ADMINISTRATIVE PROCEEDING
FILE NO. 3-5127

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

E. L. AARON & CO., INC., et al.

(8-9601) :

INITIAL DECISION

Washington, D.C.
October 7, 1977

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: George A. Schieren and Jonathan O. Lee of the New York Regional Office for the Division of Enforcement.

Charles J. Hecht and Bert Gusrae for respondent Peter Aaron.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission order (Order) dated November 29, 1976, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act), to determine whether Peter Aaron, among others,[1/] committed various charged violations of the Securities Act of 1933 (Securities Act) and the Exchange Act 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.

With respect to Peter Aaron the Order charges that during the period from November 1974 to September 1975, he willfully violated and/or wilfully aided and abetted violations of the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Act and the Exchange Act in connection with the offer and sale of the common stock of Lawn-A-Mat Chemical & Equipment Corp. (LAM).

The evidentiary hearing was held in New York, New York, at which Peter Aaron was the only witness. The other evidence in this proceeding consists of the record made during a four-day hearing in the U.S. District Court for the Southern District of New York in an injunctive action brought by the

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1/ The Commission has accepted offers of settlement from the following named respondents and has issued its findings and order imposing remedial sanctions: E.L. Aaron & Co., Inc., Edward L. Aaron, Norman Schreiber and Donald Jackson, Securities Exchange Act Release No. 13015/ November 29, 1976, Vol. 11 SEC Docket 1058.

SEC against Peter Aaron involving the same facts as alleged in this proceeding. The court record was received pursuant to stipulation between Aaron and the Division.[2/]

Peter Aaron was represented by counsel throughout these proceedings but no proposed findings of fact, conclusions of law or supporting briefs have been filed by him or on his behalf. The Division has filed proposed findings, conclusions of law and a supporting brief. The findings and conclusions herein are based on clear and convincing evidence as determined from the record and upon observation of the witness.[3/]

The findings herein are applicable only to Peter Aaron and are not binding on any of the other respondents named in the Order.

FINDINGS OF FACT AND LAW

Respondent

Peter Aaron, the remaining respondent in this proceeding, is the son of E. Aaron, the president and sole shareholder of Aaron & Co.[4/], and was employed at the firm for approximately 15

2/ On May 3, 1977, the Court found that Peter Aaron had violated the registration provisions and had aided and abetted violations of the anti-fraud provisions of the securities laws. The Court permanently enjoined Peter Aaron from any further violations of the securities laws.

3/ The Commission has traditionally employed the "preponderance of the evidence" standard of proof. However, in its recent decision in Collins Securities Corporation v. S.E.C., C.A.D.C., August 12, 1977, the Court held that, at least in cases involving alleged fraud and potentially severe sanctions, the higher "clear and convincing evidence" standard must be met. In the instant case, where there are no factual disputes of substance, the application of either standard yields the same results.

4/ Aaron & Co.'s registration as a broker-dealer was revoked by the Commission on November 29, 1976. Exchange Act Rel. No. 13015.

years. During the relevant period he was a registered representative, assistant to the president and the liaison between the operations department, the registered representatives and the trading room. He also maintained the due diligence files on all the securities in which Aaron & Co. made markets. In general, he functioned in a managerial and supervisory capacity over all the activities at Aaron & Co. In particular, he supervised the registered representatives and received and answered complaints about their activities.

Introduction

The allegations set forth in the Order involving Peter Aaron arose from his participating in and condoning of a scheme to defraud public investors which involved Aaron & Co. and two of its registered representatives who engaged in the issuance and distribution of the common stock of LAM.

LAM is a New York corporation engaged in the business of selling franchises and products for lawn care and its common stock has been registered with the Commission pursuant to Section 12(g) of the Exchange Act since March 1967 and is traded in the over-the-counter market. On January 23, 1976, LAM filed a petition in the U.S. District Court for the Eastern District of New York pursuant to Chapter Eleven of the Bankruptcy Act.

Section 5 Violations

The Order alleges that during the period from November

1974 to September 1975, Peter Aaron willfully violated and willfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act by offering to sell and selling common shares of Lawn-A-Mat Chemical & Equipment Corp. (LAM) when no registration statement was filed or in effect with respect to said securities.

During the period charged in the Order two representatives of Aaron & Co. were continuously soliciting customers for the purchase of LAM stock with the knowledge and consent of Peter Aaron. In November 1974 and January 1975, Peter Aaron and Norman Schreiber (Schreiber) one of the Aaron & Co. representatives, arranged for Daniel Dorfman (D. Dorfman) and Fred Dorfman (F. Dorfman), officers and directors of LAM to sell, without registration, a total of 21,000 shares of LAM common stock. This stock was purchased by Aaron & Co. through an intermediary, Weller & Co., a New Jersey broker-dealer, ostensibly acting as agent for the Dorfmans. In other words, Aaron & Co. arranged the sale of the Dorfmans' stock to Weller & Co. and then purchased the same shares from Weller & Co. In the case of Fred Dorfman's 20,000 shares Aaron & Co. purchased it in three blocks of 5,000, 5,000, and 10,000 shares from Weller & Co. These shares were later sold to the public from Aaron & Co.'s principal account. In these transactions Aaron & Co. was acting as a principal or dealer for its own account and not as an

agent or broker for a customer.

Respondent, Peter Aaron, relies on the exemption provided in Rule 144, which, in conjunction with Sections 4 and 2(11) of the Securities Act, permits the sale of certain unregistered securities, like the 21,000 shares sold by the Dorfmans, if the sale is made in accordance with all the conditions of the Rule.

Rule 144(f) provides:

> (f) Manner of Sale. The securities shall be sold in "brokers' transactions" within the meaning of Section 4(4) of the Act and the person selling the securities shall not (i) solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with such transactions or (ii) make any payment in connection with the offering or sale of the securities to any person other than the broker who executes the order to sell the securities.

Rule 144(g) provides:

> (g) Brokers' Transactions. The term "brokers' transactions" in Section 4(4) of the Act shall for the purposes of this rule be deemed to include transactions by a broker in which such broker --
>
> (1) does no more than execute the order or orders to sell the securities as agent for the person for whose account the securities are sold; and receives no more than the usual and customary broker's commission;
>
> (2) neither solicits nor arranges for the solicitation of customers' orders to buy the securities in anticipation of or in connection with the transaction; provided, [certain exceptions not relevant here]. . . .

Aaron & Co., through transactions in LAM stock arranged and approved by Peter Aaron, did not comply with Rule 144(f) and (g) for two reasons. First, Aaron & Co., in arranging for the Dorfmans' sale of LAM stock, acted as a principal for

its own account and never as a mere agent for the seller. Employees of Aaron & Co. solicited the Dorfmans' sales and, as a market-maker for LAM stock, purchased the stock for its own account. Accordingly, the sales were not "brokers' transactions" because Aaron & Co. was not acting "as agent" for the Rule 144 sellers as required by Rule 144(f) and (g)(1). Second, Aaron & Co. was soliciting customers' orders to buy LAM securities in connection with the Dorfmans' sales in violation of Rule 144(g)(2).

Aaron & Co. and Peter Aaron cannot avoid these requirements of Rule 144 by arranging for the sales of the Dorfmans' stock through an intermediary. Weller & Co.'s participation in the transactions was a sham to evade the intent of the Rule while feigning technical compliance. If Aaron & Co. had purchased the Dorfmans' stock from Weller & Co. or another broker-dealer in an open market interdealer transaction, Aaron & Co. would not have violated Rule 144. In this case, however, Weller & Co. was not acting "as agents" for the Dorfmans but only as an intermediary-agent for Aaron & Co. which arranged the whole transaction.

Peter Aaron's contention that he relied upon advice of counsel in arranging the Rule 144 transactions, is without basis in the evidence. Counsel for Aaron & Co. specifically stated that he never advised Peter Aaron

or anyone at Aaron & Co. to have Aaron & Co. arrange for Rule 144 stock to be sold to another broker-dealer with whom Aaron & Co. already had an arrangement to purchase the stock for subsequent sale to its own customers. Counsel only advised that in the sale of Rule 144 stock the seller be referred to several other brokers, and that Aaron & Co. could then buy those shares in an open market transaction. Peter Aaron, having not followed the advice of counsel, cannot rely on this defense to his violation of Sections 5(a) and (c) of the Securities Act.

Furthermore, the burden of establishing the availability of an exemption from the registration requirements of Section 5 of the Securities Act is on Peter Aaron, the one claiming the exemption[5/] and he has not met his burden. It is found that Peter Aaron willfully violated and willfully aided and abetted violations of Sections 5(a) and (c) of the Securities Act.

Anti-Fraud Provisions

The Order charges that during the period from November 1974 to September 1975, Peter Aaron willfully aided and abetted violations of Section 17(a) of the Securities Act and

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5/ SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953); SEC v. Culpepper, 270 F.2d 241, 246 (2d Cir. 1959).

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder[6/] in that Aaron & Co., through two of its registered representatives sold and effected transactions in the common stock of LAM by employing directly and indirectly devices, schemes and artifices to defraud and by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

As part of the aforesaid conduct and activities, two representatives of Aaron & Co. engaged in a continuous high-pressure sales campaign with respect to the common stock of LAM, based on material misrepresentations and omissions. Among other things the Aaron & Co. representatives told prospective investors that LAM's earnings were increasing; that LAM would shortly pay dividends; that LAM was involved in a program of acquisition and expansion; that LAM was planning to manufacture tractors and a new type of automobile; and that the price of the stock would increase dramatically.

As a matter of fact LAM was in poor financial condition and not able to engage in or even consider engaging in any of the above-mentioned projects.

6/ Section 10(b) as here pertinent makes its unlawful for any person to use or employ in connection with the purchase or sale of a security any manipulative device or contrivance in contravention of rules and regulations of the Commission prescribed thereunder. Rule 10b-5 defines manipulative or deceptive devices by making it unlawful for any person in such connection: "(1) to employ any device, scheme, or artifice to (cont'd.)

Peter Aaron was fully aware of the representations being made and of their falsity by LAM's corporate counsel, who on two occasions, complained to him about these misrepresentations and demanded that they be stopped. Moreover, Peter Aaron maintained a current due diligence file on LAM during this time which, among other things, contained copies of all public reports filed with the Commission. These public filings contained nothing which would even remotely support the statements being made by the Aaron & Co., representatives, as described above.

However, Peter Aaron made no serious effort to investigate the reported situation or to stop the misrepresentations, thereby assisting and condoning the continuing violations.

Consequently, Peter Aaron, although never an officer, director or shareholder of Aaron & Co., by virtue of his active participation in the management of the firm and his knowledge both of the firm's solicitation of LAM stock and the false and misleading statements being made by two representatives in connection with that solicitation, must be held responsible along with them for the fraudulent representations that were made. While Peter Aaron himself did not make any misrepresentations, by failing to stop the two representatives, he

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6/ (continued)
defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . ." Section 17(a) contains analogous provisions.

willfully aided and abetted their violations of the anti-fraud provisions of the securities laws.[7/]

Wilfullness

The findings herein that Peter Aaron violated the Securities Act and the Exchange Act have been found to have been willful.[8/] During the course of the proceeding respondent's counsel contended, relying on Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), that any violations found to exist must be based on scienter. However, in In the Matter of Steadman Security Corporation, Securities Exchange Act Release No. 13695/June 29, 1977, the Commission held that the scienter requirements of Hochfelder were inapplicable to administrative proceedings initiated by the Commission.

However, even if scienter were required the fact that Peter Aaron acted with knowledge or reckless disregard of the illegality of the arrangement with the Dorfmans and Weller & Co., and intentionally failed to terminate the false and misleading statements of the two representatives, knowing them to be fraudulent, is sufficient to establish his scienter under the securities laws.[9/] Therefore, Peter Aaron's conduct under either a willful or a scienter theory of liability

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7/ Gross v. SEC, 418 F.2d 103, 106 (2d Cir. 1969); SEC v. Galaxy Foods, 417 F. Supp. 1225, 46, 47 (E.D. N.Y. 1976).

8/ It is well established that a finding of wilfullness 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. 641, 649 (1967); Biesel, Way & Company, 40 S.E.C. 532 (1961). Hughes v. S.E.C., 174 F.2d 969, 977 (C.A.D.C. 1949).

9/ SEC v. Universal Major Industries, 546 F.2d 1044, 1046-47 (2d Cir. 1976).

violated and aided and abetted violations of the securities laws.

Public Interest

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,[10/] particularly where, as here, the action respecting others is based on offers of settlement which the Commission deemed appropriate to accept.[11/]

The violations found herein were serious and cannot be excused by lack of knowledge or understanding of pertinent requirements, particularly on the part of a registered representative who exercised supervisory authority. Also, the finding of the court in the injunctive action cannot be ignored. As the Commission has stated: ".. . in determining the public interest question we may appropriately look to the nature of the acts enjoined and the basis on which the injunction was entered by the court."[12/]

Upon careful consideration of the record it is concluded

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

11/ See Benjamin Werner, Exchange Act Release No. 9422/December 17, 1971. Cortland Investing Corporation, Exchange Act Release No. 9422/August 29, 1969.

12/ Frank Payson Todd, 40 SEC 303, 306 (1960). See also, Kimball Securities Inc., 39 SEC 921 (1960); Balbrook Securities Corp., 42 SEC 496 (1965); Kaye, Real & Co., Inc., 36 SEC 373 (1955); Gibbs & Co., 40 SEC 963 (1962).

that the public interest requires that Peter Aaron not be permitted to associate with any broker-dealer in a principal or supervisory capacity. It appears appropriate, however, to give consideration to allowing him a non-supervisory position with a broker-dealer after a period of twelve months.

ORDER

Accordingly, IT IS ORDERED that Peter Aaron is barred from association with a broker-dealer, except that after a period of twelve months from the effective date of this order, he may become associated with a registered broker-dealer in a non-supervisory capacity 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 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 decision shall not become final with respect to that party. 13/

Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.
October 7, 1977

13/ 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.