ADMINISTRATIVE PROCEEDING
FILE NO. 3-2169

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
ROBERT F. KRISCH	:
(8-12845)	:

INITIAL DECISION

(Private Proceeding)

Washington, D. C.
June 24, 1970

David J. Markun
Hearing Examiner

C O N T E N T S

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In the Matter of ROBERT F. KRISCH (8-12845)	INITIAL DECISION (Private Proceeding)

APPEARANCES: Martin S. Siegel, New York Regional Office, for the Division of Trading and Markets

Robert F. Krisch, pro se, for respondent

BEFORE: David J. Markun, Hearing Examiner

THE PROCEEDING

This private proceeding was instituted by an order of the Commission dated September 29, 1969, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether respondent Robert F. Krisch, a registered broker-dealer doing business under his own name as a sole proprietor ("registrant" or "Krisch"), committed various charged violations of the Exchange Act and the rules thereunder as alleged by the Division of Trading and Markets ("Division") and the remedial action, if any, that might be appropriate in the public interest.

The evidentiary hearing, at which Krisch appeared pro se, was held in New York, New York, from February 2 through February 5, 1970. During the course of the hearing the order for proceeding was amended [1/] on motion of the Division to add a charge of net-capital violations, a charge of violations of the registration requirements of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and of the anti-fraud provisions of the Securities Act and the Exchange Act in connection with sales of securities issued by Glendale Combine Corporation ("Glendale"), and a charge of failure to supervise.

The parties have filed proposed findings, conclusions, and supporting briefs.

1/ R., 300-301; Hearing Examiner's Ex. 1. See also footnote 28 below.

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

FINDINGS OF FACT AND LAW

The Respondent

Respondent Krisch, 26,[2] has been registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act since June 22, 1966, under his own name as a sole proprietor. His office is in Glendale, Queens County, New York, and he has employed up to eight registered representatives.

Bookkeeping Violations

The order for proceeding contains an allegation that registrant wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3[3] thereunder by failing to accurately make or keep current various books and records during the period June 6, 1966, to date of the order.

2/ The record does not establish respondent's age, but in his brief he states he was 22 when he became registered 4 years ago.

3/ Section 17(a) of the Exchange Act, as applicable here, requires registered brokers and dealers to keep such books and records as the Commission by rule or regulation may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records that must be maintained and kept current. The requirement that records be kept embodies the requirement that such records be true and correct. Lowell Niebur & Co., Inc., 18 S.E.C. 471, 475 (1945).

The record establishes a number of such deficiencies.

As of September 18, 1968, the last trial balance that had been made and retained by the registrant was that for March 31, 1968, and the last net-capital computation that had been made was for January 31, 1968.

As of March 18, 1969, the most recent trial balance and net-capital computation that registrant had made and kept were for September 30, 1968.

No net-capital computation was made or attempted for October or November, 1968, for the reason that the attempted trial balance failed to balance by some $30,000.

Again, no trial balance or computation of net capital was made for January, February, or March[4/] of 1969.

The April 30, 1969, trial balance submitted by the registrant contained material discrepancies as compared with his general ledger.[5/]

As of September 16, 1969, the last trial balance and computation of net capital made by the registrant was as of July 31, 1969.

A number of other books and records of the registrant were also deficient at various times during the charging period.

4/ On March 3, 1969, respondent Krisch voluntarily suspended doing business except for certain "liquidating" transactions (though there were a few purchase orders until March 6, 1969). On or about September 19, 1969, Krisch resumed engaging in the securities business and did so until on or about December 8, 1969, at which time, beset by net-capital and record-keeping problems, he again suspended operations. This latter suspension has continued to the time of the hearing.

5/ Thus, the trial balance showed the trading account "long" $73,374.45 whereas the general ledger showed such item at $20,353.19; the trial balance showed the trading account "short" $1,952.00 while the general ledger included no such item.

As of September 18, 1968, his general ledger was not posted past July 30, 1968, and no stock-position record was being maintained.[6/]

Registrant's effort to obtain a certified audit of its books by Price, Waterhouse as of December 31, 1968, called attention to a number of deficiencies in its books and records. As late as January 15, 1969, respondent did not have customers or brokers statements with their corresponding confirmation requests available for mailing. The responses were needed to permit preparation of a trial balance as of December 31, 1968. As of December 31, 1968, respondent's books and records were not maintained on a current basis. The stock record was at least 3 days behind in posting. Differences disclosed in the November 30 and December 31, 1968, trial balances were not satisfactorily reconciled for two months. Registrant's books and records were not completely posted to the December 31, 1968, date until February 17, 1969, and even then a reliable trial balance as of 12/31/68 was lacking. As of February 25, 1969, registrant's customer ledger and general ledger had not been posted past December 31, 1969, and its stock record, although maintained on a current basis, was inaccurate in that it did not coincide with supporting ledgers, e.g. the fail-to-deliver ledger and the trading ledger.

As of March 4, 1969, the respondent's customer ledger had not been posted past January 31, 1969, and the general ledger had not been posted beyond December 31, 1968.

6/ Respondent began keeping a stock-position record on September 30, 1968.

As of March 18, 1969, the general ledger and customers' individual ledger accounts had not been posted beyond January 31, 1969.

As of April 11, 1969, the registrant's general ledger had not been posted beyond February 3, 1969, and his customer ledger had not been posted beyond February 11, 1969. As of July 14, 1969, the postings to respondent's general ledger and customer ledger were two weeks behind.

In some instances the registrant's blotters, examined by an S.E.C. investigator intermittently during the period March 18, 1969, to December 22, 1969, failed to reflect certificate numbers in recording the receipts and deliveries of securities.

Respondent Krisch seeks to excuse his failure to maintain current and accurate records by pointing to the rapid expansion of his firm, whose accounts grew from 90 in December, 1967, to 500 by August, 1968, and to about 1500 by January, 1969. But this circumstance, which Krisch could have controlled by restricting the rate of growth of his business, if experienced personnel weren't available, cannot excuse his failure to keep accurate and current records. As has been stressed repeatedly, the requirement that books and records be kept current and accurate is at the heart of the regulatory scheme, particularly since it bears significantly on ability to determine whether other types of violations have occurred.[7/] Here the state

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7/ Pennaluna & Company, Inc., et al., Securities Exchange Act Release No. 8063, April 27, 1967; Palombi Securities Co., Inc., et al., 41 S.E.C. 266, 276 (1962); Midland Securities, Inc., et al., 40 S.E.C. 333, 339-340 (1960); Olds & Company, 37 S.E.C. 23, 26-27 (1956).

of the records was such that neither the registrant nor the Commission was in a position to determine at various times whether registrant was in compliance with the net-capital rule.[8/]

It is well established that a finding of wilfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law and that it is sufficient that a respondent intentionally engaged in conduct which constitutes a violation.[9/] Under this standard the record-keeping violations charged and established by the record were clearly wilful.

Net Capital Violations

The order for proceeding, as amended, includes a charge that during the period June 6, 1966, to February 2, 1970, respondent wilfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder[10/] in that respondent effected securities transactions

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8/ In S.E.C. v. Mainland Securities Corp., 192 F. Supp. 862 (S.D.N.Y., 1961) the court stated: "More important than the violation [of the record-keeping requirement] itself is that it prevented a determination of whether there was compliance with the Net Capital Rule."

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

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

(through jurisdictional means) while his aggregate indebtedness to all other persons exceeded 2000 percentum of his net capital and while his net capital was less than the $5,000 minimum required by the Rule.

The record establishes that registrant lacked sufficient capital to comply with the net capital rule on a number of occasions during 1968 and 1969. On August 31, 1968, respondent had a capital deficiency of $6,135.78 and on December 31, 1968 he had a total capital deficiency of $37,361.25.

During the period March 3, 1969, to September 19, 1969, when respondent had voluntarily suspended doing business,[11/] the record shows that as of March 17, 1969, respondent had a capital deficiency of approximately $10,000, without considering the $5,000 minimum requirement; as of April 30, 1969, he had a total capital deficiency of $24,904.73; and as of July 31, 1969, his capital deficiency was $24,324.[12/]

After business operations had been resumed on or about September 19, 1969, the respondent's capital computation for November 28, 1969, showed him as having a capital deficiency of $4,577.04.

11/ See footnote 4 above.

12/ During April-July of 1969 Krisch had infused additional amounts of capital into the registrant as follows: April 29, about $50,000; June 30, $30; and in July, $13,000.

On December 8, 1969, registrant again voluntarily suspended business operations.[13] As of December 18, 1969, respondent had a net capital deficiency of approximately $3,500.

The capital deficiencies shown to have existed on March 17, April 30, July 31, and December 18 in 1969 are not a basis for concluding that net-capital rule violations occurred on or about those dates, inasmuch as those dates fell within periods during which respondent had voluntarily suspended operations and was therefore, so far as the record discloses, not engaging in securities transactions or inducing or attempting to induce them.

As respects the net capital deficiency calculated for December 31, 1968, respondent contends that his books and records at that time did not represent his true financial condition because of errors in the accounts of one of his three clearing brokers,[14] Evans & Co.

13/ See footnote 4 above.

14/ The clearing broker that respondent used mostly was Evans & Co., where respondent had two "omnibus" accounts, one for the firm and one for his customers, as well as a single clearing account for both customers' and the firm's securities.

The clearing account was on an undisclosed basis. Under their oral agreement, Evans & Co. was to receive stock into the clearing account on Krisch's instructions and likewise deliver stock out on respondent's instructions. Respondent executed the orders that were cleared through the clearing account. The great bulk of the securities that cleared through this account were unlisted but a few listed (third market) securities were also included.

Respondent placed the orders (predominantly listed securities) for the two omnibus accounts and Evans & Co. executed the orders. (Continued)

The CPA firm of Price, Waterhouse had worked actively from mid-January, 1969, to March 17, 1969, on an audit of the registrant for the purpose of preparing a form X17A-5 questionnaire as of December 31, 1968. On May 20, 1969,Price, Waterhouse submitted its "report" to Krisch. The "report" was a disclaimer of opinion, the auditors having concluded that the respondent's internal accounting controls and accounting records were inadequate and could not be relied upon for accuracy. Among other things, Krisch had declined to certify to the auditors that respondent's account with Evans & Co. was in order. From the information available, it looked to the auditors that respondent was out of ratio, and they so told him.

After the clearance arrangement with Evans & Co. was terminated at the end of February, 1969, Evans & Co. found as respects the Krisch clearance accounts that they lacked some stock that their records showed they owed to Krisch and that they had some stock on hand that their records did not show as belonging to Krisch but that probably did. Evans & Co. purchased the missing securities to turn over to Krisch

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14/ (Continued)
Respondent designated for which of the two accounts the order was being placed.

At the close of each day any debit in the clearing account was reduced to zero by debiting the customers' omnibus account and crediting the clearance account so as to maintain a zero balance in the clearance account. Respondent maintained the customer's individual account records and Evans & Co. did not have any records of respondent's individual customers. Respondent confirmed directly to his customers. Similar arrangements existed between respondent and two other clearing brokers. About March 1, 1969, respondent terminated the clearing arrangements and began clearing for itself.

and they also turned over to Krisch the "overages" after Krisch agreed to indemnify if another person were to prove ownership. The value of the securities thus turned over to Krisch was approximately $33,000. In addition, 17,000 shares of Control Metals, worth some $20,000 to $25,000 during the latter part of 1968, were turned over to Krisch, although Evans & Co. disputes ownership thereof. Although Evans & Co. has written off its claims on its books, it contends this was done because of the cost of attempting to obtain collection rather than lack of faith in the merits of the claim.

The respondent urges that if the shares turned over to Krisch after the clearance agreement with Evans & Co. was terminated were credited to Krisch as of 12-31-68 he would be in compliance with the net-capital rule as of that date. However, the record contains no proof that the securities turned over to Krisch were due and owing him as of 12-31-68 rather than at some later date or dates in January or February of 1969. Accordingly, it cannot be concluded on the basis of respondent's argument that he was in ratio as of 12-31-68.

The record establishes that during the weeks preceding and following August 31, 1968, December 31, 1968, and November 28, 1969, registrant effected transactions in nonexempt securities as usual, including use of the mails, notwithstanding the fact that on the dates mentioned he was not in compliance with the net capital rule. These violations were wilful.[15/]

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

Failure to File Report of Financial Condition (Form X17A-5)

The order for proceeding includes a charge that respondent Krisch wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that he failed to file with the Commission a report of his financial condition for the calendar year 1968 as required by the rule.

It is clear that the Form X17a-5 submitted by respondent as of 12-31-68 [16] does not meet the requirements of Rule 17a-5 since it was not certified by a certified public accountant. [17] Although respondent had engaged Price, Waterhouse to make an audit in accordance with Rule 17a-5 and to prepare Form X17A-5, the auditing firm was unable to certify the audit and accordingly filed a disclaimer of opinion with the Form X17A-5. [18]

Respondent urges that the reason the auditors could not certify was that he (Krisch) was unwilling to certify that his account with Evans & Co. was correct, and that subsequent events proved his contention to have been correct as respects his clearance account with Evans & Co.

This argument lacks validity because, as concluded above in connection with the findings respecting net-capital violations, the record herein does not establish that the true status of respondent's clearance account with Evans & Co. as of 12-31-68 was different from what the records of the respondent then showed it to be. Moreover, the record herein does not indicate that Krisch made any systematic and sustained efforts to ensure that errors in his clearance account with Evans & Co. were promptly rectified and he must therefore share the responsibility for any errors and the consequences thereof.

The filing of financial reports is essential for the protection of investors and as a source of information vital to the regulatory

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16/ Hearing Examiner's Ex. 2

17/ Thomas Lee Jarvis, 40 S.E.C. 692, 693 (Note 2)

18/ Hearing Examiner's Ex. 2

functions of the Commission.[19] A respondent should not be heard to say that he is unable to file the required report because the way he conducts his business makes his financial standing uncertifiable.[20] In these circumstances it is concluded that the violation was wilful.[21]

Regulation T Violations

The record establishes, and respondent makes no serious effort to condradict, wilful violations of Section 7(c)(1) and (2) of the Securities Exchange Act of 1934 and of the regulations of the Board of Governors of the Federal Reserve System prescribed thereunder.[22]

Respondent transacted business through members of a National Securities Exchange.[23]

19/ Scientific Investors Corporation, 41 S.E.C. 618 (1963).

20/ In this connection, the record shows that respondent first approached the auditors in mid-1968 and that the auditing period ran into March, 1969. Thus there was plenty of time both before and after the 12-31-68 "audit" date for Krisch to have gotten his account with Evans & Co. straightened out.

21/ Thomas Lee Jarvis, footnote 17 above, at p. 694.

22/ Section 7(c) of the Exchange Act prohibits any broker or dealer who is a member of a national securities exchange or transacts a business in securities through the medium of such a member from extending credit to customers in violation of regulations prescribed by the Federal Reserve Board under Section 7 of that Act. Section 4(c)(2) of Regulation T promulgated by the Federal Reserve Board provides that a broker or dealer shall promptly cancel or otherwise liquidate a transaction where a customer purchases a security in a cash account and does not make full cash payment within 7 business days.

23/ Evans & Co. and Scheinman, Hochstein & Trotta, Inc., who were members of a national exchange.

A review of his books and records for the period December 31, 1968, to March 1, 1969, disclosed the following violations:

4 payments from 121 to 147 days late;
14 payments from 91 to 121 days late;
12 payments from 61 to 90 days late;
18 payments from 31 to 60 days late;
17 payments from 16 to 30 days late;
49 payments from 6 to 15 days late;
36 payments from 1 to 5 days late.

These 150 violations occurred in some 119 customer accounts. In some instances respondent obtained extensions of time for making payment, but the extended time for receiving payment expired without payment having been received or a further extension having been obtained.

Respondent's only effort to justify these violations is to stress the rapid growth that his business was experiencing. But such a circumstance cannot excuse violations if meaningful regulation is to be exercised. The violations were wilful.[24/]

Borrowing in Excess of Aggregate Indebtedness of All Customers

The order for proceeding includes a charge that during the period from about June 6, 1966, to the date of the order respondent Krisch wilfully violated Sections 8(c) and 15(c)(2) of the Exchange Act and Rules 8c-1(a) and 15c2-1 thereunder in that respondent, in effecting transactions in securities, directly and indirectly, hypothecated, arranged for and permitted the continued hypothecation

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24/ J. A. Hogle & Co. et al., 36 S.E.C. 460, 465 (1955).

of securities carried for the accounts of customers under circumstances in which securities carried for the accounts of customers were hypothecated and subjected to liens of pledgees for a sum in excess of the aggregate indebtedness of all customers in respect of securities carried for their accounts.

The record establishes that as of December 31, 1968, the respondent had "borrowed" $132,550.17 from his clearing brokers, for which extensions of credit the respondent had pledged the securities in the customers' omnibus accounts.[25/] The record further establishes that as of such date the aggregate indebtedness (debit balances) of all customers of the respondent in respect of securities carried for the accounts of customers was approximately $43,000.

Respondent transacted business through members of a National Securities Exchange. The mails were utilized in connection with the transactions that resulted in the improper hypothecation of securities.

The violation charged is thus clearly established.[26/]

25/ See footnote 14 above concerning the omnibus accounts and the clearance account maintained by respondent with Evans & Co., his principal clearing broker.

26/ The Division urges further that the record also establishes that respondent improperly commingled customers securities and firm securities for purposes of collateralizing loans from respondent's clearing brokers. However, the order for proceeding expresses no such charge, nor does the record establish such a violation since, although customers' and firm's securities were commingled in the respondent's clearing account with Evans & Co., there is no satisfactory evidence that securities in that account were pledged to secure a loan.

Sale of Unregistered Notes (Glendale Combine Corporation)

The order for proceeding, as amended, includes a charge that during the period from about January 1, 1967, to February 2, 1970, respondent wilfully violated Sections 5(a) and 5(c) of the Securities Act[27/] in that he directly and indirectly made use of the means and instruments of transportation and communication in interstate commerce and of the mails to offer to sell, sell, and deliver after sale, notes[28/] of Glendale Combine Corporation ("Glendale") when no registration statement was filed or in effect as to such securities under the Act.

Glendale was incorporated in New York in October, 1968. Although its charter was broader, its business was to be operation of a restaurant and a ski lodge. Respondent Krisch was vice president and a director of Glendale, and owned 225,000 of the 600,000 shares of Glendale's common stock. The other major owner of Glendale, Arthur J. Feeney ("Feeney"), who owned the same number of shares as Krisch did, and who was President of Glendale, was also an employee

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27/ Sections 5(a) and 5(c) of the Securities Act make it unlawful to use the mails or interstate facilities to sell or deliver a security unless a registration statement is in effect as to such security or to offer to sell a security unless a registration statement has been filed as to such security.

28/ The order as amended in the course of the hearing (see footnote 1 above) alleged the offer, sale, and delivery of common stock of Glendale. On motion of the Division accompanying its brief (Division's Brief, p. 63) the order for proceeding was further amended to refer to notes of Glendale rather than its common stock in order to conform the allegations to the proof. Hearing Examiner's order of June 19, 1970.

of the registrant. Richard Hinchey ("Hinchey") owned 50,000 shares of the Glendale common stock and was the company's secretary-treasurer. Hinchey, as did Krisch and Feeney, "earned his living" by virtue of his work with registrant, and drew no salary as an officer of Glendale. Glendale paid the salaries of three employees. Sometime in 1969 Glendale started paying Feeney also.

Glendale had the same address as registrant, with whom it shared office space.

To raise needed capital Glendale chose to issue promissory notes payable one year from date of issue at face value plus 15%. Krisch consulted Attorney Abraham L. Singer ("Singer") who had incorporated Glendale and who had long been attorney to Krisch's father and other members of the family, 29/ in connection with issuance of the proposed Glendale notes. Singer drafted the note form and orally advised that the interest rate was within legal requirements. He was not asked, either by Krisch or anyone else, whether the notes had to be registered under the Securities Act, and the question evidently did not occur to him. His knowledge of Securities law at the time was limited. Krisch never got or asked for any written opinion of Attorney Singer or any other lawyer as to whether the offer and sale of the notes would violate federal securities laws.

Between November 25, 1968, and March 6, 1969, some 87 purchasers bought Glendale notes ranging from $1000 to $5000 in amount, which

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29/ He had also earlier done other legal work for Krisch.

sales raised about $112,000 in capital for the Company. It is stipulated by the parties that over 80 of these Glendale notes were sold by registered representatives of the respondent, the purchasers being, with only a few exceptions, regular customers of the respondent[30/] who had been solicited to buy the notes.

The salesmen were promised a $5 "bonus" per note, payable by Glendale, but only if they met a certain quota of sales. Apparently the salesmen were reluctant to promote sales of the Glendale notes; in any event, at a sales meeting held on or about February 4, 1969,[31/] and by memorandum of that date[32/] from the respondent's sales manager to "All Salesmen," handed out at such meeting, respondent's salesmen were ordered to solicit their customers to make sales of the Glendale notes, were given quotas to meet, and told that unless they complied they would be suspended. The great bulk of the note sales made occurred following this draconian directive.[33/]

30/ At least 5 registered representatives of the respondent were involved in making the sales. Krisch personally talked to two of the buyers — John Buczacki and Krisch's father-in-law — but the record is not clear whether Krisch himself sold these customers their notes or whether one of the salesmen did.

31/ Krisch personally did not attend this meeting, but he had full knowledge of the instructions that were given his salesmen (by his sales manager, Ted Russo) and that they were acting thereunder.

32/ Ex. 10

33/ Ex. 28. The record does not disclose how many of the relatively small number of notes sold prior to February 4, 1969, were sold by respondent's representatives.

The salesmen utilized the same telephones, desks, offices and facilities of respondent in selling the Glendale notes as they used in their regular work. Besides those who did buy the notes, other customers of the respondent had also been solicited to buy the Glendale notes. Purchasers resided in New York and in New Jersey, and they did not execute investment letters. The mails were used in the sale of the notes.

Respondent contends that the salesmen who sold the notes were acting for and on behalf of Glendale and not respondent in their sales of the Glendale notes. He cites in support of this argument, among other things, the fact that checks in payment for the notes were made out to Glendale and not respondent, and that the compensation to the salesmen came from Glendale, not respondent.[34/] In addition, the transactions in the notes were at no point reflected in the books and records of the registrant and the registrant itself realized no commission or direct compensation in connection with the sales.

But respondent's argument that its sales representatives were in effect "moonlighting" for Glendale in the sale of the Glendale notes implies a voluntary engagement in such "outside" employment that the facts in this record do not support. The Glendale notes were sold not because the respondent's salesmen considered the $5 per note "bonus" attractive or because they voluntarily contracted with Glendale to

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34/ So far as this record discloses, none of the salesmen actually got the $5-a-note "bonus" from Glendale, perhaps because assigned quotas had not been met.

perform such services, but because they were ordered by the registrant to sell them under pain of suspension should they refuse to do so. Nor is the fact that registrant received no commission or direct compensation controlling, since Krisch, because of his common ownership interests in registrant and in Glendale, did in fact obtain indirect benefit from the sales of the Glendale notes through the opening of a securities account by Glendale with the registrant in which a free-credit balance was maintained that at one point was about $90 thousand.[35/]

The record establishes, and respondent does not dispute, that no registration statement was filed or in effect with the Commission for notes or any security of Glendale under the Securities Act during the times here material. Respondent has not sought to establish the applicability of any exemption, and the record does not disclose the availability to him of any exemption.

Respondent urges that the notes were sold not by registrant but by Glendale. The findings made above indicate that this contention lacks support in the evidence. The record is on the contrary quite clear that Krisch used the personnel and resources of his broker-dealership to participate in and promote the unlawful distribution of Glendale notes.

Respondent urges further that any violation by him was not wilful because he was entitled to rely on the "clearance" given to

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35/ See pp. 22-26 below.

the sales by Attorney Singer. This argument is unfounded. As found above, Singer never addressed himself to the question whether the notes required registration and he rendered no oral or written opinion on the subject. Krisch's misguided efforts to make it look as if respondent were not involved in the note sales and that his employees were working for Glendale in the sale of the notes indicates he was aware of a possible legal problem, and his failure in that light to have sought a written legal opinion militates against his argument that his violations were nonwilful.

Krisch was aware that the notes were not registered, knew or should have known that no exemption was available, and his violations were wilful. A finding of wilfulness is not precluded by reliance upon the advice of counsel, and the finding does not require an intention to violate the law but only that the person charged knows what he is doing.[36/]

Violations of Anti-Fraud Provisions in Sale of Glendale Combine Corporation Notes

The order for proceeding, as amended, alleges that respondent wilfully violated the anti-fraud provisions of the securities laws[37/] in selling and offering for sale the Glendale notes. In particular, it is charged, inter alia, that respondent made false or misleading statements or omitted to state material facts concerning the use of

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36/ Morris J. Reiter, 41 S.E.C. 137, 141 (1962); Hughes v. S.E.C., 174 F. 2d 969, 977 (C.A.D.C. 1949).

37/ Section 17(a) of the Securities Act and section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

proceeds from sale of the notes, the financial condition of Glendale, the business of Glendale, and the public offering of Glendale securities.

Purchasers who bought Glendale notes from respondent's registered representatives were told the business that the company was engaged in and that proceeds from the sale of the notes were to be used to buy a restaurant on Long Island and a ski lodge in upstate New York. Some of such notebuyers were told that respondent Krisch was "backing" Glendale and that he wouldn't risk his reputation in something that wasn't sound. No financial information or data concerning Glendale was given to purchasers unless requested and only five of the some 87 purchasers requested any such data. Those five received a balance sheet after they had made their purchases. While the salesmen were shown a Glendale balance sheet for early February, 1969, they did not show it to their customers or summarize its contents to them. Note holders were not told of Glendale's history of operation or its lack of it. No information was offered the customers bearing on the ability of Glendale to meet its obligation for repayment of the principal amounts and interest on the notes.

While the notes accorded their purchasers the preferential right to buy shares of Glendale in the event of a public offering of its shares, no data bearing on whether or when such a public offering might take place were given to the purchasers.

Prospective purchasers of the notes were not advised that the proceeds of the note sales would be used, at least in part, to help

run the broker-dealer firm of respondent Krisch. This use of the note proceeds grew out of the circumstance that Glendale maintained an active cash account with the respondent. To put this use of the note proceeds into proper perspective it is necessary to set forth briefly some facts respecting Glendale's and respondent's financial situation at the time.

As of December 31, 1968, by which time Glendale had realized $13,000 through sales of its notes, the Company had paid-in capital of $51,800. Its assets of just over $63,000 consisted largely of $15,000 plus in cash in a bank account; securities worth $14,000 plus; and a free-credit balance of $33,000 plus in its account with the respondent.[38/]

By February 28, 1969, the company had realized $111,000 through sales of its notes and its paid-in capital had risen to $70,000. On that date Glendale's assets included $15,000 plus in a bank account; investments in securities worth $13,000 plus;[39/] a free-credit balance in its account with the respondent of nearly $83 thousand; real and personal property listed at $88 thousand plus;[40/] and other assets.

As of March 31, 1969, corporate obligations due note holders amounted to $112,000 and the company's paid-in capital remained at $70,000. On that date the company's assets included $7 thousand plus in cash; $51,749.62 as a free-credit balance in its account with respondent; nearly $12,000 in securities; $253 thousand plus in real and personal property;[41/] and other assets.

38/ Ex. K.

39/ Trading in securities had generated profits of $7,955.12 for Glendale as of the end of February.

40/ Ex. L.

41/ Ex. M.

At its high-water mark in early March, 1969, the free-credit balance in Glendale's account with the registrant was about $90 thousand.

The free-credit balance was utilized by the registrant in the normal conduct of its business. The fact that registrant began clearing for itself on or about March 3, 1969, made availability of the free-credit balance of especial importance to registrant.

On March 13, 1969, Glendale withdrew $40,000 from its account with the registrant, and on March 17, 1969, it received a check for the balance in the account.[42/] This check was not cashed but instead was returned to Krisch at his request because a member of the Commission's staff had expressed the view that its payment would constitute an improper preference as against other customers of Krisch in view of Krisch's interest in Glendale.[43/] The remainder of the free-credit balance in the Glendale account with registrant was ultimately paid Glendale on April 30, 1969,[44/] after registrant had

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42/ The March 17 check was for $57,982.85 but respondent later concluded that this figure was high by at least $4,000. The withdrawals occurred because Feeney expressed dissatisfaction with the continued use by respondent of the free-credit balance and because Glendale needed the funds to carry out purchases of certain properties.

43/ At the time respondent paid Glendale the $40 thousand on March 13, 1969, respondent had an indication that the Price, Waterhouse audit then going on would show he had a capital deficiency; as of March 17, 1969, when registrant gave Glendale the check for some $58 thousand he had been told by Price, Waterhouse that he had a capital deficiency.

44/ The amount due was then calculated at $47,500.

borrowed extensively from two of its clearing brokers on or about March 17.

Glendale made no attempt to segregate funds generated by its sales of notes from its other funds.

Since the peak free-credit balance of some $90 thousand exceeded the maximum paid-in capital contributed by common stockholders ($70 thousand) it is evident that some undetermined but substantial portion of the Glendale note proceeds was used to maintain the free-credit balance in the Glendale account with the registrant.[45/] Respondent never advised note buyers or prospective note buyers that the proceeds were to be so used or that they were being so used. In view particularly of the added risk that such use of the funds exposed note holders to, respondent should have advised of the contemplated or actual use of such funds. Besides the risk exposure, Glendale lost the interest that its funds might have generated had they been properly invested.

Respondent's argument that only funds contributed by the common stockholders of Glendale were utilized to purchase and trade in securities and to maintain the free-credit balance does not accord

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45/ The gap between the paid-in-capital figure and the free-credit balance figure would, for purposes here relevant, be widened in the amount which Glendale had spent to purchase securities. If paid-in capital was used to buy securities then that much less of it was available to maintain the credit balance; if paid-in capital was not used, then proceeds of the note sales were used to buy securities, and that use should have been disclosed.

with the facts, as found above.[46/]

The record establishes that the mails and telephones were utilized by respondent in the sale of the Glendale notes.

The above-found failures to make necessary disclosures to the note purchasers constituted fraud under the anti-fraud provisions of the securities laws.[47/]

Failure to Supervise

The order for proceeding, as amended, alleges that respondent violated Section 15(b)(5)(E) of the Exchange Act in that he failed reasonably to supervise persons under his supervision with a view to preventing the other violations by respondent alleged to have been committed.

Section 15(b)(5)(E) of the Exchange Act, as added by the 1964 amendments to it, provides an independent ground for the imposition of a sanction against a broker or dealer who ". . .has failed reasonably to supervise, with a view to preventing violations of such

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46/ As already noted, Glendale made no effort to segregate note proceeds. Even if what respondent contends had been the case, Krisch would probably have had a duty to disclose that fact to prospective notepurchasers, since such use of paid-in capital funds would bear on the ability of Glendale to meet interest and principal obligations on the notes, in the absence of revenues from operations, which was the situation that prevailed here.

47/ E.g. Realty Securities, Inc., 41 S.E.C. 906 (1964) (financial condition of issuer); Idaho Acceptance Corp., Exchange Act Release No. 7383, August 7, 1964, at p. 5 (use of proceeds).

statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision." (emphasis supplied)

The substantive violations alleged and found herein were committed by respondent himself. In view of this it is concluded that Section 15(b)(5)(E) is not applicable in these circumstances to respondent since the terms of the statute require allegation and proof that respondent failed to supervise some other person who committed a violation. The order contains no allegation of a violation by anyone but respondent.[48/]

Conclusions

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

(1) During the period from about February 29, 1968, to the date of the order for proceeding respondent wilfully violated the books-and-records requirements of Section 17(a) of the Exchange Act

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48/ The record herein does not indicate that the violations found were the result of malfeasance, or nonfeasance of Krisch's employees or of a failure on their part to carry out his instructions or operating procedures. Only in a broad,managerial sense was there a failure on Krisch's part to supervise, e.g. his refusal to restrict the magnitude of his business to a volume that his generally untrained personnel could adequately and properly handle, his failure to make proper inquiry into the legality of selling the Glendale notes before their sale was authorized, his failure to curtail activity until back-office problems could be rectified, his failure to ensure that Reg. T was cmmplied with, and the like. Any deficiencies on the part of respondent's personnel were of a kind for which respondent was responsible under the concept of respondeat superior. Armstrong, Jones & Co. and Thomas W. Itin v. S.E.C. (C.A. 6, Docket No. 19291, January 23, 1970, F. 2d .

and Rule 17a-3 thereunder, in the particular respects found above.

(2) During the weeks preceding and following August 31, 1968, December 31, 1968, and November 28, 1969, respondent wilfully violated the net-capital requirements of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder, as more particularly found above.

(3) Respondent wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder by failing to file with the Commission a certified report of his financial condition for the year 1968 as required by the rule.

(4) During the period December 31, 1968, to March 1, 1969, respondent wilfully violated Section 7(c)(1) and (2) of the Exchange Act and the regulations of the Board of Governors of the Federal Reserve System prescribed thereunder in 150 instances involving some 119 customer accounts.

(5) As of December 31, 1968, respondent wilfully violated Sections 8(c) and 15(c)(2) of the Exchange Act and Rules 8c-1(a) and 15c2-1 thereunder by subjecting customers' securities to liens of pledgees in an amount exceeding the aggregate indebtedness of all customers in respect of securities carried for their accounts.

(6) During the period from about November 25, 1968, to March 6, 1969, respondent wilfully violated the requirements of Section 5(a) and 5(c) of the Securities Act in offering for sale, selling, and delivering the notes of Glendale Combine Corporation for which no registration statement had been filed or was in effect.

(7) During the period from about November 25, 1968, to March 6, 1969, respondent wilfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in connection with the sale of the notes of the Glendale Combine Corporation.

(8) The charge alleging a failure to supervise is not established for the reasons stated above.

PUBLIC INTEREST

The violations disclosed by this record are numerous and extensive. Each of them is a serious violation and their cumulative impact indicates that serious risk to customers would result from respondent's continued operation. All of the circumstances urged by respondent in mitigation, including his efforts to settle the matter, as well as his youth and the fact that he has not apparently heretofore been the subject of disciplinary proceedings, have been taken into account in determining the sanctions here found needed. 49/

The record-keeping violations were particularly serious in that for extended periods of time the failure to keep current records precluded knowledge by respondent or anyone else as to whether respondent was in violation of the net-capital rule. Respondent's arguments that his business was simply growing too fast and that, after all,

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49/ Respondent did not testify at the hearing, having elected to assert his constitutional privilege not to testify when called by the Division.

no customers were hurt, ignores the fact that customers were exposed to a risk of loss and suggests that respondent lacks an adequate awareness of the purposes underlying the various regulations that were violated. Compliance with regulations cannot be deferred until one's business slacks off enough to permit getting around to it.

As to the net-capital violations, it is significant that the last of them occurred after respondent had earlier voluntarily closed down for a period of time in the face of earlier net-capital problems.

The extensive Regulation T violations suggest a kind of indifference that does not speak well for respondent's sensitivity to the need for compliance with regulations. The same is true as to his professed ignorance that he was doing anything unlawful in borrowing in excess of his customers' aggregate indebtedness.

The violations in connection with the sales of the Glendale notes are particularly serious in that they involved a situation in which respondent had ownership interests in both the registrant and Glendale. Registrant's use of the Glendale funds exposed noteholders to risk of loss and, as the record herein shows, some note holders have not yet been paid the amounts they invested.

Giving due weight to all mitigative factors urged or disclosed by the record, it is concluded that the public interest requires nevertheless, in view of the number and seriousness of the violations, that the registration of the respondent be revoked and that he be barred from association with a broker-dealer. However, because it appears that the public interest would not be adversely affected if

respondent were allowed after a suitable period to work subject to appropriate supervision, it would be appropriate to permit him, after one year, to be employed by a broker-dealer in a supervised capacity.

ORDER

Accordingly, IT IS ORDERED that the registration of Robert F. Krisch, doing business as a sole proprietor under his own name, is revoked and respondent Robert F. Krisch is barred from association with a broker-dealer except that after a period of one year from the effective date of this order he may become associated with a registered broker-dealer upon an appropriate showing to the staff of the Commission that he will be adequately supervised.

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

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

Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 50/

David J. Markun
Hearing Examiner

Washington, D. C.
June 24, 1970

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