

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of :  
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ROBERT HOFFMAN :  
WALSTON & CO., INC. :  
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(8-4824) :  
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SYDNEY SENIOR SMITH :  
DANIEL T. CULLEN :  
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INITIAL DECISION

(Private Proceedings)

June 28, 1974  
Washington, D.C.

Sidney L. Feiler  
Administrative Law Judge

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APPEARANCES: Alan A. McDonald, Esq., of Halverson, Applegate, McDonald, Bond, Grahn & Wiehl, 415 North Third Street, Yakima, Washington 98901, for Walston & Co., Inc. (now known as DuPont Walston, Incorporated) and Daniel T. Cullen.

Don Paul Badgley, Esq., of Bogle, Gates, Dobrin Wakefield & Long, 14th Floor, Norton Building, Seattle, Washington, 98104, for Sydney Senior Smith.

Lane B. Emory, Esq. and Gary Swenson, Esq. of the Seattle Regional Office of the Securities and Exchange Commission, for the Division of Enforcement.

BEFORE: Sidney L. Feiler, Administrative Law Judge

## I. THE PROCEEDINGS

These proceedings were instituted by order of the Commission pursuant to Sections 15(b), 15A and 19(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), to determine whether certain allegations set forth in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.

The order for the proceedings, as amended, sets forth allegations by the Division of Enforcement that during the period commencing on or about January 20, 1970 continuing until about February 5, 1971, Walston & Co., Inc., a registered broker-dealer (now known as DuPont Walston, Incorporated), hereinafter referred to as Registrant or Walston, and Robert Hoffman, employed by Registrant as a securities salesman in its Seattle Branch Office, willfully violated the antifraud provisions of the Securities Act of 1933, as amended, ("Securities Act") and of the Exchange Act. <sup>1/</sup> It is alleged that as part of such conduct and activity Hoffman converted customers' funds to his own use and benefit; and Registrant and Hoffman effected discretionary purchases and sales in the accounts of customers which were excessive in size and frequency in view of the financial resources and character of such accounts; induced customers to repose trust and confidence in them thereby causing such customers to believe that their accounts were doing well without disclosing

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<sup>1/</sup> Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

to such customers that such accounts were sustaining substantial losses as a result of Hoffman's trading activity; effected unauthorized transactions in customers' accounts; and made untrue, deceptive and misleading statements of material facts to customers and omitted to state material facts to them concerning these matters. It is also alleged that during the aforementioned period the Registrant willfully violated and Hoffman willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that Hoffman caused Registrant to fail to designate orders entered for the account of customers of Registrant as being orders entered pursuant to Hoffman's exercise of discretionary power, and caused Registrant to fail to make and keep accurate records in respect of its margin accounts in that Hoffman signed or caused to be signed the names of customers of Registrant to customers' agreements for margin accounts without having obtained authority from such customers to do <sup>2/</sup>so.

It is further alleged that Registrant, Daniel T. Cullen, at all relevant times the Pacific Northwest Division Manager of Registrant, and Sydney Senior Smith, at all relevant times manager of Registrant's Seattle Branch Office, failed reasonably to supervise, with a view to preventing the violations set forth above by persons who were subject to their supervision at the time the violations occurred and who committed such violations. The respondents, except for Hoffman, filed answers in

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2/ The above statutory and regulatory provisions deal with the requirements of recordkeeping by broker-dealers. Such records must be true and correct.

which the material allegations of the amended order were denied.

Pursuant to notice, a hearing was held in Seattle, Washington. Prior thereto, the respondent, Robert Hoffman, had failed to file an answer as required by the order and the Commission deemed him in default and issued its Findings and Order barring Hoffman's association with a broker-dealer. (Securities Exc. Act Release No. 9805, Oct. 11, 1972). The remaining parties to the proceedings were represented by counsel. Full opportunity to present evidence and to examine and cross-examine witnesses was afforded the parties. All parties submitted proposed findings and briefs.

On the basis of the entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

## II. FINDINGS OF FACT AND LAW

### A. The Respondents

At all relevant times, the Registrant was a registered broker-dealer, a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the Exchange Act and a member, within the meaning of Section 3(a)(3) of the Exchange Act, of the New York Stock Exchange and other national securities exchanges registered pursuant to Section 6 of the Exchange Act.

Daniel T. Cullen has been associated with the Registrant since 1961. Commencing in 1968 and at all relevant times he was the Pacific Northwest Division Manager of the Registrant supervising a group of branch offices, including the Seattle Branch Office of the Registrant.

Respondent Sydney Senior Smith was associated with the Registrant from March 1956 until August 1959 and acted as a registered representative for most of that period. He was reemployed by the Registrant in November 1966 as manager of its Seattle Branch Office and continued in that employment until he resigned in 1972.

B. Issues and Contentions of the Parties

The Division's case is based upon the activities of Hoffman while he was employed at the Seattle Branch Office of the Registrant. The respondents agreed that Hoffman committed violations of the Securities Acts while in the employ of the Registrant and have stated that Hoffman ultimately, on the basis of charges brought by Walston, was convicted of grand larceny for some of his activities while employed at the Registrant. However, Walston asserts that it should not be charged with any of the violations committed by Hoffman because they were criminal activities. All respondents contend that they did not fail reasonably to supervise Hoffman with a view to preventing the violations committed.

The statutory provisions relating to the responsibilities of supervision are set forth in Section 15(b)(5)(E) of the Exchange Act wherein it is provided that the Commission may impose sanctions upon any broker-dealer or any person associated with him who has willfully violated certain statutes

". . . or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this clause (E) no person shall be deemed to have failed reasonably to supervise any person, if —

"(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such person, and  
(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with."

The respondents contend that Walston established procedures as required by the statute and that they reasonably discharged the duties and obligations incumbent upon them. The resolution of the issues and contentions requires a detailed examination of Hoffman's employment history and the operations and procedures in use by the Registrant on a regional basis and in the Seattle Branch Office.

C. Operations and Procedures of the Registrant

As manager of the Pacific Northwest Division of the Registrant, Cullen supervised the operations of eight branch offices in Washington, Idaho and Oregon, as well as certain support facilities. His office was located in San Francisco. San Francisco was the regional operations office of Registrant and New York was its headquarters office. The San Francisco office functioned as the central operations office for the Pacific Northwest Division, performing the cage, margin, wire and computer operations. Ernie Birchenough was the Pacific Northwest Division operations manager of Registrant, and was based in Portland Oregon. Dominic Bregante was the head operations officer for the Pacific Northwest Division and the Central Division of Registrant. Bob Ahart was the department head in charge of the Pacific Northwest Division Margin Department in San Francisco.

Smith, as branch manager of the Seattle office of the Registrant, was subject to the supervision of Cullen and was accountable to him with respect to all his duties as branch manager. Smith did not have authority to hire or fire an account executive, as this could be done only with the concurrence of Cullen.

Both Cullen and Smith were well aware of a booklet issued by the Registrant to all branch managers entitled, "Duties and Responsibilities of Branch Managers" (Div. 2). This booklet sets forth in great detail the responsibilities of branch managers including the obligation to weed out recruiting errors preferably before expending heavy training costs; to meet and become acquainted with the clients of account executives so as to become familiar with their investment problems; to handle all customer complaints diligently; to review order tickets, computer runs of active accounts and to periodically review account records of account executives. They were also required to closely supervise the activities of account executives and to take action when a client was trading to an excessive degree.

All parties were in agreement that the year 1970 was a very active one. The Seattle office had on its staff approximately 25 salesmen and effected approximately 25,000 to 30,000 transactions involving securities in the approximate value of \$70 to \$100 million. Smith notified Cullen on numerous occasions that he needed assistance in the performance of his supervisory tasks. Some clerical assistance was given him, but he was not given an assistant manager until after the period involved here.



Smith had available to him a compliance file, computer runs on commissions, a list of purchase orders by each account executive, required to be approved on a daily basis by the branch manager, a weekly production report for each salesman and a computer accumulation of extensions requested. All customers were mailed a confirmation of each transaction within 4 days thereof and were also sent a computerized monthly statement. Cullen regularly visited the Seattle office and he and Smith were also in touch with each other by telephone.

D. Employee Record of Robert Hoffman

Robert Hoffman was employed by the Registrant at its Seattle Branch Office from April 29, 1968 until he was terminated on February 2, 1971.

In connection with his application for employment, Hoffman filled out two registered representative forms. The first was filled out on or about March 25, 1968 and the second, on or about April 29, 1968. Cullen hired Hoffman on the latter date after a personal interview and a review of his application. The second application Hoffman filled out was used to obtain a salesman's certificate from the State of Washington and Registrant filed it together with an affidavit as to the truthfulness of the matters set forth therein.

Later investigation revealed that Hoffman did not have a college degree as he claimed, that he had a bad reputation in Honolulu in connection with certain past due debts and that contrary to his statements he did have a securities account with another broker-dealer firm and had been adjudged a bankrupt. The head of Registrant's Personnel

Department in a covering memorandum stated "in view of the discrepancies and falsifications as itemized above serious consideration should be given to the eligibility of Mr. Hoffman to become an 'account executive'" (Div. Ex. 13). Cullen testified that he decided to hire Hoffman because recruiting then was very difficult, that Hoffman had accumulated sufficient credits to obtain a college degree, and that he was paying on his debts. The application filed with the State of Washington was never corrected. Smith knew of Hoffman's true record.

The Division contends that Hoffman's misstatements of his application should have warned the respondents of his propensity to lie when he felt it was necessary and that respondents should have exercised special care in his supervision. The undersigned agrees with this contention.

Hoffman became an account executive for Registrant in December 1968. He had difficulty in maintaining his commission earnings and in performing his work. Beginning in September 1969 and during the year thereafter Hoffman requested 35 "trade adjustments" where part or all of a purchase or sell order was shifted to one or more customers' accounts (Div. Ex. 54). In 27 of these adjustments there was no similarity or proximity as to the names of the customers involved or their account numbers. Smith approved the foregoing trades and related adjustments. Hoffman had more of such errors during the period covered by the order for proceedings than any of the salesmen who did an equivalent amount of business.

On December 15, 1969, Smith sent Hoffman a memorandum stating that the San Francisco office had called his attention to the fact that there had been several changes of account numbers involving accounts of Hoffman customers. He requested an explanation. Hoffman, in reply, furnished a memorandum stating that he had oral surgery at the time of the buy orders and that pain and discomfort caused him to make the mistakes. Smith accepted this explanation and also forwarded the memorandum to the San Francisco office (Div. Exs. 20 and 21). Cullen denied any knowledge of this or any other complaints about Hoffman up to this time.

On or about March 31, 1970, Smith received a memorandum from A.T. Dexter of Registrant's San Francisco Margin Department. This memorandum referred to a telephone conversation Smith had had with Ahart the day before concerning the trading habits of Hoffman. Dexter requested Smith to look into these accounts and enumerated eight accounts, stating that Hoffman's conduct "showed a pattern of poor management" of accounts. (Div. Ex. 25).

E. Activities in Specific Accounts

The Division produced evidence of activities in specific accounts serviced by Hoffman in which it claimed serious violations occurred.

John Melin

On July 20, 1970, Smith received a telephone call from a customer, John Melin, who complained that unauthorized trades were made in his account in the Fall of 1969. Smith obtained a memorandum of explanation from Hoffman. Hoffman denied making unauthorized trades in the Melin account.

Smith did not realize that the complaint related back to his memorandum of December 15, 1969 (Div. Ex. 20) to Hoffman concerning account number changes in trades. Melin's complaint was rejected on the basis that it related to transactions occurring seven months earlier and Melin had had ample notice of the transaction involved, but had not made a timely complaint.

Maybeth Hogander

Maybeth Hogander was a customer of the Seattle office of Registrant from about March 1, 1970 to a time subsequent to February 5, 1971. Hoffman was account executive for this account.

On or about March 12, 1970, Smith received a memorandum from Ahart stating that the Hogander account had been restricted for 90 days because there had been repeated liquidations of cash account purchases because payment had not been received. (Div. Ex. 24). These restrictions were again brought to Smith's attention in a Dexter memorandum of March 31, 1970. (Div. Ex. 25). Herein it was stated that the Hogander account was restricted for 90 days due to liquidation of three purchase transactions. Smith could not recall discussing this restriction with Hogander and did not have any discussion with Hogander until after Hoffman left the Walston employment.

In practice, restriction notices were sent to the appropriate office, in this case Seattle, and also to Cullen and the appropriate account executive. They were not sent to the customer, but the account executive was under instructions to contact the customer. Copies of the restriction memoranda were kept in the Seattle branch office of the Registrant only in

chronological order and not by account executive and were not reviewed by Smith.

The restriction on the Hogander account was mentioned in a communication from Birchenough to Smith and Cullen on April 6, 1970. On August 11, 1970, Smith received another memorandum from Ahart restricting the Hogander account because the customer had apparently purchased a security in the cash account but failed to pay for it. Cullen received a copy of this memorandum.

During the month of August, 1970 Hoffman obtained two \$1000 checks from the cashier's department of the Seattle office upon misrepresentation to the cashier as to the purpose, and without the knowledge of Smith and Cullen. The checks were made payable to Hogander but Hoffman caused the checks to be endorsed with forged signatures of Hogander and deposited into his bank account for his personal use.

During the time Hoffman acted as account executive for the Hogander account he made a series of false representations to her concerning his activities on her behalf, the position of her account and his position with the Registrant. He also omitted to disclose facts necessary to render his statements truthful. These statements and omissions were willful violations of the anti-fraud provisions of the Securities Act.

When Hogander opened her account she placed therein securities valued at approximately \$20,000. Between the time the account was opened and February 5, 1971 Hoffman, acting in part on a discretionary basis, effected 30 purchases of securities totaling \$99,600 and 47 sales of

securities totalling \$107,200 in this account. There were no additional funds or securities deposited in the account, and Hogander's withdrawals amounted to \$5,680. On February 4, 1971, the account had a value of approximately \$1,500, due in part to Hoffman's unauthorized withdrawals totalling \$2,000. Registrant eventually paid Hogander's loss in the amount of \$18,642. (Div. Ex. 3).

Theodore Koopmans

Koopmans' account, as Hogander's, was restricted on or about March 12, 1970 because of repeated liquidations of cash account purchases before payment had been received (Memo Ahart of March 12, 1970, Div. Ex. 23). On or about April 6, 1970 Smith and Cullen received a copy of a memorandum from Birchenough restating that Koopmans' account, as well as two others, had been restricted.

Koopmans was a customer of the Seattle Branch Office of Registrant from a time prior to January 20, 1970 to a time subsequent to Hoffman's leaving his Walston employment. Hoffman was the account executive for the Koopmans' account.

On or about January 20, 1970 Koopmans' account with Registrant had a value of approximately \$11,900. Between that date and October 8, 1970 Hoffman, acting in part on a discretionary basis effected 27 purchases of securities totalling approximately \$71,200 and 31 sales of securities totalling approximately \$69,500 in this account. Koopmans invested an additional approximately \$2,500 in his account in this period and made no withdrawals. As of October 8, 1970 the account had a value

of approximately \$3,650, due in part to Hoffman's unauthorized withdrawal of \$1,278 caused by Hoffman's obtaining checks from the cashier department of the Seattle office of Registrant made payable to Koopmans and which Hoffman caused to be endorsed with forged signatures and then deposited into his personal bank account. (Div. Ex. 3). In addition Hoffman made a series of misleading statements to Koopmans about the condition of his account and omitted to giving him truthful information. These statements were willfully violative of the anti-fraud provisions of the Securities Acts. Eventually Registrant paid Koopmans' loss in the amount of \$8,418 (Div. Ex. 3).

On or about June 16 Smith sent Koopmans a letter advising him that during a review of his account it was observed that his account was quite active, but pointing out that rapid trading for short term capital gains could be an expensive procedure and a hazardous medium of speculation. (Div. Ex. 4). Smith also stated in the form letter that was used, "we are pleased to see that the transactions have been largely profitable. . ." Actually the transactions had **not** been profitable. While Smith claimed he had not had enough time to make a careful check of the account before sending out the letter any quick review of Koopmans' transactions would have revealed that all was not going well in that account.

Leonard Adams

On or about August 7, 1970 Smith received a complaint from a Leonard Adams in which he complained that Hoffman had effected two unauthorized

purchases of securities for his account in February and April, 1970, totalling \$6,937.50. Hoffman told Smith a few days later that the disagreement with Adams had been solved to the latter's satisfaction. However, Adams reiterated his complaint a few days later in a telephone call to Smith, and Smith prepared a memorandum in which he stated that certain shares should not be in the Adams account. He discussed the Adams account in detail with Cullen and Hoffman on September 25, 1970 and again Hoffman gave assurances that there was no problem with the Adams account.

On or about October 21, 1970 there was a further discussion among the three men and Cullen told Hoffman that the Adams case would be reviewed by himself and the Registrant's legal department. Smith was instructed to watch Hoffman closely. Hoffman admitted he used unauthorized discretion in the Adams account and placed stock in it that did not belong there.

On or about October 22, 1970 in a further discussion among the three with reference to Hoffman's conduct, Hoffman admitted he had not handled the Adams and other accounts in the best manner.

On or about November 9, 1970 Smith received a copy of a memorandum from Cullen to Hoffman asking for a written explanation of Adams' claim. On or about November 17, 1970 Hoffman submitted a memorandum to Cullen, of which Smith received a copy, in which he admitted unauthorized transactions in Adams' account. The two unauthorized purchases in Adams account were cancelled without any cost to Adams.



Michael Aber

On or about December 1, 1970 Smith and Cullen received a copy of a memorandum from Ahart to Hoffman restricting the account of Michael Aber because transactions had been made in it which violated a 90-day restriction which was in effect when new trades were made.

On or about January 12, 1971, Keith Ballard of Registrant's Seattle office wrote a memorandum which stated that at about the end of December, 1970 Hoffman had told Ballard of an error he had made in Aber's account. Smith was aware of the contents of this memorandum on or about the day it was written. Ballard attempted to have a personal conference with Aber, but was unsuccessful. Later Aber told Ballard in a telephone conversation that he never intended to make the transaction charged to his account. Ballard reported this in a memorandum in which he requested that the San Francisco office move five trades from the Aber account to the error account and charge Hoffman for the loss. Smith and Cullen were aware of this memorandum. Registrant subsequently paid Aber \$2,062.91 for the loss in his account. Although Smith was aware of the problems in Aber's account in December 1970, he did not complete his investigation of this matter until after Hoffman had left Registrant's employment.

Colonel John Combe

In July, 1970 Colonel John Combe contacted Smith and stated he was dissatisfied with the service he was getting from Hoffman. On August 7, 1970 Smith met with Combe to discuss his complaint. When Smith

inquired of Hoffman, the latter reported to him that the trouble in the Combe account was due to a mistake on the part of Colonel and Mrs. Combe. However on September 25, 1970 in a conversation with Cullen and Smith, Hoffman admitted that he had not handled the accounts of Combe and others in the best manner; but assured Cullen and Smith that all the problems were out in the open at that time. Cullen warned Hoffman that he was in a vulnerable position with the firm and Hoffman was warned that there were too many complaints against him. Cullen told Smith to exercise close supervision over Hoffman.

Between about January 20, 1970 and October 1, 1970 Hoffman effected 16 unauthorized transactions in securities in the accounts of customers of the Seattle office. Of these 16 transactions, 11 occurred between January and June, one in July, three in September, and one in October. (Div. Ex. 3).

F. General Practices of Smith and Cullen

In addition to matters developed in prior sections of this decision, additional evidence was presented as to the conduct of Smith and Cullen in carrying out their responsibilities.

Smith did not follow a standard system for dealing with complaints from customers. He either handled them himself, consulted with Cullen, or would write a memorandum to Cullen and Registrant's legal department. On many occasions when Smith spoke to Cullen he did not make records in his diary nor did he make a record of the complaint.

During the period involved here, most new accounts at Registrant's Seattle office were opened by telephone and about 95% of the time Smith

did not meet or speak with new clients. Between 75 and 125 new accounts were opened each month. One of the duties of the branch managers was to review the Account Executive Weekly Production Report, a list of the transactions of each account executive in chronological order. This production report would not show the name of any client and it only showed transactions during a single week. The branch managers' booklet instructed the branch managers to review with clients and account executives those accounts in which clients' activity appeared excessive according to the production report. However the production report did not contain the customer's name and did not group transactions by account. Also, in case of excessive activity in a client's account, a memorandum describing conversations between the manager, the account executive and the client was to be sent to the Director of Compliance for the appropriate division. Smith did not send Cullen such memorandum with respect to Hogander and Koopmans accounts.

Branch managers were required to review the monthly statement of each account executive's active accounts at least once each quarter using the records of each account executive and to keep a record of these reviews. Smith did not make such reviews and testified he felt it was impossible to make such a review because there were then over 7,500 active accounts in the Seattle office.

Branch managers were required to keep a daily log in which to record significant events, including customers' complaints. Smith kept a diary for 1970 but it was incomplete and only listed three customers' complaints for the 43 days noted.

The memoranda Smith received from San Francisco notifying him of trading restrictions in clients' accounts were kept in chronological order, not by salesman. Smith did not review this file, nor did he have a method of keeping track of how many such memoranda were accumulating as to a particular salesman. He did not bring them to Cullen's attention on Cullen's visits to the Seattle office and Cullen did not review this file. Customers received no written notice of such restrictions. Account executives were expected to inform their customers of such matters, but Registrant had no procedure to confirm or verify that such information had in fact been passed on to its customers.

Checks in the Seattle branch office were required to be mailed to customers or handed to them personally by the cashier. Any deviation from this procedure required the approval of the Divisional Vice-President. However, the Seattle office followed a procedure under which salesmen could obtain checks made out to clients if approved by the branch manager. As previously noted, Hoffman was able to obtain checks without such approval.

Cullen was under a duty to and did visit the Seattle office. He never criticized Smith for failing to meet the compliance schedule of Registrant nor did he examine Smith's complaint or compliance files.

On or about January 14, 1970, Cullen after visiting the Seattle office and making an inspection reported that Smith reviewed customers' monthly statements on a monthly basis and that the Seattle office was functioning properly and making excellent progress. In a May 1970 report

he stated that Smith was doing an excellent job of supervision and in a September 1970 report he stated that the compliance problems at the Seattle office were at a minimum. However, in that same month Cullen informed Hoffman there were too many compliants against him and told Smith to maintain close supervision over Hoffman.

From this time forward matters with Hoffman moved towards a final solution.

G. The Discharge of Hoffman

On October 6, 1970, Smith wrote Hoffman a memorandum requesting him to prepare for an examination of his books as he had had an exceptional number of errors involving changes of accounts numbers to be charged for purchases of securities. Cullen received a copy of this memorandum. On October 12, 1970, the aforementioned review was made. On October 21, 1970, Cullen, Hoffman and Smith discussed the Adams case, and Cullen and Smith received some disturbing information from Hoffman, who admitted using discretion in a purchase of securities for a customer. He also admitted making unauthorized purchases for the account of Adams. There was another critical meeting among the three at which Cullen told Hoffman that his future employment with Registrant was very vulnerable. However, on or about November, 1970, Smith delivered a memorandum to Cullen recommending that Hoffman be put on a \$950 per month salary for the purpose of allowing him enough income to meet his necessary expenses while he paid off his debt to Registrant for errors from excess of commissions credited above the amount properly due him. This was highly unusual; also at that time Hoffman was not earning the amount of his drawing. However, he did receive the

draw and at least some of that money was used to meet his obligations to Registrant which then were about \$8,000.

On or about November 25, 1970 Hoffman was censured in writing by the Registrant for effecting the unauthorized transactions in the Adams account. He was also charged for the full amount of loss in the Adams transactions -- \$4,490.18. On or about November 24, 1970, Ballard prepared a list of trade adjustments done at the request of Hoffman. This document indicated that in the period of time between September 1969 to September 1970, 35 trade adjustments were made in Hoffman's accounts by moving a security purchase or sale from one account to another at his request. This memorandum was addressed to Cullen. Hoffman thereafter executed a promissory note to registrant for \$7,943.60. However, Hoffman was permitted to continue effecting transactions for customers. On February 2, 1971 Cullen directed Smith to terminate Hoffman's services. Smith had not recommended that action at any time prior thereto.

#### H. Contentions of the Parties: Conclusions

##### 1. Supervisory Issues

Smith and Cullen were the principal witnesses at the hearing and gave extensive testimony concerning their activities in the Hoffman case. It is argued on their behalf that the employment of Hoffman involved some risk, but there was a shortage of qualified account executives at the time and he was subject to supervision. For approximately one year thereafter, there was little complaint about his work: at least nothing during that period has been made the subject of these proceedings.

The first item that caused inquiry about Hoffman were certain account changes which were called to Smith's attention in mid-December 1969. Here, Smith and the Registrant's San Francisco office, which had made the inquiry, accepted Hoffman's explanation that he was ill at the time he made certain mistakes in the accounts.

There were additional memoranda submitted to Smith in March calling his attention to restrictions on the Hogander and Koopmans accounts. It is contended that restriction notices were common during that period and were usually indicative of customers problems so that no further action was required. It also is asserted that later investigation indicated, at least to the satisfaction of the respondents, that Hogander and Koopmans, as well as other Hoffman customers were in "collusion" with him and any direct inquiry of them would have been fruitless. It was also claimed that other Hoffman customers could not be contacted easily because they were abroad or away from home for a variety of reasons during the period involved here.

As to the complaints made by Melin and Combe it is asserted that these complaints were investigated and ultimately were rejected.

The first substantial customer complaint, according to the respondents, was the Adams complaint which was first raised in August 1970. Respondents maintain that this complaint was carefully investigated by both Cullen and Smith, but their work was hampered because Adams was unavailable to give full information. According to Cullen, he knew by mid-November, from his investigation and admissions by Hoffman both to him and Smith that Hoffman had acted dishonestly. Cullen determined to keep Hoffman on the

payroll while the investigation continued. This, according to the respondents, was a calculated risk and allowed the respondents and their staff to make further investigation of Hoffman's activities and ultimately to discharge him. The respondents contend that the Walston operating procedures were in compliance with statutory requirements and that they reasonably discharged the duties and obligations of supervision imposed upon them. It was also maintained that Hoffman had engaged in criminal activities and the Registrant should not be held responsible for them.

The Division contends that Registrant failed reasonably to supervise Hoffman in that it failed to have established supervisory procedures and a system for carrying them out which could reasonably be expected to prevent and detect the violations by Hoffman. It points to the fact that Registrant did not have supervisory procedures requiring confirmation by direct contact with customers when matters indicating misconduct by account executives were revealed. Nor did it have a procedure in effect for ready determination whether there had been prior account number changes in a customer's account, such as occurred here. While the respondents argue that there was no need to take any action when restriction notices were sent to an account executive for one of his customers, it is pointed out that there was no system for determining how many such notices were accumulating as to a particular customer or salesman. Nor was there any system for following up with the customer to determine whether there were special problems requiring supervisory intervention.

Smith had informed Cullen a number of times that he was unable



to perform his supervisory duties properly and he needed help in the performance of those duties. Some clerical assistance was given Smith, but it was not adequate for him to handle the approximately 7500 active accounts in 1970. This was known to Cullen and the Registrant. Yet no effective action was taken to really meet the problem. It is claimed that during this period it was very difficult to get competent help. However, Registrant by continuing to open new accounts during this period without meeting its supervisory problems in Seattle took a calculated risk, and this, in no small measure, contributed to the Hoffman violations. Smith, at most, could glance at the Account Executive Weekly Production Reports. However, these were only furnished him for weekly and did not contain the names of customers or group transactions by single account. If such information had been available with adequate staff to make inquiry, Hoffman's churning of accounts and using unauthorized discretion might have been detected.

Cullen knew of the problems at the Seattle office. Yet in at least one inspection report, he indicated that Smith was carrying out his assigned duties to review customers' monthly statements every month. The Division also contends that Cullen failed to exercise reasonable supervision over Hoffman when he failed to take prompt and effective action against Hoffman when he first learned that Hoffman had given Registrant false and misleading information concerning trade adjustments in customer accounts. Instead he allowed Hoffman to continue for a number of months in the employment of Registrant. The Division, while

recognizing the problems Smith had in management and supervision of the Seattle office, maintains that he also failed in his duty of supervision of Hoffman. They contend that he accepted an illogical explanation for account errors and did no further checking on them nor attempted to verify Hoffman's statements with customers.

There also were instances, the Division points out, where Smith failed to pass on order errors of Hoffman to Cullen. These were later found to be more than any other salesman doing an equivalent amount of business at the Seattle office, but this was only brought to light by a much later investigation.

The Hogander and Koopmans accounts were shown on the activity list and this, according to the Division, should have alerted Smith to make some investigation to make sure that churning was not taking place. Actually, there was extensive churning taking place in the Koopmans and Hogander accounts. This was not discovered until after Hoffman had left the employ of the Registrant. In this connection, the respondents contend that all customers received confirmations of all transactions within 4 days and that customers such as Koopmans and Hogander who said nothing to Registrant, were actually in collusion with Hoffman and it would have been no use to make any inquiry of them. However, the obligation was on the Registrant and its supervisory employees to make sure that violations of this type were not occurring. The Division points out that they made no efforts to adequately check for churning activity.

The Commission has summarized the duty of supervision in the leading case of Reynolds and Co., 39 S.E.C. 902 (1960), as follows:

"We have repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and that in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention. . . .

The existence of numerous and scattered branch offices complicates the problem of supervision and makes essential the installation of an adequate system of control. The growth of securities firms also tends to increase the number of inexperienced personnel who require especially careful supervision, particularly where many firms are growing at the same time and thereby creating a shortage of experienced people. Supervisory personnel cannot rely solely upon complaints from customers to bring misconduct of employees to their attention, particularly where customers may be inexperienced and may fail to realize that they have been mistreated, or where rising markets tend to obscure the effect of such mistreatment. All of these conditions increase the importance of maintaining and enforcing adequate standards of supervision. The duty of supervision cannot be avoided by pointing to the difficulties involved where facilities are expanding or by placing the blame upon inexperienced personnel or by citing the pressures inherent in competition for new business. These factors only increase the necessity for vigorous effort." [footnotes omitted] (pp. 916-917).

Much of the language used by the Commission in the Reynolds case applies directly to the issues in the instant case and the defenses raised. The Registrant was under a duty to institute supervisory procedures which would be adequate and effective. Cullen and Smith were under the obligation to exercise great care to see to it that violations of statutory requirements and applicable rules and regulations did not occur in the management of the Seattle office. Yet, for a period of approximately one year, the respondents had notice of serious misdeeds in

customer accounts by Hoffman. When some of these were uncovered in the San Francisco office, glib explanations were accepted from Hoffman without any attempt to verify his stories. His more serious misdeeds were not discovered at all until after he had left the employ of the Registrant. Even when the Adams complaint surfaced in the July-August 1970 period, Hoffman was allowed to continue his duties for almost another six months while the Registrant attempted to make an investigation.

The evidence establishes, in the opinion of the undersigned, that while some investigation was made when errors by Hoffman were called to Smith's attention by the San Francisco office, no affirmative program was instituted by Smith or Cullen to investigate Hoffman's activities rather than waiting for complaints to reach them. Although Smith undoubtedly had a lot of work, he should have instituted a sampling program allowing him to focus on those about whom he had received complaints from his own office in San Francisco. Instead of taking such affirmative action Hoffman was permitted to make a series of very serious violations over a number of months in the accounts of his customers before there was any hint of detection. This conduct was facilitated by Registrant's supervisory procedures which permitted Hoffman to get possession of checks of customers<sup>3/</sup> and to indulge in churning activities in customer accounts, among other violations. The undersigned therefore concludes that the Registrant, Cullen and Smith violated their supervisory obligations over

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<sup>3/</sup> See Reynolds and Co., supra, p. 950.

Hoffman by their use of rules and regulations not adequate to meet supervisory responsibilities and their failure to take appropriate action to avoid violations of the Securities Acts by employees.

## 2. Record-Keeping and Anti-Fraud Violations

The Commission has found, and the evidence here, including a stipulation, further substantiates the fact that Hoffman willfully violated the anti-fraud provisions of the Securities Acts and the record-keeping provisions of the Exchange Act and the rules thereunder. The order alleges, and the Division contends, that the Registrant is also responsible for those violations and willfully violated the statutory sections and rules referred to in the order. The Registrant contends that Hoffman was engaged in criminal activities and that liability should not be imposed on the Registrant unless it can be proven that it was complicitous or lax.

Hoffman's violations occurred while he was employed as an account executive for the Registrant and in the course of his duties as such. While Hoffman obviously was not authorized to engage in criminal activities and other violations of the Securities Act and the Exchange Act, the doctrine of respondeat superior still applies to his activities and the Registrant is responsible for the violations committed by him while he was in Registrant's employ.<sup>4/</sup> These violations were willful within the

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<sup>4/</sup> Contrary to the contention of the Registrant the doctrine of respondeat superior was applied in the case of Sutro Bros. & Co., 41 S.E.C. 470 (1963) where violations committed by sales representatives of a broker-dealer were held chargeable to the broker-dealer who did not know of the commission of the violations at the time they were made.

It is asserted that Hoffman was engaged in criminal activities and undoubtedly the check forgeries fell in that category, but there is no proof that any record-keeping or anti-fraud violations were also brought to the attention of a criminal court.

meaning of the Exchange Act.<sup>5/</sup>

III. CONCLUDING FINDING: PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(5) of the Exchange Act, so far as it is material herein, is required to censure, suspend for a period not to exceed twelve months or to revoke the registration of any broker or dealer if it finds that such action is in the public interest and that such broker or dealer, subsequent to becoming such, has willfully violated any provision of the Exchange Act, the Securities Act, or any rule or regulation thereunder, or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. It also may, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, censure, bar, or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer if it finds that such sanction is in the public interest and that such person has willfully violated any provision of the Exchange Act, the Securities Act, or any rule or regulation thereunder. Furthermore, pursuant to Section 15A of the Exchange Act, it may expel or suspend a member of a registered securities association who has violated any provision of the Securities Acts

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5/ Tager v. S.E.C., 344 F.2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord Harry Marks, 25 SEC 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F.2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946).

or any rules and regulations thereunder. Similar sanctions may be imposed on members of a national securities exchange pursuant to Section 19(a) of the Exchange Act.

It has been found that the Registrant willfully violated the anti-fraud provisions of the Securities Act, the record-keeping requirements of the Exchange Act and rules and regulations thereunder, and, further, that Daniel T. Cullen and Sydney Senior Smith failed reasonably to supervise, with a view to preventing the violations aforementioned by Robert Hoffman, a person who was subject to their supervision at the time the violations occurred and who committed such violations.

In addition to their contentions that no violations occurred, which contentions have been disposed of by the findings herein, it is pointed out that after all of Hoffman's misdeeds came to light the Registrant settled all claims made by customers because of his activities, even though it felt that there were claims to which it would have an adequate defense. In excess of \$50,000 was so expended. It is further urged that the charges have worked serious personal hardships on Smith and Cullen.

The Division has recommended that the Registrant be censured and that Cullen be suspended from association with any broker or dealer in securities for a period of 90 days because of his failure of supervision and that Smith be suspended for a period of 60 days.

The recommendation as to the Registrant was made when it was actively carrying on a broker-dealer business with numerous branch offices. The interest of many customers and innocent employees would be involved in a sanction. Since that time the Registrant has announced plans to liquidate

its business and has disposed of most of its branch offices, including the Seattle Branch Office. Under these circumstances, the undersigned has determined that a sanction of censure would be appropriate for the Registrant's violations.

It has been found that Daniel T. Cullen, and Sydney Senior Smith failed in their duties of supervision with reference to the Registrant's Seattle Branch Office and the activities of Robert Hoffman while employed there. The violations committed by Hoffman were most serious and the individual respondents failed to take effective action to stop them. Smith did not have the right to hire and fire, but he was in daily attendance at the Seattle office and had the duty of exercising careful supervision over the 25 account executives under his supervision. He failed to do so. Cullen exercised his control from a distance but he had the obligation to see that adequate controls were maintained, that he was promptly informed of any derelictions and that he moved promptly to avoid and to remedy possible violations. He failed in this regard.

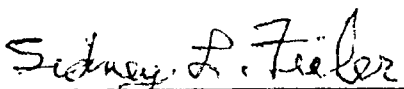
The undersigned is well aware from the evidence that both Cullen and Smith had very difficult assignments, but the Commission has pointed out in the Reynolds case, supra, that very high standards are required in supervisory positions. Both Cullen and Smith had joint responsibilities here and it is difficult to differentiate between their respective failures and to say that one is more responsible for the violations found than the other. It is concluded that the sanction of a period of suspension is appropriate here in the public interest, but not as great as that suggested by the Division. Accordingly,



IT IS ORDERED that the Registrant, Walston & Co., Inc. (now known as DuPont Walston, Incorporated) is hereby censured for the violations found herein.

FURTHER ORDERED that Daniel T. Cullen and Sydney Senior Smith are each hereby suspended from association with any broker or dealer for a period of 25 days.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. This initial decision, pursuant to Rule 17(f), 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.<sup>6/</sup>

  
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Sidney L. Feiler  
Administrative Law Judge

June 28, 1974  
Washington, D.C.

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<sup>6/</sup> All contentions and proposed findings and conclusions have been carefully considered. This initial decision incorporates those which have been accepted and found necessary for incorporation therein.