ADMINISTRATIVE PROCEEDING
FILE NO. 3-4121

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

U. S. SECURITIES & EXCHANGE COMMISSION
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In the Matter of

J. SHAPIRO CO., (8-14010)
JEROME H. SHAPIRO
OTTO D. CHRISTENSON
GEORGE W. FREDERICKS
EDWARD D. CLAPP
STEPHEN B. GOOT
HERMAN J. POLISKY

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INITIAL DECISION

Washington, D.C.
September 26, 1975

Ralph Hunter Tracy
Administrative Law Judge

ADMINISTRATIVE PROCEEDING
FILE NO. 3- 4121

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Office of Administrative Law Judges

Date September 26, 1975

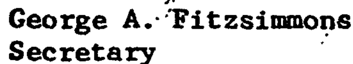
Re: J. Shapiro Co., et al.

Dear Sirs:

Enclosed is the Initial Decision of Ralph Hunter Tracy, Administrative Law Judge.

Your attention is directed to the Commission's Rules of Practice, and particularly to Rules 17, 18, 22 and 23, which pertain to petitions for review of initial decisions, briefs and the service and filing thereof.

Sincerely,



George A. Fitzsimmons
Secretary

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ADMINISTRATIVE PROCEEDING
FILE NO. 3-4121

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of J. SHAPIRO CO., (8-14010) JEROME H. SHAPIRO OTTO D. CHRISTENSON GEORGE W. FREDERICKS EDWARD D. CLAPP STEPHEN B. GOOT HERMAN J. POLISKY	:	INITIAL DECISION

APPEARANCES: Dennis J. Waldeck, Barry D. Goldman and Jeffrey R. Liebman of the Chicago Regional Office for the Division of Enforcement

Gary C. Hoffman of Hvass, Weisman & King for Jerome H. Shapiro; John H. Feldman of Goff & Goff for Otto D. Christenson; Miles E. Efron for George W. Fredericks; Lawrence R. Commers and Edgar H. Rex, Jr., of MacIntosh, Commers & Rex for Edward D. Clapp; Elliott C. Winograd for Stephen B. Goot; Richard B. Leavitt for Herman J. Polisky

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission Order (Order) dated January 11, 1973, as amended November 21, 1973, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 (Exchange Act) to determine whether the above-named respondents, among others,[1/] committed various charged violations of the Securities Act of 1933 (Securities Act), the Exchange Act, and the Securities Investor Protection Act of 1970 (SIPA), and regulations thereunder, as alleged by the Division of Enforcement (Division) and the remedial action, if any, that might be appropriate in the public interest.

The Order of January 11, 1973, alleges, in substance, that J. Shapiro Co., (registrant) wilfully violated and Jerome H. Shapiro (Shapiro) wilfully aided and abetted violations of Section 17(a) of the Securities Act, Sections 10(b), 15(b), 15(c)(2), 15(c)(3), and 17(a) of the Exchange Act and Rules 10b-5, 15b3-1, 15c2-1, 15c2-4, 15c3-1, 17a-3, 17a-5, 17a-11 and 17a-13 thereunder; that registrant and Otto D. Christenson (Christenson) singly and in concert wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Sections 10(b) of the Exchange Act and

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1/ The order, as amended, also sets forth charges against the following persons whose cases have been determined by the Commission as reflected in the Commission's respective releases as noted: Craig A. Blanchard, Exchange Act Release No. 10579/ January 3, 1974; Donald R. Anderson and Rodney G. Aaberg, Exchange Act Release No. 11076/October 30, 1974; Miles U. Braufman, (dismissed by Commission), SIPA Release No. 19/ December 3, 1974; Paul G. Kaus, (dismissed by Commission) Exchange Act Release No. 11305/March 20, 1975. In addition, David T. Hoffman was dismissed during the hearing.

Rule 10b-5 thereunder; and that registrant and Shapiro, as principal officer of registrant, failed reasonably to supervise those persons under their supervision with a view to preventing the alleged violations.

The Order of November 21, 1973, amended certain language in the original Order and further alleged that registrant wilfully violated and Shapiro wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-11 thereunder; that registrant wilfully violated and that George W. Fredericks (Fredericks) and Shapiro wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that Shapiro, Fredericks, Edward D. Clapp (Clapp), Herman J. Polisky (Polisky) and Stephen B. Goot (Goot) were officers and/or directors of registrant within the meaning of Section 10(b) of SIPA.

The evidentiary hearings were held at St. Paul, Minnesota from July 29 to August 8, 1974, and Los Angeles, California on March 5 and 6, 1975,[2/] with all respondents except registrant[3/] being represented by counsel. Proposed findings of fact and conclusions of law and supporting

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2/ Polisky did not appear at the hearing in St. Paul as he had an offer of settlement pending before the Commission which was subsequently rejected. He appeared at the reopened hearing in Los Angeles.

3/ On or about April 13, 1973, the Federal Court in Minneapolis, Minnesota, issued a preliminary injunction, consented to by registrant, enjoining registrant from violating the net capital requirements under the Exchange Act. Upon application of the Securities Investor Protection Corporation, registrant on April 13, 1973, consented to the appointment of a trustee for liquidation of registrant.

briefs were filed by the remaining parties to the proceeding, except registrant.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

FINDINGS OF FACT AND LAW

Respondents

Registrant was incorporated under the laws of the State of Minnesota on May 15, 1968, and has been registered with the Commission pursuant to Section 15(b) of the Exchange Act since July 31, 1968. It is, also, a member of the National Association of Securities Dealers (NASD). On April 13, 1973, the U.S. District Court, District of Minnesota, appointed a trustee for the liquidation of registrant, pursuant to SIPA.

Jerome H. Shapiro (Shapiro) is a graduate of the Wharton School of Finance from which he received a B.S. degree in economics in 1961. He began in the securities business with Reynolds & Co. in 1961, remaining there as a registered representative until June 1968, when he left to form J. Shapiro Co. Shapiro was at all times president, director, chief executive officer and majority shareholder of registrant.

Otto D. Christenson (Christenson) has been in the securities business since 1949. He was a registered representative with registrant from May 27, 1971 until March 31, 1972. Prior to his association with registrant Christenson was with, among others, Waddell & Reed,

Otto Christenson Co., and The First Northwest Co., of which he was a principal and part owner.

George W. Fredericks (Fredericks) entered the securities business in 1949 with Merrill Lynch where he was a messenger, board-operator and wire marker and then with Reynolds & Co. where he was in charge of the cashier's cage and clerical employees. He, also, became a registered representative while at Reynolds & Co. He subsequently was with Harvey J. Shaw Investment Co., E. Bruce Co., Naftalin & Co., Highview Nursing Home, Inc., Ebin Robertson & Co., and Fredericks, Clark & Co. In October 1970 he joined registrant as a vice-president in charge of corporation finance which included underwriting, syndication, acquisitions and mergers. He was in charge of syndication operations for registrant during 1972 and it was his responsibility to structure registrant's offerings. He became a director of registrant in December 1972.

Edward D. Clapp (Clapp) is a graduate of the University of Minnesota, having received a B.S. degree in June 1949 and a law degree in 1951. He is admitted to practice law in Minnesota but has never practiced. He is an employee and officer of Clapp-Thomssen Co. of St. Paul, a general real estate brokerage firm, president of Mustang Investment Corporation, a publicly held real estate investment corporation, president and a director of Business Motivation, Inc., and vice-president and a director of LaBelle Air Transportation Co. He became a vice-president and a director of registrant on December 31, 1972.

Stephen B. Goot (Goot) graduated from the University of Arizona in 1965 with a B.S. degree in finance. From June 1965 to June 1967 he was president of the Beacon Glove Co., New York, N.Y. He was a registered representative with Goodbody & Company, Las Vegas, Nevada from June 1967 to August 1969, with Birr, Wilson & Co., Inc., San Francisco, California, from August 1969 to July 1970, and with F.I. DuPont, Glore Forgan, Inc., from July 1970 to June 1971, when he joined J. Shapiro Co. as office manager of the Las Vegas office. About January 1972 he was made a vice-president of registrant, while continuing to manage the Las Vegas Branch office.

Herman J. Polisky (Polisky) is a director of Coast Produce Co., Los Angeles, California, which he founded in 1948. This is his principal occupation and he is still active in the business, being at the produce market from 2:30 A.M. until 12 noon. He met Shapiro while on a business trip to Las Vegas and in August 1971, became associated with the Beverly Hills office in the corporate finance department. He was named a vice-president in November 1972 and a director in December 1972. His only compensation was to be 10% commission on any underwritings he secured for the firm.

Bookkeeping Violations

The record establishes that during the period from June 30, 1972, to January 11, 1973, registrant, aided and abetted by Shapiro and Blanchard, as charged in the Order, committed a number of violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by failing

to maintain and to keep accurate and current certain required books and records.[4/] At the time of an inspection of the books and records of registrant conducted by two Commission investigators from July 17 to July 22, 1972, a number of deficiencies existed.

During the course of the inspection the investigators learned that registrant maintained two sets of records, one in Los Angeles which accounted for the Los Angeles and Las Vegas offices and the other in Minneapolis which accounted for the remaining offices of registrant.[5/] The two sets of records were not combined on a daily basis but only at the end of the month for the purpose of determining net capital. Thus registrant's purchase and sales journal did not reflect purchase and sales of its Los Angeles and Las Vegas offices and the cash receipt and disbursement records did not reflect registrant's cash receipts and disbursements at these offices.

In addition, the inspection revealed that 32 different securities positions valued at approximately $366,000 were not reflected on registrant's receipt and delivery blotter; that the receipt and delivery blotter failed to properly reflect the movement of 11 different

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4/ Section 17(a) of the Exchange Act, as pertinent here, requires brokers and dealers to make and keep current such books and records as the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records which must be maintained and kept current.

5/ Between the time of its founding on August 1, 1968, and June 30, 1972, J. Shapiro Co. had expanded to the point where it had offices in Minneapolis and Bloomington, Minnesota; Denver, Colorado; Las Vegas, Nevada; Los Angeles, Beverly Hills, Salinas and Monterey, California. It employed between 150 and 200 people and did in excess of $5,500,000 in volume.

securities valued at approximately $772,000 which had been deposited with the Security Pacific National Bank in Los Angeles as collateral for a loan.

Also, the general ledger failed to reflect securities differences of $359,000 in a dividends claim account and $55,000 in the error in transit account. While they were reflected in the customer ledger account this had the effect of burying them because the unsecured positions or the unrealized gains and losses in these accounts were not included in the registrant's net capital computations. At the time of the examination of the general ledger registrant had no account set up for unrecorded or unlocated securities differences, which, after many adjustments by Touche Ross & Co. registrant's accountants, was determined to be $142,000.

Registrant had experienced serious back office problems for some time prior to the inspection by the Commission investigators, apparently brought on, at least in part, by the failure of the registrant to employ record-keeping procedures and personnel which were able to keep up with the rapid expansion of its business. In fact registrant's X-17A-5 report of financial condition as of June 30, 1972, prepared by Touche Ross & Co., includes a lengthy letter, dated September 11, 1972, (Dx 1) addressed to the Board of Directors, which states in pertinent part:

> "Separate back office operations are maintained in Minneapolis and at the Los Angeles branch, and the cash and security records are maintained by use of a separate data processing service bureau at each location. It appears that there was inadequate direct supervision of the separate back office operations. Differences noted during the quarterly

securities counts, as required by the Securities and Exchange Commission, were not being reconciled and properly adjusted on the security records; numerous adjustments were being made without approval by appropriate supervisory personnel; and securities' movements were being made without appropriate entries to the security position records. The aging of the 'fail' details, although available, was not periodically reviewed and old items investigated and cleared up; compliance with regulation 'T' in respect to customer cash accounts and maintenance of required margins in customer margin accounts was not being strictly enforced; unsecured and partially secured customers' accounts were not reviewed and cleared on a timely basis; and excess free securities were generally not being segregated or placed in safekeeping. Bank accounts were not being reconciled to the general ledger cash accounts on a timely basis.

* * * *

"At June 30, 1972, the firm was in violation of the Securities and Exchange Commission's minimum net capital rule. The violation was primarily due to the inability of the firm to generate the necessary accurate information from its accounting system to prepare a proper net capital computation because of the deficiencies in the maintenance of the security records and customers' and brokers' accounts as noted above."

At or about the time of the Touche Ross & Co. letter registrant employed an experienced back office man in an effort to bring its record keeping procedures into compliance. He was Robert Bettis, Sr., (Bettis) formerly with Reynolds & Co., who had had 19 years experience in back office management. Bettis testified that when he joined registrant in September 1972, its office was in the worst shape of any office he had ever seen and he so informed Shapiro. There was no chain of command and no one to whom an employee could be responsible. In addition to the problems found by the Commission investigators and Touche Ross, Bettis

testified that trading department employees were trading securities for their own account and then trading them back out the same or next day to the firm account at a higher price. He reported this practice to Shapiro but did not know of any corrective steps being taken. On November 17, 1972, Bettis submitted his letter of resignation. (DX 50). In the letter he complains that his advice has not been followed, that he has not had a free hand to clean up the areas of weakness, that "it is only a matter of time before the S.E.C. and the N.A.S.D. will be converging on you like an army". . . "I have voiced my opinion to you and the other officers of the firm, and still you refuse to heed my warnings."

Shapiro does not deny that bookkeeping violations occurred. He takes the position that "there was no reason for him to suspect this situation" and that he "was unaware of (it) until the Commission inspection in July, 1972".

There is no merit to Shapiro's contention that he was unaware of the bookkeeping and back office situation. Touche Ross had addressed letters to him dated August 12, 1970 and October 11, 1971, in connection with its audits and X-17A-5 Reports for June 30, 1970 and 1971, respectively. Each of these letters pointed out shortcomings and recommended steps which were never taken. (DX 57, 58).

The Commission has repeatedly stressed the importance in the regulatory scheme for strict compliance with the requirement that books

and records be kept current.[6/] The requirement that records be kept embodies the requirement that such records be true and correct.[7/] Compliance with the rule relating to maintenance of books and records is regarded as an "unqualified statutory mandate" dictated by a broker-dealer's obligation to investors to conduct its securities business on a sound basis.[8/]

It is found that registrant wilfully violated and that Shapiro wilfully[9/] aided and abetted violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

Net Capital Violations

The Order charges that during the periods from May 1, 1972, through September 29, 1972, and from March 1, 1973, through April 11, 1973, registrant wilfully violated and Shapiro wilfully aided and abetted violations of the net capital provisions of Section 15(c) of the Exchange Act and Rule 15c-3 thereunder.[10/]

6/ Olds & Company, 37 S.E.C. 23 (1956); Pennaluna & Company, Inc., 43 S.E.C. 298 (1957).

7/ Lowell Niebur & Co., Inc., 18 S.E.C. 471 (1945).

8/ Billings Associates, Inc., 43 S.E.C. 641 (1967).

9/ It is well established that a finding of willfullness does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing. Billings Associates, Inc., 43 S.E.C. 532 (1961); Hughes v. S.E.C., 174 F. 2d 969, 977 (CA DC 1949).

10/ Section 15(c)(3) of the Exchange Act, insofar as here pertinent, prohibits securities transactions by a broker-dealer in contravention of the Commission's rules prescribed thereunder providing safeguards with respect to the financial responsibility of brokers and dealers. Rule 15c3-1 provides, subject to certain exemptions not applicable here, that no broker or dealer shall permit his aggregate indebtedness to all persons to exceed 2,000% of his net capital computed as specified in the rule or have a net capital of less than $5,000.

The record clearly establishes that during the relevant periods registrant was in violation of the Commission's net capital requirements at least 7 times during the 11 month period from May 1972 through March 1973, as shown in the following schedule:

DATE	NET CAPITAL PER REGISTRANT	REQUIRED NET CAPITAL	NET CAPITAL ADJUSTMENT (DECREASE)	ADJUSTED NET CAPITAL (DEFICIENCY)
05-31-72	$180,043	$505,424	$ (37,500)	($362,881)
06-30-72	112,287	303,330	(52,996)	244,039)
07-31-72	264,683	294,690	(105,716)	(135,723)
08-31-72	326,061	243,601	(77,164)	5,296
09-30-72	321,139	279,616	(68,004)	(26,481)
10-31-72	344,538	254,478	(38,141)	51,919
11-30-72	414,402	258,256	(38,141)	118,005
12-30-72	468,433*	239,999	(38,631)	189,803*
01-31-73	317,197	238,792	(38,631)	39,774
02-28-73	201,304	161,675	(39,751)	(122)
03-31-73	42,013	92,622	(38,631)	(89,240)

*This includes $200,000 received from sale of warrants to Clapp on 1-12-73, which the Division alleges is not includible in net capital at 12-30-72. Consequently disallowance of this $200,000 would result in a net capital deficiency of $10,197 as of 12-30-72. Division only learned that the transactions had not been consummated until 1-12-73, when Clapp testified at the hearing on 8-8-74.

Shapiro admits that obviously the net capital violations occurred. However, he argues that he did not know it and could not have known it until reported to him by Touche Ross in September 1972, as the report of his Treasurer, Craig Blanchard (Blanchard) disclosed that registrant was in compliance. Further, Shapiro urges, he was justified in relying on the correctness of the report because of Blanchard's background (he was formerly an accountant with Touche Ross) and the fact that no report had

been called into question during the preceding three years of his employment. In any event, Shapiro states, registrant's continuing to operate when the net capital was deficient cannot be said to be "willfull".[11/]

The Commission has repeatedly held that certain affirmative duties and responsibilities are imposed on officers, directors, controlling owners, and principals of a broker-dealer, or a combination of these.[12/] That Shapiro cannot avoid the responsibility for registrant's financial condition has been clearly expressed by the Commission in the case of John Munroe, 39 S.E.C. 308 (1959) where it stated, at 311:

> "The obligation to file financial reports annually, as well as other obligations set forth in the Act and the rules and regulations thereunder, are imposed upon registrants directly and are non-delegable. A registrant can obtain all the assistance he needs from clerks, accountants, attorneys, and others but he cannot instruct anyone to see to it that he is brought into compliance with applicable rules and regulations and feel that he has thereby fully discharged his obligations."

It is found that registrant wilfully violated and that Shapiro wilfully aided and abetted in the violation of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, as charged in the Order.

11/ See note 9 , supra, page 10.

12/ Herman M. Solomon, et al., 44 S.E.C. 910, 912 (1972); Security Planners Associates, 44 S.E.C. 738, 742 (1972); L.A. Frances, Ltd., 44 S.E.C. 588, 593 (1971); Billings Associates, Inc., 43 S.E.C. 641, 649 (1967); Albion Securities Company, Inc., 42 S.E.C. 544, 547 (1965).

Failure to File Required Reports

Rule 17a-5 promulgated under Section 17(a) of the Exchange Act provides generally that a registered broker or dealer shall file annually with the Commission a report of its financial condition within 45 days[13] of the "as of" day of the report. This is an X-17A-5 Report and, as filed by registrant, was due 45 days after June 30, 1972. However, such report was not filed until September 15, 1972, or 31 days after the date it was due.

Rule 17a-11[14] provides that when registrant's net capital is less than that required, immediate telegraphic notice must be given to the Commission and any self-regulatory organizations to which it belongs, and a report of the firm's financial condition must be filed within 24 hours after such net capital deficiency occurs.

The Rule also provides, as applicable to registrant, that when books and records are not made or kept current immediate telegraphic notice of such fact be given, specifying the books and records which have not been made or which are not current, and within 48 hours of such telegraphic notice file a report as to what steps have been and are being taken to correct the situation.

Despite the capital deficiency of registrant as of June 30, 1972, and despite the condition of its books and records as of the same date both as previously described, neither telegraphic notices of same or

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13/ Amended to 60 days, effective for calendar and fiscal years ending on or after December 31, 1972, SEA Rel. 9658.

14/ Rule 17a-11 under Section 17(a) of the Exchange Act, the "early warning rule" is designed to alert the Commission and other regulatory bodies to financial and operational difficulties of broker-dealers before such difficulties become so critical as to constitute actual violations of the securities laws and regulations.

the required subsequent reports were received by the Commission.

Rule 17a-11 further provides that, when as in the case of registrant, its aggregate indebtedness exceeds 1200% of its net cpaital or that its total net capital is less than 120% of the minimum net capital required the firm must, within 15 days after the end of the month, file a report on Form X-17A-11 furnishing data as to its financial and operational condition.

Although registrant's net capital condition brought it within Rule 17a-11 beginning in May 1972, registrant's X-17-a-11 reports for the months of May, June, July and August, 1972 were not timely filed.

Shapiro's response to the charge of reporting violations is that the preparation and filing of the X-17A-5 report is an accounting function and one for which Touche Ross was responsible. The extent of Shapiro's involvement was a request for an extension which was denied.

As to the X-17A-11 reports the blame is placed on the compliance officer who, allegedly did not know about the deficiencies and when he did find out instructed his secretary to give such notice by telegraph, which she apparently failed to do. Accordingly, Shapiro had no direct involvement.

There is no merit to Shapiro's contentions. The Commission has expressed itself in no uncertain terms that "the requirement that annual financial reports be filed on time and in proper form is a keystone of

the surveillance of registered broker-dealers with which we are charged in the interest of affording protection to investors, and full compliance is essential".[15/] As stated herebefore, such responsibility must be assumed by registrant and Shapiro and cannot be delegated.

It is found that registrant willfully violated and that Shapiro willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rules 17a-5 and 17a-11 thereunder.

Violation of Quarterly Securities Count

Rule 17a-13, adopted by the Commission on November 8, 1971, effective on January 1, 1972, requires a broker-dealer to physically count and examine in each quarter all securities held; account for securities in transfer, pledged, loaned, borrowed, deposited, failed to receive and failed to deliver; verify all such securities; compare count and verification with his records; and record unresolved differences.

The Commission's inspection determined that as of June 30, 1972, a securities count by registrant reflected approximately 348 differences out of a total of approximately 1,400 securities positions. The market value of 20 of these differences was $1,103,699, an amount in excess of registrant's net worth. Also, the Touche Ross letter of September 11, 1972, previously referred to, supra, page 7, confirms the fact that registrant was in violation of Rule 17a-13.

15/ W.E. Leonard & Company, Inc., 39 SEC 726, 727 (1960).

Here, again, Shapiro's only comment is that he did not know and could not have known of the violation in view of his reliance on Blanchard's experience with the firm until the Commission inspection. In fact, he says, the firm's compliance officer was, also, unaware of such violation.

Shapiro's explanation is unacceptable and the record fully supports a finding that during the period from October 11, 1971 [16/] to January 11, 1973, registrant willfully violated and Shapiro aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-13 thereunder.

Hypothecation of Customer's Securities

The Order charges that during the period from June 30, 1972 to January 11, 1973, registrant willfully violated and Shapiro willfully aided and abetted violations of Section 15(c)(2) of the Exchange Act and Rule 15c2-1 thereunder [17/] by pledging fully paid for securities of its customers.

During the course of the Commission's inspection it was determined that as of June 30, 1972, registrant had a firm loan in the amount of $982,000 with the First National Bank of Minneapolis. Among the securities pledged as collateral for this loan were 11 different securities with a

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16/ Division's motion to amend this date from July 1, 1972 to October 11, 1971, was granted during the hearing.

17/ Rule 15c2-1 provides that the term "fraudulent, deceptive, or manipulative act or practice," as used in Section 15(c)(2) of the Act, is defined to include the direct or indirect hypothecation by a broker-dealer . . . of any securities carried for the account of a customer under circumstances- (1) that will permit the commingling of securities carried for the account of any such customer, without first obtaining the written consent of each such customer to such hypothecation.

collateral value of approximately $47,000. These were fully paid for securities of customers of registrant and were commingled with other securities as collateral for the above mentioned loan.

Registrant stipulated during the course of the hearing (DX 20) that during the period from June 30, 1972 through July 17, 1972, it had 12 different securities approximating $50,000 pledged as collateral for a loan from the First National Bank of Minneapolis; that it pledged these securities without prior written consent of customers owning such securities; that said securities were commingled with securities for the accounts of other customers, without prior written consent of each customer to such hypothecation.

Shapiro claims that the pledging of customer's securities was inadvertent. However, this is not an acceptable reason for improperly pledging customers' securities to collateralize registrant's loans.

It is found that registrant, aided and abetted by Shapiro, willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-1 thereunder.

Violations in Connection with the Miller Oil Company Offering

Registrant was the underwriter for a Regulation A offering of 5,000,000 shares of Miller Oil Company (MOC), which became effective August 17, 1972. In connection with the offering registrant employed an offering circular which stated on the cover sheet:

> "(2) The Company has entered into an Underwriting Agreement with J. SHAPIRO CO. (the Underwriter) pursuant to which the Underwriter has agreed to use its 'best efforts' on an 'all or none' basis.
>
> (6) Arrangements have been made with the Colorado Division of Securities to escrow the proceeds until all of the securities offered herein are sold. The Colorado National Bank of Denver, Colorado, will act as the Escrow Agent. Upon receipt by the Underwriter, all proceeds of the offering will be deposited with the escrow agent. When receipts reach the sum of $500,000, said sum shall be delivered to the Company and the shares subscribed for shall be delivered to the shareholders." (underlining added). (DX 5)

A similar statement was made at page 10 of the offering circular. Registrant first received collections from the MOC offering on August 18, 1972, and continued to receive collections until September 5, 1970. No payments were made to the escrow account until September 5 and 8, 1972.

Prior to their transmittal to the escrow account, the monies received from the offering were deposited in accounts maintained by the registrant at the Colorado National Bank, Denver, Colorado; Security Pacific National Bank, Los Angeles, California and The First National

Bank of Nevada, Las Vegas, Nevada, and were commingled with registrant's own funds. The MOC proceeds were used for the general operation of registrant and to reduce registrant's overdraft positions. Registrant's books indicate that without the MOC proceeds it had an overdrawn cash position from August 17 through September 6, 1972, and that even with the MOC proceeds it had an overdrawn cash position from August 17 through September 1, 1972.

Respondents have stipulated to the underlying facts which support the failure to promptly deposit the MOC proceeds in the escrow account in violation of Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.[18/] Shapiro professes not to have been aware that there was a delay in transmission and Martin Berliner, registrant's compliance officer, testified that there was no intent to utilize these funds as working capital and in fact the delay occurred as a result of negligence in the underwriting department.

The remaining question is whether, in light of the representation made in the offering circular, failure promptly to deposit collected funds in the escrow account was a violation of the antifraud provisions of the Exchange Act and the Securities Act. The offering circular stated, "Upon the receipt by the Underwriter, all proceeds of the offering will be deposited with the escrow agent." Implicit in that statement is an assurance to purchasers that their funds will be promptly and safely segregated and not made subject to the vagaries of registrant's financial condition.

18/ The Rule requires that such funds be "promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interest therein . . ."

Accordingly, it is concluded that not only did registrant, willfully aided and abetted by Shapiro, willfully violate Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder by the course of conduct described above,[19/] but that registrant, also, willfully violated, and Shapiro willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Form BD Amendment

The Order charges that during the period from June 30, 1972 to January 11, 1973, registrant willfully violated and Shapiro willfully aided and abetted violations of Section 15(b) and 17(a) of the Exchange Act and Rule 15b3-1 thereunder, in that they failed to promptly file with the Commission an amendment on Form BD reflecting that Brian Landis and Herman Polisky became vice-presidents of registrant; and that John P. Barton was a vice-president but terminated the affiliation.

The Division offered no proof as to Barton, and Landis is not named in the Order. The principal proof offered was a xerox copy of a list of Registered Principals typed on the letterhead of J. Shapiro Co. containing the name of Herman Polisky, Vice-President. Also, in a letter dated June 26, 1973, addressed to the SEC, Polisky states that he became a vice-president of registrant in November 1972. However, Polisky testified at the hearing that he became a registered principal

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19/ See, Weston & Co., Inc., et al., 44 S.E.C. 692, 695 (1971); Haight & Co., Inc., et al., 44 S.E.C. 481, 508 (1971).

on the understanding that all registered principals would be made vice-presidents. However, to his knowledge he was never made a vice-president. Berliner testified that he was not sure that either Landis or Polisky were officers. He did not know whether the minutes of registrant show any ratification of Polisky's election or appointment to the position of vice-president.

It is concluded that the allegation in the Order that registrant willfully violated and that Shapiro willfully aided and abetted the violations of Sections 15(b) and 17(a) of the Exchange Act and Rule 15b3-1 thereunder has not been proven by a preponderance of the evidence and it therefore, is dismissed.

Violations in Connection with the Nolex Corporation Offering

Registrant acted as representative underwriter for an offering of 500,000 shares of Nolex Corporation (Nolex) at $7.00 per share, which became effective January 2, 1973. In connection with the offering registrant employed a prospectus which stated on page 30, under the caption Underwriting:

> "The Underwriters named below, for whom J. Shapiro Co. is acting as Representative, have severally made a firm commitment, subject to the terms and conditions of the Underwriting Agreement to purchase from the Company the respective number of shares set forth opposite their names:"

The prospectus then shows that registrant is to take down 60,000 shares as underwriter and the remaining 440,000 shares as allocated to 17 different underwriters.

This underwriting was apparently secured by Goot, vice-president and manager of the Las Vegas office, and Buddy Sarkissian (Sarkissian), sales representative of the Las Vegas office, because the employment agreement between Goot and registrant contains an addendum covering certain arrangements concerning the Flip & Sip (former name of Nolex) underwriting. This agreement was entered into on June 12, 1971, and signed by Goot and Fredericks and allocated 20% of the Nolex offering to registrant's Las Vegas office, in addition to shares allocated to Sarkissian. Fredericks, as vice-president in charge of corporation finance was responsible for structuring the offering for Registrant and was in charge of allocating the shares. The offering was filed with the Commission on September 28, 1972.

Of the 440,000 shares allocated, according to the prospectus, to 17 different underwriters, the registrant, on January 2, 1973, bought back 283,500 shares or 64.4% from the other underwriters. In total, registrant sold 368,500 shares, representing the 60,000 it underwrote, an over allotment of 25,000 shares and the 283,500 purchased from other underwriters.

In order to ascertain the amount of net capital needed by registrant to support the underwriting of 368,500 shares, the staff examiner prepared a schedule as of January 2, 1973, (Dx 12) under the assumption registrant had excess capital of $189,803 as of December 31, 1972.[20/] Even so, registrant had a net capital deficiency on January 2, 1973, of $359,322.

20/ See Net Capital schedule on page 11, *supra*.

It is clear from the record that registrant did not have sufficient net capital to underwrite the entire Nolex offering. Therefore, registrant participated in the distribution as a member of the selling group. However, registrant in fact retailed the great preponderance of the Nolex shares sold to the public, selling 368,500 shares of the 500,000 share offering. Registrant bought back 283,500 shares or 64.4% of the offering (DX 11) from the other underwriters in order to be able to fulfill the terms of the agreements it had with Goot and Sarkissian dating back to June 12, 1971.

Shapiro argues that there was no violation in the Nolex offering because he checked with the Company's California counsel, an NASD examiner and another trading firm in Minneapolis and was advised that an underwriter may act as a selling member and that similar arrangements had been effectuated before. Shapiro, also, advances the argument that he did have sufficient net capital and that the staff's computation is incorrect because it included a "hair cut" of all of the shares Registrant sold. Shapiro states that the "hair cut" is properly taken by each of the other participants in the selling group and therefore should not be charged to Registrant on the shares which it repurchased.

In the case of a firm commitment underwriting the instant the registration statement becomes effective, the underwriter's net worth is subject to an immediate deduction based upon the "haircut" on the

security's position to which he is committed and the underwriter must be prepared to meet the requisite capital requirements after this deduction at the moment the registration statement becomes effective. SEA Rel. 8024 at 11-12. The "hair cut" on the securities may be reduced pro tonto as bona fide sales are made to either public customers or selling dealers. Delson & Gordon, CCH Fed. SEC L. Rep., paragraph 78,093 at p. 80, 360 (March 3, 1971).

Thus, when Registrant contracted to purchase the Nolex securities from the other underwriters as a member of the selling group, it was required to apply the "hair cut" to its long securities position; consequently Registrant had a net capital deficiency when it participated in the Nolex offering as a selling group member.

Several of the underwriters named in the prospectus testified that although they were named as participants in the underwriting for a certain number of shares they were only allowed to retain considerably less than the number listed. For example, Stevens & Company is listed as having 30,000 shares although all of the shares were bought back by Registrant and Stevens did not distribute any of them. Accordingly, it is evident that Registrant's utilization of other broker-dealers as underwriters was a manifest subterfuge to circumvent the net capital rules.

In view of the foregoing activities on the part of Registrant the Nolex prospectus failed to disclose that at the time of the offering Registrant was in violation of the net capital provisions of the federal securities laws; that Registrant had insufficient capital to underwrite 60,000 shares of Nolex; that Registrant intended to purchase over 60% of the shares allotted to other underwriters and sell these shares to

the public; that Registrant had insufficient capital to sell 368,500 shares of Nolex on January 3, 1973. Therefore, when Registrant, Shapiro and Fredericks disseminated prospectuses which failed to disclose these deficiencies, they violated the anti-fraud provisions of the Federal Securities laws. 21/

Accordingly, it is found that Registrant, willfully violated and Shapiro and Fredericks willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Unauthorized Sales

The Order charges that during the period from August 1, 1971 to January 28, 1972, 22/ registrant and Christenson singly and in concert willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in effecting transactions in accounts of customers without written authority and for individuals who did not have accounts with registrant without their knowledge or approval.

21/ SEC v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1097 (2nd Cir. 1972).

22/ Dates amended during the course of the hearing.

Four investors testified concerning their transactions with Christenson, two of whom had not even opened an account with registrant. All four testified that they received confirmations through the mail for stocks which they had not ordered. Investor Dow testified that he did not, at any time order the 150 shares of Comtrol purchased in his name on October 15, 1971, and that he did not have an account with registrant. Investor DeLuc had no account and did not order the 2,000 shares of Miniature Instruments purchased on August 4, 1971. Investor Otten had an account but did not authorize the purchase of 200 shares of Mentor Corp., 500 shares of Contec, Inc., 400 shares of Aaro Films, Inc., or 1,500 shares of Comtrol during the period from November 30, 1971 through January 15, 1972. Investor Albrecht had an account but did not authorize the purchase of 1,000 shares of Mentor Corp. on November 30, 1971. These transactions are all stipulated to by registrant as having been executed without the investors' knowledge and under circumstances wherein they had not given written authorization to Christenson to exercise discretionary authority. (DX 20).

In each instance, registrant mailed a confirmation or statement reflecting the transaction and the "purchasers" immediately voiced their objections. Dow spoke to Christenson who was apologetic; DeLuc called registrant and the trade was cancelled; Albrecht wrote "I did not order and do not want" on the confirmation and mailed it to registrant; and Otten wrote Christenson a letter requesting that he not trade in Otten's account without Otten's authority.

Christenson argues that the testimony of the investor witnesses is unreliable for a variety of reasons and that the registrant's back office was not capable of handling the fantastic volume of sales registrant was encountering, and as a result, hundreds of errors were being made in the accounts of Christenson and other registered representatives.

In addition to the testimony of investor witnesses, which is accepted as credible, the record discloses that Christenson was the subject of numerous fines imposed by registrant for continuous violations of Regulation T and other securities rules in an effort to enforce compliance on his part. Moreover, Christenson finally had a fine of $5,000 imposed on him in February 1972 and was discharged by Shapiro on February 29, 1972.

The Commission has long held that confirmations of unauthorized transactions are violative of the anti-fraud provisions of the securities acts.[23/] Accordingly, it is found that registrant and Christenson willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

23/ R.A. Holman & Co., Inc., et al., 42 SEC 866, 876 (1965), affirmed, 366 F. 2d 446, 451 (CA 2, 1966); Shelley Roberts & Co. of California, 38 SEC 744, 751 (1958); First Anchorage Corporation, 34 SEC 299, 304 (1052).

Section 10(b) of SIPA

The Securities Investor Protection Act of 1970 (SIPA), 15 U.S.C.A. Sect. aaa, et seq., was adopted by Congress in order "to provide investors protection against losses caused by the insolvency of their broker-dealer."[24/] Section 10(b) provides:

> (b) Engaging in Business After Appointment of Trustee -- It shall be unlawful for any broker or dealer for whom a trustee has been appointed pursuant to this Act to engage thereafter in business as a broker or dealer, unless the Commission otherwise determines in the public interest. The Commission may by order bar or suspend for any period, any officer, director, general partner, owner of 10 per centum or more of the voting securities, or controlling person of any broker or dealer for whom a trustee has been appointed pursuant to this Act from being or becoming associated with a broker or dealer, if after appropriate notice or opportunity for hearing, the Commission shall determine such bar or suspension to be in the public interest.

The amending Order of November 21, 1973, added a charge that on the date the trustee was appointed (April 13, 1973) and for forty-five days prior thereto, the following persons, among others came within the second sentence of Section 10(b): Shapiro, Fredericks, Clapp, Polisky and Goot. Of these Clapp, Polisky and Goot are charged under Section 10(b)[25/] only, and no where else in the Order.

24/ H. R. Rep. No. 91-1613, 91st Cong. 2nd Sess., 2, October 21, 1970.

25/ The Commission dismissed 10(b) charges against Braufman and Kaus. See note 1, page 1, supra.

Clapp

Edward D. Clapp (Clapp) is a native of St. Paul, attended the public schools there and received a B.S. degree from the University of Minnesota in 1949 and a law degree in 1951. He is admitted to practice in Minnesota but has only engaged in military practice. He is now 48 years of age and a Colonel in the United States Army Reserve, Judge Advocate General's Corp. He is an officer of Clapp-Thomssen Co. of St. Paul, a general real estate brokerage business. He is, also, president of Mustang Investment Corp., a publicly held real estate investment corporation. He is president of Business Motivations, Inc. and an officer and director of LaBelle Air Transportation Co. Except for registrant he has never been associated with a broker-dealer.

Clapp had been acquainted with Shapiro since sometime in the early 1970's but did not have any business dealings with him or registrant until November 1972, when an associate of Clapp's in Mustang mentioned that registrant needed additional invested capital. Originally the amount discussed was $250,000 but was reduced to $200,000. Clapp headed a group of six investors who agreed to raise the money and loan it to registrant. Initially it was proposed that the investment by the group headed by Clapp would be done on a subordinated loan basis. However, as negotiations progressed it was felt that because of the financial obligations registrant already had another form should be used.

Accordingly, the investment was structured in terms of a purchase agreement for the purchase of certain warrants held by registrant with a guarantee by Shapiro and a repurchase agreement for the warrants. This agreement was negotiated as of December 31, 1972. The $200,000 was to be obtained by members of the group from the First National Bank of Minneapolis (Bank). A meeting took place at the Bank on January 2, 1973, at which time it became apparent to Clapp that the Bank intended to use the $200,000, or a portion of it, to retire old indebtedness of Shapiro to the Bank. Thereupon, Clapp called off the transaction. During the next several days Shapiro reached an agreement with the Bank that the $200,000 would not be applied to prior debts which were owed to it by Shapiro and registrant. The transaction was then completed on January 12, 1973, with the effective date being December 31, 1972.

Clapp testified that he and his group was aware that the $200,000 was needed so registrant could maintain its net capital position to satisfy SEC requirements. Clapp was named a vice-president and director as the representative of his group and solely for the purpose of looking after the investment. The money was deposited in a special account at the Bank and he was the only signatory. He was to sign checks only at the direction of Shapiro and the checkbook was left with an officer of the Bank. In late January and early February Clapp received calls from the Bank that registrant was overdrawn and

requesting that the $200,000 be used to cover its overdraft position. Despite Clapp's protestations and refusal to sign any checks the Bank, on or about February 15, 1973, took the entire $200,000 to satisfy overdrafts in certain accounts of Shapiro and registrant. The recovery of the $200,000 has been sought in a suit bought by the Trustee and Clapp has been assisting in attempting to recover the funds.

The Division charges that at the time Clapp became an officer and director of registrant he was aware of its financial problems and that it was losing money but that he did nothing to correct the situation. Also, it at least infers that he participated in backdating agreements and checks in order to make it appear that registrant had excess capital for the prior month, when it,in fact, had a deficiency. Accordingly, because of his indifference to Registrant's financial viability and its compliance with the securities laws the Division asks that Clapp be suspended from association with the securities industry for a period of at least six months and that he be permanently barred from serving in a supervisory capacity.

While it is true that the $200,000 loaned to registrant by the Clapp group was improperly included in registrant's net capital for December 31, 1972, contrary to good accounting practice, it is, also true that in December while he was negotiating the transaction the registrant's net capital computation for November 30, 1972, showed a

net capital excess of $141,133. This computation was attached to the loan agreement and was apparently the one relied on by Clapp. Even after adjustment by the Division the excess capital for November was $118,005. Further, there is no indication that Clapp had anything to do with the computation of registrant's net worth as of December 31, 1972.

The public interest has been demanding higher standards of performance from the directors of corporations but such standards must be applied individually. In this connection a member of this Commission has said: 26/

> "I must add that as the reexamination of the role of directors continues there is the temptation to impose upon them excessive demands, demands that are inconsistent with the historical role of directors in American corporations. It is easy to say that directors have responsibility whenever an enterprise goes 'bust,' whenever the shareholders suffer harm, whenever tribulations assault the enterprise they serve.
>
> I would strongly disavow any such notion. Outside directors are necessarily limited in the time and energy they can devote to the enterprise on whose board they serve, and to judge them as if they were full-time employees is in my estimation a mistake. Similarly, they have not the time nor the opportunity to review every particular of the enterprise to ascertain whether management is honest, forthright, candid, straight. They must, as has been recognized in many states' corporation laws, rely upon the reports of management and auditors in carrying out their responsibilities." (Emphasis added)

The Commission has long held that in the imposition of sanctions ". . . the remedial action which is appropriate depends upon the facts and circumstances of each particular case and cannot be precisely

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26/ A. A. Sommer, Jr., in an address before the American Bar Association, August 14, 1974.

determined by comparison with action taken against another respondent in the same case or in other cases."[27/]

Clapp appeared on his own behalf as a witness and made a favorable impression. He is a man of good family background with a reputation for integrity in the St. Paul business community. He was involved with registrant for a little more than 4 months at the most and during that time he was aware of registrant's financial condition and was trying to assist in straightening it out. There is no doubt that he and his group hoped to realize a profit but it does not follow that he was responsible for registrant's worsening financial condition or its violations of the securities laws. In determining whether a sanction shall be imposed Section 10(b) says: ". . . the Commission shall determine such bar or suspension to be in the public interest." Under all of the circumstances as determined from the record it does not appear that the public interest requires that Clapp be barred or suspended from association with a broker-dealer. Accordingly, the charge against Clapp is dismissed.

27/ Securities Planners Associates, Inc., 44 S.E.C. 738, 744 (1971), See also, Dlugash v. S.E.C., 373 F. 2d 107, 110 (CA 2, 1967); Winkler v. S.E.C., 377 F. 2d 517, 518 (CA 2, 1967).

Polisky

Herman J. Polisky (Polisky) first met Shapiro while on a visit to Las Vegas and subsequently, in August 1971, he became connected with the corporate finance department of registrant's Beverly Hills office. Polisky has been and continues to be in the produce business which requires his being at work from 2:30 A.M. until Noon daily. The total time he spent at registrant's office was 8 to 10 hours a week. His compensation was to be 5 to 10% of offerings he would bring to registrant to underwrite, but there is nothing in the record to show that he ever brought in any underwritings. In November 1972, Polisky passed a principal's examination. He did this on his own and on the assumption that all principals would be made vice-presidents. However, he was never made a vice-president of registrant. In December, 1972, he was informed on the telephone by Martin Berliner, compliance attorney for registrant, that he had been elected a director a week before. Later he was told by Shapiro that he had been elected a director simply because "we needed another director."

Polisky testified that he had never had any duties outside of corporate finance. He was never the manager of the officer, never hired or fired brokers, or reviewed their activities. At all times there were 2 managers in the office and two others in charge of the back office. The Beverly Hills office had weekly meetings between the managers and brokers but these did not involve Polisky and he was not

required to attend. When the 2 managers of the Beverly Hills office were terminated Fredericks and other personnel were sent out from Minneapolis to supervise and manage the office until replacements could be obtained.

Polisky testified that he was asked by Fredericks some 2 or 3 months before the Nolex offering became effective to find some broker-dealers to participate in the offering. Polisky contacted 2 firms which participated. Aside from this he had no part in obtaining or structuring the Nolex underwriting or allocating shares to the participants.

Polisky did not attend Director's meetings, which were held in Minneapolis, until April 1973, when he received a call from Shapiro telling him that registrant might be in net capital dificit and that he should come to Minneapolis for a meeting. In early April, the meeting took place and Polisky was first told that the registrant was in net capital compliance, but later was told it was on the verge of being out of net capital. He immediately voted to call in the SEC.

Respondent's brief points out that the only charges against Polisky set forth by the Division are contained in its Answer to Motion for More Definite Statement filed on June 24, 1974, as follows:

> "(2). The Respondent Polisky in his capacity as a Vice President and Director of Registrant, among other things:
>
> (a) did not at any time review the Registrant's X-17-A Report for the period ending June 30, 1972 and the accompanying letter addressed to the Board of Directors;

(b) did not review Registrant's month-end general ledgers, trial balances, net capital computations for the period September, 1972 through March, 1973:

(c) failed to take any steps to ensure that, since July, 1972, Respondent was in compliance with applicable record keeping requirements."

The Division concludes that Polisky's indifference to his responsibilities is manifest and that his failure to take action to remedy the deficiencies he knew and should have known to exist warrants the imposition of a suspension from association with a broker-dealer, investment advisor or investment company for six months and a permanent bar from serving in a supervisory capacity.

Polisky was, at best, a part time employee of registrant and there is nothing in the record concerning any compensation he received. He was a director for about 4 months but was invited to attend only one meeting. Resolutions and consents for the other meetings were sent to him by mail for signature. He had no authority to do anything on behalf of registrant but to obtain underwritings. This he thought he could do because of his wide acquaintance among the Los Angeles business community but there is no evidence in the record that he ever obtained any underwritings.

Polisky testified at the hearing and told a straightforward story of his own business experience and his association with registrant. He admitted that he knew nothing about the securities business and that

all he knew about what was happening to registrant was what was told to him by Shapiro, Berliner and Fredericks, usually on the telephone.

Polisky admitted, also, that in October 1972 he received and read the X-17A-5 report prepared by Touche Ross and that he did nothing about the deficiencies set forth therein. Also, in September 1972, Shapiro told Polisky that registrant was hiring Bettis to head its back office in order to assure that "it was in the best possible condition." There is no evidence that he was ever actually made a vice-president although he apparently liked the idea of being known as such and there is some evidence that he told friends that he was a vice-president.

It is concluded that the record fully supports a finding that the imposition of sanctions on Polisky is not required by the public interest. Accordingly, the Section 10(b) of SIPA charge against him is dismissed.

Goot

Stephen B. Goot (Goot) has been in the securities business since June 1967 and his educational and experience background is set forth on page 5, *supra*. He joined Registrant on June 12, 1971, pursuant to an employment contract, page 22, *supra*. Goot was originally hired as a manager of the Las Vegas branch office of Registrant and approximately 6 months later, after qualifying with the NASD became an assistant vice-president.

The Division in its Answer to Motion for More Definite Statement says that in order to impose a sanction under Section 10(b) it intends to establish that Respondent Goot in his capacity as vice-president of Registrant, among other things did not at any time review Registrant's X-17A-5 Report for the period ending June 30, 1972, or the Order for Public Proceeding dated January 11, 1973, despite his awareness of said Order; failed to examine Registrant's month end general ledgers, trial balances, net capital computation for the period of September 1972 through March 1973; and failed to take any steps to ensure that, since July 1972, Respondent was in compliance with applicable record keeping requirements.

Goot points out that while he was a full time employee of Registrant he was not a director and had no authority to review financial reports, general ledgers, trial balances or net capital computations. In fact the bookkeeping and record keeping for Las Vegas was handled in Los Angeles. His participation in the Nolex underwriting has not been questioned and no specific charges have been brought against his conduct of the Las Vegas office or against any individuals employed there.

Goot testified that he was called to Minneapolis by Shapiro on February 6, 1973, and was informed that the Las Vegas, Denver and Los Angeles offices were in the process of being sold to United Securities Company of America (United). Goot urged Shapiro to transfer

all securities held in customers accounts immediately to United. The sale to United was consummated on February 7, 1973 and the final transfer of accounts and all other aspects of the business was effective February 20, 1973. In the meantime Goot had returned to Las Vegas and was over-seeing the transition from Registrant to United. In this connection he had certain administrative duties among them being the writing of checks for employees salaries.

Goot argues that he terminated his employment with Registrant on February 20, 1973, at which time he became an employee of United and that consequently he was not connected with Registrant during the 45 days prior to a trustee being appointed. The Division, in an effort to bring Goot within the 45 day period, contends that his employment with Registrant continued to the end of the last pay period which was February 28, 1973. In addition, the Division says that Goot issued and signed 4 checks drawn on Registrant in March, the last one being March 20, 1973. Goot admits signing the checks but states they were for employees salaries and that he received approval from Fredericks before writing them. Goot testified that he never received any monies or other renumeration from Registrant after February 20, 1973, other than what was due him for services performed prior to February 20, 1973.

The 45 day period selected by the Division is apparently an arbitrary one and is not to be found in the statute. In any event it is not determinative of the charge in the Order. The question is whether

Goot's position with Registrant imposed on him certain responsibilities which the Division alleges he failed to discharge. His duties were to manage the branch office in Las Vegas. The record keeping was done in Los Angeles and the net worth computations and filing of financial reports was done in Minneapolis. He had no responsibility other than to supply whatever information was required of him for these purposes. There is no evidence that the Las Vegas office did not maintain proper records or that it engaged in any securities laws violations. Indeed, Goot seems to have accomplished a smooth transition from one owner to another and there is no allegation that the Las Vegas office contributed to the losses suffered by customers of Registrant.

Careful consideration of the record as a whole leads to the conclusion that the public interest does not require the imposition of any sanctions on Goot. Accordingly, the charges as to him are dismissed.

Shapiro and Fredericks

In view of the fact that violations previously found herein require the imposition of sanctions in the public interest against Shapiro and Fredericks it is not necessary to make any additional finding with respect to Section 10(b).

Supervision

The Order, also, charged that Registrant, and Shapiro, as principal officer of Registrant, failed reasonably to supervise those persons under their supervision with a view to preventing the violations alleged in paragraph A through K of Section II of the Order.

Failure of supervision connotes an inattention to supervisory responsibilities, a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them and that was certainly the case here. However, having found that Registrant willfully violated several substantive provisions of the securities laws and the regulations thereunder and that Shapiro willfully aided and abetted such violations, it is inappropriate and inconsistent to find Registrant and Shapiro responsible for a failure of supervision with respect to the same misconduct. See In the Matter of Anthony J. Amato, Securities Exchange Act Release No. 10265 (June 29, 1973.) See, also, Securities Exchange Act Releases, as follows: Adolph D. Silverman, 10237 (August 6, 1973); Fox Securities Company, Inc., 10475 (November 1, 1973); Charles E. Marland & Co., Inc., 11065 (October 21, 1974).

Other Matters

Section III, paragraph K of the Order of January 11, 1973, charges that registrant willfully violated and Shapiro willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that registrant sent to its customers a statement indicating the firm's net capital and its required net capital which had not been computed in accordance with Rule 15c3-1.

Section II, paragraph N, which was added by amending Order of November 21, 1973, charges that registrant willfully violated and Shapiro willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-11, by filing false and misleading Forms X-17a-11.

In view of findings previously made herein that registrant willfully violated and that Shapiro willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-5 and 17a-11 thereunder it appears that these charges are in effect repetitious and cumulative, and that further findings are unnecessary.

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the respondents who have been found to have committed certain violations as alleged in the Order.

The appropriate remedial action as to a particular respondent depends on the facts and circumstances applicable to him and cannot be measured precisely on the basis of action taken against other respondents,[28/] particularly where, as here, the action respecting others is based on offers of settlement which the Commission deemed appropriate to accept.[29/]

Review of the record in this matter discloses that the basic cause of the violations was the inattention to the proper running of a broker-dealer office from the standpoint of maintaining books and records accurately; computing net capital correctly; filing reports promptly and supervising personnel diligently. There was little attempt to comply with the securities laws and deal fairly with the public. On the contrary, the emphasis was on production and underwriting to produce the maximum income without regard to the fact that such activity outran the ability of back office personnel and procedures to keep the business under control.

28/ See Dlugash v. SEC, 373 F. 2d 107, 110 (CA 2 1967)

29/ See Benjamin Werner, 44 S.E.C. 745, 748 (1971)

Repeated warnings by certified public accountants and others were ignored in the interest of continually expanding production. The supervisory technique of imposing fines on salesmen for Regulation T and other violations did little to prevent such violations as illustrated by Christenson who testified that fines mean nothing when you are doing $12,000 a month in commissions.

On or about April 13, 1975, the Federal Court in Minneapolis issued a preliminary injunction, consented to by Registrant, enjoining Registrant from violating the net capital requirements under the Exchange Act.

Registrant was controlled and run by Shapiro who must bear the major blame for its collapse. His attitude is that what happened occurred despite him and that his reliance on others was totally reasonable under the circumstances -- given the size and complexity of the business.

Fredericks who has been in the securities business for 22 years and has no prior record of violations argues that he was only a director for 3 months and that during that time directors' meetings were not noticed or held. He, also, asserts that the events that contributed to Registrant's demise were all set in motion before he was a director and no fault or failure can be legally or morally assigned to him.

Christenson has previously been sanctioned by both this Commission and the State of Minnesota. In First Northwest Company, SEA Rel. 8992 (October 9, 1970), he was suspended from association for 15 days and from acting in a supervisory capacity for a period of 2 years. The Commissioner of Securities for Minnesota suspended his securities agent's license from May 23, 1972 until September 15, 1973. One of the violations found by the Commissioner was the effecting of transactions in the accounts of customers without their knowledge. (See page 26, supra).

Taking into account the gravity of the violations found herein; the length of time respondents have been in the securities business; the existence or absence of prior disciplinary sanctions against them; the mitigating factors applicable; the respective degrees of participation that each respondent had in the various violations; and the entire record, it is concluded that the sanctions ordered below are necessary and appropriate in the public interest.

ORDER

Accordingly, IT IS ORDERED:

(1) That the registration as a broker-dealer of J. Shapiro Co., is revoked and the company is expelled from membership in the National Association of Securities Dealers, Inc.

(2) That Jerome H. Shapiro and Otto D. Christenson are barred from association with a broker-dealer. 30/

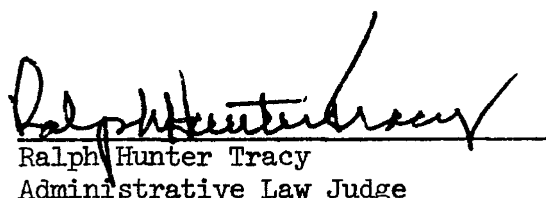
30/ It should be noted that a bar order does not preclude the person barred from making such application to the Commission in the future as may be warranted by the then-existing facts. Fink v. SEC (C.A. 1969), 417 F. 2d 1058, 1060; Vanasco v. SEC, (C.A. 2d,1968) F. 2d 349, 353.

(3) That George W. Fredericks is suspended from association with any broker-dealer for a period of six months.

(4) That these proceedings are hereby dismissed as to Edward D. Clapp, Herman J. Polisky and Stephen B. Goot.

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

Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen 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 decison shall not become final with respect to that party. 31/



Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.
September 26, 1975

31/ To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected.