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UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of
R. BARUCH & COMPANY, et al.
Files 8-8712, et al.

RECOMMENDED DECISION

SIDNEY L. FEILER
Hearing Examiner

Washington, D. C.

August 5, 1965.

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APPEARANCES:

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James W. Fredericks, Edward B. Wagner,
Sydney H. Mendelsohn, and Stanley H. Ragle, Esqs.
for the Division of Trading and Markets.

BEFORE: SIDNEY L. FEILER, HEARING EXAMINER.

I. THE PROCEEDINGS

The Commission, by order dated February 19, 1962 instituted proceedings pursuant to Section 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") [1/] to determine whether to revoke the broker-dealer registrations of A. T. Brod & Company ("Brod), R. Baruch & Company ("Baruch"), and Sutro Bros. & Co. ("Sutro") and whether certain named persons associated with those firms should be named causes of any order which might be entered by the Commission in those proceedings. On February 27, 1962, the Commission instituted broker-dealer revocation proceedings against Seraphim & Company, Inc. ("Seraphim"), Fairfax Investment Corporation ("Fairfax") and associated persons based upon their activities while employed by other broker-dealers. On the same date all the above proceedings were consolidated.

On April 10, 1962, hearings were commenced and continued until July 11, 1962 when the Commission stayed the proceedings pending a decision on a motion for dismissal made by counsel for certain of the respondents.

Pursuant to a motion by the Division, the Commission, on September 27, 1962, severed the proceedings with respect to Sutro, Irving Rudd, Stanley Bennett, and David Hersh. [2/]

1/ These proceedings were instituted prior to the adoption of the Securities Acts Amendments of 1964, 78 Stat. 565 (August 20, 1964). References to provisions of the Securities Act and the Exchange Act are to provisions as they existed prior to the adoption of the amendments, except as noted.

2/ The above firm and persons submitted an offer of settlement which was accepted by the Commission in its Findings and Opinion, In the Matter of Sutro Bros. & Co., Securities Exchange Act Release No. 7053 (April 10, 1963).

On September 27, 1962, the Commission also terminated the proceedings against Brod, Baruch, Seraphim and Fairfax and all persons named in the orders with respect to those broker-dealers. Proceedings were also terminated with respect to Sutro, insofar as the proceedings involved Claude V. Warren. The Commission's action was taken upon the consideration of motions seeking a determination whether a Commissioner who had participated in the proceedings should be disqualified, and whether the proceedings with respect to those respondents should be dismissed. In view of the decision in Amos Treat & Co. v. Securities and Exchange Commission, 306 F. 2d 260 (1962), the Commission, without conceding that any Commissioner was disqualified, terminated the proceedings but without prejudice to the subsequent institution of new proceedings.

On October 15, 1962, the Commission entered orders reinstituting proceedings against the aforementioned respondents (excpting Sutro, Rudd, Bennett and Hersh), and consolidated the proceedings.

Hearings commenced on May 20, 1963. The record of the prior proceedings was incorporated into the new proceedings. The parties were afforded full opportunity to be heard and to examine and cross-examine witnesses. At the conclusion of the presentation of evidence, opportunity was afforded the parties to state their positions orally on the record. Opportunity was then afforded the parties for filing proposed findings of fact and conclusions of law, or both, together with briefs in support thereof. Written material was received from all the parties actively participating in the hearing at its close.

As the result of various consents and settlements,[3/] the present posture of the proceedings reveals six remaining respondents, namely, Seraphim, Fairfax, John D. Pappas, John Meslovich, Eugene Tucker, and Bernard Hammett.

The matters put in issue by the orders for these proceedings as to these respondents are:

A. Whether the individual respondents and their broker-dealer employers at relevant times, singly and in concert, willfully violated Sections 5(a) and (c) of the Securities Act of 1933 ("Securities Act") in that these respondents, 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, to sell, and to deliver after

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3/ R. Baruch & Company, Baruch Rabinowitz, Conrad Lippman and David Starr submitted offers of settlement which were accepted by the Commission in its Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7138 (September 11, 1963).

A. T. Brod & Company, Albert T. Brod and Martin Lesser submitted offers of settlement which were accepted by the Commission in its Findings and Opinion, In the Matter of A. T. Brod & Company, Securities Exchange Act Release No. 7139 (September 11, 1963). Sidney Herwood submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7352 (June 22, 1964).

Sidney Spector submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7382 (August 5, 1964).

Claude V. Warren submitted an offer of settlement which was accepted by the Commission in its Order Barring Association with Broker or Dealer, In the Matter of Fairfax Investment Corporation, Securities Exchange Act Release No. 7475 (November 27, 1964).

S. Thomas Guren submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7480 (December 7, 1964).

sale, securities, namely, the common stock of Agricultural Research and Development, Inc. ("AGR") when no registration statement had been filed and when no registration statement was in effect as to such securities under the Securities Act.[4/]

B. Whether the individual respondents and their broker-dealer employers, singly and in concert, willfully violated Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-6, promulgated by the Commission thereunder, in that said respondents, in connection with the purchase and sale of AGR stock, employed manipulative and deceptive devices and contrivances by bidding for and purchasing AGR stock for accounts in which respondents had a beneficial interest while engaged in the distribution of the common stock of AGR.[5/]

C. Whether the individual respondents, singly and in concert, willfully violated and aided and abetted willful violations of the anti-fraud provisions of the Securities Acts in the purchase and

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4/ Section 5 of the Securities Act provides in pertinent part that it shall be unlawful to make use of the instruments of transportation or communication in interstate commerce or of the mails to offer to sell or to sell a security unless a registration statement is in effect as to it.

5/ Rule 10b-6 defines as a "manipulative or deceptive device or contrivance" as used in Section 10(b) of the Act for any person who has agreed to participate or is participating in a distribution of securities to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution.

sale of AGR stock.[6/]

D. As to Fairfax and Seraphim, the gist of the allegations against them is that they had associated with them individual respondents named in the orders for these proceedings as having violated the Securities Acts.

Upon the entire record and from his observation of the witnesses, the undersigned makes the following:

II. FINDINGS OF FACT AND LAW

A. The Respondents

1. Seraphim & Co., Inc.

(1) Seraphim is a Washington, D. C. corporation which has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since February 10, 1962.

(2) Orders for proceedings dated February 27, 1962 and October 15, 1962 and notices and motions filed by the Division have been mailed to the address given on Seraphim's broker-dealer registration form. Seraphim has failed to plead, defend, or otherwise appear in these proceedings and the Division has requested that a default be entered against Seraphim and the proceedings be determined against such party

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6/ Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 (17 CFR 240.10b-5 and 15c1-2) thereunder are sometimes referred to as the anti-fraud provisions of the Securities Acts. 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.

upon consideration of the order for the proceedings, the allegations of which may be deemed to be true.

(3) The orders for proceedings on which the Division bases its motion for entry of default against Seraphim were served prior to a revision of the Commission's Rules of Practice on June 30, 1964 (Securities Act Release No. 4705) in which a substantial revision of default procedures was adopted. In its release, the Commission summarized the prior default procedures (which are applicable to the instant case) as follows:

> "The Commission also has adopted new rules relating to defaults. Rule 7(e) of the Commission's Rules of Practice formerly provided that a proceeding may be determined against a party in accordance with the allegations in the order for proceeding only if he fails to file an answer that is specifically required in the order. Since answers are not required in many Commission proceedings, the Commission's Rules of Practice formerly provided no general procedure for determining in advance of a hearing whether persons named in the order for proceeding intended to participate in the hearing. Moreover, under Rule 16 of the Rules of Practice as formerly in effect, when such persons did not appear at a hearing they waived only their rights to a recommended decision and to object to participation by the staff in the preparation of that decision."
>
> (pp. 4-5)

(4) No answer was required in the Seraphim orders. Accordingly, there is no basis under the Rules of Practice applicable to these proceedings for granting the Division's request. 7/

7/ For procedures under the revised Rules, see Diversified Securities Corporation, Securities Exchange Act Release No. 7489 (December 23, 1964).

2. John C. Pappas

(5) Pappas is named in the Brod and Seraphim orders for proceedings. The Division has been unable to serve Pappas and has stated that it does not intend to submit proposed findings against him at this time.

3. Fairfax Investment Corporation

(6) Fairfax is a Washington, D. C. corporation which has been registered with the Commission as a broker-dealer since April 19, 1961.

(7) Orders for proceedings and notices and motions filed by the Division have been mailed to this registrant at the address furnished on its broker-dealer application for registration, but no response had been filed on its behalf. The Division has requested that a default be entered against Fairfax and that the proceedings be determined against this party on consideration of the orders for proceedings, the allegations of which may be deemed to be true.

(8) The proceedings against Fairfax are based on the activities of Claude Warren, an alleged person in control of Fairfax, while Warren was employed by Sutro. Unlike the situation in the Seraphim proceedings, some evidence was introduced as to Warren's activities. However, as previously noted, the case against him has been disposed of by his offer of settlement which was accepted by the Commission in which he neither admitted nor denied the allegations against him. As pointed out in the instance of the Division's application in connection with Seraphim, there is no basis under the Rules of Practice applicable to these proceedings for granting the Division's request for an order against Fairfax because of its default. The Division has not relied on the adequacy of the evidence in support of its application for an order against Fairfax.

(9) It should be noted in passing that at the time of the hearing both Seraphim and Fairfax were out of business. There was no evidence that any effort was being or would be made to reactivate those concerns.

4. John Meslovich

(10) John Meslovich first entered the securities business in May, 1960. In August, 1960, he became a registered representative at Brod and was so employed during the period here relevant. He appeared in person, testified as a witness, and submitted a written memorandum. 8/

5. Eugene Tucker

(11) Tucker was employed as a salesman for several brokerage concerns for short periods on a part-time basis during 1960 and 1961. He became employed as a registered representative of Baruch in February, 1961 and continued there for approximately six months. Tucker appeared in these proceedings by counsel. He was called as a witness to testify, but refused, relying on the Fifth Amendment.

6. Bernard Hammett

(12) Hammett is an attorney. He appeared in these proceedings in person and testified as a witness. He was never on the payroll as an employee of either Brod or Baruch, but in connection with certain of his activities in AGR stock, the Division has contended that he falls within the provisions of Section 15(b) of the Exchange Act and is subject to an order of the Commission.

8/ When first called to the stand, Meslovich refused to testify on constitutional grounds and at a later stage in the proceedings, he took the stand and testified fully.

B. Distribution of AGR Stock

The Regulation A Offering

(13) In January, 1960, AGR filed a registration statement with the Commission covering a proposed public offering of 200,000 shares of its common stock at $5 per share. In March, 1960, the registration statement was withdrawn by AGR after it was advised that the Division of Corporation Finance would recommend that stop order proceedings be instituted to suspend the effectiveness of the registration statement if it did not do so. Thereafter, on May 23, 1960, after changing the par value of its stock, AGR filed a notification pursuant to Regulation A of the Securities Act in the Denver Regional Office of the Commission with respect to an offering of 120,000 shares of its recapitalized 5¢ par value common stock at $2.50 per share.

(14) The offering circular gave details of the history and program of AGR. AGR had been organized in 1959. Its principal asset was a farm near Wiggins, Colorado, acquired from Eugene Petersen, a controlling person of AGR and its largest stockholder, on which it intended to raise hogs and market a quality pork product under controlled sanitary conditions. In the transaction by which Petersen had transferred the farm property to AGR, Petersen received 64,400 shares of which he retained 32,400 shares of common stock out of the 69,400 shares issued and outstanding when the Regulation A offering was made to the public. 69,400 shares, according to the offering circular, had been escrowed with a bank and would not be reoffered or sold for a period of one year from and after the commencement of the public offering. In a paragraph

headed "Speculative Aspects of the Proposed Business" it was pointed out there were no firm commitments for the sale of the securities to be offered and no assurance that sufficient funds would be raised to undertake to any degree the program of development set forth in detail in other sections of the offering circular; the offering price of the stock was arbitrarily determined and had no relation to the value of the company or its assets; the principal asset of the company then consisted of an equity in the farm on which there were mortgages in the amount of $96,631.67; as of the date of the offering circular the current assets of the company amounted to $9.15 and current liabilities amounted to $16,389.27, and therefore a portion of the proceeds would have to be used to pay those liabilities; and that if sufficient money were not raised, the principal assets of the company might be lost through foreclosure sale; the company was not engaged in business at that time and if substantially all of the shares being offered were not sold, AGR would not be able to engage in its proposed business.

(15) The offering circular, as amended and used in the presentation to the public, is dated August 3, 1960. Sale to the public commenced a few days later. The underwriter of the issue was W. Edward Tague Company, of Pittsburgh, which undertook the sale of the issue on a best-efforts basis.

(16) The offering did not proceed well. Up to early January, 1961, only 9,685 shares of the 120,000 offered had been sold (Div. Ex. 138, pp. 4-6, Tr. 173). Petersen, meanwhile, had developed an acquaintanceship with brokers and other representatives in the Washington area.

In the summer of 1960, Hammett, who had done legal work for AGR, introduced Meslovich, then employed by Brod as a registered representative, to Petersen. In early January, 1961, a social gathering was held in Meslovich's home at which Claude Warren, then a registered representative of Sutro, was introduced to Petersen. Meslovich suggested in the winter of 1960 that the Regulation A offering might be closed when Petersen informed him "that he was having a great deal of trouble getting it out" (Tr. A1651-62). Petersen also discussed with Warren the possibility of Sutro participating in the offering and was told by Warren that it was Sutro's policy not to participate in primary distribution of securities offered pursuant to Regulation A but that it could have trading transactions in stock for customers after a public offering was terminated. George Stanford, who was a director of AGR, and planning its public relations campaign (Tr. A1303), introduced Petersen to Baruch Rabinowitz, president of R. Baruch & Co., one of the respondents named in the order for these proceedings (Tr. A1344-45).

(17) On February 17, 1961, AGR filed a Form 2-A report pursuant to Regulation A, dated February 16, 1961, stating that as of February 14, 1961, 39,685 shares had been sold and that the total amount received from the public was $99,212.50 of which the issuer had received $82,330.62 and that the offering was being discontinued due to the lack of acceptance of the offering. It was also stated that there had been no change in the number of shares held by each promoter, director and officer or controlling person of the issuer from that stated in the offering circular.

(18) Three days prior to the filing of the Form 2-A report, on February 14, 1961, a meeting of AGR stockholders was held in Denver in which the termination of the Regulation A offering was discussed. Among those present at the meeting were Petersen, Emil Jensen, an associate of Petersen, C. Henry Roath, counsel for AGR, and Herman Tripp, vice-president and a director of AGR. Jensen was elected a director of the company. Petersen stated that 30,000 shares, in addition to the previously sold 9,865 shares issued, had been sold and showed checks in payment for 20,000 shares signed by Hammett and Jensen. He stated that these sales were contingent on the offering being closed immediately after purchase of these shares (Tr. 3887),

(19) The 10,000 shares represented as sold, for which Petersen did not display checks, according to the transfer records of AGR (Div. Ex. 138) had been issued on January 30, 1961 in the name of Tague and had been sight-drafted by Roath on Petersen's instructions to a Washington bank to be picked up by Petersen. These 10,000 shares were not paid for and were returned to Roath around February 15 or 16, 1961. Roath retained them in his office until late in March when he turned them over to Petersen (Tr. 3865-75). These certificates were turned over by Roath to Petersen on March 24, 1961, but the receipt Petersen signed for them was falsely backdated to February 16, 1961 (Div. Ex. 181, Tr. 3878).

(20) As to the 30,000 shares Petersen reported sold in addition to the prior 9,865 shares sold by Tague, the latter was supplied with the names of Emil Jensen, E. Neal Smith, and Bernard Hammett, and prepared confirmations to these individuals for record purposes only (Div.

Exs. 6, 7, 8). The originals of the confirmationswere not sent nor were any payments received by him, Tague testified (Tr. 212-214). Tague's records reflect that on February 6, 1961, 10,000 shares were sold to Bernard Hammett and that on February 10, 10,000 share blocks were sold to E. Neal Smith and Emil Jensen. Neal Smith denied that he purchased the stock allotted or knew anything about the proposed purchase (Tr. 3241-42). The shares earmarked for him were those issued in the name of Tague and sightdrafted to be picked up by Petersen in Washington, which shares were ultimately returned to Roath.

(21) The transfer record of AGR stock (Div. Ex. 138) reflects the issuance of 10,000 shares blocks to Jensen and Hammett on February 16, 1961. According to Jensen, about two days before the annual meeting of AGR, previously referred to, Petersen told him that he would need Jensen's personal check for 10,000 shares for a total sum of $21,250. Jensen gave him a check but told Petersen that his bank account was not sufficient to cover it. According to Jensen, the check was never presented for payment or honored (Tr. 775-780).

(22) Bernard J. Hammett has known Eugene Petersen since 1957 or 1958 and has performed legal services for him at various times. At the time of the hearing he was employed in a company with which Petersen was also associated. In March, 1961 Hammett also performed some legal services for AGR.

(23) Hammett testified that he first learned of AGR from Petersen in October or November, 1960 when the latter told him he was engaged in a new venture. Hammett asked for a selling brochure which he received

approximately a month later. Hammett denied that he had any discussion with Petersen about the affairs of AGR nor with the underwriter, Tague, before he made a commitment to purchase 10,000 shares of AGR.

(24) Hammett admitted that in December, 1960, he may have told Petersen that he might have some outlets for AGR stock in the Washington area. He was vague as to whom he may have introduced Petersen to, but mentioned several persons named in these proceedings as respondents as persons to whom he possibly might have introduced Petersen.

(25) Hammett stated that he talked with Tague and gave him an order for a purchase of 10,000 shares of AGR. He was not certain of the exact date when the order was placed nor when the conversation with Tague took place. He denied having any information about the company except that contained in the selling brochure and stated that he obligated himself to pay the large amount of money involved in the purchase because he believed in the company and the promoters behind it. He also affirmed that he paid Tague for the purchase in cash, first giving him checks.

(26) The original arrangement with Tague, according to Hammett, was that Tague was to obligate himself to hold 10,000 shares of AGR stock for Hammett, bill Hammett for what would be owing when the issue was to be closed, and then Hammett was to deposit sufficient money in his bank account to cover the checks issued. While Hammett affirmed that he was acting for himself and not as a nominee, he refused to give the name of the person from whom he stated he received the cash with which to pay Tague. He also testified that the actual amount he paid for the stock was not $25,000, as shown on the confirmation issued in connection with

his purchase, but $21,500. He refused to reveal the name of the client from whom he claimed he received the money, stating the client had asked him not to do so because he did not want to be bothered with the Internal Revenue Service (Tr. A1138).

(27) After he paid Tague, Hammett testified he asked for the return of his checks but Tague said the checks were unavailable but would be sent later. He was not sure of the exact date on which he paid for the shares although the checks previously given were dated January 29 and the confirmation was dated February 6, 1961. The checks Hammett gave Tague were in fact not returned to him immediately but were deposited in the AGR account and when they were presented for payment, payment was refused (Tr. A1144). Subsequently they were returned to Hammett.

(28) Hammett was unable to state who gave him shares of AGR he actually received, when this took place, or in what denominations its certificates were. He did not know if Petersen had ever had possession of his shares in Colorado and denied he had given Petersen any authorization to make use of the shares. He denied having any arrangement with Petersen to distribute the stock in Washington although he admitted he testified in an investigative proceeding that he could not answer the same question because it would give some indication who his client was and in his opinion violate the attorney-client relationship.

(29) Tague invoked the Fifth Amendment and refused to answer questions as to his dealings with Hammett in the sale of AGR stock (Tr. 166-167). Tague also relied on his constitutional rights in refusing to answer questions as to any payments he may have made to AGR in

connection with the Regulation A underwriting (Tr. 178-9).

(30) According to Dr. Carl Telleen, who was president of the company from December, 1959 to February 14, 1961, AGR never had more than several hundred dollars in the bank at any one time. The evidence establishes that instead of obtaining $82,330.62, which AGR claimed it had received, in its 2-A report, it in fact received some worthless checks which were not honored when presented for payment. There is no evidence that any substantial sum in the Regulation A offering ever actually reached its treasury.

C. Further Distribution of AGR Stock

(31) The 30,000 shares which were purportedly issued and sold in three 10,000 share blocks at or about the time of the closing of sales of the original Regulation A issue all found their way to the Washington securities market.

1. Distribution of stock issued in the name of Emil Jensen

(32) According to the AGR transfer records a block of 10,000 shares in various denominations was issued to Emil Jensen on February 16, 1961 and forwarded to him at Sutro Bros. & Co. in Washington (Div. Ex. 138, p. 8). An account was opened for Jensen at Sutro on February 24, 1961 into which the AGR shares were received. In the period from February 24 to March 20, 1961, approximately 4,500 shares were sold to the public from this account (Div. Ex. 37). The account was long 300 shares when Sutro returned 5,300 shares to Jensen on March 28, 1961.

(33) On March 28, 1961, Jensen sold 5,000 shares to Martin Lesser, then the Washington partner of A. T. Brod & Company, in the name

of Silvia and Rose Gronich, close relatives of Lesser (Div. Ex. 45). Jensen requested that payment of $16,250 be made to Eugene Petersen (Div. Ex. 46). The block of stock purchased by Lesser was sold to the general public.

2. Distribution of Stock issued in the name of Bernard Hammett

(34) Hammett knew Martin Lesser, managing partner in its Washington office of A. T. Brod & Company, since about 1959. Hammett testified that on March 28, 1961 he approached Lesser and told him he had 5,000 shares of AGR which he wished to sell at a price of $2.50 net and asked whether Lesser could sell the shares for him. Lesser told Hammett that he thought he could and wanted Hammett to bring in a bill of sale with him that afternoon. Hammett did so and the transaction was consummated that day. The stock was transferred to a relative of Lesser (Div. Ex. A20). Hammett received a check of A. T. Brod made payable to the order of Lesser which Lesser in turn endorsed over to Hammett. Hammett proceeded to go to his bank with Petersen and after endorsing the check turned it over to Petersen who cashed the check and pocketed the proceeds (Div. Ex. A23, Tr. A542-45). Hammett asserted that this was a loan. He received no note or document evidencing the loan from Petersen. There is no evidence of the repayment which Hammett testified he received some time within a period of two weeks. The repayment was in cash, according to Hammett. He further testified that he used the money to discharge part of his indebtedness to the client who had advanced him money to buy the stock and whom he refused to identify.

(35) Hammett also approached Baruch Rabinowitz, president of R. Baruch and Company, whom he knew, and told him that he wanted to sell 5,000 shares of AGR at $2.50 a share. Some time later, according to Hammett, Rabinowitz told him that the sale had been completed but at a lower price. Of the two checks Hammett testified he received in payment of the stock, he admitted giving the check for $2,125 to Petersen as a loan. He was uncertain what he did with a larger check of $7,875. The evidence establishes that on the date following receipt of the $7,875 check, Hammett purchased a bank draft to the order of E. E. Petersen in the exact amount (Div. Ex. A81, Tr. 1172-74, A1459). It is evident that Petersen received the proceeds of all the AGR stock Hammett admitted selling. Hammett asserted that all these transactions were loan transactions and that repayment was subsequently made. There is no evidence that has been produced in writing or otherwise to substantiate Hammett's testimony. The stock involved in both the sales to Lesser and to Baruch resulted in the eventual distribution of these shares to the public.

(36) Hammett denied that he had any dealings with Baruch and Company other than the transaction or sale of 5,000 shares of AGR. He denied any knowledge of an account maintained in his name at Baruch listing an address in Alexandria, Virginia, which was the address of a person he knew. He further denied that he knew of trades listed in that account in AGR and National Film Studios. He denied receiving confirmation of those trades, or receiving receipts for stock deposited in that account.

(37) In a statement on his behalf from the witness stand, Hammett asserted that he never had any connection with Brod or Baruch other than as a customer, that he invested in AGR as a speculation, that he had nothing to do with registered representatives or any stock broker with reference to AGR, and that he never authorized the transactions listed in his name at Baruch.

(38) The records at Baruch indicate that 4,800 shares of the 10,000 shares of AGR stock issued in the name of Hammett on or about February 16, 1961 were received into that account and sold for the account of Joan Eisenberg, the wife of Rabinowitz (Div. Ex. 43). From the Eisenberg account, the shares were sold to the Baruch trading account and from that account to the public.

(39) In addition, Hammett's account at Baruch evidences the payment to Hammett of 5,000 shares of National Film Studios, Inc. stock. These shares were made use of by Petersen as collateral for a loan and also some of the shares were placed in the "Tom Wood" account at Baruch which was an account used and controlled by Petersen.

3. Distribution of stock issued in the name of Tague purportedly sold to E. Neal Smith

(40) Of this block, 4,800 shares were received into the Hammett account at Baruch in March, 1961 (Div. Ex. A40). An additional 2,000 shares were received into an account established at Brod for Petersen to cover shares sold. An additional 1,000 shares were sold by Petersen to Lesser in the name of the latter's mother. Hammett denied receiving any payment for the shares purportedly sold out of the account listed in

his name at Baruch. Petersen received payment for the other blocks of stock in the name of Tague, which he disposed of directly. He placed a substantial part of the sums received in the AGR bank account (Div. Ex. 215, 216, A107).

D. The Petersen account at Brod and the activities of John Meslovich in AGR stock

(41) John Meslovich began working for Brod in May, 1960 and became a registered representative for it in August of that year. This was his first position in the securities business.

(42) Hammett had acted as attorney for Meslovich over a period of time. In the summer of 1960 Hammett introduced Meslovich to Petersen and Meslovich had a short discussion with Petersen about AGR and Petersen's connection with it. In the fall of 1960 Petersen, at another meeting with Meslovich, gave him some more facts about AGR, told him of the underwriting that had taken place, and gave Meslovich a copy of the offering circular.

(43) In the period of November and December, 1960, Petersen called Meslovich and arranged to meet with him. Petersen told Meslovich that the underwriting was not going well and asked if he knew any Washington brokers that might be interested in participating in the sale of AGR stock. When he asked Meslovich if he would be interested in making sales, Meslovich told him that he would first have to get the approval of Brod's resident partner, Lesser. Meslovich saw Petersen in Lesser's office on one occasion and Petersen told Meslovich that Lesser said that this was not an opportune time for Brod to take an interest in

AGR stock. Also, in that same period, Meslovich told Petersen that if he was in a hurry to get the stock traded, he should think in terms of closing the issue out and checking on other methods of financing, such as sale and lease-back arrangements.

(44) In January, 1961 Petersen was present at a dinner party at Meslovich's home attended also by Claude Warren, formerly a salesman for Brod but then on the staff of Sutro, at which there was a further discussion of AGR plans and prospects. As previously noted, a 2A report was filed on behalf of AGR on February 17 closing out the underwriting. Shortly thereafter, the bulk of the stock allegedly sold to the public found its way to the Washington securities market.

(45) Petersen opened an account with Brod on March 1st with Meslovich acting as his representative. Meslovich had Petersen fill out an account card and obtained Lesser's approval for the opening of the account. Petersen turned over certificates for 2,000 shares of AGR and directed Meslovich to sell the stock for any price in excess of 2½. Meslovich took the stock certificates to Hyman Rosen, the Brod cashier, and obtained Rosen's determination that they were tradeable. The procedure adopted by Rosen in cases such as this was that if no restriction appeared on a stock certificate and it was properly stamped and the signature guaranteed, the stock would be accepted as free trading stock. Meslovich was aware that the offering circular contained a statement that Petersen owned approximately 47% of the issued and outstanding stock of the company. However, he did not discuss Petersen's connection with AGR with either Lesser or Rosen prior to obtaining the approval

to open Petersen's account at Brod and to sell AGR stock for him. Between March 17 and March 27, 1961, Meslovich was instrumental in selling 3,400 shares of AGR stock to the public from the Petersen account (Meslovich Ex. A-3).

(46) Meslovich considered Petersen a personal friend. In addition to his several meetings with Petersen at which there was a discussion of AGR, Petersen was invited to stay at Meslovich's home on several occasions and was loaned money by Meslovich. Around April 20, 1961, Petersen telephoned Meslovich and introduced C. Henry Roath to him, stating that Roath was his attorney, that he wished to sell 250 shares of AGR stock and that Petersen would bring the stock in. Meslovich opened an account for Roath, although this was irregular procedure, and sold 250 shares of AGR for Roath. When Petersen did not produce the shares, Meslovich used shares of his brother-in-law to cover the transaction. Eventually Petersen produced the stock and appropriate adjustments were made.

(47) Petersen also filed an authorization permitting Meslovich to withdraw money from his account. Meslovich testified that pursuant to this authority he obtained checks for $1,915.42 and $500, cashed them and gave the proceeds to Petersen. Meslovich further testified that at one time Petersen told him he was doing a good job with the stock and there might be some options for him at a later date. Nothing further came of this promise.

E. The financial condition of AGR

(48) The offering circular issued by AGR in connection with the Regulation A offering commenced on August 3, 1960 revealed a serious lack of cash assets. As previously noted, the offering did not go well and not many shares were sold by the end of the year. Evidence adduced at the hearing established that in early 1961 AGR could not pay its debts as they became due. Roath had not been paid for his legal services and threatened to take action in February, 1961. Officials and directors of AGR were forced to sign a note to obtain funds to pay first mortgage interest on AGR's farm in Wiggins, Colorado. The AGR bank account at the First National Bank of Denver had a total of $64.29 on deposit on March 10, 1961. There is no evidence that AGR received any funds for the 30,000 shares of stock allegedly sold immediately prior to the close of the underwriting.

(49) Franchise agreements were entered into by AGR with Lombardy Farms in Leesburg, Virginia and McNair Farms in Laurinburg, North Carolina on April 8 and April 6, 1961, respectively. The two franchise agreements are substantially identical and the only firm commitment thereunder by each franchiser was to purchase 330 pigs for $38,250 (Div. Ex. 85 and 86A-B). No pigs had been delivered prior to August 31, 1961 even though the two franchise agreements called for delivery in June, 1961.

(50) AGR was obligated under a construction contract involving the building of certain facilities for Lombardy Farms in consideration of a payment of $159,000. As of August 31, 1961 this construction had not been completed and according to the financial statements prepared as of

that date by Arthur Anderson & Co., Inc. $37,148 had already been expended on the construction work and it was estimated that an additional expenditure of $150,460 would be required to complete the project. Accordingly, in addition to its other difficulties, AGR was committed to a construction project which would eventually entail a net loss of approximately $28,608. A balance sheet for AGR as of August 31, 1961, prepared by Arthur Andersen & Co., showed current assets of $87,347, current liabilities of $339,178, and a deficit in earned surplus of $425,115 (Div. Ex. 121, Tr. 2993-94).

F. Activities of Eugene Tucker in the sale of AGR stock

(51) Eugene Tucker was employed at R. Baruch & Co. as a salesman for five or six months from the end of February, 1961. He had previously had approximately a year and a half experience as a part-time salesman at several brokerage firms. In March and April, 1961 he bought 1,380 shares of AGR stock for his customers and sold 740 shares (Div. Ex. A41).

(52) Three witnesses testified concerning their dealings with Tucker in the purchase of AGR stock. Mr. A.C. purchased 75 shares of AGR stock on March 30, 1961 through Tucker. A.C. worked with Tucker at the Government Printing Office. Tucker, according to A.C., kept giving him reports of price rises in AGR and relaying information to him about it. Among other things, Tucker told him that the stock was getting hot and starting to move, the product would have quite a market from the consuming public, that two or three franchises had been sold and four or five were in process, the stock might even go as high as $100

a share, and that the stock might split 10 for one. A.C. further testified that he went to the office of Baruch and spoke to another salesman as well as Rabinowitz, who confirmed some of the statements made to him by Tucker. A.C. then placed his order with Tucker for his shares.

(53) A.C. further testified that Tucker never gave him a prospectus, although he asked for one, and that he did not know the financial condition of the company at the time he bought the stock.

(54) Mr. P.J.C. purchased 100 shares of AGR through Tucker on April 10, 1961. He testified that he received a telephone call from Tucker, who told him that one of his customers suggested that he call him. Tucker told P.J.C. that AGR had developed a method for producing disease-free pigs, that the process would revolutionize the pork industry and that the stock would perform fabulously in the future. Tucker also said, according to P.J.C., that when the stock reached 50, it would split 5 for one.

(55) Mr. R.T.W., Jr. purchased 100 shares of AGR through Tucker on April 6, 1961.

(56) According to W., Tucker telephoned him after W. had answered a newspaper advertisement of Baruch. Tucker told him, according to W., that AGR was involved in some process to produce a germ-free pig analagous to the Beltsville turkey and was producing food or feed for pigs which was superior to anything used at that time. Tucker told W. that the company had sold five franchises at a price of $500,000 per franchise and that additional franchises were being negotiated. He said there would be a

profit of $100,000 on each franchise, giving first year earnings of $6 per share.

(57) In subsequent conversations, Tucker told W., according to the latter, that the stock would be driven to $35 or $40 per share, split 5 for one, and eventually go to $90 per share. He further stated that Morrell Packing Co. was either attempting to contract or had contracted to purchase the entire output of AGR. W. also stated that several times he attempted to sell his stock but Tucker talked him out of it.

(58) It is contended, on behalf of Tucker, that AC's testimony should be disregarded because at the outset of the hearing, he testified that his memory as to his dealings with Tucker was very hazy. It is asserted that it was error to allow him to refresh his recollection by reading a letter he had sent to an attorney dealing with the facts, which letter was prepared approximately a year after the transactions involved. Any writing may be used to stimulate and revive a recollection.[9/] The memorandum used to refresh the recollection of the witnesses need not be a contemporaneous account of the events it describes.[10/]

(59) As to P.J.C., it was asserted that he was attempting to recall a telephone conversation which occurred three years ago and that his testimony might have been affected by the fact that he took a loss on his transaction.

9/ Wigmore, Evidence (3d Ed.) Vol. 3, pp. 100-113; U.S. v. Rappy, 157 F. 2d 964, 967 (2d Cir. 1946), cert. denied 329 U.S. 806 (1947).

10/ Wigmore, Evidence, supra, p. 105; Fanelli v. U.S. Gypsum Co., 141 F. 2d 216 (2d Cir. 1944).

(60) It is pointed out with respect to the testimony of R.C.W., Jr. that his testimony was refreshed on the basis of a deposition taken two months after his purchase of stock and that he also sustained a loss on his AGR investment.

(61) Tucker refused to testify as to his dealings in AGR stock on constitutional grounds. He did testify in investigative proceedings and the transcript of his testimony was offered and received for admissions contained therein (Div. Ex. A76). In the course of his testimony Tucker stated that he had read the AGR prospectus and recommended it to customers on a speculative basis (p. 6); he told customers that AGR had two signed contracts, but had not seen them; he told customers that there was a possibility of the stock increasing as high as 90 (p. 17); and told customers there was a possibility that the stock would be split around 40 on the basis of four to one (p. 34). He further stated that he understood that the profit on each franchise would be $100,000 including royalties and that the earnings on each contract would be $2 per share. This, he stated, was information around the office (p. 21). He stated he was never asked the financial condition of the company and he never brought that up although he knew from the offering circular that the company at that time had $9.15 in the bank, nor did he tell customers that the company had indicated in the offering circular that if it did not sell all its offering, the property might be foreclosed (p. 68). He had never seen any balance sheet of the company other than that contained in the offering circular.

(62) Tucker's testimony broadly corroborates the testimony of the three customer witnesses as to the highly optimistic statements made

to them by Tucker as to anticipated price rise, splitting of the stock, and its earnings. The undersigned credits the testimony of the customer witnesses in view of this state of the record and Tucker's failure and refusal to testify as to his specific dealings with those customers. 11/

(63) Incorrect and misleading information was printed in the financial column of a newspaper published in the Washington area on April 8, 1961 (Div. Ex. A66). According to a former registered representative at Baruch, Tucker said before the publication of the article that he had asked a friend of his to do an article on AGR, that it would appear in the area newspaper (Tr. A1061-62). Tucker, in his investigation testimony, admitted knowing the financial writer who prepared the column in question but in his testimony in this proceeding refused to answer questions about the article. The undersigned credits the testimony indicating that Tucker played a part in the publication of the aforementioned article.

11/ The Commission has stated: "The failure of a party to testify, in a non-criminal case, in explanation of suspicious facts and circumstances peculiarly within his knowledge fairly warrants the inference that his testimony, if produced, would have been adverse." N. Sims Organ & Co., Inc., 40 S.E.C. 573, 577, aff'd 293 F. 2d 78, 81 (1961), cert. denied 368 U.S. 968 (1962); Heft, Kahn & Infante, Inc., Sec. Exch. Act Rel. 7020 (February 11, 1963).

(64) A letter to shareholders of AGR, dated May 18, 1961, was issued by Petersen, then president of AGR. This letter, which contained incomplete and misleading information about AGR, was sent to customers of Tucker with his participation (Div. Ex. A79; Tr. A1436).

G. Quotation activities by brokers

(65) Quotations for AGR stock appeared in the National Daily Quotations or pink sheets between February 28 and September 15, 1961 (Div. Ex. A29). Quotations by Baruch, both bid and asked, appeared from March 6 to June 26, 1961. Quotations by Brod appeared from March 21 to April 6, 1961.

(66) Sales and purchases of AGR stock by these and other brokers set forth in the findings involved the use of the mails or instrumentalities of interstate commerce and/or occurred in the District of Columbia.

H. Violations of Registration Provisions of the Securities Act

(67) Section 5 of the Securities Act prohibits the use of the mails or facilities of interstate commerce to sell a security unless a registration is in effect. The mails and facilities of interstate commerce were used to sell the AGR stock referred to in prior sections. No registration was ever filed for an issue of AGR stock. Instead, exemption was claimed pursuant to Regulation A of the Rules and Regulations promulgated by the Commission under the Securities Act. The burden of showing an exemption from registration is on the person claiming it.[12/]

12/ S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); Gilligan, Will & Co. v. S.E.C., 267 F. 2d 461 (C.A. 2, 1959); S.E.C. v. Culpepper, 270 F. 2d 241 (C.A. 2, 1959); Whitehall Corporation, 38 S.E.C. 259, 270 (1958).

The exemption under Regulation A is available only if the terms and conditions described in the regulation are complied with.[13/]

(68) A Form 2-A report was filed on behalf of AGR on February 17, 1961 stating that the offering under Regulation A had been completed on February 14, 1961 by the sale of 39,685 shares of the total offering of 120,000 and that a net amount of $82,330.62 had been received by AGR.

(69) The evidence establishes that from the commencement of the offering in August, 1960, great difficulty had been encountered in selling the AGR offering. Only 9,685 shares had been sold by the end of the year. At or about the time of the purported closing of the offering, 3 blocks of 10,000 shares each were put in the names of three individuals and thereafter disposed of in the Washington securities market. Substantial amounts from these blocks were sold to brokers who in turn distributed them to the public. Other shares were sold directly from brokerage accounts to the public. Money from these sales went back to Petersen, a person in control of AGR by virtue of a substantial stock interest in that company. He also was in charge of the marketing of the AGR stock.

(70) A distribution of securities comprises the entire process by which, in the course of a public offering, the block of securities is disbursed and ultimately comes to rest in the hands of the investing public.[14/] It is evident here that instead of the AGR stock having been

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13/ David Joel Benjamin, d/b/a Benjamin and Company, 38 S.E.C. 614, 616 (1958); Justin Steppler, Inc., 37 S.E.C. 252, 256 (1956).

14/ Advanced Research Associates, Inc., Sec. Act Rel. No. 4630, page 31 (August 16, 1963); Lewisohn Copper Corp., 38 S.E.C. 226, 234 (1958); Oklahoma-Texas Trust, 2 S.E.C. 764, 769 (1939), aff'd 100 F. 2d 888 (C.A. 10, 1939); Homestead Gold Exploration Corporation, Sec. Act Rel. No. 4770 (March 17, 1965).

sold to the public as of February 14, 1961, actually the stock had been placed in the names of nominees as a step toward the further distribution of the stock to the public in an attempt to make large blocks of the stock available to the Washington brokers for trading in that securities market.

(71) Hammett received a block of 10,000 shares, or approximately 25% of the total allegedly sold to the public. The only evidence of his payment that was ever produced were payments by check which did not clear because there were insufficient funds on hand in Hammett's bank account to honor the checks when presented. Hammett admitted that this was so but asserted he had made payment in cash from funds he had borrowed from a client. He was unable to produce any written document evidencing the loan. He refused to identify the client from whom he had purportedly made the loan, asserting that the matter was subject to the attorney-client privilege. During the course of his testimony he stated that he did not want to identify his client because the client did not want to be bothered with any problems with the Internal Revenue Service. The attorney-client privilege has been defined as follows:

> "(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived." 15/

15/ 8 Wigmore, Evidence, Sec. 2291 (McNaughton Rev. 1961).

(72) By the above standards, the attorney-client privilege did not attach to the information Hammett withheld from the record. No legal advice was apparently involved here nor was Hammett being consulted in his capacity as a professional legal adviser. What was said in the case of In re Bonanno [16/] applies with particular force here.

> "We recognize that an attorney-client relationship arises when legal advice of any kind is sought from a professional legal adviser in his capacity as such. 8 Wigmore, Evidence (McNaughton Rev. 1961), §2292. Bonanno concedes, as he must, United States v. Kovel, 296 F. 2d 918 (2 Cir. 1961), that the burden of establishing the existence of the relationship rests on the claimant of the privilege against disclosure. That burden is not, of course, discharged by mere conclusory or ipse dixit assertions, for any such rule would foreclose meaningful inquiry into the existence of the relationship, and any spurious claims could never be exposed."

(73) It is concluded that the attorney-client privilege did not attach to Hammett's purported loan transactions with a client for whom he claimed he acted as an attorney. As far as repayment for the 10,000 shares of AGR stock that Hammett admittedly disposed of in two 5,000 blocks to two brokers, Petersen was either on hand to immediately receive the checks obtained from Hammett or, in the one instance when he was not present, Hammett remitted the proceeds to him the day after he received it. The undersigned concludes that Hammett was acting for AGR and/or Petersen in his dealings in AGR stock.

(74) Jensen, according to his own testimony, did not pay for the 10,000 shares of AGR stock received into his account in Sutro. The record

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16/ _____ F. 2d _____ (C.A. 2d Cir. April 30, 1965). See also U.S. v. Goldfarb (C.A. 6th Cir., 1964), 328 F. 2d 280.

of his account shows a distribution of part of his shares to the public and another part was sold to Lesser, the managing partner at Brod, who in turn distributed his stock to the public. Here again a check for the proceeds of 5,000 shares of AGR was given to Petersen.

(75) Activities in the third block of AGR stock in the name of Tague and purportedly sold to E. Neal Smith evidence direct control by Petersen and a further distribution of the stock to the public.

(76) It is evident that a false 2-A report was filed in connection with the distribution of AGR stock. The report is false in misrepresenting the amount of money received by AGR as the proceeds of sale. The evidence establishes that the 30,000 shares purportedly sold were actually put in the names of nominees from whom no consideration was obtained. What moneys accrued to AGR came later when Petersen placed some of the funds realized in the AGR bank account. The 2-A report further falsely stated that the offering had been completed on February 14, 1961 when actually additional distribution was taking place, without any compliance with the registration processes, as the AGR stock did not finally come to rest in the hands of the public until a substantially later time. It is concluded that the offering of AGR stock was made in violation of the registration provisions of the Securities Act. There was a failure to comply with the requirements of Regulation A. The shares of stock were therefore subject to the full registration requirements of the Act

which were not met.[17/]

(77) It has been argued that violations of Section 5 of the Securities Act, if any, by the individual respondents were not willful. As pointed out in a recent decision, Gearhart & Otis, Inc.,et al v. S.E.C. (C.A.D.C. No. 18,817, June 30, 1965) ____F. 2d ____, C.C.H. Fed. Sec. Law Rep., par. 91,546, the definition of "willful" does not require that there be a specific intent to violate the law but rather means intentionally committing the act which constitutes the violation. This standard has been applied in a long line of cases before the Commission and the courts.[18/]

17/ Oregon King Consolidated Mines, Inc., Sec. Exch. Act Rel. 7629 (June 17, 1965).

On April 19, 1961, the Commission temporarily suspended the Regulation A offering of AGR and the temporary suspension became permanent on May 18, 1961. The grounds for suspension included charges that the offering circular was false and misleading in failing to disclose the activities of Petersen in connection with the distribution of AGR stock, that a false report on Form 2-A had been filed, and that the offering had been made in violation of the anti-fraud provisions of Section 17 of the Securities Act (Sec. Act Rel. No. 4357). The evidence adduced at this hearing establishes that a false report on Form 2-A had been filed and that Petersen played a leading part in the filing of this report and in the later distribution of stock through brokers. Fraud allegations will be dealt with in later sections in this decision.

18/ See e.g. Securities Exchange Corporation, 2 S.E.C. 760 (1937); Foreman and Company, Inc., 3 S.E.C. 132 (1938); Thompson Ross Securities Co., 6 S.E.C. 1111 (1940); Scott McIntyre & Company, 11 S.E.C. 442 (1942); James Benjamin Wheeler, 28 S.E.C. 894 (1948); Sidney Ascher, 31 S.E.C. 753 (1950); Van Alstyne, Noel & Company, 33 S.E.C. 311 (1952); Robert Dermot French, 36 S.E.C. 603 (1955); George W. Chilian, 37 S.E.C. 384 (1957); The Whitehall Corporation, 38 S.E.C. 259 (1958); Bruns, Nordeman & Company, 40 S.E.C. 652 (1951); Gilligan, Will & Co., 38 S.E.C. 388 (1958), aff'd, Gilligan, Will & Co. v. Securities and Exchange Commission, 267 F. 2d 461 (C.A. 2, 1959); Norris & Hirshberg, 21 S.E.C. 865 (1946), aff'd., Norris & Hirshberg v. Securities and Exchange Commission, 177 F. 2d 228

(continued on next page)

(78) Hammett denied any knowledge or participation on his part in an account maintained in his name at Baruch through which some of the AGR stock, previously referred to, was handled in the course of its distribution to the public. While the circumstances are highly suspicious, it has not been established clearly that Hammett received any of the proceeds from that account. Even if activity in this account is not considered, it is undenied that Hammett received in his own name 25% of the stock before distribution to the public and that after selling the shares in two blocks to brokers, he remitted the proceeds to Petersen, the person in control of AGR. Hammett knew Petersen's connection with AGR and the record indicates that he was the first person to introduce Petersen to brokers in Washington whom Petersen used later in a further distribution of AGR stock. Under all the circumstances which have been set forth previously, the undersigned concludes that Hammett's willful violation has been established.

(79) Meslovich met Petersen through Hammett. He was friendly with Petersen and had discussions with him concerning AGR over a period of months. The first suggestion of closing out the issue short of its goal so that trading in the stock would commence in the open market came from him. He opened an account for Petersen at Brod from which 2,000 shares of AGR (originally issued in the name of Tague) were sold.

18/ (continued from preceding page)

(C.A.D.C. 1949); Hughes v. S.E.C., 174 F. 2d 969, 977 (C.A.D.C. 1949); Shuck v. S.E.C., 264 F. 2d 358, 363 (C.A.D.C. 1950); Tager v. S.E.C., 344 F. 2d 5, 8 (C.A. 2d Cir. 1965).

(80) Meslovich had seen a copy of the offering circular and knew that Petersen was named therein as a controlling person. He made no effort to check Petersen's present connection with AGR nor did he raise any question with his superiors so as to put them on notice of problems as to the tradeability of the shares which Petersen was seeking to sell. Under these circumstances, the undersigned concludes that Meslovich's violation of the registration provisions of Section 5 of the Securities Act in the marketing of the aforementioned shares and his other trading activities was willful.

(81) Tucker did not have the close connection with Petersen that Hammett and Meslovich had. However, he had read the offering circular. He testified in the investigative proceeding that he knew that AGR had not been able to sell the entire issue of stock it was offering, but had only been able to market 39,000 shares. His testimony concerning a great deal of discussion about AGR at the offices of his employer, Baruch, certainly indicates he was on notice that a major selling effort was under way at Baruch. He made no inquiry as to the source of supply from which Baruch was making shares available for sale to customers. Under these circumstances, and in view of the standards set forth in decided cases, the undersigned concludes that Tucker's conduct was willfully violative of Section 5 of the Securities

Act. [19/]

I. Violations of prohibitions against trading by persons interested in a distribution

(82) It has been alleged that the respondents violated Section 10(b) of the Exchange Act and Rule 10b-6 promulgated by the Commission thereunder. Rule 10b-6 provides in pertinent part that it shall constitute a "manipulative or deceptive device or contrivance" as used in Section 10(b) of the Act for any person, who is an underwriter in a particular distribution of securities, or who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, directly or indirectly, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution.

(83) The evidence establishes that the distribution of AGR stock was not completed when the Form 2-A report was filed. Instead, three-quarters

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19/ In the Matter of Robinette & Co., Inc. (Sec. Exch. Act Rel. No. 7386, August 11, 1964).

In support of the contention that Tucker's conduct was not willful, reliance has been placed on the case of U.S. v. Crosby, 294 F. 2d 928 (2d Cir. 1961). In the Crosby case, a criminal conspiracy trial, the defense was raised that reliance had been placed on a legal opinion in selling large blocks of unregistered stock. The facts in the instant case are much different from those in the Crosby case. Furthermore, the Commission, in a special release dealing with the Crosby case has stressed the duty to make full investigation where substantial amounts of a previously little known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act ("Distribution by Broker-Dealers of Unregistered Securities", Sec. Act Rel. No. 4445, Feb. 2, 1962).

of the shares supposedly distributed were placed in the names of nominees in the form of three 10,000 share blocks, brought to the Washington securities market, and disposed of by sales directly to brokers who promptly resold them to the public, or sold to the public through accounts established at brokerage offices. The pattern followed is a classic case of a distribution to the public without compliance with the registration provisions of the Securities Act and in violation of Rule 10b-6.[20/] Public sales of a block of control shares by an underwriter, which are subject to registration under the Securities Act, are included within the meaning of the term "distribution" in the Rule.[21/]

20/ See authorities cited in footnote 14, page 31. Cf. "Distribution by Broker-Dealers of Unregistered Securities", supra.

21/ J. H. Goddard & Co., Inc., et al, Securities Exch. Act Rel. No. 7618 (June 4, 1965); Sutro Bros. & Co., Sec. Exch. Act Rel. No. 7053, p. 8 (April 10, 1963); Batten & Co., Inc., Sec. Exch. Act Rel. No. 7086 (May 29, 1963); A. T. Brod & Company, Sec. Exch. Act Rel. No. 7139 (September 11, 1963); Woods & Company, Inc., Sec. Exch. Act Rel. No. 7178 (November 29, 1963); cf. Bruns, Nordeman & Company, 40 S.E.C. 652, 660 (1961); Gob Shops of America, Inc., 39 S.E.C. 92, 103, n. 25 (1959).

(84) Brod and Baruch and Sutro were the brokerage firms which took leading parts in the distribution. They were "underwriters" as that term is defined in Section 2(11) of the Securities Act and as used in Section 10b-6 of the Exchange Act in that they purchased or sold AGR stock for an issuer in connection with the distribution of that security. The term "issuer" includes, in addition to an issuer, any person directly or indirectly controlling an issuer. Therefore, whether the sales of AGR stock by these brokers was on behalf of AGR or on behalf of Petersen, who took the proceeds of the sales at least in the first instance, these brokers would still be underwriters in view of Petersen's control of AGR.[22/]

(85) Since Brod and Baruch were underwriters participating in a distribution of AGR stock, their placing of bids for stock in the pink sheets was a violation of Rule 10b-6 under Section 10(b) of the Exchange Act. Their sales to the public were the result, not of unsolicited orders, but a consequence of an aggressive selling campaign through which they disposed of a substantial number of shares.[23/]

22/ Cf. S.E.C. v. Chinese Consolidated Benevolent Association, 120 F. 2d 738 (C.A. 2, 1941), cert. denied, 314 U.S. 618; S.E.C. v. Culpepper, 270 F. 2d 241 (C.A. 2, 1959); S.E.C. v. Guild Films Company, Inc. 279 F. 2d 485 (C.A. 2, 1960).

23/ Cf. Gob Shops of America, Inc., supra, f.n. 25, p. 103 (1959); Bruns, Nordeman & Co., supra, pp. 7-8.

(86) The individual respondents also played an important part in the distribution. Hammett was instrumental in placing 10,000 shares of AGR stock with brokers through whom the public distribution took place. Meslovich was instrumental in helping to distribute shares owned or controlled by Petersen through Brod. Both he and Tucker were active in distributing shares of AGR stock to the public without attempting to make any inquiry as to the source of the supply of stock which was suddenly coming on the market in substantial amounts.

(87) It is concluded that Brod and Baruch willfully violated Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-6 thereunder by their activities in the distribution of AGR stock and that the individual respondents, by their activities, aided and abetted in these violations. As "other persons" . . . "participating in such a distribution", directly or indirectly, the individual respondents by their activities in open market transactions also willfully violated Rule 10b-6.

J. Violations of the anti-fraud provisions of the Securities Acts

(88) In the course of the distribution to the public of the 30,000 shares of AGR stock, investors were not furnished with any information as to the true nature of the distribution which was taking place. They were unaware of the activities of Petersen on behalf of himself and/or AGR, that AGR shares had been placed in the names of nominees who had not paid AGR for them, that these shares had been disposed of to brokers who in turn retailed them to the public, and that violations of applicable provisions of the Securities Acts had

occurred in the course of these activities. All this information was of vital importance to investors. Without it, they were unable to make an informed judgment as to the true value of the shares of AGR they were purchasing.

(89) It has been pointed out that under the anti-fraud provisions of the Securities Acts " . . . fraud is not limited to a misstatement of or an omission to state a material fact. Those anti-fraud provisions also proscribe the use of any device, scheme or artifice to defraud and any act, practice or course of business which operates or would operate as a fraud or deceit upon any person." 24/ The three individual respondents in this proceeding all played a part in the deception of investors. Hammett co-operated with Petersen in marketing unregistered and unpaid-for shares in the Washington securities market. Meslovich assisted Petersen by advice and by helping Petersen directly to market shares in Washington without compliance with applicable registration provisions. Tucker took part in the final process of retailing shares to public customers. The undersigned concludes that by their activities these three respondents engaged in acts, practices and a course of business which operated as a fraud and deceit upon persons as a scheme to defraud. Hammett's violations were clearly willful. At best, Meslovich was guilty of gross negligence or indifference in ignoring Petersen's connection with AGR which was of such gross disregard of his obligations that his acts amounted to intentional misconduct and thus were willfully violative

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24/ Mac Robbins & Co., Inc., Sec. Exch. Act Rel. No. 6846, July 11, 1962, p. 2), aff'd sub nom. Berko v. S.E.C., 316 F. 2d 137 (2d Cir. 1963).

of the anti-fraud provisions applicable. 25/ Tucker, as previously pointed out, did not have the knowledge of Petersen's activities that Meslovich and Hammett possessed but, by ignoring aspects of Baruch's marketing activities which he should have inquired into, he willfully participated in the aforementioned violation.

(90) Evidence was presented as to Tucker's dealings with individual customers. The undersigned has credited the testimony of those witnesses concerning statements made to them by Tucker about AGR. It is urged in Tucker's behalf that he acted in good faith and with lack of knowledge as to the activities of his employer, Baruch; that he sold AGR stock to relatives; that he was the unfortunate victim of wrongful schemes by Baruch Rabinowitz, president of Baruch; that his alleged statements were mere statements of future events and speculative possilities; that any representations by him were not willful misstatements of material facts; and that any expressions of opinion by Tucker would not be violative of the anti-fraud provisions of the Securities Acts.

(91) Basic to the relationship between a broker or dealer and his customers is the representation that the latter will be

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25/ See John Munroe, 39 S.E.C. 308, 311 (1959); Charles E. Bailey & Company, 35 S.E.C. 33, 41-2, (1953); Sidney Ascher, 31 S.E.C. 753 (1950); David Brody, 31 S.E.C. 757, 758 (1950); Lawrence Steele Costelle, 31 S.E.C. 759, 760 (1950); Rudolph v. Klein, Sec. Exch. Act Rel. No. 6415, Nov. 17, 1960, p. 5; Barnett v. S.E.C. 319 F. 2d 340 (8th Cir. 1963).

dealt with fairly in accordance with the standards of the profession.[26]

(92) This obligation also is applicable to securities salesmen.[27] Outright false statements are, of course, expressly prohibited by the Securities Acts and are inconsistent with the duty of fair dealing. In addition, as the Commission has pointed out, the making of representations to prospective purchasers without a reasonable basis, couched in terms of opinion or fact and designed to induce purchases, is contrary to the obligation of fair dealing assumed by those who engage in the sale of securities to the public.[28]

(93) Another aspect of the standard of fair dealing is the prohibition against concealment by a person engaged in the securities business of material facts of an adverse nature, the disclosure of which is necessary to render statements made not misleading.

26/ Mac Robbins & Co., Inc., supra; Duker v. Duker, 6 S.E.C. 386, 388-89 (1939). Cohen & Rabin, "Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication In Their Development", in "Law and Contemporary Problems", Summer 1964, pp. 703-708

27/ A. J. Caradean & Co., Sec. Exch. Act Rel. 6903, p. 2 (Oct. 1, 1962).

28/ Mac Robbins & Co., Inc., supra; Ross Securities, Inc., Sec. Exch. Act Rel. 7069 (April 30, 1963).

As was observed in the case of Leonard Burton Corporation[29] "a prediction by a securities salesman or dealer to an investor that a stock is likely to go up implies that there is an adequate foundation for such prediction and that there are no known facts which make such a prediction dangerous and unreliable." Easily ascertainable facts bearing upon the justification for the representations must be disclosed.[30]

(94) Tucker had seen a copy of the AGR offering circular. He knew of AGR's precarious financial condition as of the date of the offering circular. This was the only written material he ever saw dealing with AGR's affairs. He did not see any AGR current balance sheet nor, apparently, did he seek to obtain one. Despite this lack of information he proceeded to paint a glowing picture of great price increases in AGR stock and accompanying stock splits. At the time he was making these statements he knew that the AGR Regulation A offering had to be closed out several weeks beforehand because the stock could not be sold at a price of $2.50 a share. This was the same stock that he was predicting would rise anywhere to $35 or $100 per share. He told

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29/ 39 S.E.C. 211, 214 (1959).

30/ Best Securities, Inc., 39 S.E.C. 931; Barnett & Co., Inc., 40 S.E.C. 1, 521 (1960, 1961); D. F. Bernheimer & Co., Inc., Sec. Exch. Act Rel. 7000 (Jan. 23, 1963).

investors that franchises had been sold and gave them figures on the profit per franchise that would be obtained, as well as the resultant earnings per share. He made no attempt to verify the actual number of franchises which had been sold, the actual terms of each franchise, AGR's ability to perform its obligations under the contracts, what performance, if any, had taken place and other pertinent information. In actual fact, Tucker made misstatements as to the number of franchises sold, the extent of the obligations under each franchise, and the reasonable profits potential under the actual agreements signed. At the time Tucker was selling AGR stock, AGR was in poor financial condition. Tucker made no effort to check on AGR's financial condition. His customers were not given that information or any of the details contained in the offering circular.

(95) The Commission has repeatedly stated that predictions of substantial price rises in specified amounts within stated periods with respect to promotional and speculative securities cannot possibly be justified.[31/] Tucker's representations that the AGR stock would move to $35, $40, $90 or $100 a share in a short time and be split were, under the circumstances, incomplete, false and misleading.

(96) It has been urged that Tucker acted in good faith, as shown by the fact that he sold AGR stock to relatives. This does not

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31/ Idaho Acceptance Corp., Sec. Exch. Act Rel. No. 7383 (August 7, 1964); A. H. Davis Co. Sec. Exch. Act Rel. No. 7654 (July 23, 1965); Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962); Best Securities, Inc., supra, at p. 934.

furnish any justification for Tucker's disregarding his obligations to his customers to make reasonable inquiry into the operations of the company whose stock he was recommending.

(97) It is further urged that Tucker's statements to customers were merely statements of future events and speculative possibilities and expressions of opinion. As has been pointed out in the case of S.E.C. v. F. S. Johns & Co., Inc. 32/ such a contention furnishes no defense. There, it was stated with reference to the securities business:

> "The standards of conduct prescribed for this type of business cannot be whittled away by the excuse that false statements made were inadvertently made without intent to deceive, or by reliance upon the literal truth of a statement which, in the light of other facts not disclosed, is nothing more than a half-truth. Nor may refuge be sought in the argument that representations made to induce sale of stock dealt merely with forecasts of future events relating to projected earnings and the value of the securities, except to the extent that there is a rational basis from existing facts upon which such forecast can be made, and a fair disclosure of the material facts. The element of speculation is inherent in stock investments, but the investor is entitled to have the opportunity to evaluate the risk of loss, as against the hope of a lucrative return, from true statements of the financial status of the corporate enterprise in which he is acquiring an interest." 33/
> (p. 573)

32/ 207 Fed. Supp. 566 (1962).

33/ See also S.E.C. v. Broadwall Securities, Inc., __ Fed. Supp. __ (S.D. N.Y., July 8, 1965); Robert Edelstein Co., Sec. Exch. Act Rel. No. 7400 (1964); Aircraft Dynamics International Corp., Sec. Exch. Act Rel. No. 7113 (August 8, 1963).

Also the fact that some of Tucker's customers may have been seeking speculative securities does not detract from the obligations owed them by Tucker.[34/]

(98) Reliance has also been placed on the contention that Tucker received information from Rabinowitz and was unaware of any scheme to defraud in which Rabinowitz was engaged. This contention ignores Tucker's duties and obligations. Tucker was recommending the stock in a new and untried company. He had seen unfavorable financial information which pointed to the need of further inquiry before recommendation. Yet Tucker made no independent inquiry, but as his testimony indicates, he took unverified office gossip and embroidered it when he related it to his customers. Under the circumstances known to him, he was not justified in accepting statements from Rabinowitz and others at his office at face value and without further inquiry.[35/]

(99) The undersigned concludes that, under all the circumstances, Tucker's statements to his customers were incomplete,false and misleading, and in disregard of his obligations as a securities salesman, and willfully violative of the anti-fraud provisions of the Securities Acts.

34/ Wright, Myers & Bessell, Inc., Sec. Exch. Act Rel. No. 7415 (Sept. 8, 1964).

35/ Mac Robbins & Co., Inc., supra; Ross Securities, Inc., supra; B. Fennekohl & Co., Sec. Exch. Act Rel. 6898 (Sept. 18, 1962); Harold Grill, Sec. Exch. Act Rel. No. 6989 (January 8, 1963).

III. RECOMMENDATIONS

It has been found that the three individual respondents in this proceeding willfully violated and aided and abetted violations of the registration and anti-fraud provisions of the Securities Acts. It has been urged, on Tucker's behalf, that he was not a willful violator but acted in good faith and, therefore, should not be found a cause of the order of revocation entered against Baruch. However, it has been found that Tucker's violations were willful. Among other violations, he made false and misleading representations to his customers in contravention of his duties and responsibilities to them. Under these circumstances, his contentions are rejected.[36/] It is, therefore, recommended that Eugene Tucker be found a cause of the order of revocation previously entered against R. Baruch and Company.

John Meslovich played an important part in the distribution of AGR stock to the public on behalf of Petersen, as previously set forth. It is recommended that Meslovich be found a cause of the order of suspension previously issued against his employer, A. T. Brod & Company.

The Division contends that Bernard Hammett should also be found a cause of the orders issued against Brod and Baruch within the meaning of Section 15A(b)(4) of the Exchange Act. This Section, prior to certain amendments effective August 20, 1964, ("Amendments Act"), provided in

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36/ Sutro Bros. & Co., Sec. Exch. Rel. No. 7053, April 10, 1963,(Hersh, p. 13); Ross Securities, Inc., Sec. Exch. Act Rel. No. 7069, April 30, 1963, (pp. 7-8).

pertinent part that the rules of a registered national securities association must provide that no broker-dealer should be admitted to or continued in membership in such association if such broker-dealer or any person directly or indirectly controlling or controlled by such broker-dealer, whether prior or subsequent to becoming such, by his conduct while "employed by, acting for, or directly or indirectly controlling or controlled by," a broker or dealer was a cause of any order of suspension or expulsion. (Emphasis supplied.)

Hammett denied any connection with either Brod or Baruch of the kind set forth in Section 15A(b)(4) and maintains that his only connection with them was the sale of blocks of AGR stock to them. The Division contends that Hammett was a full-fledged participant in schemes to defraud at both Baruch and Brod, in view of his participation in the illegal distribution of AGR stock, and by his activities was a member and a participant in a controlling group at each brokerage house, thus "acting for" within the meaning of the statutory section set forth above.

While Hammett did play an important part in the distribution of AGR stock to the public through Brod and Baruch, there is no evidence that those concerns controlled his activities or that he exercised any control over the management, policies, or activities of those brokerage houses or their employees in their distribution of AGR stock.[37/] Nor is

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37/ See Section 12b-2 of the Exchange Act Rules which provides, "The term 'control' (including the terms 'controlling', 'controlled by' and 'under common control with') means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

there any evidence that Hammett acted for Brod or Baruch on any occasion. Nor was he ever on their payroll. Under these circumstances the finding requested by the Division cannot be made, since the prerequisites for such finding are not present.

Section 15A(b)(4) as now amended provides sanctions against a person who by his conduct while "associated" with a broker-dealer was a cause of any order of suspension or expulsion. The concept of controlling or controlled is embodied in the term "associated" as defined in the statute (Exchange Act, Section 3(a)(18)), and for reasons just stated cannot form the basis of a finding against Hammett.

A new Section, Section 15(b)(7), has been added to the Exchange Act by the Amendments Act. This Section provides in substance and in pertinent part that the Commission may censure any person, or bar or suspend for a period not exceeding twelve months, any person from being associated with a broker or dealer, if the Commission finds that such action is in the public interest and that such person has committed any violations of the Securities Act or the Exchange Act. This Section is applicable to any person whether or not he is in a control position with a broker or dealer. It may be used against a person who has never been a broker-dealer or an associated person but who aids and abets a broker-dealer in a securities fraud.[38/] Neither the Section itself nor the legislative history indicates an intention to restrict the Commission

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38/ Senate Report No. 379, 88th Cong., 1st Sess. (1963), pp. 78-79, 88; Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6793, and S. 1642, 88th Cong., 1st & 2d Sess. (1963-1964), pp. 227, 234; Phillips and Shipman, "An Analysis of the Securities Acts Amendments", Duke Law Journal, 1964 Volume pp. 706, 812, 815.

from imposing these sanctions for acts committed prior to the enactment of the Amendments Act. Similarly, in the case of prior amendments, no such limitations were placed upon the scope of amendments to the Securities Acts.[39/] The Commission itself has expressed the view that sanctions can be applied with respect to activities occurring either before or after the enactment of the Amendments Act.[40/] Section 15(b)(7) is remedial in nature. It does not make conduct violative of the Securities Acts which was not a violation previous to the enactment of the Amendments Act. It furnishes a tool for the Commission's use in determining the qualifications of persons to engage in the securities business with due regard to the public interest.[41/]

The instant case is one where, in the public interest, the Commission should apply the provisions of Section 15(b)(7). Hammett played a very important and essential part in the illegal distribution of a large block of stock from AGR to the public. Under all the circumstances,

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39/ J. A. Sisto & Co., 7 S.E.C. 1102, 1103 (1940); Louis Grow, 2 S.E.C. 306 (1937); Harry H. Natanson, 1 S.E.C. 852; Frank B. Hamlin, 2 S.E.C. 509; Charles E. Rogers, 3 S.E.C. 597.

40/ Sec. Exch. Act Rel. No. 7425, (Sept. 15, 1964), pp. 14-16; Sec. Exch. Act Rel. No. 7430, (Sept. 10, 1964).

41/ See Flemming v. Nestor, 363 U. S. 603 (1960); DeVeau v. Braisted, 363 U. S. 144, 160; Hawker v. New York, 170 U. S. 189 (1897) for approval of similar procedures in other fields.

the undersigned recommends that the Commission, in view of the violations found, enter an order barring Bernard Hammett from being associated with a broker or dealer.[42/]

Respectfully submitted,

Sidney L. Feiler
Hearing Examiner

Washington, D. C.

August 5, 1965

42/ All contentions and proposed findings submitted by the parties have been carefully considered. This Recommended Decision incorporates those which have been accepted and found necessary for incorporation therein.