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ADMINISTRATIVE PROCEEDING
FILE NO. 3-1543

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
SAMUEL B. FRANKLIN & COMPANY, INC. SAMUEL B. FRANKLIN RICHARD J. FRANKLIN JACK J. APPLE BRUCE D. LIVINGSTON DELMAR GLADSTONE	:
(8-11825)	:
	:

INITIAL DECISION

Washington, D.C.
June 4, 1970

Samuel Binder
Hearing Examiner

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DELMAR GLADSTONE	
(8-11825)	

APPEARANCES: Arthur W. Fred, Arthur F. Matthews, Burton H. Finkelstein, Howard Jacobs, Joseph M. Berl, and Richard H. Sheehan, Attorneys for the Division of Trading and Markets, Securities and Exchange Commission.

Donald C. Smaltz and Felix Grossman, Esqs. of Grossman, Smaltz, Gravey & Perry, Suite 2320 One Wilshire Blvd., Los Angeles, California 90017 and Arnold L. Kupitz, Esq., 408 South Spring Street, Los Angeles, California, for the Respondents, except Bruce D. Livingston.

Bruce D. Livingston, pro se, 8386 Blockburn, Los Angeles, California.

BEFORE: Samuel Binder, Hearing Examiner

These public proceedings were instituted by the Commission on April 15, 1968 pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether allegations made by the Division of Trading and Markets ("Division) charging respondents with violations of the Exchange Act and of the Securities Act of 1933 ("Securities Act") were true and, if so, what if any remedial action would be appropriate in the public interest. The Division, among other things, alleged that during the period between May 27, 1963 and about March 16, 1964 the respondent Samuel B. Franklin & Company, Inc. ("registrant"), Samuel B. Franklin ("Franklin") and Richard J. Franklin ("RJF"), acting singly and in concert, wilfully violated Sections 5(a) and (c) of the Securities Act in the sale of unregistered stock of Kramer-American Corporation ("KAC"); and that such respondents during the same period similarly violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder while effecting a distribution of such KAC shares. The Division also charged that between on or about July 1, 1965 and the date of the Commission's order all the respondents including the registrant, Franklin, RJF, Jack J. Apple, ("Apple"), Bruce D. Livingston ("Livingston") and Delmar Gladstone ("Gladstone"), singly and in concert, wilfully violated and wilfully aided and abetted violations of the anti-fraud provisions of the Acts (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 of the Exchange Act) in connection with the offer, sale, and purchase of specifically named securities, and otherwise.[1/]

1/ The Division subsequently informed respondents that the period of time in which they claimed that these alleged violations occurred was narrowed to the time between July 1965 to April 1967. See Hearing Examiner's order page 4, dated May 24, 1968.

The principal questions raised in this proceeding were the following:

1. Did the respondents Samuel B. Franklin & Company, Inc., Samuel B. Franklin, and Richard J. Franklin violate Sections 5(a) and 5(c) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in the sale and distribution of Kramer-American Corporation ("KAC") stock? In this connection it is also necessary to determine whether the respondents received immunity from suit by the SEC in this administrative proceeding and whether SEC was equitably estopped from bringing this proceeding insofar as it related to the alleged sale and distribution of KAC stock by reason of oral assurances allegedly made by a Commission staff lawyer to counsel for the respondents in connection with the taking of the deposition of Samuel B. Franklin on January 6, 1965 in an injunctive proceeding, in which Franklin was not a party, instituted in the Federal District Court in Los Angeles entitled SEC v. Kramer-American Corp., et al. Civil Action No. 64-463-PH.

2. Did the respondents violate the anti-fraud provisions of the Securities Acts between July 1, 1965 and the date of the Commission's order herein in the making of false and misleading statements to members of the investing public particularly in the sale and purchase of the stock of Continental Food Markets of California, Inc. (formerly Piggly Wiggly of California, Inc.)

("CFM"), Landsverk Electrometer ("LVK") Inc., and Squire for Men, Inc. ("Squire")[2/] and did the respondents during this period otherwise engage in violations of the anti-fraud provisions of the Securities Acts in the offer and sale of other over-the-counter securities to the investing public ?

3. Did the respondents engage in excessive mark-ups and mark-downs from approximately July 1, 1965 about April 1967 with regard to 13 named securities, i.e. the stock of American Tin, California Girl, Chemical Milling, Construction Design, Continental Food Markets of California Inc. (formerly Piggly Wiggly of California), Controlled Products, Device Seals, Nova Tech, Ideal Brushes, Landsverk, Squire for Men, Sunset Industries, and Tobach?[3/]

All the respondents filed answers denying generally the allegations made against them by the Division.

All parties were represented by counsel and participated in the formal hearing held in these proceedings.

2/ See Paragraph D(7) of the Commission's order herein (Administrative Proceeding No. 3-1513) issued herein on April 1968.

3/ The Commission's order had alleged that such violations had occurred from on or about July 1, 1965 to the date of the order, i.e. April 15, 1968, but prior to the commencement of the hearing herein the Division narrowed the period in which it was charging the respondents with such violations to the period between on or about July 1, 1965 and April, 1967.

Proposed Findings of Fact and Conclusions of Law and an initial supporting brief were filed on behalf of the Division, and Proposed Findings of Fact and Conclusions of Law and a supporting brief were filed on behalf of all respondents, except Bruce D. Livingston. Livingston filed a letter dated July 2, 1969, stating that he was no longer represented by counsel but that he wished to substitute himself in propria persona and wished to have the proposed findings of fact, conclusions of law and brief filed by and on behalf of the other respondents be considered in all respects by the Hearing Examiner and the Commission on his behalf. The Division filed a reply brief.

Oral argument was held at respondents' request on October 1, 1969 in Washington, D.C.

The Findings, Conclusions and Initial Decision made herein are based on the entire record including the Proposed Findings, Conclusions and briefs filed by all parties, the pleadings, stipulations, all orders issued herein, the oral argument held herein, and upon careful observation of all witnesses at the hearing.

Registrant, a California corporation, is a broker-dealer, which has been registered with the Commission since February 1, 1964 and is a member of the National Association of Securities Dealers, Inc. ("NASD"). On January 1, 1964, the corporate registrant succeeded to the business of Samuel B. Franklin, a sole proprietor, d/b/a Samuel B. Franklin & Co., a broker-dealer registered as such

with the Commission. Franklin's broker-dealer registration as a sole proprietor was withdrawn on March 23, 1964.

Franklin is president, treasurer, a director and owner of more than 50% of the outstanding stock of registrant. RJF became Franklin's trader in or about 1961-2, continuing in that capacity until registrant corporation was formed and in January 1964 became registrant's trader and has functioned as such at all times pertinent to these proceedings. Apple and Gladstone are and have been salesmen for registrant since 1957 and 1959 respectively; and Livingston was a salesman for registrant from on or about July 1, 1965 to December 3, 1967.

While engaged in the transactions alleged in the Order, respondents made use of the mails and means and instrumentalities of transportation and communication in interstate commerce. Such transactions were effected by the respondents otherwise than on a national securities exchange (as principal in direct sales and purchases).

The Violations of Section 5 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-6 Adopted Thereunder

In July, 1960 KAC made a public offering of 150,000 shares of its capital stock to the public under a claimed exemption from registration pursuant to Regulation A adopted under Section 3(b) of the Securities Act. The issue was underwritten by Raymond C. Moore & Company and the sale of such shares of stock was completed about August 2, 1960.

One hundred fifty thousand options covering 150,000 additional shares of KAC stock not covered by the Regulation A filing or a registration statement were issued to Vern Coggle ("Coggle ") (60,000 options), Raymond C. Moore ("Moore") (40,000 options") and the balance to others for promotional services. No filing was made with the Commission claiming an exemption from registration for the KAC stock subject to options. KAC stock issued upon the exercise of the outstanding options was not registered nor was there any exemption from registration available for such stock under the Securities Act.[4/]

Franklin knew that Coggle was an organizer, the president and a director of KAC in 1963 - 1964, the holder of large blocks of KAC stock and a controlling person of KAC.[5/] From June 10, 1963 to October 31, 1963 Samuel B. Franklin d/b/a Samuel B. Franklin & Co. in eight transactions as a principal purchased 16,600 shares of KAC stock from Coggle.[6/] All of these shares were issued under Coggle's KAC stock options.

Franklin bought KAC stock from Coggle for purposes of sale and distribution and traded such shares, made a market in such shares, and quoted the stock in the National Daily Quotation Sheets.

4/ The claimant of an exemption from the registration requirements under the Securities Act has the burden of proving entitlement to such exemption. SEC v. Ralston Purina, 346 U.S. 119 (1953). No such exemption is claimed here.

5/ Rule 405 under the Securities Act, Cf. U.S. v. Re 336 F.2d 306 (C.A. 2, 1964), cert. den. 379 U.S. 904.

6/ Certain KAC shares were purchased and distributed by Samuel B. Franklin d/b/a Samuel B. Franklin and Co. and additional shares were purchased and distributed by the registrant corporation which succeeded to Samuel B. Franklin's broker-dealer business and the latter purchases and distributions will be considered hereinafter.

These shares were sold by Franklin to the public in both retail and wholesale transactions.

On June 7, 1963 Franklin as principal (then operating as a sole proprietor) bought 1,000 shares of KAC stock from RJF. RJF had received these shares directly from Coggle after their issuance under Coggle's KAC options. These shares were also directly distributed by Franklin in sales made to the public. RJF was Franklin's trader during this period of time and received a percentage of the money made in the trading of such stock. Franklin was making a market in KAC stock at that time. All of the stock delivered to and received by Franklin in his transactions with Coggle and RJF and subsequently distributed were shares of KAC stock issued under the KAC options and were unregistered.

It is clear that Franklin and RJF acquired the stock or options from a controlling person of the issuer, KAC, with a view to effecting a public distribution and accordingly both Franklin and RJF were underwriters within the meaning of Section 2(11) of the Securities Act and that Franklin and RJF participated in such distribution.

All of the stock delivered to and received by Franklin in his transactions with Coggle and RJF and subsequently distributed were shares of stock delivered under the KAC options.

According to Franklin, Coggle had told him verbally and later by letter that the KAC shares issued upon the exercise of options

were "free trading" securities and that Franklin, RJF and subsequently the corporate registrant relied upon such alleged statements. Such alleged reliance did not relieve them of their responsibility to investigate the facts as to any claimed exemption from registration or of their burden to establish the availability of an exemption from registration. 7/

Franklin's claim of reliance on Coggle's representation that KAC stock was "free trading" was made in the following context. Franklin first bought a block of 1600 shares of KAC stock on June 10, 1963 and claimed that at the time of the transaction he asked Coggle for a letter to the effect that the shares were "free trading" for his files. Coggle did not send him such a letter in June when Franklin first requested it. However, on October 14, 1963 Franklin made a further purchase of 2000 KAC shares from Coggle following prior purchases totaling 12,600 shares in a number of transactions, and on the following day, October 15,1963 he got a letter from Coggle stating that the shares were "free trading".

Despite Coggle's representation to Franklin that he could sell KAC stock without registration,it strains credulity to believe that a man of Franklin's long experience and sophistication in the securities business was unaware that he was violating the registration provisions of the Securities Act in selling and distributing KAC stock.

7/ See, for example, In the Matter of Assurance Investment Company, 34-7862 (April 15, 1966).

Franklin's claim of reliance on Coggle's statement that KAC stock was "free trading", is without merit as a defense to the overwhelming evidence presented here that the KAC stock which he sold was unregistered and was sold in violation of Section 5 of the Securities Act and distributed in violation of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder thereof. In view of Franklin's experience of over 40 years as a broker-dealer his entire course of conduct and his transactions with Coggle reflected a complete disregard of the normal care required of brokers and dealers to avoid violations of the registration provisions of the Securities Act. Nor is it reasonable to assume that RJF who was Franklin's trader and his son was not under an obligation to make reasonable inquiry concerning the status of the securities he was quoting and trading insofar as the provisions of the Securities Act is concerned.

Franklin knew that Coggle was a controlling person of KAC, knew the status of KAC, knew KAC's attorney, Ralph Frank , an attorney experienced in SEC matters who also had represented Franklin in the past, and knew Moore, a former employee of his who had left his employ to underwrite the original public offering of KAC stock and who was the source of a substantial block of KAC options then held by Franklin and Franklin also knew that Moore was secretary and a director of KAC. It would be unreasonable to assume that RJF was not aware of these facts.

Even if it were assumed that Franklin was not fully aware of the registration provisions of the Securities Act his failure to make any independent inquiry of the Commission or of any other person or agency concerning the status of KAC stock for purposes of public sale and distribution reflected his complete disregard of his duty as a broker-dealer.

Franklin was an underwriter with respect to the unregistered KAC shares purchased as a principal from Coggle since the latter was a controlling person of KAC and Franklin had purchased for purposes of public offering and distribution. Accordingly, in the offer and sale of unregistered stock of KAC, Franklin and RJF wilfully violated Sections 5(a) and 5(c) of the Securities Act and in the distribution of such shares they violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder. 8/

8/ In a substantially indentical situation, in Assurance Investment Company, 34-7862 the Commission held: "*** Pelton had acquired those and additional shares or options to purchase such shares, from Vern Coggle, president of K-A, and another officer of K-A, in consideration of services rendered to the company. Those officers had received options from K-A and had obtained their shares through the exercise of such options. It is clear that Pelton acquired the stock or options from controlling persons of the issuer with a view to effecting a public distribution and accordingly was an underwriter within the meaning of Section 2(11) of the Securities Act, and that registrant participated in such distribution. Coggle's assurances that the shares were free for trading, upon which respondents allegedly relied, did not relieve them or their responsibility to investigate the facts or of their burden to establish the availability of an exemption from registration." See also Securities Act Release No. 4445. It is insufficient for a broker-dealer merely to accept self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts and calling further for "searching inquiry" in doubtful situations."

On January 28, 1964 registrant (i.e. the corporation) as a principal bought 4,000 shares of KAC stock through Coggle. The KAC shares received in this transaction were shares issued under KAC options and were unregistered. The registrant offered and publicly distributed these shares as a principal.

Moore, a former employee of Franklin's prior to 1960 when he left Franklin's employ became a registered broker-dealer and opened his own securities firm. Subsequently, Moore became an underwriter of a Regulation A offering of KAC stock. KAC issued options for 40,000 shares to Moore for promotional services. Since Moore had begun his negotiations with KAC while still in Franklin's employ he gave Franklin 5,000 of his KAC options. In addition in 1962, in partial settlement of a legal action brought by Franklin against Moore for money owed, Moore gave Franklin options for an additional 24,000 shares of KAC stock. Franklin in this manner acquired options for a total of 29,000 shares.

From January 22, 1964 to March 18, 1964 registrant purchased 29,000 KAC shares directly from KAC in six transactions all through the exercise of the options previously obtained by Franklin through Moore. This stock was purchased by registrant as a principal, for purposes of distribution. Such distribution was made by the registrant as principal in both retail and wholesale sales.

In the public distribution of unregistered KAC shares, obtained through both Coggle and Moore registrant was a statutory underwriter, and registrant, Franklin, and RJF (as principal officers) violated the provisions of Sections 5(a) and 5(c) of the Securities Act and Section 10(b) and Rule 10b-6 of the Exchange Act.

The respondents claimed that the Division is estopped from proceeding against the respondents because of assurances made to Franklin that if he cooperated in another proceeding involving KAC, no action would be taken against him.

The material facts upon which the respondents' claim is predicated are as follows:

Samuel B. Franklin was served with a subpoena duces tecum requiring his appearance at the Commission's Los Angeles Branch Office on January 6, 1965. The Los Angeles Branch office served the subpoena for the purpose of taking Franklin's deposition in an injunctive action, SEC v. Kramer-American Corp., et al. brought in the Federal District Court in Los Angeles to enjoin further violations by KAC and seven other defendants of Section 5 of the Securities Act in the sale of KAC stock to the public. Civil Action No. 64-463-PH.

Prior to Samuel B. Franklin's appearance at the Commission's Los Angeles Branch Office on January 6, 1965 John Joseph Kennedy, a lawyer formerly in the employ of the Commission and attached at that time to the Los Angeles Branch Office received a telephone call from Arnold L. Kupetz ("Kupetz").

Kupetz is Franklin's son-in-law, RJF's brother-in-law, was the attorney of record in filing the registrant's broker-dealer registration, is one of the attorney's of record in this proceeding, one of registrant's directors and an officer of the corporate registrant since its inception.

During his telephone conversation Kupetz told Kennedy that he represented Franklin and wanted to know what the matter, on which Franklin had been subpoenaed, concerned.

Kupetz testified, in pertinent part, that Kennedy had told him that an investigation was being conducted with regard to "improper transfers and sales of Kramer-American stock, something about stock, sales of unregistered stock, and there were proceedings pending against certain individuals and certain broker-dealers."

Kupetz further testified that when he asked Kennedy whether Franklin or Samuel B. Franklin & Co. were respondents or were involved, Kennedy replied in the negative; that he was calling Franklin as a witness; and that there were no charges pending against Mr. Franklin or to be taken against Mr. Franklin.

On cross-examination, when Kupetz was asked whether Kennedy had told him that no action would ever be taken against Kennedy, in the context of Kramer-American, he replied that Kennedy did not use those words. Kupetz' testimony was that "Mr. Kennedy stated that 'no action would be taken'". Further, Kupetz testified that "Now he didn't say in an 'administrative proceeding',or 'criminal proceeding'. He did tell me that there were pending at the time

administrative proceedings against other broker-dealers and other individuals and that is basically what we were talking about at that time."

"Now I have no recollection of him saying that 'no action would be taken in administrative proceedings, or 'no action would be taken in other proceedings'. He just said 'no action would be taken.'"

When Kupetz was asked whether the immediate action in which Franklin was being called as a witness was an injunctive action Kupetz testified that he did not know. In fact, the matter in which Franklin's deposition was to be taken was not an administrative proceeding against broker-dealers and other individuals but was an injunctive action in the United States District Court.

Franklin appeared on January 6, 1965 and was not represented by Kupetz but was represented by Ralph R. Frank ("Frank"), an attorney with substantial experience in SEC matters.[9/] Frank was the attorney for Kramer-American and had represented Franklin in other SEC matters.

Kennedy testified in the instant proceeding that he had formerly been employed as a staff attorney in the Los Angeles Branch Office. At the time of Kennedy's testimony in the instant case he was engaged in private practice. However, during the time he was employed in the SEC Los Angeles Branch Office he had been assigned to the Kramer-American matter. In the latter connection, the Commission had

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9/ Kupetz testified that he was not experienced in SEC matters.

instituted an action in the United States District Court for the Southern District of California, Central Division, in which the Commission sought an injunction against certain defendants for the alleged violation of Section 5 of the Securities Act in the offer and sale of the common stock of Kramer-American Corporation. The action was entitled Securities and Exchange Commission, Plaintiff against Kramer-American Corp., a California Corporation, Vern Coggle, as an officer of the corporation and individually, Raymond C. Moore, as an officer of the corporation and individually; Diversified Securities Corporation, a California corporation, Leon Kimel, as an officer of the corporation and individually, Donald A. Forsblade, as an officer of the corporation and individually, Assurance Investment Company, a partnership, Harold M. Pelton, as managing partner and individually; and Patrick Clements, Defendants. Civil Action No. 64-463-PH.

Kennedy recalled that Kupetz had telephoned him about the Franklin deposition shortly before the taking of the latter's deposition on January 6, 1965; and that Kupetz had asked him what the matter concerned. Kennedy told Kupetz that the Commission had a civil action pending in the U.S. District Court and he told Kupetz who the defendants were and that he had subpoenaed Franklin to take his deposition.

Kupetz asked Kennedy whether the Commission intended to make Franklin a defendant in the Commission's injunctive action. Kennedy

told Kupetz that these were only two defendants remaining, and "that at that stage of the proceeding I did not believe we were going to amend the complaint to add Franklin as a defendant."

Kennedy remembered that the conversation was rather short. It was his recollection that the "conversation was entirely limited to the civil suit that was pending in the U.S. District Court," and he was "certain that we didn't discuss any other type of action, any administrative action or any criminal type of action that the Commission could have taken."

In addition, Kennedy testified that he had read Kupetz' testimony. In this connection Kennedy testified that "Kupetz' references to his conversation with [him] concerning future action and recommendations on [his] part concerning future action" were incorrect. In addition, Kennedy testified that shortly after the Commission issued its order in the instant case and it was reported in the press Kupetz called and told him that he was attempting to find a firm of lawyers to represent Franklin and in that conversation Kupetz never mentioned any prior conversation which Kupetz had had with him. The conversation was limited to the charges contained in the Commission's order in this proceeding and the choice of a law firm to represent Franklin in this case.

Finally, Kupetz called Kennedy on a subsequent Sunday evening but there was no discussion of any kind in this conversation concerning any prior conversations that they had had.

The hearing examiner credits the testimony of Kennedy.

The hearing examiner finds and concludes that Kennedy, other than stating that he did not believe that the Commission was going to amend the complaint in the injunctive action to add Franklin as a defendant, never made any representations to Kupetz as to any future action which might be taken by the Commission with regard to Franklin and never had any discussion with Kupetz concerning any recommendations to the Commission concerning any future action which might be taken with regard to Franklin.

When Franklin appeared on January 6, 1965 in response to the subpoena served upon him he was not represented by Kupetz but was represented by Ralph R. Frank ("Frank"), who was counsel for Kramer-American and was experienced in SEC proceedings.

Frank testified that he had a conversation with Kennedy in the hallway just outside the room where Franklin's deposition was to be taken. According to Frank this conversation took place before Franklin gave his deposition. Frank testified that he told Kennedy that he had some knowledge that Franklin had engaged in transactions in KAC stock but that at all times he [i.e. Frank] had to be conscious of [his] ability to protect Franklin's license as a broker-dealer.[10/] In this connection, Frank testified that he

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10/ Franklin's individual registration as a broker-dealer had been withdrawn prior to the time of the deposition. The registrant at the time of the deposition was Samuel B. Franklin & Co., Inc. a corporation which had succeeded to the business of Samuel B. Franklin d/b/a Samuel B. Franklin & Company.

"discussed directly with Mr. Kennedy the fact that Mr. Franklin should not testify in any regard to this transaction if in any way it jeopardizes his ability to continue as a broker-dealer."

According to Frank, Kennedy told him ". . . that there was absolutely nothing pending at that time relating to Mr. Franklin or his broker-dealer registration; that [Frank] should be assured the hearing in no way had anything to do with Mr. Franklin or his license; that he fully understood the fact that Mr. Franklin would not want to be testifying to any matter that would jeopardize Mr. Franklin or his license in the future." Frank also testified that he advised Kennedy that he "would suggest to Mr. Franklin, as his attorney, he utilize the Fifth Amendment and not testify in any regard relating to the matters beforehand, if he had any jeopardy of his license or there was any investigation pending at that time."

Frank also testified that "Mr. Kennedy at that time or immediately thereafter said: "Well, I will put it on the record if you like." He further testified that, "It was my recollection that it was put on the record that there was nothing pending against Mr. Franklin or his firm."

Frank further testified that he did not want Mr. Franklin testifying against himself. He also testified that Kennedy had stated ". . . that he was conscious of the fact that Mr. Franklin should not be testifying against himself, and that he would not be testifying against himself because there was nothing at all pending against Mr. Franklin."

Frank testified further that Kennedy went away for a few minutes and that Kennedy came back and said, "I will put it on the record that there is nothing pending against him; that we simply want his testimony as a witness because we feel he knows a great many of the facts, and I will put it on the record that we have nothing against him and he will not be testifying in any way against himself nor jeopardizing his broker-dealer license."

According to Frank the conversation probably took ten to twenty minutes, and there might well have been one or more members of the SEC staff present at various times but he did not recall who they were.

Franklin's deposition which was taken for the federal district court proceeding was offered in evidence by respondents and was received in evidence.

Frank testified that it was his "recollection a month or so ago when [he] was first contacted by Mr. Smaltz [counsel for respondents] something was put on the record relating to the fact that Mr. Franklin was testifying with the understanding there was no investigation pending against him, or if there was, he would be advised to take the Fifth Amendment."

A reading of the deposition shows that the statement which Frank testified that he told Smaltz was in the record does not appear therein. Nor does the deposition contain any other language even remotely resembling or supportive of Frank's recollection that "something was put on the record relating to the fact that

Mr. Franklin was testifying with the understanding there was no investigation pending against him, or if there was, he would be advised to take the Fifth Amendment."

Further, the deposition does not contain any statement which Frank testified Kennedy volunteered to make saying he would ". . . put it on the record that there is nothing pending against [Franklin] and [Franklin] will not be testifying in any way against himself nor jeopardizing his broker-dealer license."

Earlier in his testimony Frank had adverted to this same alleged conversation to the effect that Kennedy had said he would put this statement on the record "if you [i.e. Frank] like", and Frank then testified "It was my recollection that it was put on the record that there was nothing pending against Mr. Franklin or his firm."

Such a statement, which according to Frank, Kennedy voluntarily offered to make, would have been helpful to Franklin and in view of Kennedy's alleged sympathy for Franklin's position there would not appear to have been any impediment to the placing of such a statement in the record had Kennedy actually made the offer attributed to him. Certainly in view of Kennedy's alleged voluntary offer there would be no reasonable basis for concluding that respondents would have objected to the record containing such statement, nor would there have been any reasonable basis for concluding that Frank would not have reminded Kennedy of his alleged statement during the taking of Franklin's deposition.

The fact is that in every pertinent part Frank was incorrect in his recollection as to the contents of the deposition.

Frank was informed by counsel for the respondents a month before he testified in the instant proceeding that his recollection of the contents of Franklin's deposition was not borne out by a reading of such document. 11/

At the hearing in this proceeding Frank testified that "then if it isn't on the record then I would have taken Mr. Kennedy's word, which I would always take to the effect that there is nothing pending." Later in his testimony Frank testified, "But, as I now reflect on it, and I am advised it is not on the record, then I am inclined to say I probably said to Mr. Kennedy "I will take your word for it. If you tell me there is nothing pending I have complete faith in you, and I will tell him to testify, and he has no problems."

Frank's recollection of the content of Franklin's deposition is admittedly incorrect. In reality, Frank's testimony insofar as material to respondents claims does not appear to be recollection but merely a statement of what he was inclined to say was "probable" in light of the fact that he was wrong in his recollection of what Franklin's deposition actually contained.

Frank does not claim that Kennedy asked him to take his word for anything. In these circumstances there would appear to be no rational basis for assuming that Kennedy had made such a request

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11/ Frank testified on September 10, 1968. Frank's discussion with respondents' counsel prior to his appearance on the witness stand as to his initial recollection of the content of the deposition taken in January 1965 therefore appear to have been had in August, 1968.

or had suggested that Frank accept his word for such an important statement rather than having the record reflect such statement.

According to Frank's testimony Kennedy voluntarily offered to make such statement for the record. Being very favorable to Franklin, it would appear certain that if Kennedy had voluntarily offered to make such statement there would be no reason for Frank to have rejected such offer and every reason for such statement if made to appear in the record. Furthermore, according to Frank, Kennedy fully understood his position that Franklin should assert his privilege under the Fifth Amendment and Kennedy does not appear, in Frank's version of events attending the deposition, to have said anything to him which would have prevented him from having Franklin take such position if he had wished to do so. In fact, the indications from Frank's testimony are that if Franklin wanted to assert his rights and privileges under the Fifth Amendment, Kennedy would have been very understanding of Franklin's constitutional rights and privileges under the Fifth Amendment. In any event Kennedy, could not have raised any objection to the assertion by respondents of their constitutional privileges.

Kennedy's testimony is in direct contradiction of Frank's testimony.

Kennedy testified on cross-examination that his clear recollection was that he did not confer with Frank prior to the time Franklin testified, that Franklin's deposition was taken in his [Kennedy's] office and Frank and Franklin "came into [Kennedy's] office and sat down but we didn't have any lengthy discussion prior to the deposition."

Kennedy's testimony is clear, unequivocal, and is fully credited. Frank's testimony is not credited.

There is no reasonable basis for concluding that Franklin or any of the respondents obtained immunity or that any estoppel was created by statements made by Kennedy to respondents' counsel and such claims are rejected. 12/

12/ "The need for an explicit claim of privilege as a prerequisite to grant of immunity is especially great when the testimonial disclosure is made before an administrative officer having the auxiliary power to subpoena witnesses and to obtain judicial aid to enforce his testimonial powers -- and particularly where the administrative officer makes a general demand for documents or testimony upon a broad class of topics. The reason is clear. The officer has testimonial powers to extract a general mass of facts, of which some, many or most will certainly be innocent and unprivileged, some may be privileged communications (e.g., between attorney and client) whose privilege remains unaffected by the statute defining his powers, and some may be privileged as self-incriminating but liable to become demandable by overriding his privilege with a grant of immunity. Among this mass of facts, then, the officer will seek those which are relevant to his administrative inquiry. He cannot know which of them fall within one or another privilege, in particular, which of them tend to incriminate at all, or to incriminate a particular person. If such facts are there, he may not desire or be authorized to exercise the option of granting immunity so as to obtain them. His primary function and power is to obtain the relevant facts at large, and his power to obtain a special and limited class of facts by grant of immunity is only a secondary one, and one which he will not exercise till a cause arises, if even then. So here, it is especially necessary that the claim of the particular privilege against self-incrimination should be explicitly put forward by the witness to segregate and mark the specific facts which he knows or believes to have that quality. Then, and then only, is the officer placed in a position where he can consciously exercise the option which the immunity statute gives him. This option he can certainly not be deemed to exercise unwittingly and in gross by the mere circumstance of pursuing his normal course of duty and power for relevant facts at large.

It follows that testimony given actually by deliberate choice under only the appearance of compulsion, either by imposing upon the judge's inadvertence, or by collision with opposing counsel can of course not earn immunity. It is to defeat such collusive attempts to obtain immunity that the witness' plain expression of the claim of privilege should, on practical grounds, be insisted upon.

(continued on following page)

Respondent's failure at any time to assert his constitutional privilege leaves him in no position to complain now that he was compelled to give testimony against himself. Cf. United States, Petitioner v. Kordel and Feldsten 38 U.S. Law Week 4153, 4155 (February 24, 1970).

Violations of the Anti-Fraud Provisions Under the Securities Acts

The Division charged that the respondents as principals had induced customers to purchase and had offered to sell to customers securities at prices which were excessive and unreasonable; and as principals had induced customers to sell and had offered to buy from customers securities at prices which were inadequate and unreasonable. The alleged excessive mark-ups and mark-downs engaged in by respondents related to 13 specifically named securities, i.e. the common stocks of Continental Food Markets of California, Inc., formerly Piggly Wiggly of California, Inc. ("CFM" or "PW"), Landsverk Electrometer, Inc. ("LVK"), Squire for Men ("Squire"), American Tin, California Girl, Chemical Milling, Construction Design, Controlled Products, Device Seals, Ideal Brushes, Sunset Industries, Tabach and Nova Tech.[13/]

The registrant placed quotations at specific bid and asked prices regularly during the period at issue covering these securities

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12/ continued from preceding page
It also follows that the statute granting immunity is applicable ordinarily, to witnesses called by the prosecution only. Otherwise, collusion with a defendant would enable an offender to secure immunity by his own contrivance in being called as a witness." [Footnote omitted] Wigmore on Evidence, Vol. VIII, §2282 pp. 517 et seq.

13/ Prior to the commencement of the hearing the Division advised respondents that it was limiting itself to transactions involving the 13 securities and reduced the time period at issue to that of from on or about July 1, 1965 to April, 1967.

in the National Daily Quotation Service's Pacific Coast "white sheets". With the exception of Nova Tech there was no competitive market in any of these securities and in 12 of the 13 securities, the registrant was the sole or dominant market maker. In all such securities the registrant fixed the quoted market prices at a high level over its contemporaneous costs to enable it to retail such securities at unconscionable profits.

During the periods in which registrant was quoting these securities in the white sheets, registrant through its salesmen was engaged in an aggressive campaign to sell these securities to the investing public. This campaign was conducted by registrant's salesmen almost entirely through telephone calls made to persons unknown to them for the purpose of offering them the securities being quoted by registrant in the white sheets. In this connection it was the frequent practice for registrant and its salesmen to induce customers who did not have the funds to buy those securities to sell other securities they held to obtain the funds to buy securities offered by registrant. It is observed that registrants' salesmen received remuneration only where they sold over-the-counter securities to customers but received no compensation where the customers sold securities to the registrant. 14/

The order alleged that all such securities were sold by the registrant and its salesmen through fraudulent means. In addition

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14/ The Division did not allege that respondents violated the anti-fraud provisions by engaging in "switching". These facts are alluded to in order that the circumstances in which the transactions took place could be clearly understood.

to the allegedly fraudulent character of the violations relating to excessive and unreasonable prices charged customers by the respondents the Division charged that the respondents made numerous false and misleading representations to customers specifically to induce them to buy the stock of CFM, LVK and Squire. The fraudulent character of the sales and purchases relating to these three securities concerned not only the excessive mark-ups and mark downs including the failure to inform customers concerning the absence of a market for such securities other than that maintained by the registrant, but, in addition, involved among other things, false and misleading representations concerning the financial condition of the issuers of such securities and the mounting deficits of such issuers; the future prospects for growth and financial success of such issuers as well as misrepresentations concerning possible mergers; and an increase in the market price of the securities.[15/]

Piggly Wiggly of California, Inc. was organized in 1949 but changed its name to Continental Food Markets of California, Inc. on November 8, 1965. It is engaged in the operation of modern grocery supermarkets.

15/ As the Second Circuit observed in SEC v. North American Research and Development Corp., et al. (Docket Nos. 32246, 32247, 32248 and 33817) decided March 25, 1970; Slip Op. p. 2000 ". . . the entire structure of federal securities regulation [is in] an area of law in which it is particularly important to view the statutes not individually but as interdependent components of an integrated regulatory plan. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-187 (1964); 6 Loss Securities Regulation, 3915-16 (1969)." While the facts in this case are different from those in North American the court's comment is equally pertinent to the facts of the instant case.

As of June 27, 1965 CFM had the following securities outstanding: debentures - $280,000; convertible preferred stock - 6,903; [16/] common stock - 978,927.

The common stock consisted of 300,000 shares of promotional stock held in escrow; 4,900 treasury shares; 200,000 shares which were owned by Toluca Mart, Inc., which was controlled by Albert Goldstein. Toluca Mart, Inc. held proxies and "a right of first refusal" to purchase 91,963 shares; and the directors owned a total of 12,175 shares.

The financial history of this company may be described, in pertinent part as follows:

On June 30, 1963, the end of CFM's fiscal year, its retained earnings deficit was $98,159. By June 1964 this deficit had increased to $129,565. By June 1965 the deficit mounted to $758,756; the company's net worth was $219,868 and the book value of CFM common stock was only 22 cents per share. In fiscal 1966 its retained earnings deficit was reduced to $671,518. The reduction in CFM's retained earnings deficit was not attributable to improved operations of the company but to a change in the basis for depreciation

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16/ Based upon a common stock value of $1.375 a share, the preferred stock was convertible under a temporary plan of conversion in effect during the period involved here at the rate of 7.85 shares for each preferred share plus the cash equivalent for fractional shares. The preferred shares are normally convertible at the rate of one share of common stock for each share of preferred stock. (See CFM's financial statements for fiscal 1965). As a result of this temporary plan owners of convertible preferred stock who converted to common stock and were in a position to sell such stock acquired a substantial economic advantage not theretofore available to them, and common stockholders sustained a dilution of values upon conversion of preferred shares. Franklin was a substantial holder of such convertible preferred (continued on following page)

of furniture and fixtures by giving these assets a longer useful life. In this manner the company retroactively changed the basis of depreciation from that which had been previously applied, and consequently the profit and loss statement as of fiscal June, 1966 reflected a profit of $4,374 for fiscal year 1966 as compared with a loss of $10,000 for the same period had depreciation been estimated on the prior basis. A net income of approximately $4,374 represented a profit of only about 4/10ths of 1% based on gross revenues for the period. As a result of changing the basis of depreciation the book value of CFM common stock rose to 31 cents per share. This increase in book value was not attributable to any improvement in the company's business.

For fiscal year 1967 even on the new basis for depreciation the deficit mounted to $1,008,297, and as a result CFM common stock had no book value and in fact had a negative book value of 3 cents per share.

On June 16, 1966 CFM made an offering of 235,283 shares of its common stock to California stockholders at $1.375 per share at the rate of one share for each four shares owned. Dependent on the success of the offering the proceeds were to be used to retire certain 8% subordinated debentures. The offer expired August 25, 1966. As the permit issue by Division of Corporations of the State of California issued on May 26, 1966 stated, "The price fixed by the Board of

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16/ (continued from preceding page)
stock and during the period under consideration here converted preferred stock to common stock. Such common stock was marketed through the registrant to the public. As of June 25, 1967, as a result of conversions the outstanding common stock was 1,014,633 shares and the convertible preferred was 2,352 shares.

Directors of applicant [CFM] as the exercise price of such rights was determined as nearly as possible to represent the mean between the bid and asked prices for the common stock on the over-the-counter market for representative period prior to the action of the Board." 17/

The only market quotations which the board of directors could employ to fix the "mean between the bid and asked prices" to the California stockholders on the over-the-counter market were those quoted by registrant in the white sheets. Those prices were arbitrarily fixed by registrant in a market which it dominated and such prices were unrelated to any free or competitive market.

CFM offered not more than 61,092 common shares to holders of its preferred shares.

Registrant was a primary market-maker for the stock of Continental Food Markets from June 25, 1965 to December 22, 1966, and was essentially the sole market-maker for Continental Food Markets on the West Coast during this time period. Registrant was regularly quoting Continental Food Markets in the "white sheets" at specific bid and asked prices throughout this time period. The only quotes for Continental Food Markets in the "pink sheets" during this time period were sporadic quotes by two New York City broker-dealers, one of whom consistently quoted only an asked price of $2, which never varied, and the other sometimes quoted both specific bid and asked prices, sometimes only quoted one side of the market and for substantial time periods placed no quotes at all. After June 15, 1966, this latter broker-dealer did not quote

17/ On this basis registrant's quotations in the white sheets were the determining factor in fixing the price of CFM stock to the public (see infra) under the company's offering to its California stockholders.

Continental Food Markets in the "pink sheets" at all. Other than registrant, the only quotes in the "white sheets" were an "offer wanted" quote by one broker-dealer from September 27, 1965 to November 11, 1965, and specific bid and asked quotes by another broker-dealer,Kesler & Co.,from December 20, 1965 to December 22, 1966. In this connection, Harry Kesler, the sole proprietor of Kesler & Co., testified that he was a former employee of registrant and registrant's predecessor, that he was solely a retailer, not a wholesaler in the stock, that he quoted Continental Food Markets in the "white sheets" solely to enable him to pick up the stock for his retail customers at the best prices possible, that he was never a primary market-maker in the stock, that he based his quotations on the quotes that he contemporaneously received from registrant, that registrant was the only broker-dealer who made a market in the stock away from him, and that registrant was the primary market-maker in the stock.

Of the 609,038 outstanding shares of CFM only 369,889 shares were in the hands of the general public. From July 1, 1965 to December 22, 1966 within the pertinent period herein the registrant engaged in 645 transactions in the stock. It made 284 purchases and 361 sales, trading a total of 285,524 CFM shares, consisting of 143,176 shares purchased and 142,348 shares sold. Included in registrant's purchases were 8,595 CFM shares from Franklin who

obtained the common stock by conversion of the CFM preferred convertible stock he personally held.[18/]

These figures together with the other facts referred to herein reflect that on the basis of the total number of shares traded i.e. 285,524 shares as compared with the number of shares held in he hands of the public, i.e. 369,889 shares, the registrant controlled and dominated the market in CFM shares.

During above mentioned time period, registrant had a total of 290 sales transactions in Continental Food Markets with retail customers and in 218 of such transactions charged such customers mark-ups varying from 8.3% to 37.5%.[19/] There were 71 sales transactions with dealers.

Many of these transactions were riskless since registrant had a substantial short position in Continental Food Markets for extended time periods when it was selling the stock to retail customers, which short position was covered on three separate occasions by the conversion of convertible debentures of Continental Food Markets held by Franklin.

During the above-mentioned time period, registrant had a total of 101 purchase transactions in Continental Food Markets with retail customers and in 12 of such transactions charged mark-downs varying from 8.5% to 13.9%.

18/ Registrant purchased these CFM shares in three transactions with Franklin, June 30, July 29 and August 31, 1966. In each instance the shares were acquired by registrant when it was in a short position in the stock. Additionally, registrant purchased 1,727 CFM common shares from Franklin on June 24, 1966. Although this transaction is unexplained in registrant's CFM stock ledger sheets, contrary to the recorded details of the above three transactions, the shares undoubtedly came from the conversion of CFM preferred stock since Franklin denied holding any CFM common stock. Accordingly, with over 10,000 shares of CFM common available to it from Franklin, registrant's sales during these months were riskless.

19/ The gross profits on mark-ups in CFM was over $19,000.

During the same period in which it was quoting this security in the white sheets the registrant and its salesmen were engaging in a campaign to sell CFM by means of materially false and misleading representations made almost entirely over the telephone to persons they did not know and had never met.

At the time of this stock offering CFM was in serious need of equity capital. However, the offering was a failure and was "recalled". Only about 10 percent of the offering was purchased by the stockholders. The failure of the offering seriously affected the company's financial position.[20/] There were meetings of CFM's stockholders between October and November 1965, 1966 and 1967. These meetings were attended by Franklin and RJF.

During the 1965 meeting the treasurer of the company advised the stockholders that "the company was in a horrible condition." The failure of the stock offering in 1966 was not an event which could be said to improve the company's "horrible condition", and in the management's opinion constituted a "severe financial setback".

20/ The president of CFM wrote a letter to the stockholders which accompanied the June 26, 1966 financial statement of the company stating among other things, that, "The company suffered a severe financial setback when our stock subscription offering to stockholders proved unsuccessful . . . . The expansion of this company can go forward only with equity capital." For the pertinent period involved in this proceeding the company never obtained such equity capital.

In the notes to CFM's financial statement for fiscal 1966 the following statement appears:

> "In the current and prior years certain cash dividends have been paid in violation of the terms of the Indenture. On February 10, 1966, the Trustee notified the holders of the Debenture of the violation and that the Company is in default. The Indenture provides that if the Company fails to cure a default within sixty days of notice to cure such default, either the Trustee or holders of 25% of the outstanding Debentures may declare the principal of all Debentures to be due and payable. As of October 11, 1966, no notice to cure default has been received by the Company."

The treasurer of CFM had received periodic telephone inquiries from RJF concerning the company but did not receive any inquiries from any of registrant's salesmen. Registrant was well aware of CFM's financial and operating condition.

Landsverk Electrometer, Inc. ("Landsverk" or "LVK")

Landsverk Electrometer, Inc. is principally engaged in the production of radiation measurement instruments in Glendale, California. It has 1,265,000 shares of capital stock outstanding. During 1965, 1966 and 1967, 74% of the outstanding stock was owned by management.

Registrant was essentially the sole market-maker for Landsverk from November 2, 1965 to May 5, 1966. Registrant was regularly quoting Landsverk in the "white sheets" at specific bid and asked price throughout this time period. The only quotes for Landsverk in the "pink sheets" during this time period were sporadic one-sided quotes by two New York City broker-dealers from time to time, and a continued quote by a third New York City broker-dealer throughout this time period, but usually only on the bid side of the market. Other than registrant, the only other quotes in the "white sheets" were bid only quotes by another broker-dealer from November 2, 1965 to December 10, 1965.

During the above-mentioned time period, registrant had a total of 16 sales transactions in Landsverk with retail customers and in 9 of such transactions charged such customers mark-ups varying from 33.3% to 60%.

The company's fiscal year ended March 31. As of March 31, 1963 LVK had an earned surplus deficit of over $104,000.

In fiscal 1964 the company apparently had a quasi-reorganization in which the company reduced paid-in capital from $690,000 to $400,000. In this connection, it is noted that the company wrote off a bad investment,[21/] and by this write-off it reduced paid-in capital from $690,000 to $400,000. This reduction of $290,000, together with an adjustment relating to investment credit of $2,023.58 was offset against the earned surplus deficit at that time of $359,815. This resulted in a deficit at March 31, 1964 of $67,791. Thus, the lower deficit as compared to the prior fiscal year did not come about because of any improvement in the company's operations but was brought about as a result of a capital adjustment. In fact the fiscal 1964 operations resulted in a loss of $176,000 and were from a financial standpoint substantially worse than were the company's operations in fiscal 1963. By March 31, 1965, the deficit had grown to $202,449. By March 31, 1966 the earned surplus deficit had increased by $318,870. In fiscal 1967 LVK had an operating profit of $59,114. This was the only year in which the company had shown a profit since 1961.

The financial statements reflect, however, that in a steady downward curve the net worth of LVK had decreased from $581,000 in fiscal 1963 to approximately $136,000 in fiscal 1967. The book value of the common stock for fiscal year 1963 was 46 cents per share; for

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21/ LVK acquired C.W. Reed Company by issuing 145,000 shares of LVK stock valued at $2 a share. C.W. Reed Company was dissolved.

fiscal year 1965 it was 15 cents per share; and for fiscal year 1967 it was 11 cents per share.

A registered investment adviser published a document dated January 21, 1966 entitled North's News Letter and Special Reports dealing with LVK. The salesmen respondents herein claimed to have relied upon this report which highlighted a contract for $1,900,000 which LVK had with Civil Defense.

LVK's secretary-treasurer, an industrial accountant in charge of the company's accounts had been with the company continuously since 1959 and he testified, among other things, that this contract was obtained in June 1964 and that by November 1965 the company was "in trouble with the contract and that the contract was unprofitable."

This witness who was in charge of the company's accounts did not know Franklin or RJF and had no recollection of ever having received any inquiry from the registrant, its officers, or any of its salesmen concerning LVK's financial affairs.

North's Newsletter presented a highly optimistic picture of the prospects of LVK. In view of the financial condition of the company as described hereinabove, such picture was highly misleading at the time North's Newsletter was published.

It is also observed that the letter under the heading "Finances" stated: "As of March 13, 1965 current assets totaled $209,000 including cash of $20,000. Current liabilities were $38,000 and other liabilities $44,000." The letter does not point out, however, that three quarters of the current assets on the balance sheet as of March 31, 1965 consisted of inventories which totaled

$157,905.27. In Note 2 of the financial statements it appears under the heading "Inventory" that "work in process" totaled $94,613.82 which included a cost of $89,309.21 accumulated on two Government contracts, both of which were contingent on permission from the Government to proceed with full production. As of the date of the letter the Government had not granted such approval, but the note stated negotiations are continuing and approval is expected momentarily. The use of figures in North's Newsletter concerning current assets as compared to current liabilities was misleading without explaining that the value attributed to current inventories of a highly special nature was dependent on the hazard of obtaining government approval to proceed before such assets were realizable. The language imports a highly favorable relationship of current assets to current liabilities and should have been qualified so as to be properly understood and as employed in the Newsletter this language was misleading.

In addition, North's Newsletter pointed out that as of April 1, 1965, the tax loss carried forward available against future earnings amounted to $149,480. This statement would reflect an opinion that this tax loss carried forward had some value to LVK; however, the history of LVK and its condition as at January 31, 1965, would not indicate that a tax loss carried forward would be of material benefit to LVK because such tax loss carried forward would be valuable only in the event the company were to earn money in the future.

Under the heading "Much Improved Outlook" North's Newsletter referred to an operating loss of $90,000 on sales of $509,000 for fiscal 1965. However, the letter failed to point out that in fiscal 1964 the company had sales of $1,134,000 and nevertheless lost $176,100.

These figures do not lend support nor should they have been used to assert that the company had a "Much Improved Outlook". A more accurate description of its outlook would have been for North's Newsletter to advise its readers that the company's sales were down more than half and that its losses were continuing.

In addition to the excessive mark-ups charged customers for LVK, the registrant and its salesmen made false and misleading representations, over the telephone, to members of the public whom they did not know and had never met to effect sales of the stock of LVK.

Squire for Men, Inc. ("Squire")

Squire's original name was Squire for Men of Southern California, Inc. In May or June 1966 its name was changed to Consolidated Hair Products, pursuant to an agreement permitting the use of the name by another corporation. Squire manufactured and sold custom hair pieces for men and wigs for women.

In 1962 Squire made a public offering of its stock.

Bernard Snyder was general counsel for Squire from the time of its incorporation to the time of the hearing with the exception of several short periods of time. He testified that he had been a member of the Board of Directors of Squire at various times; that Franklin was underwriter of a Squire debenture offering in 1963; that Squire had labor union difficulties in 1964 to 1966; that Squire had difficulties in collecting on its sales contracts and accounts

receivables, a substantial part of which were uncollectible; that Squire had been factoring their receivables for a number of years preceding 1965 and up to March 1966; that the company financing Squire through collateralization of Squire's receivables refused in March 1966 to advance further funds because they had "over-advanced" on the accounts receivables and took possession of Squire's inventory pursuant to an inventory lien; that then the only remaining Squire asset was its name and a licensing agreement which was consummated with another company for the use of Squire's name in consideration of royalties; that Squire ceased doing business on March 22, 1966; and that Squire had not engaged in any business under its new name of Consolidated Hair Products having only the right to royalties none of which were ever received; that the stockholders ratified the licensing agreement at a stockholders meeting in June 1966 which RJF attended; that the company has no money or place of business; that he had received telephone calls concerning the progress of Squire and has never refused to give information.

As of September 30, 1964 Squire had a retained earnings deficit of $90,689; and by September 30, 1965 this deficit had increased by $445,551 to a total of $536,241. By fiscal 1965 Squire had an operating loss of $12,782 and after writing off bad debts of $269,000; research and development costs of $133,651 and financing charges of $30,108, totaling $432,769, the company had a retained earnings deficit of $536,241. The company at that time had a negative book value of 88 cents per share.

Squire had 266,246 shares of common stock outstanding of which $126,782 or almost half were owned by the company president and 10,300 shares owned by the first underwriter leaving 129,166 shares publicly held.

Registrant was the sole market-maker for Squire for Men from June 25, 1965 to May 13, 1966. Registrant was regularly quoting Squire for Men in the "white sheets" at specific bid and asked prices throughout this time period. There were no quotes for Squire for Men in the "pink sheets" by any broker-dealers during this period.

During the above-mentioned time period registrant had a total of 17 sales transactions in Squire for Men with retail customers and in 16 of such transactions charged such customers mark-ups varying from 50% to 200%.

During the above-mentioned time period, registrant had a total of 17 purchase transactions in Squire for Men with retail customers and in 3 of such transactions charged markdowns varying from 8.3% to 30%.

In addition to the excessive mark-ups and mark-downs registrant through its salesmen made false and misleading statements to investors concerning the stock of Squire.

Ideal Brushes

Registrant was the sole market-maker for Ideal Brushes from June 29, 1965 to December 23, 1966. Registrant was regularly quoting Ideal Brushes in the "white sheets" at specific bid and ask prices throughout this time period. There were no quotes for Ideal Brushes in the "pink sheets" by any broker-dealer during this period.

During the above-mentioned time period registrant had a total of 195 sales transactions in Ideal Brushes with retail customers and in 163 of such transactions charged such customers mark-ups varying from 5.5% to 45.4%.

During the above-mentioned time period, registrant had a total of 87 purchase transactions in Ideal Brushes with retail customers and in 3 of such transactions charged markdowns varying from 12.5% to 23.5%.

American Tin

Registrant was the sole market-maker for American Tin from September 29, 1966 to December 22, 1966. Registrant was regularly quoting American Tin in the National Daily Quotation Service's Pacific Coast "white sheets" at specific bid and asked prices throughout this time period. There were no quotes for American Tin in the "pink sheets" during this period and on only one day (December 16, 1966) was there a quote inserted in the "white sheets" by another broker-dealer.

During above-mentioned time period, registrant had a total of 15 sales transactions in American Tin with retail customers, and in 13 of such transactions charged such customers mark-ups varying from 14.2% to 33.3%.

California Girl

Registrant was essentially the sole market-maker for California Girl from July 19, 1965 to December 22, 1966. Registrant was regularly quoting California Girl in the "white sheets" at specific bid and asked prices throughout this time period. There were no quotes for California Girl in the "pink sheets" during this period, and the only other quotes in the "white sheets" were quotes by another broker-dealer, who, from July 19,1965 to September 22, 1965 entered bid only quotes and from September 28, 1965 to January 24, 1966, entered specific bid and asked quotations, and at all times such other broker -dealer's quotes were outside the range of registrant's quotes, i.e., registrant always had a higher bid and a lower asked quote in the "white sheets" each day than such other broker-dealer quoted California Girl.

During the above-mentioned time period, registrant had a total of 85 sales transactions in California Girl with retail customers, and in 68 of such transactions charged such customers mark-upss varying from 6.2% to 100%.

During the above-mentioned time period, registrant had a total of 36 purchase transactions in California Girl with retail customers and in 2 of such transactions charged mark-downs of 25%.

Chemical Milling

Registrant was essentially the sole market-maker for Chemical Milling from February 21, 1966 to December 23, 1966. Registrant was regularly quoting Chemical Milling in the "white sheets" at specific bid and asked prices throughout this time period. There were no quotes for Chemical Milling in the "pink sheets" during this period, and the only other quotes in the "white sheets" were quotes by another broker-dealer, who, from March 16, 1966 to

September 16, 1966, entered specific bid and asked quotations, and from September 19, 1966 to December 23, 1966, entered only bid quotes.

During the above-mentioned time period, registrant had a total of 19 sales transactions in Chemical Milling with retail customers and in 15 of such transactions charged such customers mark-ups varying from 8.3% to 25%.

During the above-mentioned time period, registrant had a total of 14 purchase transactions in Chemical Milling with retail customers and in 3 of such transactions charged markdowns varying from 8.3% to 16.6%.

Construction Design

Registrant was a primary market-maker for Construction Design from July 1, 1965 to December 23, 1966, and was essentially the sole market-maker for Construction Design on the West Coast during this time period. Registrant was regularly quoting Construction Design in the "white sheets" at specific bid and asked prices throughout this time period. The only quotes for Construction Design in the "pink sheets" during this time period were placed by one New York City broker-dealer, and the other quotes in the "white sheets" were quotes by one-broker-dealer during the period from October 20, 1965 to December 10, 1965, and quotes by another broker-dealer from November 1, 1966 to December 23, 1966.

During the above-mentioned time period, registrant had a total of 39 sales transactions in Construction Design with retail customers and in 25 of such transactions charged such customers mark-ups varying

from 21.4% to 41.6%.

Controlled Products

Registrant was a primary market-maker for Controlled Products from August 4, 1965 until December 21, 1966, and was essentially the sole market-maker for Controlled Products from August 4, 1965 to April 22, 1966. Registrant was regularly quoting Controlled Products in the "white sheets" at specific bid and asked prices throughout this time period. The only quotes for Controlled Products in the "pink sheets" during this time period were essentially "offer wanted" quotes by two New York City broker-dealers. Other than registrant, the only other quotes in the "white sheets" were specific bid and asked quotes by one broker-dealer from April 22, 1966 to August 3, 1966, and specific bid and asked quotes by another broker-dealer, Kesler & Co., from September 21, 1966 to December 21, 1966. In this connection, Harry Kesler, the sole proprietor of Kesler & Co., testified that he was solely a retailer, not a wholesaler, in the stock, that he quoted Controlled Products in the "white sheets" solely to enable him to pick up the stock for his retail customers at the best prices possible, that he was never a primary market-maker in the stock, that he based his quotations on the quotes that he contemporaneously received from registrant, and that registrant was the only primary market-maker in the stock.

During the above-mentioned time period, registrant had a total of 317 sales transactions in Controlled Products with retail customers and in 283 of such transactions charged such customers mark-ups

varying from 5.2% to 42.8%.

During the above-mentioned time period, registrant had a total of 158 purchase transactions in Controlled Products with retail customers and in 3 such transactions charged markdowns varying from 11.7% to 26.9%.

Device Seals

Registrant was the sole market-maker for Device Seals from September 8, 1965 to December 14, 1966. Registrant was regularly quoting Device Seals in the "white sheets" at specific bid and asked prices throughout the time period. There were no quotes for Device Seals in the "pink sheets" by any broker-dealer during this period.

During the above-mentioned time period, registrant had a total of 27 sales tran sactions in Device Seals with retail customers and in 15 of such transactions charged such customers mark-ups varying from 33.3% to 100%.

During the above-mentioned time period, registrant had a total of 22 purchase transactions in Device Seals with retail customers and in 7 of such transactions charged markdowns varying from 14.2% to 40%.

Sunset Industries

Registrant was a primary market-maker for Sunset Industries from July 19, 1965 to December 21, 1966, and was the sole market-maker from May 2, 1966 to December 21, 1966. Registrant was regularly quoting Sunset Industries in the "white sheets" at specific bid and asked prices throughout this time period. No broker-dealer quoted Sunset Industries in the "pink sheets" during this period. Other than registrant, the only other quotes in the "white sheets" were specific bid and asked quotations placed by one other broker-dealer from July 19, 1965 to April 26, 1966.

During the above-mentioned time period registrant had a total of 103 sales transactions in Sunset Industries with retail customers and in 71 of such transactions charged such customers mark-ups varying from 6.2% to 30.7%.

During the above-mentioned time period registrant had a total of 74 purchase transactions in Sunset Industries with retail customers and in 3 of such transactions charged markdowns varying from 5.8% to 7.6%.

Tabach

Registrant was essentially the sole market-maker for Tabach from June 2, 1966 to December 22, 1966. Registrant was regularly quoting Tabach in the "white sheets" at specific bid and asked prices throughout this time period. The only quotes for Tabach in the "pink sheets" during this period were quoted by a New York City broker-dealer as correspondent for a California broker-dealer from November 21, 1966 to December 22, 1966. Other than registrant the only quotes in the "white sheets" during this time period were bid only quotes by one broker-dealer from June 2, 1966 to July 28, 1966, and specific bid and asked quotes by another broker-dealer from November 3, 1966 to December 8, 1966.

During the above-mentioned time period, registrant had a total of 30 sales transactions in Tabach with retail customers and in 16 of such transactions charged such customers with mark-ups varying from 9% to 66.2%.

During the above-mentioned time period, registrant had a total of 55 purchase transactions in Tabach with retail customers and in 16 of such transactions charged mark-downs varying from 7.6% to 26.6%.

Nova Tech

Registrant was a primary market-maker in Nova Tech on the West Coast, and quoted it in the "white sheets" at specific bid and asked prices from June 29, 1965 to November 30, 1966. Other market-makers quoted Nova Tech in both the "white sheets" and in the "pink sheets" during this time period.

During the above-mentioned time period, registrant had a total

of 39 sales transactions in Nova Tech with retail customers and in 28 of such transactions charged such customers mark-ups varying from 5.1% to 27.2%.

During the above-mentioned time period registrant had a total of 109 purchase transactions in Nova Tech with retail customers and in 7 of such transactions charged mark-downs varying from 5.2% to 11.1%.

In determining whether there were or were not excessive mark-ups and mark-downs in this proceeding resort must be had to standards long established by the Commission and the courts. In substance both the Commission, the courts and the National Association of Securities Dealers have held that it is a fraud and deceit upon customers to charge prices not reasonably related to current market prices absent countervailing evidence. See, e.g. Barnett v. United States, 319 F.2d 340 (C.A. 8, 1963); Hughes v. SEC, 139 F.2d 434 (C.A. 2, 1943); Samuel B. Franklin & Co. v. SEC, 290 F.2d 719 (C.A. 9, 1961), cert. denied, 368 U.S. 889; Duker v. Duker, 6 SEC 386 (1939); Naftalin & Co., Inc., 41 SEC 823 (1964).

The reasonableness of a mark-up or mark-down must be determined for each individual transaction on the basis of the best evidence of the market price for the particular security at the time of the transaction.[22/] It is necessary in considering whether specific retail prices under consideration are or are not excessive to consider specifically the type of securities involved, the availability of the

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22/ Shearson Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965).

securities in the market, the price of the securities, the amount of money involved in the transaction, the disclosure to the customer, the pattern of mark-ups and mark-downs, and the nature of the firm's business.[23/]

During the period from July 1, 1965 to December 30, 1966, in the 13 securities issues described above, registrant executed a total of 1,192 sales transactions with retail customers. Eighty-four of these transactions involved stocks selling at prices less than $1 per share, 1,105 involving stocks selling at prices more than $1 but less than $5 per share, and the remaining 3 transactions involved stocks selling at prices more than $5 but less than $10 per share.

In 60 of such transactions, registrant charged mark-ups varying from 5.1% to 10.9% In 611 of such transactions, registrant charged mark-ups varying from 11% to 25.9%. In 209 of such transactions registrant charged mark-ups varying from 25% to 40.9%. In 61 of such transactions, registrant charged mark-ups exceeding 41%. Thus, in 941 of the 1,192 sales transactions in the relevant 13 issues that registrant had with retail customers, or in approximately 80% of its retail transactions, registrant charged customers mark-ups in excess of 5%.

The Commission has repeatedly held that in the absence of countervailing evidence, a dealer's contemporaneous cost is the best evidence of the current market price.

The term current market price refers to a free and open market

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23/ Naftalin & Co., 41 SEC 823 (1964).

which is not made, controlled or artificially influenced by any party participating in an offering of securities. As the Commission pointed out In the Matter of Hazel Bishop, 40 SEC 718 at p. 736 ". . . the basic principle [is] that any representation that a security is being offered at the market implies the existence of a free and open market. . . ." In D. Earl Hensley & Co., 40 SEC 849, 852 (August 1961) the Commission pointed out that registrant ". . . offered to sell securities at the market price without revealing that it created such market as may have existed." In an important footnote the Commission pointed out that "By engaging in the securities business a broker-dealer represents, among other things, . . . that it would effectuate transactions at prices reasonably related to prevailing market prices (Charles Hughes & Co., Inc., 13 SEC 676 (C.A. 2, 1943), aff'd 139 F.2d 434, 436 (C.A. 2, 1943), cert. denied 321 U.S. 786; Manthos, Moss & Co., Inc., 40 SEC 542 (1961); and that such market prices are determined in a free and open market not maintained or controlled by itself (Otis & Co. v. SEC, 106 F.2d 579, 582 (C.A. 6, 1939); Gob Shops of America, Inc., 39 SEC 92 (1959); Russell Maguire & Co., Inc., 10 SEC 332, 348 (1941)." (Underscoring supplied).

In the case at issue here the fact is that with the exception of Nova Tech the registrant was the dominant or sole market. Moreover the prices charged were controlled by registrant and were not determined in a free and open market.

In computing mark-ups the Division utilized as the "current market price" for each security the prices at which registrant sold the particular security to another dealer on the day in question, and

for days where registrant did not have a same-day dealer sale, the Division used registrant's contemporaneous cost of the particular security as the proper basis.

Contemporaneous cost has been defined as either the price a dealer paid for the security on the same day the sale to a retail customer was effected, or if no same day purchase occurred, the price the dealer paid for the stock on the day nearest to the date of its sale to a retail customer. Linder, Bilotti & Co., Inc., Securities Exchange Act Release No. 7738 (November 5, 1965), p. 2, n. 4 [3 days]; Advance Research Associates, 41 SEC 579, at 611 (1963) [3 days]; Samuel B. Franklin & Co. v. SEC, 290 F.2d 719 (C.A. 9, 1961), cert. denied 368 U.S. 889.

In determining registrant's "contemporaneous cost" of each particular security where registrant did not have same day sales to dealers the Division utilized the registrant's same day cost whenever available (579 out of 941 instances), registrant's cost one day before or after the day of the alleged illegal mark-up, when same day costs were unavailable (215 out of 941 instances) and on some occasions the Division employed registrant's cost two days away (74 out of 941 instances), three days away (64 out of 941 instances), and four days away (9 out of 941 instances). The Division's computations of mark-ups and mark-downs in this case follows past Commission precedent.

The mark-up prices of the 13 relevant securities seldom changed from day to day during the period involved. In this case the Division did not charge the respondents with violations relating to

allegedly excessive mark-ups or mark-downs where Franklin sold to a retail customer and on the same day sold to a dealer where the price to the customer was not in excess of the price to the dealer.[24/]

As has been pointed out with the exception of Nova Tech there was little if any dealer activity independent of the registrant and registrant was either absolutely or primarily the sole market in each of the issues.

Each of the 13 stocks was a relatively speculative, low-priced security and in at least three of the issues the securities offered were of companies in serious financial difficulties having large accumulated deficits and whose stock had little or no book value.

The Division contended that rregistrant was conducting primarily a retail operation. The respondents contested this claim. The pertinent facts may be summarized as follows:

Out of 1,501 total sales transactions that registrant executed in the 13 issues during the pertinent time period 1,192 were sales to retail customers and only 309 were sales to other customers. The percentage of retail sales to total sales in each issue was as follows:

American Tin 93%; California Girl 94%; Chemical Milling 70%; Construction Design 93%; Continental Food 80%; Controlled Products 95%; Device Seals 80%; Ideal Brushes 97%; Landsverk 76%; Nova Tech 27%; Squire for Men 63%; Sunset Industries 89%; and Tabach 35%.

24/ See, e.g., Shearson Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965); Century Securities Company, Securities Exchange Act Release No. 8123 (July 14, 1967), p. 7; Gateway Stock and Bond, Inc., Securities Exchange Act Release No. 8003 (December 8, 1966), p. 4; Langley-Howard, Inc., Securities Exchange Act Release No. 7986 (October 26, 1966), p. 6; Mark E. O'Leary, et al., Securities Exchange Act Release No. 8361 (July 25, 1968).

Thus it appears that in five of these issues over 90% of the sales were to retail customers, that in five other issues between 70% and 89% of sales were to retail customers and in the remaining three issues between 27% and 63% of sales were to retail customers.

In approximately 80% of registrant's sales to retail customers of stock in the 13 pertinent issues during the period under consideration the registrant charged illegal excessive mark-ups varying from 5% to 200%.

The respondents in their proposed findings, (proposed finding No. 464) pointed out that during the pertinent period herein the registrant "sold an aggregate of 418,202 shares to retail customers. During the same period of time it sold over 122,000 shares to other dealers. During the same period of time it purchased 279,450 shares from retail customers and purchased 258,656 shares from other dealers."

On the basis of these figures it appears that less than one quarter of the shares referred to by registrant was sold to other dealers and that during the same period over three quarters of the shares were sold by registrant to retail customers. The figures also disclose that registrant bought more shares from retail customers than it bought from dealers. Contrary to respondents' contentions, these figures reflect that registrant was conducting primarily a retail business.

Furthermore, contrary to respondents' contentions most of registrant's dealer sales in the 13 relevant issues were effected at negotiated prices below registrant's offer quoted in the sheets on

the appropriate day when each transaction occurred. Thus, out of 309 total dealer sales, at least 212 of them were made below registrant's quoted offer price. It is reasonable to conclude that when the essentially sole market-maker effectuates approximately 70% of his dealer sales at negotiated prices below his offer quotes in the sheets, that the market-maker's offer quotes in the sheets were not necessarily reflective of the prevailing market. Instead they reflect that such registrant exercised wide latitude in arbitrarily setting its inside asked price at a self-serving, high figure. In this case, it appears that these arbitrary prices were set in material part for the purpose of facilitating a retail distribution of stock at excessive and illegal mark-ups. See e.g. Costello Russotto & Co., Securities Exchange Act Release No. 7729, p. 4 (see infra).

The evidence does not reflect any inability on the part of registrant to obtain any of the securities comprising the 13 issues involved here. Indeed it appears that whenever the registrant needed securities it was always able to purchase stock in the 13 relevant issues from other dealers or from retail customers at or below its quoted bid price.

The respondents offered as experts certain securities traders and the secretary of District Two of the NASD who contended that there were no mark-ups and mark-downs. The witness produced on behalf of respondents reached their conclusions on the basis of their examination of exhibits prepared by the Division and not on the basis of alleged telephone quotations.

The respondents, however, claimed inconsistently with the testimony offered by their experts that no attention should be paid

to the quotations in the National Daily Quotation Sheets since they were at least a day old at the time transactions occurred and consequently market conditions changed and they were therefore justified in engaging in transactions inconsistent with their quotations in the sheets. For example, the respondents argued that the Division seemed to be interpreting the position of the respondents as being that its bid and asked prices as set forth in the National Daily Quotations Bureau Sheets constituted in all cases the current market price for the securities in question and constituted the basis for calculating mark-ups. Respondents stated that they ". . . do not and did not take this position. The position of respondents is and has been that the bona fide representative current market price of the securities was the bid and asked quotations given at the time of a particular transaction on any given day." (Underscoring by respondents). To support its contention that the quotations given in the white sheets should be given little or no consideration the respondents contended that they were relying upon comments made by the Commission in its Shearson Hammill opinion. However, the Commission's statements made in Shearson Hammill do not support respondents' position.

Moreover, there is no evidence in the record in this case specifying precisely what respondents' oral telephone quotes were with respect to any specific transactions in issue in the case. Furthermore, as the Commission clearly pointed out in the Naftalin case Securities Exchange Act Release No. 7220 (January 10, 1964) at p. 7

such telephone quotes cannot be utilized as the proper basis for computing mark-ups in a situation where a dealer consistently took mark-ups of at least 10% over contemporaneous costs in its retail sales in spite of the fact that such retail sales were made at the quoted offer price. Respondents' contentions are wholly without merit and are rejected.

The position of registrant and certain expert witnesses who testified on registrant's behalf (as contrasted with Division's position described hereinabove) was that so long as the registrant was willing to buy or sell reasonable quantities of securities at his quoted prices the appropriate standard for determining the "current market price" on any specific day and to determine whether or not there was a mark-up was the offer price quoted by registrant in the sheets on that day. In the opinion of these experts even in the case of a sole or non-competitive market if he sold at his quoted offer price there was no mark-up and his contemporaneous cost was irrelevant.

The facts in this case are that, essentially, the registrant was in a monopoly position with regard to securities involved here. Neither dealers nor members of the investing public had any source other than registrant. Dealers, being professionals and much more sophisticated than the investors who were the target of respondents' sales efforts were able to and frequently picked up the stock at negotiated prices below the quoted offer.

Respondents' position assumes that the prices quoted by the sole market maker constitute a better standard for determining "current market prices" than the registrant's contemporaneous cost.

This contention disregards the fact that in this case the registrant was the sole market maker in 12 of the 13 securities at issue here, and that he dominated and controlled the market in these securities and that he fixed his quotes arbitrarily at high levels.

The difference of opinion as to the appropriate standards to apply in this case was not based upon any difference in the objective facts disclosed by the record. This difference of opinion between the registrant and the Division is based essentially on differing viewpoints as to how the evidence adduced (principally in the form of Division exhibits) should be evaluated or interpreted.

Normally, in an administrative proceeding, a conflict in expert testimony is not considered in the same light as a conflict based on straight evidentiary grounds.[25/]

In Brockton Taunton Gas Co. v. SEC, 396 F.2d 717 at page 721 the court pointed out that ". . . the traditional opinion rule does not apply in administrative proceedings." 2 K. Davis, Administrative Law §14.13 (1958). In Market Street Railway Company v. The Railroad Commission, 324 U.S. 548 at p. 560 the Supreme Court pointed out that

> "This is not a case where the data basic to a judgment have been withheld from the record. The complaint is that the Commission formed its own conclusions without

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25/ "One of the most common arguments is that an agency cannot accept the expert testimony of its own staff members as against the testimony of outside experts; the federal courts consistently reject the argument. Sometimes the agency follows the conventional rule and the reviewing court has to remind it that the administrative process should be free from such a rule; . . . ."

In many cases the question recurs whether a supposedly expert tribunal may use its own judgment in the face of uncontradicted expert testimony to the contrary. The early federal cases sometimes required specific expert opinion to support the findings, but more recently the federal courts have generally permitted agencies to use their own judgment." (Footnotes omitted). (2K Davis, Administrative Law §14.13 (1958).

> the aid of expert opinions. It is contended that the Commission should draw conclusions from these facts only upon hearing testimony of experts as to the conclusions they would draw from the facts of record. Experts' judgment, however, would not bind the Commission. Their testimony would be in the nature of argument or opinion, and the weight to be given it would depend upon the Commission's estimate of the reasonableness of their conclusions and the force of their reasoning. There is nothing to indicate that any consideration which could be advanced by an expert has not been advanced by the company in argument and fully weighed."

The Commission is privileged to make such reasonable interpretation of the anti-fraud provisions of the statutes and its own rules as may be pertinent to a given situation.[26/]

The cases and authorities including the rules of the NASD cited by respondents do not support their position in this case. In fact, respondents' position and that of their experts is inconsistent with the past and recent decisions of the Commission, the courts and the NASD. In essence it is based on nothing more than registrant's ipse dixit supported by four securities traders with whom the registrant does business and the secretary of a local NASD district committee who disclaimed speaking for such Committee.[27/]

26/ See NLRB v. Hearst Publications, Inc., 322 U.S. 111, 131; Gray v. Powell, 314 U.S. 402, 412, Gray v. Powell was a case where there was no dispute as to the evidentiary facts but there was a difference of judgment as to the impact of such facts. In Gray v. Powell there was also a dispute as to the meaning of language.

27/ The respondents' position as expressed in their proposed findings was, inter alia, that "The evidence supporting the market making activities of Samuel B. Franklin distinguishes this case from every case cited by the Division." In the sense that this appears to be the first case in which experts produced by respondents testified to their opinions which were to the contrary of expert opinion elicted from an SEC witness the respondents are correct. However, it should be pointed out that, contrary to respondents' contentions the evidence offered by their experts is not evidence which contradicts any of the objective facts such as the actual bid and ask quotations placed in the sheets by registrant or the facts relating to registrant's contemporaneous costs. The testimony of the experts are in the nature of argument or opinion and the weight to be given such testimony depends on the reasonableness of their conclusions.

The interpretation of the terms "current market price" and "mark-ups" as invoked by the registrant and its experts are not binding on the Commission.

To accept the position of registrant and its experts would require a reversal of past Commission, court, and NASD precedent and would be inconsistent with the protection of investors.

One of the registrant's experts, Robert B. Bernard ("Bernard") testified that he was familiar with NASD Rules of Fair Practice. When he was asked on cross-examination how he reconciled his testimony in this proceeding that Franklin's mark-ups and mark-downs were "zero" with the principle that in the absence of an independent market contemporaneous cost was normally used for determining mark-ups, he replied that the NASD had changed its interpretation of the rules. He was also of the opinion that the NASD's prior rules were obviously unfair. When the witness was asked when and where the NASD had changed its rules relating to mark-ups he stated that the Association had changed them approximately two years prior to the time that he was testifying. After examining the NASD Manual containing the Association's rules he stated that he could find no basis in the Manual for his statement that the NASD had changed its rules or its position. The fact was that there were no changes in the pertinent NASD rules nor had there been any published changes in NASD interpretations of such rules. When asked what authority he had for making the statement that the NASD had changed its position with regard to determining mark-ups he stated that "the only authority I have would be a discussion with a local NASD official about the change." The witness went on to explain that he meant a discussion he had had with James Resh, another

witness for registrant in this proceeding who was secretary of District 2 of the NASD. Finally, the witness conceded that there had been no change whatever in the pertinent rules published in the NASD Manual. The witness also conceded that no officer of District 2 of the NASD had advised him that there had been a change in NASD policy.

This witness was unfamiliar with NASD decisions relating to mark-ups and was simply expressing a personal opinion which appeared to be based on an erroneous idea of the content and meaning of the NASD decisions or Securities and Exchange Commission decisions based upon alleged mark-ups. His testimony was not persuasive.

The respondents presented a second witness who managed the trading department in the Los Angeles area for Merrill, Lynch, Pierce, Fenner and Smith ("Merrill Lynch"). According to respondents' counsel this witness was offered "primarily, as (1) someone familiar with the trading practices of Samuel B. Franklin, and (2) as an experienced trader familiar with the professional practices in the industry."

Respondents' counsel also stated that they were "not offering this witness either as a lawyer or an expert in the decisions of the SEC or the NASD," but respondents had asked him if he were "familiar with the NASD rules which generally govern the operation of the over-the-counter markets and trading practices."

However, the witness explained that he was not testifying as to the views of Merrill, Lynch but was only giving his own opinion.

It also appeared that Merrill, Lynch the firm in which this witness' experience as a trader appears to have been gained, did not make a market in the kind of low-priced stocks such as the registrant

did, the lowest priced security which the firm traded locally (i.e. Los Angeles) being $11. In addition, the witness testified that he did not "determine the mark-ups [he charge]d in [his] company transactions", and that Merrill Lynch had an "automatic policy" with regard to "mark-ups", i.e., "They are either up or down the exact amount of the New York Stock Exchange Commission."

As far as this witness was concerned the cost of a security had no relevancy with respect to the definition of a mark-up even in a case where the dealer was the sole market in a low-priced stock where the broker dealer as a principal bought in small quantities and sold in small quantities. The only factor according to the witness is whether the dealer stands behind his quotes. If he does he is a good market maker.

The witness further testified that he was expressing a view simply as to how his business with the registrant affected the firm with which he was associated, and that as long as the company stood behind its bid and ask quotations and meets the orders he was unconcerned with the company's integrity and that he did not "know Samuel Franklin" and had only met Dick Franklin once at a convention of traders. The witness also testified that insofar as he was concerned ". . . as long as the company stands behind its bid and asked quotations and meets the orders he was unconcerned with the company's integrity, and that he was only concerned with the integrity of Samuel Franklin or Richard Franklin insofar "as their operation with us was concerned in the handling of orders between us and on the telephone."

The witness' testimony as to the appropriate way to calculate excessive mark-ups was not based on any expertise by the witness

through his experience with Merrill, Lynch since the latter had an automatic policy with regard to mark-ups wholly unrelated to registrant's practices with regard to mark-ups. On the basis of his own statement as to his experience it appears that the witness' knowledge of how mark-ups should be calculated for low-priced over-the-counter securities was quite limited. Finally, the standard invoked by the witness as to the calculation of mark-ups, i.e. the dealer stands behind his quotes, receives no recognition as a standard for determining mark-ups in the decisions of the NASD, Commission or the Courts and if adopted would amount to a regression in the standards for the protection of investors.

It should also be noted that the excessive mark-ups charged retail customers by registrant stand in stark contrast with the practices which the witness testified were utilized by the firm which employed him.

He also testified that where 20% of the transactions are with broker-dealers and 80% are with retail customers he would consider that the broker-dealer was primarily a retailer.

A third witness called by the respondents, Robert D. Diehl, testified that he did not believe that contemporaneous cost or same day cost should be employed as a standard for determining mark-ups. He testified that he did not feel "under any circumstances that a dealer's cost as long as he stays within the prescribed market . . ." (i.e."the one he is quoting or has quoted in the white sheets") should be employed to calculate mark-ups and that as long as he stays within his quoted market a dealer could "set up any market that he thinks is reasonable." (Underscoring supplied). Apparently this was the witness'

view no matter how high the mark-ups were over the dealer's contemporaneous cost even in the case of a sole market. His view was that the correct standard to employ for a sole market maker was the offer price. This position ignores the fact that the term "current market price" refers to a free and open market which is not made, controlled, or artificially influenced by any party participating in an offering of securities. Furthermore his views are inconsistent with the decisions of the Commission, the courts and the NASD in mark-up cases. His views are rejected.

Another witness Arthur Lee Benson, testified on behalf of the respondent similarly to the respondents' other experts. The witness agreed that his "sole consideration in the determination of whether a good market is being made by a market maker is whether he stands by his quotations" and that he considers no other factors. The witness also conceded that "based on purely just these figures of those stocks, these 13 stocks here, he [registrant] would be more of a retail broker." He also stated that he did not set up "mark-ups" for his firm but that he had some experience in this field, that he was aware of the 5% rule and that "If someone were to put 2 points on $20 stock, I know to blow a whistle on it. I know it doesn't mean something else. This is merely my knowledge as far as mark-ups go. I am not an expert. I don't think I have been called as an expert in mark-ups per se. An opinion I do have." (Underscoring supplied). This witness' views are rejected as inconsistent with the applicable law.

In connection with the matter of dealers standing by their quotations, it should be observed that under arrangements with the National Quotation Bureau, Inc. broker-dealer subscribers who publish bids and offers are required to honor their quotations unless their

needs have already been fulfilled or some changes have occurred so that they no longer need to buy or sell, as the case may be, the securities which they quoted.[28/] Accordingly when broker-dealers honor their quotations in the sheets they do no more than law and trade custom require and they do not deserve any special commendation for so doing. Further a broker-dealer who honors his quotations does not thereby acquire a license or right to charge excessive mark-ups or mark-downs. Specifically the fact that a broker-dealer in a non-competitive market stands behinds his quotes is not an excuse or a defense for charging excessive mark-ups and mark-downs.

Another witness who testified in support of respondent's position was James H. Resh, District Secretary of District 2 of the NASD. When this witness appeared counsel for the respondents stated that ". . . Mr. Resh is not authorized to speak for the NASD, he is speaking for Mr. Resh." And Mr. Resh stated that counsel's statement was correct. Later in his testimony, however, Resh testified ". . . I speak as the District Secretary for the NASD. . . I am here in the official capacity as the District Secretary, yes sir."

Resh had discussed his views with respondents' counsel prior to appearing on the witness stand and was familiar with the Division exhibits relating to mark-ups. However, he did not tell the District Committee what opinions he would express in his official capacity as the District Secretary, nor did he obtain approval from the District Committee for the views he expressed concerning the appropriate way to calculate mark-ups in this case. He testified that he had not taken to the Committee the questions of the fairness of the mark-ups in this case.

28/ See Registration and Regulation of Brokers and Dealers, Sec. 16-4 E. Weiss.

Resh, among other things, testified that he was of the opinion that where ". . . a broker holds himself out to be willing to buy or sell a security at the price [which he has] quoted in the white sheets, for example, and doesn't back away, he meets that obligation . . . [and that] indicates a bona fide market maker." Resh's testimony was also to the effect that his view applied for example, where the market maker was selling to members of the public, not only to the broker-dealer community and this view was also applicable even in the case of a sole market. However, when Resh was asked what the effect of an existing competitive market for securities being traded by a firm was with regard to confirming or establishing the bona bide reasonable current market price of securities, he answered that he was not qualified to answer that question.

Resh testified ". . . that in general in [his] opinion . . . that Franklin . . . makes good markets and even though [he] had no specific information on how the market was being made in these issues the fact that generally [he] considered Franklin as a good bona fide market maker that was sufficient basis for [him] to say the ask price could be used."

This is a standard which has no basis in logic or in the law.

Resh testified that in his capacity as District Secretary he tried to read every Board of Governors decision and SEC decision in the mark-up area.

Resh also testified that District 2 had never formally since he had "been District Secretary ever in witing or in an opinion or otherwise, sanctioned a formal policy that would authorize using as

a basis for computing compliance with mark-up policy . . . the ask quotation prices of an integrated broker-dealer, placed in the white sheets in the situation where the market for over-the-counter stocks was a non-competitive market."

Resh, in his career with the NASD had never read an opinion by either the NASD Board of Governors or by the SEC involving a mark-up problem where either one of these two bodies had ever sanctioned the use of an interested broker-dealer's ask quotations as the proper basis for computing mark-ups as opposed to contemporaneous costs or as opposed to the closest intradealer sales.

Resh while he was on the witness stand testified concerning various exhibits relating to mark-ups which had been prepared by the Division and which had been examined by him. In this connection he was asked what he used to determine whether the market was a negotiated one or not. He replied that he did not make that determination. When asked to make such a determination as an expert witness he answered that he did not know and finally stated "I am not an expert witness in trading." He conceded that in determining what the proper basis for computing a mark-up was he "gave no consideration to whether or not the market in the particular security issue was a negotiated one." He further added that when he looked at figures he didn't use that. He testified, however, that he believed that ". . . a committee looking at a series of figures probably considers that." Presumably, he was referring to a District Committee of the NASD, and to the probability that in determining the proper basis for computing mark-ups such a committee would give consideration to whether the market in the particular security was a negotiated one.

Resh also testified that if the sole market maker was generally effecting transactions at prices between the bid and the offer quoted in the sheets that fact would probably influence his decision as to whether or not he would be able to use his ask quotations as the basis for his mark-up. Resh conceded that the existence of a negotiated market could be a factor that would indicate that the dealer's ask price should not be used as a basis for determining mark-ups.

Resh was asked whether he agreed with certain statements made in the Naftalin case, 41 SEC 823 (1964). Specifically he was asked whether he agreed with the following statement:

> "On the other hand, quotations for securities with limited interdealer trading activity, particularly low price speculative securities frequently show wide spreads between the bid and the offer and are likely to be the subject of negotiation. Such quotations may have little value as evidence of the prevailing market price."

Resh expressed his agreement with the statement.

He also agreed with the following statement in the Naftalin case:

> "In other instances such quotations have been used as the base for the computation of mark-ups in the absence of evidence of same day costs. It seems clear that the propriety of using quotations as evidence of prevailing market price must be tested in the light of all relevant circumstances. For example, the nature of the security, the breadth of the market, and whether it is independent of the dealer relying upon the quotations, the spread in the quotations and the functions of the dealer."

Resh was asked whether the quoted language indicated to him that when quotations to be relied upon are not independent of the dealer in the question that that would be a factor which would go

against using the quotes as the mark-up basis. He answered that it could or that it might and "it does, among other things, have a bearing on the matter." The witness was also asked whether he could state why the fact that the quotes were not independent of Franklin would bear against using them to determine Franklin's mark-ups. He did not answer the question directly but stated that such factor "would be one of the things that would be looked at in presenting these quotations and/or these mark-ups to the committee." He denied that he disregarded the fact that in general there were no quotes independent of Franklin and was of the opinion that some weight should be given to the fact that there were no independent quotations away from Franklin but was unable to say in what way he considered such fact and could not explain what weight if any he gave to this factor. It was clear from his testimony that in his opinion the fact that there were no independent quotes might affect the judgment of a District Committee but that such factor had no effect on his conclusions concerning mark-ups in this case. This witness was asked, "Mr. Resh, in your opinion and based upon your experience in connection with this industry, what is the effect of an existing competitive market for securities being traded by a firm with regard to confirming or establishing the bona fide reasonable current market price of the securities." His answer was "I don't think, Your Honor, I am qualified to answer that question." However, Resh was of the opinion that where a broker-dealer was conducting primarily a retail operation it would not be proper for him to use his ask quotations as the basis to determine mark-ups. In this connection Resh agreed with the following statement in the

Gateway case.[29/] As we have recently observed in a smiliar case in rejecting a contention that the inside offer should be used as a base in computing mark-ups:

> "Where a dealer, although regularly in the sheets, sells primarily to retail customers, its 'own ask quotations can be a self-serving figure, and to allow its use as a base for computing mark-ups on retail sales to customers would be to countenance a bootstrap operation which would give a dealer unrestricted latitude in setting its inside ask price, and therefore the retail prices, and nullify the NASD's fair pricing policy as a protection of investors."'

Resh's views are rejected.

Here as we have seen the registrant was conducting primarily a retail operation in a sole or non-competitive market and it was inappropriate to use his ask quotations as a basis for determining mark-ups.

The respondents in their brief attempt to distinguish the principles enunciated by the Commission and affirmed by the Court of Appeals in Samuel B. Franklin & Co. v. SEC, 290 F.2d 719 (1961) from the principles applicable in the instant case. This case reached the Ninth Circuit following an appeal from the Commission's affirmance, 38 SEC 908 (1959) of a decision of the NASD.

The NASD District Business Conduct Committee of District No. 2 found that during the period January through May 1956 Franklin sold securities to and purchased securities from customers at prices that were not fair in view of all the relevant circumstances, in violation of Sections 1 and 4 of Article III of the NASD Rules of Fair Practice and that such conduct was contrary to just and equitable principles

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29/ Securities Exchange Act Release No. 8003 (1966).

of trade. The Board of Governors affirmed the decision of the District Committee and censured and fined the respondent.

The respondents imply that the only point for which this decision stood was that it overruled Franklin's contention that "the NASD mark-up rule (the 5% rule) was unfair when applied to low priced and penny stocks." The fact is, however, that in this case (sometimes referred to herein as the first Franklin case) the respondent in his defense pointed to his published bid and ask quotations. In this connection the Commission stated that:

> "Applicant is not aided by pointing to the fact that published bid and asked quotations on low-priced securities sometimes have spreads in amounts as great as those involved in the mark-ups charged by applicant. It does not appear from the record whether the particular securities dealt in by applicant were the subject of such wide-spread quotations when his transactions were effected. But even assuming they were, in our opinion, it is clear that while published quotations have been used as an indication of prevailing market prices in the absence of evidence to the contrary, the difference between a bid quotation, which generally represents the lowest price at which a dealer considers he may be able to induce other dealers to negotiate with him respecting his purchase of the security, and the asked quotations, which generally represents the high price at which a dealer considers he can induce negotiations for sale of his security, cannot properly be treated as a measure of what is a fair or reasonable mark-up over contemporaneous cost." (Underscoring supplied).

The Commission in its opinion as did the NASD also pointed out to Franklin how computations of mark-ups and mark-downs should appropriately be made. In this connection the Commission stated:

> "The mark-ups were computed on the basis of applicant's own cost on same day or contemporaneous purchases of shares of the same securities, except that in a relatively small number of instances where a contemporaneous cost was not available, the computations were made on the basis of quotations obtained from the National Daily Quotation Service.

> The mark-downs on applicant's purchases from customers were computed on the basis of same day or contemporaneous sales by applicant of shares of the same securities."

The NASD instituted a second disciplinary action against Samuel B. Franklin & Co. and again the NASD found that he had violated Sections 1 and 4 of Article III of the NASD Rules of Fair Practice by the sale of securities at unfair prices.

Franklin again sought Commission review of the NASD's decision and thereafter the Commission affirmed the NASD In the Matter of Samuel B. Franklin & Co., Securities Exchange Act Release No. 7407 (September 3, 1964).

The principles relating to the appropriate computation of mark-ups are even more sharply enunciated in the second Franklin case than they were in the first. In the second Franklin case the respondents made the same contention that he made in the instant case namely that it was appropriate for him to sell stock to customers at the price at which he sold to dealers even on days when there were no dealer sales and that, therefore, no mark-ups were involved. In this connection Franklin asserted that he maintained an inventory position in a great majority of the securities at issue and made a primary market in most of them. The NASD accepted the applicant's claim that it was his normal practice to sell stock to customers at the same price at which he sold to dealers but it refused to accept his contention that, therefore, no mark-ups were involved, and it refused to agree that his activities in selling to customers at the same price as he sold to dealers was sufficient justification for the use of an individual firm's stated professional offer as the

best evidence of the prevailing market. Instead the Commission stated that:

> "We agree that, under the circumstances here, it would have been improper to use applicant's own inside ask price to determine the fairness of the prices which he charged customers in principal transactions, and that the NASD properly computed the mark-ups charged by the applicant."

The only possible distinction between the mark-up issues in the case at bar and the mark-up issues in the 1964 Franklin case, is the fact that in the 1964 opinion it is not clear whether the firm was the sole market-maker in a "noncompetitive market, or whether the firm was merely one of several primary market-makers in a "competitive market." If the holding to the 1964 Franklin case quoted above quoted above applied to a potentially competitive market where competition could affect the quoted market prices, a fortiori, it applies even more so to the noncompetitive market situation in the case at bar, where the complete lack of competition allowed the Franklin firm to arbitrarily fix the quoted marked prices at a high enough level over its contemporaneous costs to enable it to retail securities at unconscionable profits. In this connection, it is significant that the 1964 Franklin opinion predated the violations charged in the instant case, but nevertheless respondents wilfully chose to disregard its holding in conducting their broker-dealer business, even though the case has never been overruled or otherwise rejected by the NASD, the Commission, or the courts.

The Division contends that mark-ups in this case should be computed as they were in both the first and second Franklin cases.

The Special Study pointed out that there are a number of securities of limited activity in the over-the-counter market where market-making may be confined to one or two broker-dealers at most and for which there is no competitive market. In such instances the Study pointed out:

> ". . . the use of the inside offer as the base for computing the mark-up may be unsatisfactory, particularly if the firm is engaged in a retail selling campaign where its own inside quoted prices provide the basis for retail prices." [Part 2, p. 651]

In this context, the Special Study pointed out that:

> "In enforcing the mark-up policy, the NASD has taken the position that, if there is no independent market, contemporaneous cost should be used. This is apparently based on the premise that, if a dealer is in a position to establish the price level through its own retail selling its inside offer is not a valid basis for computing mark-ups . . . [T]o ignore the fact there is no independent market may be to permit mark-ups on an artificial base." [Part 2, p. 652]

The Special Study, Part 2, points out that "The Commission has stated in numerous mark-up cases that . . . in the absence of countervailing evidence, the prices paid by a dealer are the best evidence of market price." The Study footnotes this quotation by reference to the brief of the NASD in the Boren case (Securities Exchange Act Release No. 6367), September 19, 1960, in which the NASD stated in reply to the argument that a dealer's quoted market as opposed to contemporaneous cost should be used as the basis for computing mark-ups:

> ". . . while in certain instances, where often better evidence is lacking, reference may be made to the quoted markets, the best determination of a market is the price at which a dealer purchased a security from one or more professionals dealing in the security at a given time. Thus, where there is an actual transaction of purchase, the contemporaneous cost to a broker-dealer is the best indication of a market. This general proposition has been repeatedly asserted by the association and accepted by the Securities and Exchange Commission."

In every Commission case dealing with this kind of problem i.e. that is where there is no independent market it has specifically rejected the approach taken by the registrant and its experts and it has done so in a number of recent cases. For example, in Gateway Stock and Bond, Inc., Securities Exchange Act Release No. 8003 (December 8, 1966), the Commission pointed out:

> ". . . whatever the NASD's understanding may have been as to the consideration applicable to integrated dealers in an independent competitive market, it is clear, as noted by the Special Study, that where there is no such market, the NASD has used contemporaneous cost as the basis for computing mark-ups."

In the O'Leary case, Securities Exchange Act Release No. 8361 (July 25, 1968) the Commission pointed out:

> ". . . that even when other dealers are quoting the particular stock issue in the sheets, such quotes independent of the respondent-dealer can not be used as the mark-up basis by the respondent firm when the respondent firm was able to continually acquire stock in the market at a contemporaneous cost lower than such independent quotes."

In Naftalin & Co., Inc., 41 SEC 823 (1964), the Commission did not accept an argument made by the respondents that the asked quotations of another market-maker should have been used as the appropriate basis for computing mark-ups rather than the dealer-respondents' own contemporaneous costs.[30/]

In Costello Russotto & Co., Securities Exchange Act Release No. 7729, the Commission at page 4 said:

> "It would be particularly inappropriate to use the firm's own asked price where, as here, the firm at times was the only one publishing quotations and it made only retail sales and no sale to other dealers. In such a situation the firm's own ask quotations can be a self-serving figure, and to allow its use as a base for computing

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30 / See also General Investing Corporation, 41 SEC 952.

> mark-ups on retail sales to customers would be to countenance a boot-strap operation which would give a dealer unrestrictive latitude in setting its inside ask price and therefore the retail prices, and nullify the NASD's fair pricing policy as a protection to investors. Under all the circumstances we conclude, as did the NASD that in this case the prices paid by the firm to other dealers in contemporaneous transactions in the same securities, rather than the ask quotations, were representative of the prevailing market price."

While it may be argued that the instant case is distinguishable from Costello Russotto in that here sales were made to dealers, insofar as this case is concerned when sales were made to dealers on the same day that sales at retail were made to customers at the same price no finding of excessive mark-ups were sought and none has been made. The findings of excessive mark-ups and mark-downs deal only with retail sales on days where where were no dealer sales.

As pointed out in Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943),

> "[t]he essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do."

Regulation of the conduct of broker-dealers in the over-the-counter market by the Commission has been bottomed primarily upon the anti-fraud provisions of the Securities Act and the Exchange Act.

In Lawrence Rappee & Co., 40 SEC 606 at 609, 610 the Commission dealt with a situation where no broker other than the registrant quoted a specific security. In this connection the Commission held that where a registered broker-dealer sold securities at prices not reasonably related to and substantially in excess of his contemporaneous

costs and created the market therefor without disclosure of such facts to retail customers a fraud was involved. Of course, other aspects of fraud were considered by the Commission but essentially the Commission held that "When a broker-dealer engages in the securities business, he impliedly represents to customers that they will be dealt with fairly and honestly that the prices they are charged or are reasonably related to the prevailing market prices and that the market is a free and independent market insofar as that broker-dealer is concerned. Registrant's mark-ups over his closely contemporaneous costs, which averaged 20% and ranged as high as 30% were clearly unreasonably." (sic)

In a footnote to this decision the Commission stated that it is well established that a dealer's own contemporaneous cost is normally considered the best indication of the current market price for purposes of determining what constituted a reasonable mark-up citing Manthos, Moss & Co., Inc., 40 SEC 542 (1961; W.T. Anderson Company, Inc., 39 SEC 900 (1959).

In D. Earl Hensley Co., Inc., 40 SEC 849, the Commission held that it was a fraud for a registered broker-dealer to offer to sell securities at the market price without revealing that it created such market as may have existed.

In Palombi Securities Co., et al., 41 SEC 266, 271 the Commission pointed out that "At the time of Barath's (security salesman for Palombi Securities Co., Inc.) solicitations the member was the only broker-dealer bidding for or buying National stock and the only

broker-dealer actively engaged in soliciting purchases of this stock by retail customers. We find that these facts form a sufficient basis for the finding by the NASD that the prices quoted by Barath were not determined in a competitive market.

In view of this trading Barath's representations that there was a free trading market in the stock were false and misleading. He claims that he intended that phrase to mean only that the offering had been completed and that the stock could now be freely traded. But whatever meaning that phrase might have among broker-dealers, it is evident that without disclosure that Palombi controlled the market, it would convey the impression to the ordinary investor that the quoted prices were determined in a competitive market."

In Sterling Securities Company, 39 SEC 487 (Securities Exchange Act Release No. 6100, November 2, 1959) the Commission held that it is well established that a dealer, impliedly represents that the sale price bears "some relation to a price prevailing in a free and open market." Such representation is false when, as here, the dealer dominates and controls the market and fixes the price of the stock. As we stated in Norris & Hirshberg:

> ". . . the vice inherent in respondent's . . . sales without full disclosure of the fact that the market was dominated by respondent is the same as that inherent in a classic manipulation: The substitution of a private system of pricing for the collective judgment of buyers and sellers in an open market."

The following statement is an accurate and concise statement of the applicable law:

> ". . . the quotations in the sheets will be accepted as reflecting market prices in the absence of other more convincing evidence. However, the quotations must be genuine, for if fictitious they will not in fact

represent the market prices. For example, quotations in the sheets will not be taken as the measure of the market if they do not truly reflect the collective judgment of buyers and sellers in an open market. Thus, quotations as to a particular security will not be given weight if the market in that security is created or controlled by a broker-dealer and he places or causes the quotations to be placed in the sheets. Such quotations would represent an artificial rather than an independent market. [Footnotes omitted.]

* * * *

"In general, the most satisfactory measure of the market price of a security sold to or bought from a customer is the price involved in a contemporaneous offsetting transaction by the broker-dealer with a third person. Thus, the market price to be used as a measure for a proper sales price to a customer is the price paid for the security by the dealer on the same day of, or shortly before, the sale to the customer, if in fact the dealer made purchases of the security for his own account within such period. Similarly, in measuring the market price of securities purchased by a dealer from his customer, the dealer's own contemporaneous or nearly contemporaneous sales to others provide the best gauge." Registration and Regulation of Brokers and Dealers, E. Weiss, Sections 16-5 and 16-6; Footnotes omitted. (Underscoring supplied).

Respondent salesmen Gladstone, Livingston and Apple as registered representatives of Franklin engaged in selling to and purchasing from customers securities at excessive mark-ups and mark-downs as fixed by registrant and described hereinabove. In this connection, the record indicates and it is conceded in respondents' proposed findings and brief that Livingston and Apple informed their clients of the registrant's bid and asked prices in the securities in which Franklin was making a market each time they attempted to sell them such securities.

According to the testimony of seven of the eight witnesses who testified concerning their transactions with Gladstone he also informed them of the registrant's bid and asked prices in the securities in which Franklin was making a market. While respondent salesmen told persons

they solicited to buy stock that Franklin was making a market, not one of the three respondent salesmen ever told a customer that Franklin was the dominant or the sole market maker in anyone of the 13 securities at issue here.

In making their representations as to the bid and asked prices these respondents clearly implied, contrary to the facts, that a true market in such securities actually existed[31/] and that the prices they were quoting represented the true current market price for the securities. As the Commission pointed out to the respondent Samuel B. Franklin in the first Franklin case, the bid and asked quotations "cannot properly be treated as a measure of what is a fair or reasonable mark-up over contemporaneous cost", 38 SEC 908, 912; 290 F.2d 719 (9th Cir. 1961) cert denied 368 U.S. 889; Loss, Vol. 3 p. 1496; J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7334

As we have already noted the market in the securities being offered by these respondent salesmen, at least insofar as twelve of the thirteen securities which are at issue here, are concerned, was one which was controlled and dominated by the registrant. The respondent salesmen in failing to advise their customers of this fact omitted to advise them of a material fact necessary to the exercise of an informed judgment. It should also be observed that a broker-dealer like Franklin who engaged in making markets in highly speculative and little known securities can choose at any time to stop making such markets. Under such circumstances it is material for an investor to

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31/ Landau Company, et al., 40 SEC 119, 126 (April 1962); Charles Hughes & Co., Inc., 139 F.2d 434, 437 (C.A. 2, 1943).

know whether or not an independent market existed for the securities being offered him so that he could make an informed judgment concerning the marketability of the securities he is being asked to buy.

The respondent salesmen solicited the customers over the telephone to buy such securities. The respondents did not know such customers, and did not know what securities, if any, were suitable to their needs. In most cases the respondents never ascertained the financial condition of the customers, their ages, or any other facts bearing upon the kind of securities which might be suitable to the needs of their customers. Many of the customers were aged, widowed or retired and for the most part had small income and had modest means, were unsophisticated and reposed trust and confidence in the financial advice concerning the purchase of securities offered them by the registrant and the respondent registered representatives.

The Commission pointed out in Norris & Hirshberg, Inc., et al., 21 SEC 865, 881 (1946) aff'd sub nom Norris & Hirshberg, Inc. v. SEC, 177 F.2d 229 (D.C. Cir. 1949) that

> ". . . every sale to a customer carried with it the necessary representation that the sale price bore some relation to a price prevailing in a free and open market. But there was no such market. Consequently no price charged by respondent could have avoided the effect of the essential misrepresentation.
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> * * * *
>
> While many of the classic manipulative techniques may not have been used, the vice inherent in respondent's purchases and sales without full disclosure of the fact that the market was dominated by respondent is the same as that inherent in a classic manipulation: The substitution of a private system of pricing for the collective judgment of buyers and sellers in an open market.
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> * * * *

> As to sales made on the express representation that they are 'at market' we have repeatedly held that such a representation is false where in fact the 'market' has been subject to artificial influences or where no true market existed. See Richard Pamore Gold Mines, 2 SEC 377; Canusa Gold Mines, 2 SEC 548; Old Diamond Gold Mines, 2 SEC 786; Queensboro Gold Mines, 2 SEC 860; Ypres Cadillac Mines, 3 SEC 41; Unity Gold Corp., 3 SEC 618; Austin Silver Mining Co. 3 SEC 601; Thomas Bond, Inc., 5 SEC 60; Potrero Sugar Company, 5 SEC 982. The Court of Appeals for the 6th Circuit has affirmed this proposition. Ottis v. SEC, 106 F.2d 579 (1939). Each of respondent's sales carried with it the clear -- though implied -- representation that the price was reasonably related to that prevailing an an open market. See Duker & Duker, 6 SEC 386; Charles Hughes & Co., Inc. SEC (1943, Aff'd Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (C.C.A. 2d, 1943), cert denied 321 U.S. 786 (1944). Without disclosure fully revealing that the 'market' was an internal system created, controlled and dominated by the respondent that representation was materially false and misleading."

The Commission's observations in Norris & Hirshberg are equally pertinent to the facts of the instant case.

In discussing the obligations inherent in the sale of securities and in connection with recommendations which may be made for the pur chase of the securities the Commission in Securities Exchange Act Release No. 4445 stated that:

> "The Commission has, however, repeatedly held that it is a violation of the anti-fraud provisions for a broker-dealer to recommend a security unless there is an adequate and reasonable basis for the recommendations and, further, that such recommendations should not be made without disclosure of facts known or reasonably ascertainable, bearing upon the justification for the recommendation. As indicated, the making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation. In addition, if such dealer lacks essential information about the issuer, such as knowledge of its financial condition, he must disclose this lack of knowledge and caution customers as to the risk involved in purchasing securities without it."

The Commission in making the above quoted statement cited a series of decisions which prompted Release No. 4445. 32/

In the instant case Gladstone and Livingston repeatedly recommended CFM and Landsverk to customers as good securities or interesting speculations without disclosing any of the materially adverse financial facts such as have been described hereinabove. Jack Apple also made such recommendations concerning over-the-counter securities and in addition recommended the purchase of Squire for Men without advising such customers of the materially adverse facts related to Squire.

In the Matter of MacRobbins & Company, Securities Exchange Act Release No. 6864 (July 11, 1962) the Commission stated that

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

In the well-known shingle theory the dealer's primary obligation is to deal fairly with his customer. The shingle theory is that "even a dealer at arms length impliedly represents when he hangs out his shingle that he will deal fairly with the public. It is an element of that implied representation, the theory goes, that his prices will bear some reasonable relation to the current market unless he discloses to the contrary. Therefore, charging a price that does not

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32/ See N. 1 of Securities Act Release No. 4445, which cites United States v. Crosby, 294 F.2d 928 (2d Cir. 1961); SEC v. Culpepper, 270 F.2d 241 (2d Cir. 1959); Gilligan, Will & Co. v. SEC, 267 F.2d 461 (2d Cir., 1959); SEC v. Mono-Kearsarge, 167 F. Supp. 248 (D. Utah 1958); In the Matter of Barnett & Co., Securities Exchange Act Release No. 6310, July 5, 1960; In the Matter of Best Securities, Inc., id., No. 6282, June 3, 1960.

bear such a relation is a breach of the implied representation and works as a fraud on the customer."[33/]

One of the most recent expositions of the obligations of dealers and brokers in disseminating opinions about stock which they offer the public is set forth in the recent opinion of the United States Court of Appeals for the Second Circuit in SEC v. North American Research and Development Corporation, et al., Nos. 61, 62, 62, 180 (September term 1969) decided March 25, 1970. In its opinion the Court stated at p. 2005 et seq. of its slip opinion that:

"In Hanley v. SEC, 415 F.2d 589, 595-97 (2d Cir. 1969), this Court enunciated in detail the duties of brokers under Rule 10b-5 in disseminating their opinions about stocks to the public. Although that case concerned review of a disciplinary proceeding against brokers, we think the principles expressed there and in similar cases are equally applicable to SEC injunction proceedings under Rule 10b-5. Accord, SEC v. R.A. Holman & Co., Inc., 366 F.2d 456, 458 (2d Cir. 1966) (under Section 17(a) of the Securities Act of 1933). The "special relationship" between a broker and the public creates an implied warranty that the broker has an adequate and reasonable basis in fact for his opinion, and we hold that the SEC has the power to enforce that warranty against a broker by an injunctive action. The Court in Hanly summarized the applicable duties as follows (415 F.2d at 597):

> 'In summary, the standards by which the actions of each petitioner must be judged are strict. He cannot recommend a security unless there is an adequate and

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33/ (See Securities Regulation, Loss Vol. 3, p. 1483). In addition to violating their obligations to deal fairly with the customer under the shingle theory the respondents directly violated the anti-fraud provisions under the Securities Acts by their false and misleading representations concerning CFM, Landsverk and Squire.

> reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonable ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security he should disclose this as well as the risks which arise from his lack of information.
>
> A salesman may not rely blindly upon the issuer for information concerning a company, although the degree of independent investigation which must be made by a securities dealer will vary in each case. Securities issued by smaller companies of recent origin obviously require more thorough investigation.'

The standards remain the same regardless of the sophisitcation or knowledge of the customer and reliance is immaterial because it is not an element of fraudulent representation under Rule 10b-5 in the context of an SEC proceeding against a broker, whether disciplinary (see id. at 596) or injunctive. For similar expositions of these principles of disclosure, investigation, and fair dealing, see e.g. Walker v. SEC, 383 F.2d 344 (2d Cir. 1967); Berko v. SEC, 316 F.2d 137 (2d Cir. 1963); Kahn v. SEC, 397 F.2d 112, 115 (2d Cir. 1961) (Clark, J., concurring); Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944); 3 L. Loss, Securities Regulation, pp. 1482-83, 1490 (2d ed. 1961). The language in Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 543-44 (2d Cir. 1967), referred to by the court below about limiting the scope of Rule 10b-5, was expressed in context of private actions and thus is distinguishable from the instant case. See Hanly v. SEC, supra. 415 F.2d at 596; SEC v. Texas Gulf Sulphur Co., supra, 401 F.2d at 863, 868 . . . ."

Of the 46 customer-witnesses who testified in this proceeding 21 were men, including 4 who classified themselves as "retired," and 25 were women, including 8 widows, 3 divorcees and 6 unmarried women. Excluding 3 of the women witnesses, each of whom appeared to be about 50 years of age, thirty-four of these witnesses ranged in age from 48 to 86. Three were from 81 to 86 years of age; 12, including 5 widows and 2 divorcees, were from 70 to 75 years of age; 7, including 1 widow, were from 60 to 68 years of age; and 12, including 2 widows, ranged from 48 to 59 years of age. The great majority of the customer-witnesses depended on their salaries or salaries of their husbands for their livelihood. Some were dependent on pensions and social security. A few had small amounts of investment income. A substantial number were elderly with limited financial means and were required to continue working in order to support themselves.

The investment objectives of these witnesses varied. But at least half, either by specific statements made to the salesmen, or by implication, desired income. A few professed interest in capital gains, but did not associate that interest with highly speculative securities. A few others were interested in speculative securities generally, without indicating any apparent knowledge of the qualitative differences in such securities with the consequent varying degrees of speculation; i.e., the differences between low-priced, unseasoned O-T-C stocks such as Squire, Landsverk or CFM and a speculative stock listed on the New York Stock Exchange. A substantial number of investors were very naive, gave no investment objectives, other than that common to all securities investors, namely: "to make money."

None of Franklin's salesmen who approached these customers received any commission when the customer sold stock through Franklin. The earnings of each of respondent salesmen depended on his ability to sell stock to Franklin customers.

When respondent salesmen requested customers to buy stock being offered by them and were advised by customers that they did not have funds available to purchase such stock they frequently advised the customers to sell securities which they owned or which they had previously sold to such customers in order to buy the securities then being suggested or recommended to such customers. Frequently the amounts realized in the sale of such securities matched or substantially matched the cost of the new securities being acquired by the customers.

On a substantial number of occasions respondent salesmen engaged in the practice of recommending that a customer buy one of the securities being offered by Franklin and that another customer at the same time sell the same security making the corresponding sales and purchases at a profit to Franklin and to themselves. This practice necessarily in the context of respondents relations with these customers involved the essentially false representation that the trade was advisable for each one of the customers. Any argument in this context that this cross trading cannot be found to be fraudulent because Franklin's prices represented the "current market price" in each instance is irrelevant and in fact ignores the truth that cross trading in its customers' accounts was one of the ways in which the respondents exacted their overall extortionate mark-ups, and mark-downs and dealt unfairly with their customers. The record shows that this

method was an integral part of Franklin's scheme of business and that it was conducted for Franklin's profits rather than in the best interests of its trusting customers. The practice violated the essential obligation of the respondents to act fairly towards their customers.

The intangible character of securities and the fact that they are representative of funds invested in a business renders them different from the ordinary merchandise dealt in by the butcher or the grocer. The intricate nature of the securities markets has resulted in placing dealers in securities in positions of special advantage with relation to their customers and has placed upon them special obligations.

The Congress, in enacting the Securities Act of 1933, regarded securities as "intricate merchandise." H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 8. And the President in his message to Congress recommending that legislation, stated among other things, that

> "This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware'. It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence."

Following the adoption of the Securities Act, the next step in the Congressional program for safe-guarding investors in securities was the adoption of the Securities Exchange Act of 1934. This Act followed a very thorough investigation into the abuses common in the securities markets, the complexity of those markets, and the need of investors for protection against overreaching by insiders including particularly dealers in securities.

In Archer v. Securities and Exchange Commission, 133 F 2d 795, 903 (C.C.A. 8th, 1943), cert. denied 319 U.S. 767, June 7, 1943, confirming a Commission order of revocation of a dealer's registration, the Court stated:

> "The business of trading in securities is one in which opportunities for dishonesty are of constant recurrence and ever present. It engages acute, active minds, trained to quick apprehension, decision and action. The Congress has seen fit to regulate this business. Though such regulation must be done in strict subordination to constitutional and lawful safeguards of individual rights, it is to be enforced notwithstanding the frauds to be suppressed may take on more subtle and involved forms than those in which dishonesty manifests itself in cruder and less specialized activities."

In connection with his approach to selling securities to the public Gladstone explained that

> "It is natural if you are going to sell somebody a stock, you are not going to tell them why they shouldn't buy. You try to give them some information why it appears to have an attractive potential as a speculation."

Gladstone's views typify the position of all the respondent salesmen in selling securities to the public.

Their approach to their customers was directly contrary to their obligations.

Seven of the eight witnesses who testified concerning their transactions with Gladstone were women, six were elderly, and the other two were in their fifties. They appeared unaware of the facts upon which ordinary investment judgments would ordinarily be based, and did not ask and were not informed by the respondents. It is true that some of the investors received financial information from CFM but observation of these witnesses and their replies to questions indicates that few if any of the investors could read a financial statement with any substantial degree of understanding.

Gladstone sold 100 shares of CFM on August 9, 1965 and 100 shares of CFM on June 22, 1963 to LCM, a 70 year old woman who was a completely unsophisticated investor.[34/] The witness was unfamiliar with CFM but was familiar with Piggly Wiggly of Chicago and thought contrary to fact that Piggly Wiggly of California was the same company that she knew when she lived in Chicago. Gladstone sold HL, a 74 year old divorcee who was retired 200 shares of CFM in June 1966. Gladstone sold 100 shares of CFM on June 29, 1965 to GB, a 50 year old woman and he sold her 200 shares of CFM on August 25, 1966. Gladstone also sold GWJ, a 60 year old man retired for about 30 years because of his health, 1,000 shares of CFM for $1,375. He also sold MAR, a 72 year old widow 350 shares of CFM on June 22, 1965. On June 16, 1965 Gladstone sold IEB 250 shares of CFM. IEB was a 73 year old widow. On June 30, 1966 Gladstone sold ASW, a 70 year old retired school teacher who was a widow living principally on a pension 500 shares of CFM stock.

According to Gladstone's testimony he advised these investor witnesses that he was offering them a speculative stock. However, this advice by itself was wholly inadequate insofar as his obligation to furnish information to investors to whom he was recommending stock is concerned. The fact was that during the 1965 stockholders' meeting of CFM which was attended by the Franklins, the treasurer of that company advised the stockholders that the company was "in a horrible condition." Gladstone did not inform any of these customers

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34/ Her understanding of a principal is that ". . . if they are principals that is when there is not a particular dividend. I don't mean commission offer if that is a principal. Isn't that right? They do not have to pay a commission on principals. A principal is a master holder." Gladstone in his first conversation with LCM wanted to know if she wanted to buy . . . certain items were recommendable [sic] or suggested." He told her that the company was principals. She would ask Gladstone for his recommendations.

of that fact or that at the end of fiscal year 1963 the company had a retained earnings deficit of almost $100,000; that by June 1964 this deficit had increased to almost $130,000 and that by June 1965 the deficit amounted to over three quarters of a million dollars; that the company's net worth had declined substantially and the book value of CFM's common stock by June 1965 was only 22 cents per share. In addition, he failed to advise the customers that Franklin was the sole market for these securities and that the prices at which Franklin was offering the securities to them was not the true market price.

Although MAR told Gladstone that she wasn't in any position to do any gambling he persisted in his efforts and was finally able to persuade her to buy CFM stock. Gladstone told another customer IEB, that CFM was very good, was in good shape, the company was OK, that the company was growing and that the company was holding its own. She testified that "I take my word from the broker . . . I ask him whether he thinks it is OK and I take a chance on it . . . ." When Gladstone asked HSW to buy Piggly Wiggly she informed him initially that she would not or could not buy these shares but Gladstone persisted in telephoning her in his efforts to sell her this stock. Gladstone told her that many people were moving into the area of Continental Markets and that they had to eat and so Continental Markets would make money. Finally, she told Gladstone she would have to get some money from her savings and loan because she didn't have any money in the bank.

In connection with sales of stock of CFM Gladstone "didn't speak about mounting deficits because they only had a deficit for a

couple of years." He did not tell customers, HL, HSW, GB and GWJ of the mounting deficits although he claimed that he made independent inquiries concerning the issuer. He never talked to any of the principals of CFM.

Gladstone offered and sold the stock of CFM by means of false and misleading statements. In connection with these sales it may also be noted that Gladstone did not know any of the customers he was soliciting, all of whom were solicited by telephone; never made any serious attempt to find out the financial condition of the customers he was soliciting, nor did he give any thought to the suitability of the securities for the customers to whom he was offering such securities.

In addition Gladstone offered and sold the stock of LVK to LCM who bought 200 shares and MBJ who bought 500 shares. Gladstone did not tell MBJ of LVK's mounting deficits. As in the case of his sales of CFM stock he omitted to advise such customers of any of the materially adverse facts relating to LVK which have been discussed hereinabove in this decision.

Livingston had at the time of the hearing been in the securities business for over five years. In late 1963 or early 1964 he was employed by Costello Russotto & Co., where his father Bernard Livingston, had been a registered representative until Costello Russotto's registration had been revoked, and his father suspended because, among other things, they had engaged in violations of the anti-fraud provisions under the Securities Act.[35/] Livingston

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35/ Customer OEH testified that Livingston told her "He [the father] had been ill, had been away somewhere ***"; RMF was told by Livingston that his father "had gone into teaching"; FS testified (continued on following page)

left Costello Russotto because, among other reasons, four other salesmen had left and because of rumors concerning an SEC investigation.[36] In February 1965 he became a salesman for the registrant[37] and left in November 1967.

Eleven (11) of Livingston's customers testified concerning transactions with him. Of the 11, the majority were women; 7 were 50 years of age or older, including 1, aged 62, 2 were 72 and 1 was 81 years of age. Livingston testified that he initially contacted nine of the eleven customer witnesses by telephone calls to them. He obtained their names from his father's list of accounts and in substance told them all that because of various personal problems his father was no longer in the securities business. Livingston did not ask the ages of customers but claims to have had such knowledge through various other inquiries. His "knowledge" was apparently based on guess and appears to have been inaccurate.

Livingston sold 400 shares of CFM on July 23, 1965 to RMF, a 52 year old widow with limited financial resources and income. In this connection Livingston persuaded RMF to sell 1,000 shares of Sunset Industries to buy CFM. Livingston told her that CFM was a good stock to buy but did not give her any specifics concerning the financial condition of CFM.

In August 1965 Livingston sold 700 shares of CFM to OEH, a 72 year old widow. She obtained the funds to buy the stock by following

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35/ (Continued)
that on the initial call, in response to her inquiry concerning the source of her name, Livingston referred to some stock she bought in 1959 from another broker; GEB in testifying concerning Livingston's initial call, made no mention of any reference to Livingston's father but stated that Livingston was referred through his relations with another broker, Osborne Co.

36/ On July 15, 1966 the Commission issued an order revoking Costello Russotto's registration and suspending Bernard Livingston. Bruce Livingston thereafter approached certain of his father's customers to sell them securities over the telephone. In doing so he misrepresented the facts to them concerning his father's disassociation from the securities business by telling them his father had retired or gone into teaching.

37/ See Costello Russotto & Co., Securities Exchange Act Release No. 7729.

Livingston's suggestion by selling 600 shares of Ideal Brushes. The amount of proceeds from the sale of Ideal Brushes was $1,049.60 and the amount of the CFM purchase was $1,050. In July 1965 Livingston sold NWC, a director owner of a nursery school 200 shares of CFM. The funds for the Piggly Wiggly shares were derived from a concurrent sale of another security made at the suggestion of Livingston. In July 1965 Livingston sold RAN 375 shares of CFM for $562.50 and persuaded RAN to use the proceeds from the sale of another security to acquire the CFM shares. Livingston told RAN that CFM showed promise and had a good chance to make a dollar or two. In April 1967 Livingston persuaded RAN to buy an additional 125 shares of CFM. This was another sale in which the purchaser sold another security in order to acquire CFM. In July 1965 Livingston sold GEB, an engineer 200 shares of CFM. In nearly all of these sales the funds to acquire CFM were obtained through the sale by the customer of another security at Livingston's recommendation. Livingston persuaded RMF to purchase CFM on three separate occasions. On July 23, 1965 she bought 400 CFM shares, on November 16, 1965 he persuaded her to buy 400 additional shares of CFM and on July 12, 1966 he persuaded her to buy 100 more shares of CFM. RMF is a 52 year old widow with limited financial resources and income. RMF told Livingston that "these stocks were to be used to put her two boys through college." Livingston told RMF that CFM was a "good stock to buy" [38/] and that Piggly Wiggly (CFM) had purchased Toluca Markets. CFM had not purchased Toluca markets. RMF had other transactions and in nearly all cases sold one security to buy another at Livingston's suggestions. OEH, a 72 year old widow told Livingston that she wanted

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38/ See In the Matter of Richard J. Buck & Co., Securities Exchange Act Release No. 8482, p. 6 (December 31, 1968).

dividends and "what I was always hollering for was dividends." In addition she testified that ". . . with Bruce I never put out cash he was always trading one stock for another." In August 1965 on Livingston's recommendation she sold 100 shares of Ideal Brushes for $1,049.60 and concurrently bought 700 CFM shares for $1,050 after Livingston falsely represented to her that CFM would merge with Boys Market and told her CFM was a "good stock for me to have". Livingston told NWC that in July 1965 that CFM might be a good stock because of a merger or acquisition that was going to take place. As a result on Livingston's recommendation he sold 600 shares of one security for $323.88 and concurrently bought 200 CFM shares for $300. Livingston told RAN that CFM showed promise and had a good chance to make a dollar or two. There were no mergers or acquisitions and none were contemplated.

Livingston never advised any of his customers concerning the true financial condition of CFM and that CFM was in no position whatever to acquire another company. In fact, Livingston never made any disclosure of the adverse facts concerning CFM which were clearly material to an investment determination.

In May 1965 Livingston sold 500 shares of Landsverk to MLEM, a 50 year old woman, with funds from the sale of another stock. In this connection, Livingston told MLEM that Landsverk had good prospects and since the other stock hadn't moved, he suggested "we could switch into this Landsverk and probably do better." She knew nothing about Landsverk's financial condition and Livingston did

not tell her. In February 1966 she bought 800 additional shares of Landsverk with the proceeds of the concurrent sales of another stock on Livingston's advice that "it would be a good idea to pick up some more of it."

In February 1966 Livingston sold LEB, an 81 year old retired office worker 500 shares of Landsverk using the funds from a concurrent sale of another stock. LEB had been a customer of this respondent's father and had also done business with Franklin. Livingston never asked this witness any questions about his financial background or objectives. Livingston told this investor that Landsverk had a better future than Sonoma another stock held by LEB. According to LEB he was complaining to Livingston about Sonoma, a stock he had purchased through Franklin and Livingston told him that Landsverk had a better future than Sonoma and there "was a better chance of recovering my money than hanging on to Sonoma." He told LEB nothing about the financial condition of Landsverk. LEB got his first reports on Landsverk from the company after he bought the stock. In January 1966 Livingston sold 400 shares of Landsverk to GEB. This witness has no recollection of Livingston's advising him concerning Landsverk's financial condition.

Apple has been in the securities business since August 1954. He was first employed by James Logan for a period of approximately three years after which he became employed by Franklin and the registrant.

Twenty-one customers testified concerning their transactions with Apple. In general, the witnesses who testified concerning their

transactions with Apple like those who transacted business with Gladstone and Livingston were on the whole unsophisticated and uninformed.

Apple telephoned ALS, a physician either in November or December 1965. For a year and a half prior to this telephone call ALS had had no transactions with the registrant. From the time of Apple's phone call to February 1967 ALS pursuant to Apple's recommendations engaged in 64 transactions including 13 involving CFM, Ideal Brushes, Controlled Products, and Sunset Industries, four of the 13 securities in which Franklin was the sole or dominant market maker. These transactions were all brought about by telephone calls initiated by Apple and by Apple's recommendations which ALS followed. Apple never discussed with ALS any information concerning the financial condition of any of these companies. ALS did not know whether or not CFM, Controlled Products or Ideal Brushes were listed securities. ALS' conversations with Apple were never extensive and he "would go on his [Apple's] recommendation." On June 17, 1966 ALS purchased 1,000 shares of CFM and on December 15, 1966 he purchased an additional 500 shares of CFM. In January 1967 he purchased an additional 800 shares of CFM.

ALS never made any independent inquiries concerning any of the companies for which he purchased stock. All these shares were purchased solely on the basis of Apple's recommendations to ALS. "He [Apple] would call me and make recommendations and I would go along with them". Apple never disclosed "any financial figures like liabilities and assets" or "deficit or profit". Most of the transactions

involved sets of concurrent sells and buys utilizing the same funds. As ALS explained "we would buy something and we would sell something " based on Apple's statements that the stocks purchased "were good or I [ALS] would be better off making the change," and all transactions "were recommended for a better position or a better stock," that is, better "than the ones we were selling". ALS was "willing to buy anything listed on the board" but didn't know whether CFM, Controlled Products or Ideal Brushes were listed securities; he had never given instructions to Apple concerning any type of securities he wished to buy and "was just selling to buy anything that was over the counter as [sic] listed on one of the big boards. ALS does not know what a "principal transaction" is.

HMB is 71 years old, and self-employed. He had some income from rental properties. Apple called him in October 1965 and referred to stocks he had purchased from Costello Russotto. Apple made no inquiry concerning HMB's financial resources. HMB did not advise Apple that he had any interest in speculative stock. In October 1965 on Apple's recommendation HMB bought 700 Piggly Wiggly and concurrently sold 540 shares of Sunset Industries. At that time Apple told HMB that "they expected the price [of Piggly Wiggly] to really rise on it, thought it was a good deal" but did not give him any information concerning the financial condition of Piggly Wiggly. At the same time he told him to sell Sunset Industries because "it was stagnant and not moving." There was no reasonable basis for the price prediction.

AP works in the produce business, is 75 years of age and relied on his salary to support himself and his blind wife. Apple telephoned him several years ago but he did not inquire concerning his financial condition. AP borrowed money from his daughter to buy stocks. In January 1966 on Apple's recommendation he sold 1,000 shares Controlled Products and Electronics at 1-3/4 to buy 1,000 shares of CFM at 1½. Apple told AP Controlled Products was "not doing so well" and that CFM was a ". . . very good buy, it was expanding and it was a good buy". But he did not tell AP anything at all about the poor financial condition of CFM. He also told AP that CFM's third quarter report would soon be out and it would prove it would be substantial." He also told AP that CFM was a new company and expanding. In August 1966 in two transactions, involving precisely the same amount of money., AP sold 1,375 Controlled Products shares for $2,750 in order to buy CFM stock for $2,750. He bought CFM solely because of his faith in Apple's recommendation. In connection with this purchase he told Apple that he had heard that someone else had bought CFM for $1.10. Apple said that "it was impossible because no one had a right to sell Continental stock other than the Franklin Company, no one else had authority and if it came from any other broker they would have to buy it through the Franklin Company and sell it to their clients...." Later AP told Apple that he had not received a quarterly report. Apple told him not to worry about it they are doing okay. He also said that Apple expressed the opinion that the stock ought to get to $2 pretty soon. The opinion was without reasonable basis.

REH a retired oil company worker, is 81 years of age. Except for the purchase of oil company stock from his employer and a purchase of Piggly Wiggly stock about 1963 or 1964 REH had no securities experience. From June 1965 to March 1967 REH engaged in 28 transactions with Apple the only salesman with whom he traded. Each of the transactions was initiated by telephone calls from Apple in which he recommended the specific securities involved. On June 18, 1965 he recommended the sale of 525 Piggly Wiggly and the purchase of another security with the proceeds. On September 10, 1965 he recommended the purchase of 1,000 shares of Squire without disclosing the financial condition of the company.

AD a retired grocer is 68 years old. He first invested in securities through Costello Russotto. Apple first telephoned AD in 1965. AD has never met Apple. He informed Apple as to the securities he held. About five months later he started to do business with Apple. Thereafter on Apple's recommendation he engaged in five sets of transactions all involving securities in these proceedings which he characterized as "exchanging"; all involving about the same amounts of money on both the sell and the buy side. In October 1965 he purchased 1,300 shares of Piggly Wiggly but was given no information concerning the financial condition of the company except that Piggly Wiggly was reorganizing with new management. AD did not receive any information concerning the financial condition of any of the companies whose securities he purchased. AD did not know what a principal or agency transaction was and Apple did not tell him whether any of the

transactions were on a principal or agency basis.

JAG is single, middle aged, is principally reliant upon her salary as a laboratory technician with a milk company for her livelihood. She has some securities. In 1964 Apple telephoned that "he would be handling" her in place of another salesman. She had no recollection that Apple ever inquired concerning her financial position or investment aims. She had 61 transactions from January 1964 to March 1967, including 32 transactions from July 1965 to March 1967, many involving Squire, Controlled Products, Piggly Wiggly, Ideal Brushes, and California Girl. On October 21, 1965 she made a concurrent sale of 2,000 Controlled Products for $2,998 and purchased 1,800 Piggly Wiggly for $2,700. On September 30, 1966 she made a concurrent sale of 1,800 Piggly Wiggly shares for $2,250 and purchased 1,100 Ideal Brushes shares for $2,200. The transactions were based on recommendations by Apple and JAG made no inquiry concerning tne stock she purchased and doesn't know what a principal transaction is.

LC is a 57 year old secretary who has been with the same employer approximately 25 years. She first bought Piggly Wiggly in 1961 after seeing an advertisement for the stock put out by Samuel B. Franklin. In 1964, Apple, whom she has never met, took over her account. Apple never inquired as to her financial position. On Apple's recommendation she engaged in numerous concurrent transactions involving sales and use of the same funds for purchases. In March 1965 she purchased in one of three concurrent transactions 200 shares of Piggly Wiggly. On May 11, 1965 she sold 375 Piggly Wiggly shares and purchased another security. All of her transactions were made on Apple's recommendations.

RKK is a 54 year old housewife financially dependent on her husband. Apple called her in 1964. She has never met him. He told her that if she "would trust him that he would make money" for her but he never inquired concerning her financial position. She also engaged in buying and selling concurrently using the sales proceeds to buy other securities. She took Apple's recommendation and accepted "his word" with regard to transactions on which he was advising her.

DLB is a middle ageddivorcee with four children and is dependent upon her employment as a real estate agent for her livelihood. Apple whom she has never met called her in 1965. In July 1965 she purchased 400 Piggly Wiggly shares upon Apple's recommendation with funds from a concurrent sale of Squire. In October 1965 in two concurrent transactions she purchased 400 Piggly Wiggly shares with funds from the sale of Controlled Products. Apple told her Piggly Wiggly was a "good buy". In March 1966 she sold the 800 shares after calling Apple because she needed money. Apple told her he would try to get the best buy he could for her. Thereafter the registrant bought the 800 shares from DLB at a mark-down of 9%. Apple did not discuss Piggly's Wiggly's financial condition with her nor did he ask her about her financial circumstances. She did not know what a principal transaction was.

GJC is a 67 year old insurance man. In July 1965 Apple whom he had never met telephoned him and referred to his holdings in Piggly Wiggly shares. Apple stated in substance that there was little

action in Piggly Wiggly stock and that he could give GJC $1.25 per share. Apple told him that he had a buyer that wanted to purchase some Piggly Wiggly stock. Apple did not discuss whether registrant was taking the stock as a principal. In the same telephone call Apple concurrently sold him another security as part of the same transaction and the proceeds of the Piggly Wiggly sale was used in partial payment of the purchase of the other securities. Apple did not inquire concerning GJC's financial objectives nor did he give him the bid and ask quotations on Piggly Wiggly.

VFC is a self-employed surveyor with no experience in the purchase of securities prior to 1965 when he bought stock from the registrant. VFC in October 1965 sold 300 Controlled Products shares for $449.84 and bought 300 Piggly Wiggly shares for $450. Apple told him that Piggly Wiggly was "a good stock to buy." VFC told Apple he did not have any extra "money". Apple then suggested the sale of Controlled Products because Piggly Wiggly was "a better deal than Controlled Products." Apple did not discuss the financial condition of Piggly Wiggly and both the purchase and sale were recommended by Apple. VFC does not know what a principal transaction is.

SPS owns a delicatessen and is 51 years old. He had been a client with Costello Russotto and had bought 200 shares of Tabach. In 1965 or 1966 he received a telephone call from Apple whom he has never met. On Apple's recommendation he sold his Tabach shares. At that time Apple recommended that he buy CFM. After Apple told him of a possible merger between CFM and Boys Market he "let Apple

use the $500 realized from the sale of Tabach to buy 400 shares of CFM for $500. His understanding of a principal transaction is that it is "a transaction where a person buy a security from a broker on his own initiative and not recommended."

FAB is a middle aged registered nurse 65 years of age. She received a telephone call from Apple whom she had never met. She purchased on Apple's recommendation Ideal Brushes on three separate occasions: 400 shares on July 19, 1965, 150 shares on August 1965 and 550 shares on August 18, 1965. Apple claimed that he told FAB that Ideal Brushes was a speculation, that "we were making a market" in the stock and gave her the "bid and ask". In connection with the August 1965 transaction FAB used the funds from the sale of Hitco to purchase Ideal Brushes pursuant to Apple's recommendation. In October 1965 pursuant to Apple's recommendation she sold 300 shares of Controlled Products and bought 200 additional shares of Ideal Brushes also pursuant to Apple's recommendation. The two sets of concurrent transactions involved like amounts of money. Apple did not inquire concerning her financial condition or her investment objectives.

MM is a 48 year old widow with two dependent children. She had invested approximately $15,000 in stocks which she had bought for "long term" and for the "interest and dividends off of them". Apple had sold her some Piggly Wiggly bonds in about 1960 or 1961. He continued to call her occasionally thereafter. In December 1966 Apple telephoned her and told her that he had something fine and

asked her if she would be interested in buying some more Piggly Wiggly stock. He said "There was something about to happen. He couldn't tell me what it was, but if I had extra money to invest, it would be wise to invest it then, which I did and bought 300 shares." MM asked him specifically what was going on but Apple told her that ". . . he could not tell me at that time but he would let me know later on." Based upon these representations she bought 300 shares of CFM. Apple gave her no information concerning CFM's financial condition and she did not know what it was.

RL is a retired school librarian 86 years of age who relied on her pension for a livelihood. She began receiving telephone calls from Apple but does not recall whether he inquired concerning her investment aims or whether she was desirous of income not speculation. Apple telephoned her and told her that Controlled Products hadn't done much and perhaps it was a good time to get something different which would be better. RL told Apple that she was willing to take his judgment on that and in February 1966 she sold 200 shares of Controlled Products for $400 and concurrently bought 150 Ideal Brushes for $375. According to Apple he gave RL the bid and asked quotations and indicated that "we were making a market." He also told her that Ideal Brushes was an "interesting speculation".

WFN is a 73 year old semi-retired man employed by a milk company for 40 years which use his services from time to time. In 1965 he received a call from Apple who told him that Costello Russotto had

gone out of business, that Franklin had taken over their business and Apple had his name from that source.

Apple did not inquire concerning WFN's financial condition nor his investment objectives but WFN told Apple that he was "too old to worry about capital gains" and wanted income stocks. On August 3, 1965 on Apple's recommendation WFN sold stock of California Girl and White Lighting, securities which he held and with the proceeds he bought 400 shares of Santa Anita. On August 25, 1965 on Apple's recommendation WFN sold 900 shares of Ideal Brushes and bought 6 shares of Santa Anita. On October 7, 1965 on Apple's recommendation WFN sold 4 shares of Santa Anita, and bought 1,000 CFM shares. The CFM purchase amounted to $1,375 and the amount received from Santa Anita shares was $1,359. In this connection Apple told WFN that CFM ". . . was a wonderful buy . . . ." It may be pointed out that this customer was getting dividends from the Santa Anita stock but did not get any from CFM. Apple did not tell WFN anything concerning the financial condition of CFM nor did he tell WFN whether the company was making or losing money or whether there was a deficit. On October 19, 1965 WFN pursuant to Apple's recommendation purchased 500 shares of Piggly Wiggly for $750. Prior to the purchase it was WFN's recollection that Apple told him that Piggly Wiggly had purchased Park View Drugs and that would make the company that much better. WFN had never made a study of these securities and when asked what a principal transaction was he replied that he did not know except that he thought he was a principal.

EMO is a 64 year old widow employed as a substitute cafeteria worker in the Los Angeles schools who relied on social security and her earnings for her livelihood. EMO had purchased CFM (PW) shares through Franklin in 1955. In 1965 she received a telephone call from Apple whom she did not know and didn't meet until 1967. He didn't ask her any questions concerning her financial condition or investment aims but asked whether she would be interested in buying stock. In July 1965 she told Apple she was dissatisfied with CFM stock because it had not paid a dividend and on his suggestion she used the proceeds from the sale of such stock to buy one share of Hollywood Turf. After Santa Anita split its stock, on Apple's recommendation, she sold such stock and used the proceeds to buy 200 shares of Ideal Brushes. Apple testified that he furnished the bid and asked prices of Ideal Brushes and told her that Franklin was making a market in the stock.

EEN a 49 year old married woman received a telephone call from Apple in 1965. She had never met him. She advised Apple that her objective was to make a larger profit than she would in a savings and loan account. In July 1965 in two concurrent transactions on

Apple's recommendation she sold 620 shares of Squire for $774.68 and bought 400 shares of Ideal Brushes for $800.00 Apple did not discuss the financial condition of Ideal Brushes. In August 1965 she purchased 600 additional shares of Ideal Brushes also without any information concerning the company's financial condition.

In February 1966 Apple called ASW a lawyer engaged in the office machine business and recommended the purchase of Squire shares. When ASW told Apple that he didn't want to invest any more money Apple suggested he sell Controlled Products in order to obtain the funds to purchase the shares of Squire. He advised ASW that "Squire would move better than Controlled Products and that Squire was a "growing company" and it had a "real future". At the time of this recommendation Squire was practically defunct and ceased business entirely in the following month. He did not discuss with ASW Squire's financial condition and deficits. ASW knew little about securities did not know what a principal or agency transaction was, and testified that financial reports would have been "meaningless" to him.

JA is an unmarried woman 57 years of age engaged in retailing girls' clothing. She originally bought stock through Costello Russotto, In October 1965 she received a telephone call from Apple. Apple called her thereafter with respect to purchases and sales. She told Apple she wouldn't invest any more money in the market but would buy and sell only with the money she had already invested. JA engaged in 14 transactions from October 1965 to July 1966 principally in concurrent buys and sales where the sale proceeds were used to effect the purchases.

Apple did not discuss or disclose the financial condition of any of the firms whose securities were involved. JA does not know the difference between a principal or agency transaction.

In addition to the testimony of witnesses who transacted business with the respondent salesmen, six witnesses testified to transactions with three registered representatives formerly employed by the registrant.

RLF a 74 year old widow transacted business with RJF and a registered representative named Fleischman.[39/] In 1959 a friend recommended that RLF see RJF and subsequently she purchased through RJF a Piggly Wiggly debenture. In September, 1966 she received a telephone call from Fleischman who was then employed by the registrant. He did not inquire concerning her financial condition, age, or investment objectives. She had purchased through Fleischman some shares of Chemical Milling International. Fleischman told RLF to sell her Chemical Milling International shares and buy CFM shares because CFM was "going to put on a big advertising campaign soon . . . and "the stock was going to go up to $2½ . . . ." Fleischman did not discuss CFM's financial condition. RLF "did what he said" and in concurrent transactions sold 200 Chemical Milling International shares for $250 and bought 200 CFM shares @1½ for a total of $300.

39/ Fleischman was found by the NASD in 1962 to have engaged in unfair practices in the churning of an account while in Franklin's employ in 1959-60. In 1960 he became a partner in Century Securities Company and returned to the employ of registrant in late 1965 or early 1966 after Century ceased doing business. On July 14, 1967, the Commission barred Fleischman from association with any broker or dealer by reason of multiple acts of fraud found in the Century case.

The sale proceeds were applied to the purchase cost.

GGL a real estate saleslady 70 years of age relied on her earnings in selling real estate, social security and income from some stocks for her livelihood. She did business with James Logan & Co. and after it was put out of business she received a call from Frank Colton then with Franklin and she did some business with him.[40/] In 1966 she did business with Allan Adams a registered representative then employed by the registrant. She had done business with Adams when he was associated with Costello Russotto. Adams called this witness many times seeking to sell her securities. In August 1966 at Adams suggestion she sold Sunset Industries and bought CFM shares. She concurrently sold 200 Sunset Industries for $630 and purchased 500 CFM for $687.50 applying the sale proceeds to the purchase cost.

In June 1966, Adams telephoned MLM whom he had never met. MLM is a lawyer who had been in practice 15 years. He owned 100 shares of Pathe stock. Adams recommended that MLM sell the Pathe stock and apply the money received to the purchase of CFM. Adams told the witness "that the Government had ordered Von's and Shopping Bag Markets split, and that there was a good possibility that Continental Markets--he mentioned a Mr. Goldstein -- would be able to pick up Shopping Bag and this would be a reason why Continental Markets would be a desirable investment at that time."

40/ Colton became Fleischman's partner in Century Securities Company in 1960 and was barred from broker-dealer association on findings of multiple fraud in the Century revocation proceeding.

He told MLM that the stock was being offered in a very limited amount, and "I recall that it was some stock, either Mr. Goldstein personally held or that was corporation stock, not in the hands of any other shareholder who was not part of the management of Continental."

Following these false and misleading representations MLM sold his Pathe stock and applied the proceeds of $205.25 to the purchase of 500 shares of CFM and paid a balance of $482.25. Adams never advised MLM concerning the financial or operating condition of CFM.

KW was first contacted by Adams in 1965 when the latter was with Costello Russotto & Co. In September 1966 Adams then with registrant recommended that KW buy 1,000 shares of CFM because the price was only $1½. Since KW did not have $1,500, at Adams' suggestion he sold 200 shares of Sunset Industries and used the proceeds from that sale and added $900 to cover the cost of CFM stock. Adams did not discuss CFM's financial condition. KW did not know what a principal transaction was.

DPS of middle age owns a restaurant. James Briddle, a registered representative of Franklin was "a regular customer at the bar". On Briddle's recommendation DPS purchased 400 CFM shares in July 1965 after Briddle had told him "one of the big firms and I forget which one expected to buy this Piggly Wiggly out." Briddle did not disclose Piggly Wiggly's financial condition or whether it

was making or losing money. The testimony of the investor witnesses concerning their transactions with Fleischman, Adams and Briddle were not contradicted and is credited.

LN is 62 years old and is in the retail grocery business. In 1966 he received a telephone call from Adams who was then a registered representative employed by Franklin. LN has never met Adams. Adams telephoned and "recommended to me [LN] that I buy CFM shares." Adams made no inquiry concerning LN's financial position or objectives. Adams never advised LN of the financial condition of the companies whose stock he was offering. LN "just took his [Adams'] word for it." In June 1966 Adams called LN and told him of a possible merger of CFM with an eastern firm and that the stock would "substantially increase" if a merger took place. He also told LN that "they [CFM] are going good" but made no disclosure of CFM's financial condition. In March 1967 Adams telephoned LN and told him that California Girl had a few shares and there was "a chance to double my money within a short period" but did not advise LN concerning the company's financial condition.

The respondents contended in connection with their discussion of the testimony relating to Jack Apple stated that "There not only is not substantial evidence to support the Division's contentions, there is no evidence to support these contentions." (Underscoring by respondents). In substance, they make the same contentions with regard to the other respondents.

Numerous investor witnesses appeared and testified as to the false and misleading representations made to them by respondent salesmen. On the other hand the registered representatives in many instances directly contradicted the testimony of investor witnesses or gave testimony which was otherwise inconsistent with the testimony of investor witnesses. In their proposed findings and brief and in the oral argument made to the Hearing Examiner following the conclusion of the hearing, the respondents directly attacked the credibility of certain investor witnesses. Further, the testimony of six witnesses who had been sold securities by three salesmen formerly employed by registrant includes numerous false and misleading statements made by such salesmen and such testimony is uncontradicted and is credited.

It should also be observed that the Division contended that in selling CFM, Landsverk, and Squire the registrant and the respondent salesmen, among other representations, made misleading representations in that in recommending the purchase of these securities the salesmen omitted to tell investors of the unfavorable material financial condition and operating facts necessary to the exercise of a reasonable judgment whether or not to buy such stock. While the respondents on the other hand claim to have furnished adequate information to investors concerning these companies nearly all investor witnesses testified that little or no specific information was given them by respondent salesmen concerning the unfavorable financial or operating facts pertaining to these companies. Further, the respondents attempted to explain

away these material omissions by claiming that they told their customers that these companies were losing money and that they were being offered speculative securities and by emphasizing the alleged desire of the investors to buy low-priced speculative securities and by pointing to the fact that some of them received literature including financial statements from CFM or had received North's Newsletter. Not only was the adequacy of the alleged representations made by the salesmen concerning the financial condition of these companies an issue, but in a substantial number of instances a credibility issue arose as to whether even these inadequate representations were made at all. Contrary to respondents' contentions the testimony presented in this proceeding raised important credibility questions as between the respondent salesmen and the investor witnesses which required resolution. Furthermore, in connection with the question of excessive mark-ups and mark-downs the testimony of the registered representatives particularly concerning their representations to customers as to the bid and asked prices and their representations as to the market in the securities at issue here were, even if not so intended, supportive of the Division's position that such registered representatives made false and misleading statements to their customers in that they implied the existence of a free open and competitive market and quoted bid and asked prices related to such a market when in fact such a market did not exist. The market was not a free, open, and competitive one but was either a sole market or one dominated by the registrant. And the registrant and the salesmen failed to disclose this material fact.

The respondents, among other things, pointed to minor inconsistencies in the testimony of some of the witnesses and emphasized that some of the witnesses were, in the language of the respondents, willing to engage in "interesting speculations" in the hope of making quick profits but this does not justify the making of misleading representations to them by the respondents. It affords them no license to engage in fraudulent conduct. Contrary to respondents' contentions, the comparatively minor inconsistencies in the testimony of some of the investor witnesses are insufficient to discredit them. The Division's contentions were supported by a preponderance of the evidence.

The evidence established that the respondents engaged in a scheme to defraud members of the investing public in an aggressive campaign to sell and buy numerous issues of low-priced speculative securities at unfair prices; and made numerous false and misleading statements to investors to induce them to buy securities offered by the registrant and its salesmen.

Registrant's establishment is comparatively small and while the salesmen occupied separate partitioned desk spaces they were in close proximity to the management of the registrant. The corporate registrant is the successor of Samuel B. Franklin & Co. d/b/a Samuel B. Franklin & Company. Samuel B. Franklin and his son, Richard J. Franklin were both active in the business and were responsible for the failure to supervise properly the salesmen employed by them and in addition were directly responsible for the sales of securities made by them

at the excessive mark-ups and mark-downs which have been described hereinabove. Samuel B. Franklin and Richard J. Franklin were the officers, directors and the sole stockholders of registrant as well as its entire maragement. The salesmen are equally chargeable and responsible for their own actions and as the link between the registrant and its customers in aiding and abetting the registrant in the violations of the anti-fraud provisions under the Securities Acts committed. In this connection it should also be pointed out that "Where salesmen are or should reasonably be aware that their customers may be defrauded through the charging of unfair prices, their responsibility is no less than that of their employer." 41/

Apple, Livingston and Gladstone were all quoting Franklin's bid and asked prices regularly to customers in their effort to sell securities. They knew or should have known that Franklin's bid and asked quotations in the white sheets were not representative of a free and open market. It is well established that in presenting such prices they impliedly represented that the sale prices bore "some relation to a price prevailing in a free and open market." 42/ Such a representation was false when, as here, the dealer dominated and controlled the market and fixed the price of the stock. In these circumstances the salesmen had an obligation not to offer the securities at Franklin's quoted prices without advising them of the facts regarding Franklin's market and the prices they were quoting.

Apple became a registered representative for Franklin in 1957 and Gladstone in 1959. Before making the sales to members of the

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41/ In the Matter of O'Leary, et al., Securities Exchange Act Release No. 8361, p. 9 (July 25, 1968).

42/ Sterling Securities Co., 39 SEC 487 (1959).

investing public in this proceeding they had become familiar with the fraudulent character of excessive mark-ups through their experiences as his employees. Specifically during their period of employment with Franklin, viz in 1959 the Commission affirmed disciplinary action taken against Franklin by the NASD for selling securities to customers at prices that were unfair and not reasonably related to the market. That decision was affirmed by the Court of Appeals in May, 1961, 290 F.2d 719. In September 1964, the Commission sustained a decision by the NASD which held, among other violations, that Franklin had again violated Sections 1 and 4 of Article III of the NASD Rules of Fair Practice by the sale of securities at unfair prices. Their experience should have made them particularly aware of the necessity of complying with the requirements attaching to the conduct of a broker-dealer's business, and in particular they should have been aware of the dangers to customers of practices involving excessive "mark-ups".[43/]

In this context we have the picture of Franklin following the same practices for which he had been the subject of sanctions on two prior occasions, and we have experienced salesmen aiding and abetting Franklin in following such practices.

The salesmen had an obligation to refrain from selling stock at Franklin's quoted prices and their failure to live up to this obligation resulted in sales at excessive mark-ups and purchases at mark-downs.

43/ Merritt, Vickers, Securities Exchange Act Release No. 7409 (September 2, 1964).

Here it is clear or should have been clear to the salesmen that the prices they were quoting did not represent fair prices but they took no steps to ascertain the facts. They took no steps to refrain from selling stock at prices which they had good reason to believe were unfair.

Similarly, Livingston had had experience with the problem of excessive mark-ups when he was employed by Costello Russotto. This broker-dealer was found by the Commission to have charged excessive mark-ups. It would strain credulity to believe that Livingston was unaware of the Commission's determination in the Costello Russotto case. Nevertheless, he also followed the same course as Apple and Livingston. The same conclusion is applicable to him.

Each of the salesmen made false and misleading statements and made optimistic representations without reasonable basis and without the disclosure of materially adverse financial information with regard to CFM, LVK and Squire in order to induce customers to purchase these securities.

The anti-fraud provisions not only prohibit false and misleading statements of a material nature, but also prohibit statements made without adequate basis,[44/] even though the person making them may believe them.[45/] Thus, broker-dealers have a duty of investigation. This rule applies to statements in the form of opinions as well as

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44/ e.g. Barnett & Co., Inc., 40 SEC 521 (1961); Leonard Burton Corp., 39 SEC 211 (1959).

45/ Alexander Reid & Co., Securities Exchange Act Release No. 6727 at p. 5 (February 8, 1962).

of facts, and in the case of predictions, it is immaterial that they ultimately prove correct if the person making them had no basis on which to make them at the time.[46/]

Futhermore a salesman is not entitled to rely upon statements by his superiors concerning securities who in turn rely upon self-serving statements of the issuer's officers.[47/]

Both Franklin and Richard J. Franklin were clearly responsible for representations made by registrant's registered representatives.[48/] It is inherent in the broker-dealer registration requirements that a registrant be accountable for all violations of the anti-fraud provisions of the Securities Acts committed by any person employed by him as a registered representative.[49/] This principle which has been expressed in Commission opinions was codified in Section 15(a)(5)(E) of the Securities Exchange Act of 1934 calling for appropriate administrative sanctions against a registrant's failure to supervise his employees. It is a requirement under the Exchange Act that a registrant establish a system of internal controls for the purpose of

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46/ Securities Exchange Act Release No. 6721 at p. 3 (February 2, 1952) (Statement of Policy); Cf. Standard Bond & Share Co., 34 SEC 208 (1952). See also Cohen & Rabin, Broker-Dealer Selling Practice Standards; The Importance of Administrative Adjustication in Their Development, 29 Law & Contemporary Problems 691 (1964).

47/ J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7737 (June 8, 1964); Berko v. SEC, 316 F.2d 137 (1963).

48/ S.P. Levine & Co., Inc., Securities Exchange Act Release No. 7401 p. 3 (August 20, 1961); Best Securities, Inc., 39 SEC 931, 934 n. 137 (1960).

49/ See National Association of Securities Dealers, Inc., 20 SEC 508, 516 (1945); see Securities Exchange Act Release No. 3674 April 9, 1945, pp. 1-2.

preventing violations of the securities laws by controlled persons.[50]

On March 24, 1959 and September 3, 1964 the Commission affirmed NASD sanctions against Franklin based on violations of the NASD Rules of Fair Practice.

Gladstone's first employment in the securities business was with J. Logan & Company from December 1955 to October 1956. After Gladstone left Logan & Co. he instituted his own broker-dealer firm under the name of Bennett, Gladstone and Manning of which he was secretary-treasurer. He left this firm in 1957 and Gladstone believes that this firm was subsequently revoked. His next employment in the securities business was as a sales representative from August-September 1957 with Arthur Hogan & Co. which withdrew its registration in 1963. It is clear from the history of his employment that he had extensive experience in the securities business and in such circumstances there can be no excuse for his misconduct. In general, Gladstone had a set sales presentation similar to those employed by salesmen in Logan & Co., 41 SEC 88. Livingston was employed for a short time by California Investors, and left that firm in late 1963 or early 1964 to become a registered representative in Costello Russotto where his father was employed. He remained with that firm until February 1965 when he became employed by the registrant. He terminated his employment with registrant in November 1967. He left Costello Russotto because other salesmen had left and because of

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50/ R.H. Rollins & Sons, 18 SEC 347, 390, 395 (1945); Bond & Goodwin, Inc., 15 SEC 584, 599, 601 (1944).

rumors concerning an SEC investigation. Livingston while comparatively young has had extensive experience in the securities business. He appeared to be highly intelligent and in the Hearing Examiner's opinion his misconduct was wilful. Apple became a registered representative in August 1954. His first employment was also with J. Logan & Co., supra. In June 1961 the NASD initiated a proceeding against Franklin, Apple and another respondent which after hearings resulted in a decision on May 17, 1962 in which the NASD found, among other things that Apple had recommended and induced excessive trading (churning) in an account and that Franklin was in violation of the mark-up and mark-down policy. Apple was fined $500 and censured.

Apple also had extensive experience in the securities business. Fleischman another of respondent's registered representatives was found by the NASD in 1962 to have engaged in unfair practices in churning an account while in Franklin's employ in 1959-1960. In 1960 he became a partner in Century Securities Company and returned to the employ of registrant in late 1965 or early 1966 after Century ceased doing business. On July 14, 1967 the Commission barred Fleischman from association with any broker or dealer by reason on multiple acts of fraud found in the Century case (34-8123);(34-8187).

Adams another of the registrant's registered representatives had earlier also been associated with Costello Russotto and he and Fleischman appear to have had substantial experience.

Under the Exchange Act, a registered broker-dealer may not engage in careless hiring practices.[51/] In view of the background of the registered representatives close supervision was necessary. Such supervision was seriously lacking in this case.

The Hearing Examiner concludes that:

A. During the period from about May 27, 1963 to about March 16, 1964 registrant Franklin and Richard J. Franklin singly and in concert, wilfully violated Sections 5(a) and (c) of the Securities Act of 1933 (Securities Act), in that they, directly and indirectly offered to sell, sold, and delivered after sale, shares of the common stock of Kramer-American Corporation, when no registration statement had been filed or was in effect as to such securities under the Securities Act.

B. During the period from about May 27, 1963 to March 16, 1964, registrant, Franklin and Richard J. Franklin, singly and in concert wilfully violated the anti-manipulative provisions of Section 10(b) of the Exchange Act and Rule 10b-6 thereunder in that, during their distribution of Kramer-American stock, they bid for and effected purchases purchases of some common stock for accounts in which they had a beneficial interest.

C. During the period from on or about July 1965 to April 1967 Franklin, Richard J. Franklin, Apple, Livingston and Gladstone

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52/ SEC v. Rapp. 304 F.2d 786 (2d Cir. 1962); J. Logan & Co., Securities Exchange Act Release No. 6848, p. 11. And see Boruski v. SEC, 289 F.2d 738 (2d Cir. 1961).

wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder in that respondents, in connection with the offer, sale and purchase of various securities directly and indirectly, employed devices, schemes and artifices to defraud, obtained money and property 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 and engaged in transactions, acts and practices and a course of business which would and did operate as a fraud and deceit upon customers.

Public Interest

The record is abundantly clear that the respondents, Jack Apple, Bruce D. Livingston and Delmar Gladstone made wilfully false and misleading statements in violation of the anti-fraud provisions of the Securities Act over an extended period of time and that Samuel B. Franklin & Co., Inc., Samuel B. Franklin and Richard J. Franklin failed to maintain and enforce adequate standards of supervision. In addition the registrant, Samuel B. Franklin, and Richard J. Franklin were directly responsible for the excessive mark-ups and mark-downs of the securities referred to herein above and were directly responsible for the false and misleading statements made by the respondent salesmen and other salesmen in their employ relating to CFM, Landsverk and Squire and relating to the bid and asked quotations and the current market prices relating

to securities in which registrant was making a market. Moreover, as has been found, the registrant Samuel B. Franklin's and Richard J. Franklin's violations included effecting numerous transactions in a large number of securities at excessive mark-ups and mark-downs. The conduct of Samuel B. Franklin in this respect has been persistent and wilful. Both Samuel B. Franklin and Richard J. Franklin were aware of the unlawful nature of their conduct but persisted in following this fraudulent practice to the detriment of the investing public. It is clear that the respondents Samuel B. Franklin & Co., Inc., Samuel B. Franklin and Richard J. Franklin, wilfully violated Sections 5(a) and 5(c) of the Securities Act in the sale of unregistered stock of Kramer-American Corporation and that they similarly violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder while effecting a distribution of such shares.

In view of the wilful, numerous and extremely serious violations committed herein by all the respondents the appropriate sanction is to revoke the registration of Samuel B. Franklin & Co., Inc. and to bar Samuel B Franklin and Richard J. Franklin, Jack Apple, Bruce D. Livingston and Delmar Gladstone from being associated with a broker or dealer. It is also in the public interest to expel the registrant from the National Association of Securities Dealers, Inc.

Accordingly, IT IS ORDERED that the registration of Samuel B. Franklin & Co., Inc. is revoked; and that Samuel B. Franklin, Richard J. Franklin, Jack Apple, Bruce D. Livingston and Delmar Gladstone are barred from being associated with a broker-dealer, and that Samuel B. Franklin & Co., Inc., be and hereby is expelled from the National Association of Securities Dealers, Inc.

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

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a decision for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or 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 to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.[53/]

Samuel Binder
Hearing Examiner

Washington, D.C.
June 4, 1970

53/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.