Act is also contained in the order but the evidence does not establish such charge as the Division concedes in its brief.

some of the company's stock. His discussions with the Denny brothers and Simpson indicated that the company needed additional capital of from $40,000 to $200,000 which it sought to obtain without a public offering. After extended discussions Gray agreed orally that he, or he and the registrant together, would buy, over the next few months, 400 shares of the Class B stock at $100 a share. As consideration for Gray's agreeing to purchase that substantial an amount of stock it was agreed that Gray would be given the stock at the $100 figure per share rather than the higher figure the American Monitor principals had sought to get,and it was further agreed that if American Monitor decided to seek additional capital beyond the $40,000 that Gray's purchase of 400 shares would provide, Gray would have the first option of taking up to a total of 2,000 shares (including the initial 400 shares) at a price of $100 per share. As discussed at the meeting, the parties understood and contemplated that some or all of any shares sold beyond the initial 400 shares would be sold to friends or customers of Gray. It was understood that any such investors would be charged more for the stock than the $100 a share it would cost Gray, but there was no discussion of any specific amount to be charged, the American Monitor principals having considered that figure was for Gray to set. While Gray had the option to purchase discussed above, he was under no obligation to purchase any shares beyond the initial 400 shares contemplated by the agreement. The shares of American Monitor that were to be purchased under the agreement were shares belonging to the three principals, not shares owned by the company.

By early October, 1967, Gray had purchased under the agreement 200 shares in his own name and 100 shares in the name of the registrant. These were the only shares of American Monitor ever registered in the names of respondents. 21/

After conversations by phone between Gray and the American Monitor principals the latter indicated they did desire additional capital for the company up to the $200,000 total contemplated by the earlier agreement and Gray began rounding up the buyers.

During the period from about October 11 to October 17, 1967, Gray sold 1,420 shares of American Monitor Class B stock to some 72 Michigan residents. Of these shares, 405 were sold at $100 per share to 24 persons who were either registered representatives or employees 22/ of the registrant. The other 1,015 shares were sold to 48 other Michigan residents at $120 per share. Purchasers' checks were made payable to Gray personally, some of which were mailed to him. These checks were deposited in Gray's personal checking account and he in turn mailed

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21/ Registrant indirectly paid for certain additional shares in connection with the distribution of American Monitor shares to certain employees of the registrant who elected to take their "Christmas bonus" in shares of such stock in lieu of cash; however, these shares were issued directly to the employees involved.

22/ See footnote 21 above.

his personal checks, payable to the principals of American Monitor who were selling their stock.[23/] As the sales were being made, Gray's secretary called Simpson to furnish him the names of the purchasers and the number of shares purchased, and a few days later Gray mailed written transfer instructions to Simpson. Thereafter Simpson prepared the stock certificates pursuant to Gray's instructions and mailed the certificates to Gray. Gray or his secretary then mailed the stock certificates to the purchasers.

These October 1967 sales of American Monitor by Gray were not exempted under Section 4(1) of the Securities Act, which exempts from Section 5 of that Act "transactions by any person other than an issuer, underwriter, or dealer", because Gray was a statutory "underwriter"[24/] under Section 2(11) of the Securities Act, having sold the shares for an "issuer" in connection with the distribution. Sutro Bros. & Co., 41 S.E.C. 470, 477 (1963); N. Pinkser & Co., Inc., 40 S.E.C. 285, 288-89 (1960).

In mid December of 1967 Gray sold an additional 91 shares of the Class B stock of American Monitor to 14 Michigan residents.

23/ The last check was payable to American Monitor directly. After the three American Monitor principals sold off their shares in the manner described, they purchased from the corporation equivalent numbers of shares at the same price.

24/ Section 2(11) includes as an "underwriter": "any person who . . . sells for an issuer in connection with, the distribution of any security . . . ." The term "issuer", for purposes of defining an "underwriter" is defined to include "any person directly or indirectly controlling . . . the issuer" As principal officers, directors, and owners of most of the stock, the Denny bothers and Simpson were clearly "controlling" persons.

These 91 shares were from one of the two 100 share certificates of American Monitor stock that Gray had personally bought in August 1967. After making these sales Gray issued transfer instructions to American Monitor on how to "break up" his previously-issued 100 share certificate, and new certificates were then issued to the 14 buyers. These December sales were made by Gray after the three American Monitor principals had halted Gray's selling of their shares in October somewhat before a total of 2,000 shares had been distributed.[25/] Gray's incentive for selling the 91 shares in December was the fact that he was able to turn a good profit, for he sold at $175 shares that he had purchased at $100 no more than three and a half months earlier.

It is concluded that as to these 91 shares Gray was an "underwriter" on the basis that he purchased from an issuer with a view to distribution. As already noted above, distribution of stock to various "friends" of Gray's was clearly contemplated when the agreement for distribution was worked out in August. In view of this, the short time the shares were held, plus the fact that the sales were prompted by the desire for profit rather than any unusual circumstance, it seems reasonable to conclude that Gray contemplated resale, given the emergence of the right circumstances, when he initially acquired his 200 shares.

25/ Evidently the sales were halted because the American Monitor principals had been advised by new counsel that the sales were of questionable legality but the evidence does not establish that Gray was advised at the time of the reason for halting the selling.

As already noted, respondents in their brief concede that Gray wilfully violated Section 5(a) of the Securities Act and they do not urge the applicability of any exemption. The record does not suggest the existence of any exemption. The record is clear that no registration statement had been filed with the Commission as to the Class B American Monitor stock and that the mails were used in connection with the sales and deliveries after sale.

Gray concedes he knew the stock was not registered but respondents urge in mitigation that Gray relied upon erroneous legal advice given to American Monitor.

The evidence establishes that an attorney had advised the American Monitor principals that it was legally permissible for them to sell their personally-owned shares of American Monitor and that this information had been conveyed to Gray. Gray did not personally talk to this attorney nor did he personally consult an attorney prior to commencing the purchases and sales of American Monitor stock. In any event, a finding of wilfulness (which respondents here concede) is not negated by reliance upon counsel. N. Pinsker & Co., Inc., 40 S.E.C. 285, 289 (1960); Associated Securities Corporation, 40 S.E.C. 10, 13 (1960).

Violations of Anti-Fraud Provisions in Sale of American Monitor Corporation Stock.

The order for proceeding, as amended, includes a charge that Gray wilfully violated the anti-fraud provisions 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 in various particulars in connection with his sale of American Monitor stock.

American Monitor, incorporated as mentioned above in Indiana in 1966, initially authorized 1,000 shares of common stock (later redesignated as Class A), of which the two Denny brothers and Simpson purchased 200 shares each for $250 apiece. The other two incorporators, Donald McDivitt ("McDivitt") and Ray Speck, contributed a patent application, valued at $400, plus $50 each in cash, as consideration for 200 shares each. About March or April, 1967, the issuance of 100 shares of Class B common stock was authorized of which the Denny brothers and Simpson each bought 20 shares at $100 per share, or a combined cash payment of $6,000. An additional 9 shares each were issued to these three as payment for past due salary. On April 3, 1967, a 300-for-1 split of the Class B shares was authorized. With this, the Dennys and Simpson each owned 8,700 shares of the Class B common, for a collective total of 26,100 of the 30,000 shares then authorized. Their average cost per share for the stock they purchased for $2,000 each was about 33 cents, and the average cost in cash for the 8,700 shares that each owned was about 23 cents per share. Gray was aware of the extent of ownership of the Class B shares by these three principal officers of American Monitor and was aware that they had put very little money into the corporation. As of June 30, 1967, the book value of the combined Class A and Class B stock was approximately 86 cents per share.

Though Gray was unfamiliar with any calculations of book value of the shares he was aware that the book value of the Class B shares was "very small" and that it was less than $1 per share.

During his meeting with the American Monitor people in August 1967 Gray was shown a company financial statement as of May which indicated that from its incorporation in June 1966 until the end of the year its sales were $8,200 and that from January 1 through April 30, 1967, sales were $26,200. In addition, Gray was shown a pencilled financial statement prepared by the American Monitor officers, but he did not otherwise inspect any of the company's books and records. The reports Gray saw showed him that sales were "very small" and that the company was losing money. In response to Gray's request, Simpson promised to send him subsequent financial statements as they were prepared. A financial statement as of June 30, 1967, was prepared by a C.P.A. firm and forwarded to American Monitor on or about September 7, 1967. This report showed net sales for the year ending June 30, 1967, of $57,241.14 and a net loss of $10,277.98. Total assets of American Monitor as of that time were $60,963.47 with liabilities of $37,171.40.

Interim financial statements for the three months ending September 30, 1967, reported net sales of $27,190 and a net operating loss of $19,722 for the period. This report was forwarded to American Monitor by the firm that prepared it on or about October 30, 1967. A report for the four months ending October 31, 1967, showed net sales of $55,629 and a net loss of $16,433. This report was forwarded to American Monitor on or about November 6, 1967.

The evidence is not entirely clear that Gray received these financial reports that became available subsequent to his August meeting. However, it is clear that he kept in regular telephone contact with the officers of American Monitor and that he kept himself informed of the financial condition of the company. Accordingly, it is concluded that Gray was aware of the substance of the reports at about the times they became available to American Monitor whether or not he actually received copies of the reports.

Gray's sales of American Monitor stock in October, which he testified he contemplated making to only a small number of his friends, actually came to embrace a much broader spectrum and larger number of customers. The diffusion started when Gray gave some of registrant's employees the option of taking their "Christmas bonuses" in shares of the stock in lieu of cash. When word of this got around interest in the stock developed among the registrant's registered representatives, particularly after Gray spoke in very enthusiastic terms about the company at a salesmen's meeting. Gray agreed to allow registered representatives to purchase the stock at $100, though regular customers were to be offered it at $120 a share. Gray told the representatives that if they had any customers who might want to buy they should call or contact him personally.

During the middle part of October, 1967, registrant's salesmen and other employees purchased 405 shares of American Monitor at $100 a share and some 48 other Michigan residents purchased through Gray 1,015 shares at $120 per share. The "outside" purchasers, for the most part regular customers of the registrant, were not told that a lower price was being paid by registrant's salesmen and other employees, Gray having agreed to the $100 price for the salesmen on the understanding it would not be "made public".

As already found and discussed above, in mid-December of 1967 Gray sold an additional 91 shares of American Monitor from shares previously purchased by him, to 14 Michigan residents. These were sold at $175 a share.

Gray personally talked with nearly all the buyers of American Monitor shares. Gray had no written financial reports or information to show the prospective buyers, and he testified that orally he "gave very little financial" information to the purchasers. Gray did not advise purchasers of the extent of the company's losses and at least 4 of the purchasers called testified that they were not even advised that the company was losing money. The amounts of American Monitor's losses and accumulated deficits were "material investment facts" and should have been disclosed to the buyers. Alexander Reid & Co., Inc., 41 S.E.C. 372, 376 (1963). Respondents rely on the fact that Gray did advise purchasers that the stock was "speculative"; however, such a characterization is not a sufficient disclosure of an issuer's adverse financial condition. Alfred Miller, Sec. Exch. Act Release 8012, p. 5 (Dec. 28, 1966). While an element of speculation is inherent in stock investments, the investor is entitled to the opportunity to evaluate the risk of loss, as against the hope of a lucrative return, on the basis of accurate statements of the financial status of the company whose stock he is considering for purchase. S.E.C. v. F.S. Johns & Co., 207 F. Supp. 566, 573 (D.C.N.J. 1962).[26/]

The evidence is clear that Gray did not advise purchasers of the actual or approximate book value of American Monitor. Under all the circumstances present, including the great disparity between the book value of 86 cents and the $120 and $175 prices Gray charged, it is concluded that approximate book value was a material investment fact that should have been disclosed by Gray. It was not enough merely to advise potential customers, as Gray did, that American Monitor was a new company that needed capital and 3 to 5 years time before results could be expected.

The record is further clear that Gray did not advise the purchasers how much Class B stock was held by the Dennys and Simpson or how much it had cost them. This knowledge was essential to permit buyers to assess the worth of the stock. Thus, the Michigan buyers contributed $178,225 for the purchase of 1,511 shares of the Class B stock, or slightly more than five percent of the 30,000 authorized Class B shares, while the three American

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26/ Gray in fact employed the characterization "speculative" not as a caveat but as a device to whet the purchasing desire of his customers. He testified (R. 586*): "The more speculative I told them it was at that time the greater was their desire to buy. We certainly used reverse psychology on these people. We did not pressure anyone to buy it."

Monitor officers had paid in cash only $6,000 for 26,100 shares or 87% of the total. The Commission has held that when shares are issued to insiders for "questionable considerations", that fact must be disclosed to investors in the issuer in order to give them a full and adequate picture of the condition of the issuer and its relationship to its organizers." Oxford Company, Inc., 21 S.E.C. 681, 683 (note 4) (1946). Here, the issuance of 8,100 shares (post-split) to the Dennys and Simpson in payment for past due salary mentioned above, was an issuance on "questionable considerations", and the cash contribution of only $6,000 for 18,000 post-split shares also seems questionable. The insiders' position, acquired "for token amounts of cash", substantially diluted the equity position of the Michigan purchasers of American Monitor stock. Associated Investors Securities, Inc., 41 S.E.C. 160, 166-67 (1962). The facts which would have shown such dilution should have been disclosed by Gray to purchasers.

Gray told the October 1967 purchasers that the price of the American Monitor stock was $120 per share, and in December 1967 he told those who bought then that the price was $175 a share. Such a statement by a broker or dealer 27/ with respect to the price of a security carries with it an implied representation that such price

27/ Although Gray sold the American Monitor shares as an individual and not through the registrant, the record is clear that in dealing with Gray the customers were relying upon his reputation (good) as a broker-dealer and upon his expertness as such. Accordingly, Gray must be held to the same standards as apply to broker-dealers generally.

is, or bears some reasonable relationship to, the prevailing market price. Landau Company, 40 S.E.C. 1119, 1126 (1962). It is a fraud to charge prices not reasonably related to prevailing market prices without disclosing that fact. Associated Securities Corporation, 40 S.E.C. 10, 14 (1960). It is undisputed that there had never been any trading market for the shares and that no broker or dealer had ever executed transactions in them, which facts Gray was aware of at the time he made the sales here involved. Some 200 shares of American Monitor stock had been sold from April to June, 1967, by American Monitor or its principals at $100 and $110 per share, directly to individuals. Simpson testified that these were "arbitrary" prices, fixed by him and the Dennys. The price of $100 that Gray paid was a "negotiated" price, representing a reduction of $20 from the initial asking price of $120 which in turn was a figure the American Monitor principals "thought [they] could get", based in part upon what another firm in a similar business had priced its shares at.

Respondents contend that the prices Gray charged were reasonably related to a market for the stock established, it is contended, by small, sporadic sales made to individuals in private sales by McDivitt, an original incorporator of American Monitor who had since left the company. The evidence shows that Gray had never personally talked to McDivitt prior to the October or the December sales and that Gray did not know how many shares McDivitt had sold at the reported prices of $120 and $175. In fact, McDivitt had sold ten shares at $120 per share and ten shares at $125 per share about October 1, 1967. These were the only shares McDivitt had sold at $120 or better prior to the time Gray made his October sales at $120. Besides, in June 1967 McDivitt had sold ten shares at only $30 per share and in July he sold his father 20 shares at an average price of $55 per share. Prior to the time Gray made his December sales at $175 per share, McDivitt had sold only 20 shares at that price. It is apparent that McDivitt's sales of 100 shares of the stock over a period of time to individuals in casual, isolated sales did not establish a market. Cf. Associated Securities Corporation, 40 S.E.C. 10, 16-17 (1960).

Since the prices Gray charged were not related to any established market price (there was none) Gray should have stated that fact to his purchasers, and his failure to do so constituted fraud. Associated Securities Corporation, supra. The absence of an established market in the stock would have been material to potential customers not only in assessing the worth of the stock, but in determining suitability of the investment for themselves.

When Gray quoted the $120 price to his customers he failed to advise them that at the same time he was selling the stock at $100 per share to registrant's salesmen and other employees. This failure, under the circumstances here present, represented a further element of fraud.

Gray realized a profit of $27,125 on the sales of the 1,511 shares of American Monitor he sold in October and December 1967. The purchasers were not told the amount of profit Gray would make nor the amount per share that Gray had paid or was to remit to American Monitor for the shares being sold. With respect to at least two of the purchasers, Mrs. Schultz (a widow) and Mr. Brenner, a relationship of trust existed between the customer and Gray.[28/] As to these purchasers at least, Gray's failure to disclose the extent of his profits was fraudulent. The Ramey Kelly Corporation, 39 S.E.C. 756, 761 (1960).[29/]

While there were individual variations, Gray generally told the purchasers that American Monitor was a young company presently needing capital which in his opinion had good prospects and was a good investment which would eventually make money for the investor, after three to five years.

The record discloses that there was no reasonable basis for making such predictions or representations. Absent such a reasonable basis, the representations were fraudulent. Alexander Reid & Co., Inc., 41 S.E.C. 372, 375 (1963).

American Monitor's business is the development and manufacture of diagnostic chemicals for hospital and laboratory use. At the

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28/ Mr. Schultz testified: "I use him for my lawyer, he sells my cars, advises me in all my undertakings. He's my confidante. He's very helpful." Brenner showed his trust in testifying that if American Monitor stock "was good enough for" Gray, "it was good enough for" Brenner.

29/ The profit on the shares sold to Mrs. Schultz was $4,000, she having purchased 200 shares, as much as Gray had purchased for himself.

time of the October 1967 sales it had been in business a little more than a year and, as described above, had low sales volume and was losing money. While American Monitor had some patents pending, it had no existing patents and was then marketing only two drug products, one of which was also being then marketed by three competitors. In August 1967 the company had only some 6 employees, including the three principal officers. While the company was attempting to develop new products at the time, there was no assurance that any new product could be successfully marketed or that it would generate profits.

Gray testified, in effect, that he expected his investment, and that of the other purchasers, to pay off in from 3 to 5 years either on the basis that the company would have succeeded by that time or that it would, if it "ran out of money", be picked up by a larger company through merger or acquisition. But this was sheer speculation on Gray's part. There had been no merger offer made at the time of the October sales, and, indeed, while there were some "feelers", no solid merger offer was made to American Monitor at any time here material.

Gray's personal belief or faith in the ultimate success of the company, absent a reasonable factual basis for it, is no adequate basis for the representations he made. D.F. Bernheimer & Co., Inc., 41 S.E.C. 358, 361 (1963).

Likewise, by the time the December sales were made, there had been no dramatic changes in the fortunes or posture of American

Monitor to warrant the representations Gray made to those purchasers.

It is no defense that Gray himself purchased shares in the company. Alfred Miller, Sec. Exch. Act Release 8012, pp. 5-6 (Dec. 28, 1966). Nor that he in good faith sold shares of the company to relatives. R. Baruch and Company, Sec. Exch. Act Release 7932, pp. 7-8 (August 9, 1966). Neither is it a defense that the amount of money invested by some of the purchasers was small or that they could afford the risk. Alfred Miller, supra.

The evidence establishes that the mails were used in connection with the sales of American Monitor to which the anti-fraud violations found above relate.

These violations by Gray were "wilfull" since he intentionally omitted to state material facts, misrepresented certain material facts and made representations and predictions without reasonable basis. Alfred Miller, supra, at p. 5. A finding of wilfulness does not require an intent to violate the law, or that the actor be aware that he is violating the securities laws or any of the rules thereunder. Tager v. S.E.C., 344 F.2d 5, 8 (C.A.2d 1965).

Conclusions

In general summary of the foregoing, the following conclusions of law are reached:

(1) During the period from about September 30, 1967 to December 16, 1968, registrant wilfully violated and Gray wilfully aided and abetted violations of Section 17(a) of the Exchange Act

and Rule 17a-3 thereunder in that registrant failed to accurately make and keep current its books and records in the particular respects found above.

(2) During the period from about April 1, 1968 through July 30, 1968, registrant wilfully violated and Gray wilfully aided and abetted violations of the net-capital provisions of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.

(3) During the period from about January 1968 to December 16, 1968, registrant wilfully violated and Gray wilfully aided and abetted violations of Section 7(c)(1) of the Exchange Act and Regulation T promulgated by the Board of Governors of the Federal Reserve System.

(4) During the period from about February 1, 1968 until December 16, 1968, registrant wilfully violated, and Gray wilfully aided and abetted violation of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder through failure of the registrant promptly to file an amendment on Form BD reflecting a change in its officers.

(5) The charge alleging a failure to supervise is defective for failing to meet the terms of Section 15(b)(5)(E) of the Exchange Act.

(6) During the period from about October 1967 to about December 31, 1967, Gray wilfully violated the requirements of Section 5(a) of the Securities Act in the sale and delivery after sale of the unregistered Class B common stock of American Monitor Corporation.

Under Section 15(b)(5)(E) of the Exchange Act such violation by Gray, a "person associated" with the registrant, is a basis for sanctions against the registrant.

(7) During the period from about October 1967 to about December 31, 1967, Gray wilfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in connection with the sale of the Class B common stock of American Monitor Corporation. Under Section 15(b)(5)(E) of the Exchange Act such violations by Gray, a "person associated" with the registrant, are a basis for sanctions against the registrant.

PUBLIC INTEREST

The violations disclosed by this record are numerous and varied. Each is a serious violation and all of them persisted or were carried out over relatively long periods of time. All of the circumstances urged by respondents in mitigation including the fact that respondents have not previously been the subjects of disciplinary proceedings, have been taken into account in determining the sanctions here found needed. For the most part, however, the considerations urged in mitigation by respondents lack merit.

Respondents urge that they were unable to prevent the books and records violations and the net-capital violations in part because of Gray's impaired vision. But these violations occurred after a written admonition from the Regional Administrator concerning the importance of compliance with such requirements. Moreover, as found above, Gray's visual impairment did not in fact preclude appropriate action on his part to insure that the violations did not take place.

While the registrant has now adopted certain new office and internal procedures which make future violations less likely, such modifications, taken under the prod of this proceeding, cannot serve to excuse the violations, particularly in light of the earlier written admonition. Moreover, even under the "new procedures" ultimate management responsibility would still necessarily rest with Gray who, the record shows, has to date manifested far more interest and capacity for the selling aspects of the business than for compliance procedures.

The violations involving the sales of American Monitor stock reflect a disturbing lack of sensitivity to the requirements for making full and complete disclosure to customers and in a broad sense for treating them fairly.

The record discloses that for at least two of the purchasers American Monitor did not represent a suitable investment. These were Mrs. Schultz, who bought 200 shares, and Herman Collet, who was 80 years old at the time.

Respondents' brief refers to a rescission offer by Gray, citing Respondents' Exhibit U. Actually, Exhibit U is an example of a notice sent purchasers of American Monitor, with attachments by Michigan authorities advising purchasers of their rights under Michigan law to rescind their purchases in the event there have been violations of law. The exhibit neither contains nor reflects any offer of rescission by Gray. Even if Gray had made and communicated a written rescission offer to the purchasers, such would not have been sufficient to materially alter the sanctions, in view of the numerous and serious other violations.

Giving due weight to all mitigative factors disclosed by the record, the public interest nevertheless requires that the registration of the registrant be revoked, in view of the number and seriousness of the violations committed. 30/

As to respondent Gray, it is concluded that the nature and extent of the violations committed by him require that he be barred from association with a broker-dealer. However, because it appears that the public interest would not be adversely affected if Gray were allowed after a suitable period to work subject to appropriate supervision, it would be appropriate to permit him, after one year, to be employed by a broker-dealer in a supervised capacity.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer of M.V. Gray Investments, Inc. is revoked, and the company is expelled from membership in the National Association of Securities Dealers, Inc.; and that Maxel V. Gray is barred from association with

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30/ Including the violations respecting sales of American Monitor stock committed by Gray. As concluded above, Gray's violations, he being a "person associated" with the registrant, are a basis for sanctions against the registrant under Section 15(b)(5)(E) of the Exchange Act. It should be noted, as respects registrant's motion to reopen the hearing to introduce evidence, on the question of sanctions, of a proposal to alter the ownership of registrant (the motion was denied), that a revocation of registration would not preclude registrant's subsequent reorganization and application for registration. Investment Registry of America, Inc., 21 S.E.C. 745, 761 (1946).

a broker-dealer, except that after a period of one year from the effective date of this order, he may become associated with a registered broker-dealer upon an appropriate showing to the staff of the Commission that he will be adequately supervised.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 31/

David J. Markun

David J. Markun
Hearing Examiner

Washington, D.C.
January 12, 1970

31/ To the extent that the proposed findings and conclusions submitted by the parties are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the issued presented.