ADMINISTRATIVE PROCEEDING
FILE NO. 3-4980

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of CAROB SECURITIES, INC. AND ROBERT A. SCHILLEMAN (8-20294)	

INITIAL DECISION

Washington, D.C.
August 30, 1976

Edward B. Wagner
Administrative Law Judge

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APPEARANCES: David P. Goss and Wayne M. Secore of the San Francisco Branch Office for the Division of Enforcement

Paul Kallman, Marina City Club, 4316 Marina City Drive, Marina Del Rey, California for respondents Carob Securities, Inc. and Robert A. Schilleman

BEFORE: Edward B. Wagner, Administrative Law Judge

THE PROCEEDING

This public proceeding was instituted by an order of the Commission, dated March 10, 1976 pursuant to Section 15(b)(1)(B) and 15(b)(6) of the Securities Exchange Act of 1934 against respondents Carob Securities, Inc. (Carob) and Robert A. Schilleman (Schilleman).

In the order the Division of Enforcement (Division) charges that Carob wilfully violated provisions[1/] of the Exchange Act, and Schilleman, its President, wilfully aided and abetted these violations, in filing a false and misleading broker-dealer application and in failing to amend such application. The Carob application is allegedly false in that it fails to disclose facts concerning Schilleman's employment background and a prior order of permanent injunction entered against him.

A hearing was ordered to determine the truth of the Division's charges, to afford Carob and Schilleman an opportunity to establish any defense to the charges and to determine whether it is in the public interest to deny Carob's broker-dealer registration and what, if any, remedial action should be taken against Schilleman.

On March 23, 1976 on motion of the Division for an extension of time in accordance with Section 15(b)(1)(B) of the Act, and with the consent of respondents, the Commission ordered cancellation of the hearing date and the schedule of post-hearing procedures which had been set forth in the order and ordered that the hearing be rescheduled in

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1/ Section 15(b) of the Act and Rules 15b1-1 and 15b3-1 thereunder, 17 CFR 240. 15b1-1 and 15b3-1.

accordance with Rule 6 of the Rules of Practice.[2/] The Commission further ordered that the dates for post-hearing procedures be specified by the presiding Administrative Law Judge, and that the date for the conclusion of these proceedings be extended until such time as the Commission may finally determine what, if any, remedial action should be taken.

A hearing was held in April 1976 in San Francisco at which respondents were represented by their counsel, Paul Kallman.

The Division and respondents filed Proposed Findings, Conclusions and Briefs, and the Division filed a Reply Brief.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the witnesses. Preponderance of the evidence is the standard of proof applied.

Respondents

Carob has an application to become registered as a broker-dealer pending before this Commission. The application was executed by Schilleman, Carob's President and Treasurer.

Schilleman has been engaged in the securities business for 10 years.

Violations

On March 8, 1971, Schilleman was elected President of Financial Trends Mutual Fund, Inc. (Financial Trends), an investment company registered with the Commission under the Investment Company Act of 1940 (Investment Company

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2/ 17 CFR 201.6.

[redacted] Act). He was also President and a Director of Heritage National Management Fund, Inc. (Heritage) which had a management agreement with Financial Trends. The management contract did not become effective, because it was not approved by the required majority of the outstanding shares at a meeting on June 23, 1971 called for the purpose of approving the contract. While President,Schilleman made recommendations concerning purchases and sales of several securities in the Fund's portfolio (Tr. 76) and met with Robert Dempsey, another officer of the Fund, and Paul Kallman, his present attorney who also did legal work for the Fund, on two occasions for discussions concerning its numerous outstanding unpaid debts and what could be offered to the creditors. He participated in telephone conversations concerning the unpaid obligations. Schilleman also presided as chairman at the shareholders meeting on June 23, 1971. As President of the mutual fund, he had authority to co-sign checks. He received no compensation from the fund nor the management company.

Schilleman was employed by a brokerage firm as a registered representative at the time he was elected President of Financial Trends. This employment terminated in June, 1971 when he shifted his base of operations to Phoenix, Arizona to manage a company called Patio Products.

In 1972 the Commission instituted suit in the United States District Court, Central District of California, against Financial Trends, Heritage, Schilleman, Dempsey, Robert A. Redfearn, a Director of the Fund, and William J. Philbee, a Director and Officer, for alleged violations of provisions of the Securities Exchange Act of 1934 (Exchange Act) and the Investment Company

Act. The suit sought injunctive relief.

On February 15, 1973, Schilleman personally executed a stipulation and consent to a decree of permanent injunction. On the same date, as President of Heritage, he executed a further stipulation and consent. Both documents recited that they had been executed without admitting or denying the allegations made by the Commission.

In accordance with the consents, District Court Judge Albert Lee Stephens, Jr. entered a Final Judgment of Permanent Injunction on February 16, 1973. This injunction barred Schilleman, in connection with his activities as President of Financial Trends and Heritage, from violating a number of provisions under the Investment Company Act of 1940 and the Exchange Act. Included were prohibitions against conduct violating the antifraud provisions of Section 10(b) and Rule 10b-5 under the latter Act and violating Section 36 of the Investment Company Act, dealing with breach of fiduciary duty, and Section 37 under that Act, dealing with larceny and embezzlement.

Both the individual consent and the Final Judgment of Permanent Injunction bear the signature of "Paul Kallman" as "Attorney" for "Robert A. Schilleman."

Defendants Redfearn and Philbee did not execute consents and went to trial on November 7, 1972. By Minute Order filed June 29, 1973, Judge Stephens decided the case in favor of Redfearn and Philbee. Findings of Fact and Conclusions of Law were filed by the Court on August 16, 1973.

Schilleman prepared and executed Carob's sworn application for registration as a broker-dealer on Form BD, dated December 29, 1975. It was filed with the Commission on January 9, 1976.

Schedule D to the application form requires for each officer a "complete, consecutive statement of all business experience and employment for the past ten years". Schilleman listed several brokerage firms, periods of unemployment and Patio Products as reflecting his past business experience and employment. He made no mention of his association with a registered investment company, Financial Trends.

The schedule in Item 10(a)(iii) inquired whether any officer, director, controlling person or employee of Carob was the subject of an injunction of the kind to which he had consented. Schilleman answered "no". An affirmative answer would have required a detailed explanation on Schedule D.

In investigative testimony before Commission Staff personnel on March 23, 1976 Schilleman conceded that his association with Financial Trends constituted "business experience".

At an earlier meeting on February 19, 1976 with Staff personnel, Schilleman stated that he was the subject of an injunction and that he had been served with a copy. As a result of that meeting, Schilleman sent a telegraphic notice on the day of the meeting postponing indefinitely the application for registration as a broker-dealer.

Schilleman contended at the hearing that the above misstatements on the BD application were not "wilful." He stated that although he had stipulated to the entry of an injunction, the document he had signed merely states that he "may" be enjoined, that he had never been served with a copy of the final judgment of injunction and had never been advised that he had been enjoined. He further stated that a co-defendant, James Philbee

had told him[3/] that the case had been thrown out and he, accordingly, thought the stipulation could not "have any effect upon me anymore" (Tr. 46).

He further contended that earlier he had filed an application with the New York Stock Exchange (NYSE) for approval of employment with a New York Stock Exchange firm. He stated he had based his answers in the BD application on his NYSE filing. He had answered similar questions in the NYSE filing in the same fashion and, since he understood that there "was some supervisory control of the New York Stock Exchange by the Securities and Exchange Commission" (Tr. 50) he assumed that the Commission had received a copy of his Exchange application or "somehow knew the contents" (Tr. 50) and had passed upon it.

He further represented that he had omitted to state his association with Financial Trends and Heritage because he thought the question called for "paid employment".

Schilleman conceded on cross-examination that he made no inquiries of the Commission, or anyone else, to ascertain the meaning of the items on the BD schedule and that he had not called the Clerk of the Court to find out if he had been enjoined, nor Mr. Kallman, nor the Commission.

Even if Schilleman's explanation is accepted as fact, his violations and those of Carob are, nevertheless, wilful. As the Division contends, under Section 15(b), a finding of wilfulness does not require a showing of an intention to violate the law. It is enough that the person charged intentionally commits the act constituting the violation. Hughes v. S.E.C., 174 F. 2d 969, 977 (2d Cir. 1958); Tager v. S.E.C., 344 F.2d 5, 8 (2d Cir. 1965);

3/ He was unable to pin down with any precision when this conversation occurred.

Gearhart & Otis v. S.E.C., 348 F 2d 975 (D.C. Cir. 1965). Here, Schilleman on behalf of Carob prepared and executed a false BD application.

In its latest opinion in the "wilfulness" area the Commission held that a mistake of fact may preclude a finding of wilful misconduct. International Shareholders Services Corporation, SEA Rel. No. 12,389 (April 29, 1976). But the Commission indicated that one cannot safely rely upon mistaken impressions in "situations in which the totality of the circumstances necessitates inquiries . . ." (SEA Rel. No. 12,389, p. 6). Here, Schilleman knew he had executed a consent to an injunction, and the question concerning business experience said nothing about "paid employment". Inquiries to, for example, his attorney, the Clerk of the Court and the Commission were called for and would have been simple enough. Even a specific inquiry of Philbee concerning what had happened as to him, Schillemen, would have been helpful and is not shown on the record.

Moreover, the Commission has specifically held that an applicant has a duty in any event to verify information contained in a BD form and its failure to do so "rendered wilful its making of false and misleading statements in the application ... and its violation of Section 15(b) ...." Peoples Securities Company, 39 S.E.C. 641, 645 (1960).

Further, Schilleman's statements as to his mental state are not credited for the following reasons:

1. He stated at a meeting at the Commission's Regional Office on February 19, 1976 that he had been enjoined and that he had

received a copy of the injunction. At the hearing he did not directly deny that he had so stated, and an attempt by his attorney to shake the Division witness's testimony to this effect was unsuccessful.[4/]

2. In his application to the NYSE submitted in 1974 he gave a "no" answer to the question, "Are you presently or have you ever been involved in any litigation including any suits, liens, judgments or other actions to which you have been a party whether you appeared in court or not?" The form called for a "complete explanation" if the answer were affirmative. He also gave a negative answer to the following question in an application to the Pacific Coast Stock Exchange, dated December 29, 1975:[5/] "Are you now or have you ever been a defendant in any litigation alleging the violation of any agreement with or provision of a securities or commodities industry self-regulatory body's constitution, by-laws or rules, or any securities, commodities or insurance law or regulation?" If the answer had been affirmative, the form required an attachment, giving "complete details". He acknowledged at the hearing that he knew at the time he gave these answers that he had been a defendant in the Financial Trends litigation.[6/]

4/ No assertion was made by Schilleman that he propounded his defense of unawareness at the February 19 meeting, although it appears that he logically and naturally would have done so.

5/ The Pacific Coast Stock Exchange application is a sworn document and the NYSE application is certified.

6/ His only explanation for his admittedly false answers was, "First of all, I figured I did not mean wrong, and secondly, the case was eventually thrown out of court" (Tr. 77).

In fact, he retained Mr. Kallman to represent him in such litigation but consented because he could not afford to litigate. His association with Financial Trends and the injunction were likewise not disclosed in either the NYSE or Pacific Coast Stock Exchange applications.

3. In order to swallow Schilleman's story one must not only accept his self-serving statements as to his state of mind concerning the injunction and his association with Financial Trends, but must also believe that he was so convinced of the correctness of his impressions that he did not think it necessary before preparing and executing 3 formal applications to get in touch with the lawyer he had retained to represent him in the litigation, nor the Court, nor the Commission. This strains credulity a bit too far as does his assertion at the hearing (as one who has been in the securities business for 10 years) that he believed the NYSE and the Commission "are all one entity" (Tr. 50).

The Division argues convincingly that the only reasonable explanation for Schilleman's suppression of information concerning his employment and the related lawsuit and injunction was that it was deliberate. They further point out that a strong motive for such concealment is operative in that under Section 15(b) of the Exchange Act the existence of the injunction is a basis for denying Carob's broker-dealer application and barring Schilleman from association with any broker-dealer.[7/]

7/ The Order for Proceedings does not explicitly charge the injunction as a basis for remedial action, and the Division has not argued in the Proposed Findings, etc. that the injunction is so charged.

I conclude that Schilleman knowingly attempted to conceal the entire episode, including, particularly, the injunction, from the regulatory authorities. That he might have felt some justification[8/] in view of the fact that the case was dismissed on the merits against the defendants who could afford to contest it is no excuse.

Clearly, Carob, wilfully aided and abetted by Schilleman, wilfully violated Section 15(b) of the Exchange Act and Rule 15b1-1 thereunder in failing to disclose Schilleman's business association with Financial Trends and the injunction in its broker-dealer application.

The order also charged respondents with having violated Section 15(b) of the Exchange Act and 15b3-1 thereunder from the date of Carob's BD application, because no correcting amendment was filed. The Division makes the more limited argument that failure to amend after respondents were concededly aware of the injunction, i.e., after the February 19, 1976 meeting, constituted a violation because the application, as provided in Rule 15b3-1, had become inaccurate.[9/] (Division Proposed Findings, etc. pp. 19-20). Respondents contend that their telegram in the form dictated to them by Staff personnel to the Commission requesting an indefinite postponement held the matter in abeyance, and no amendment was necessary.

It is unnecessary to address this argument of respondents, since in my view Carob and Schilleman deliberately concealed information concerning

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8/ Compare fn. 6, supra.

9/ See Roberts Securities Corporation, 38 S.E.C. 63, 65 (1957); Cf. Peoples Securities Company, 39 S.E.C. 641, 645 (1960).

his employment and the injunction from the date of the BD application. As indicated, Rule 15b3-1, which governs amendments, becomes applicable where information contained in an application "becomes inaccurate for any reason" -- presumably because of developments occurring since the filing of the application, or (as the Division contends here) because of newly discovered facts. However, no newly discovered facts were involved in this case, and the application had not become inaccurate. It had always been so.

Accordingly, the further charge of failing to amend in violation of Rule 15b3-1 is dismissed.

Public Interest

The Division argues, and I find, that respondents have demonstrated an indifference to the requirements of the law. The Division contends that Carob's BD registration should be denied and Schilleman should be barred permanently from association with a broker or dealer.

Respondents state that their purpose in applying for registration is to act as a floor broker on the Pacific Coast Option Exchange, in which capacity they will be dealing only with other floor brokers and Pacific Coast Option Exchange personnel. They contend that registration should be granted, because they will not be dealing with the public. There is, however, no exception for those who conduct business in the fashion indicated, and their activities must also be in compliance with applicable rules and statutory provisions. Further, if registration as a broker-dealer were to become

effective, it would carry with it the right to engage in other areas of the securities business.

Respondents also contend that the District Court's Findings of Fact and Conclusions of Law in the Financial Trends litigation demonstrate that the Commission presented no evidence to prove one of the counts in the complaint which included "charges of conversion of monies of the Fund ... causing the Fund to pay a sum of money to a third party ... [and] causing the Fund to purchase securities in excess of market quotations" (Respondents' Proposed Findings, etc., p. 5) against defendant Philbee and, consequently, could not prove the same charges which it made against Schilleman. However, it does not necessarily follow that no evidence would have been presented against defendant Schilleman as to the particular count. But in any event, Respondents' argument and the broader argument that the case was dismissed as to those who contested are beside the point. The proper remedy would have been to seek to vacate the consent injunction, or to put all the circumstances on record in his application, not to conceal the facts on the basis of his own self-serving determination that he "did not mean wrong" (Tr. 77).

Respondents' violations are serious and deliberate. Under all the circumstances, I conclude that the requirements of Section 15 have not been met and that the public interest requires that the registration of Carob be denied and that, in order to impress upon Schilleman the need for strict compliance in the future with applicable law, he be suspended from association with a broker or dealer for a period of six months.

Accordingly, IT IS ORDERED that the registration of Carob Securities, Inc. is denied and that Robert A. Schilleman is suspended from association with a broker or dealer for a period of six months from the effective date of this order.

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. 10/

Edward B. Wagner
Administrative Law Judge

Washington, D.C.
August 30, 1976

10/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.