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UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
J. A. WINSTON & CO., INC. 11 Broadway New York 4, New York	:
File No. 8-4594	:

RECOMMENDED DECISION

Washington, D. C.
March 8, 1963

Irving Schiller
Hearing Examiner

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File No. 8-4594	:	

BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: Andrew N. Grass, George Mahr and Irene Duffy, Esqs. of the New York Regional Office of the Commission for the Division of Trading and Exchanges.

Milton S. Gould and Alan J. Hartnick, Esqs. of Gallop, Climenko & Gould for J. A. Winston & Co., Inc., Joel Alfred Winston, Irving Bernstein, Morrison Gilbert and Albert Bernstein.

These are proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether to revoke or, pending final determination of the question of revocation, to suspend the registration as a broker-dealer of J. A. Winston & Co., Inc. ("registrant"), whether to suspend or expel registrant from membership in the National Association of Securities Dealers, Inc., ("NASD"), a registered securities association, and whether under Section 15A(b)(4) of the Exchange Act Joel Alfred Winston ("Winston"), Irving Bernstein ("I. Bernstein"), Morrison Gilbert ("Gilbert") and Albert Bernstein ("A. Bernstein"), or any of them, are causes of any order of revocation or suspension which may be issued.[1/]

The order for proceedings alleges that during the period

1/ Section 15(b) of the Exchange Act, as applicable here, provides that the Commission shall revoke the registration of a broker or dealer if it finds that it is in the public interest and that such broker or dealer or any officer, director, or controlling or controlled person of such broker or dealer, has willfully violated any provision of that Act or of the Securities Act of 1933 or any rule thereunder.

Section 15A(1)(2) of the Exchange Act provides for the suspension for a maximum of twelve months or the expulsion from a national securities association of any member who has violated any provision of the Exchange Act or has willfully violated any provision of the Securities Act of 1933 or any rule or regulation thereunder if the Commission finds such action to be necessary or appropriate in the public interest or for the protection of investors.

Under Section 15A(b)(4) of the Exchange Act, in the absence of Commission approval or direction, no broker or dealer may be admitted to or continued in membership in a national securities association if the broker or dealer or any partner, officer, director or controlling or controlled person of such broker or dealer was a cause of any order of revocation which is in effect.

from about November 1, 1956 to March 1, 1957 registrant, Winston, I. Bernstein, Gilbert and A. Bernstein obtained money and property by means of false and misleading statements of material fact and omission to state material facts necessary in order to make the statements made, not misleading, employed devices, schemes and artifices to defraud and generally engaged in a course of conduct which operated as a fraud in connection with the offer and sale of shares of common stock of Gob Shops of America, Inc. ("Gob Shops") in willful violation of the anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act [2/]; that during the period from about May 1, 1960 to August 1, 1960 registrant, together with or aided and abetted by Winston, I. Bernstein, Gilbert and A. Bernstein for the purpose of selling to certain persons and inducing them to purchase various securities at prices far in excess of prevailing market prices, as indicated by registrant's contemporaneous costs for such securities, withheld from such persons information as to the prevailing market

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2/ The anti-fraud provisions referred to are 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. 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 to defraud, an untrue or misleading statement of a material fact, or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by means of any other manipulative or fraudulent device.

prices of the said securities and sold to them and induced them to purchase such securities at prices far in excess of and having no reasonable relationship to registrant's contemporaneous costs for such securities, thereby obtaining unreasonable and excessive profits in willful violation of the anti-fraud provisions of the Securities Act and the Exchange Act. 3/

After appropriate notice, hearings were held before the undersigned Hearing Examiner and proposed findings of fact and conclusions of law and briefs in support thereof were filed by the Division of Trading and Exchanges and by registrant, Winston, I. Bernstein, Gilbert and A. Bernstein.

The following findings and conclusions are based on the record, the documents and exhibits therein and the Hearing Examiner's observations of the various witnesses.

1. Registrant, a New York corporation, was registered with this Commission as a broker and dealer since September 28, 1955. Winston is President and Director, I. Bernstein is Vice President, Secretary and Director, Gilbert is Treasurer and A. Bernstein is Vice President and Director of the registrant and all of the aforesaid individuals are owners of 10% or more of the common stock of registrant. Registrant is a member of the NASD.

3/ See footnote 2, supra.

Violations of the Anti-Fraud Provisions

2. To fully understand registrant's activities in connection with its sales of the Gob Shops stock a brief outline of the events preceding such sales and registrant's association with the securities of the said company would be helpful. Registrant's familiarity with the securities of Gob Shops antidated November 1, 1960 when the sales which are the subject matter of the instant proceeding commenced. In the fall of 1955 Gob Shops filed with the Commission a notification and offering circular under Regulation A relating to an offering of 299,000 shares of 30¢ par value common stock at $1 per share. Bruns Nordeman & Company ("Bruns") was the underwriter of the said offering. Harold S. Coleman ("Coleman") and Lawrence H. Lubin ("Lubin"), two of the Bruns partners, became directors of Gob Shops. In December 1955, after the offering had commenced, Coleman and Lubin requested registrant to participate in the aforesaid distribution and registrant agreed to do so. At the time the arrangements were being made Coleman and Lubin informed registrant in general that they had investigated Gob Shops and believed it had growth possibilities. Shortly prior to registrant's commencement of the offering the president of Gob Shops visited registrant's office, conferred briefly with its officers and addressed its salesmen informing them among other things that the company should prosper. Registrant purchased 30,000 shares of Gob Shops stock and Coleman and Lubin furnished registrant with a sufficient number of the offering circulars for distribution to its customers. Registrant sold its

allotment within two or three days and by the end of January 1956 had completed its offering. In February and March 1956 there were two or three more brief meetings between Gob Shops' president and registrant followed by about four or five telephone conversations during the remainder of the year.[4/] In addition, Coleman frequently communicated with registrant's president and kept him informed of the progress of the said company. Registrant traded in the Gob Shops stock until some time around October 1, 1956 when it acquired a block of Gob Shops stock and commenced a second selling campaign to distribute the said stock. The oral representations made by registrant's salesman and the sales literature used in connection therewith, referred to below, relate to this latter sales campaign.

3. Sixteen witnesses testified concerning the representations made to them with respect to Gob Shops. Thirteen of such witnesses testified they were told by registrant's salesmen that the stock of Gob Shops would appreciate in value, that it "can go up to 10 or 15 times the value"; that "it would fly - could go up ten times"; that "[it] went up to 1-7/16ths. Going higher, better get in on the ground floor"; that "Gob was practically a sure thing"; that the "business growing and stock will be growing"; that an investor could

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4/ Registrant's president testified that the purpose of the February and March meetings held after registrant had completed its offering was to keep its customers aware of the affairs of the company. There is no evidence in the record however as to the number of registrant's customers who owned stock of Gob Shops during this period or the number of inquiries, if any, registrant received concerning the said company.

double his money in short period of time - about 6 months; that the "price would double"; that "it would go higher and higher . . . "; that the stock would "probably double, triple itself in a very short time" and that Gob Shops "is not a speculation . . . this is a sure thing". Six of the said witnesses testified they were informed by registrant's salesmen that Gob Shops would be listed on an exchange, that it "wouldn't be long before it is on the big board"; that Gob Shops "would go on the American Exchange"; that " . . . by March . . . the Gob Shops was going to be listed on the Stock Exchange, on the American Board"; or that "they were preparing to list it on a stock exchange." Nine of the said witnesses testified that they were informed by registrant's salesmen that Gob Shops would pay dividends of "6 to 10% dividends"; that the investor "would be getting dividends and with the dividends they would buy more stock . . . "; that"this particular security would pay a dividend of about . . . in about six months . . . cash dividend . . ."; they would be cash dividends." With respect to Gob Shops' business and earnings, thirteen of the investor witnesses testified they were told by registrant's salesmen that the company's operations were successful, that the company was making money, was in fine condition, was operating at a profit, was expanding, that it presented a great opportunity to make money, that the company was growing and opening new stores, that the company was like or bigger than Korvette, that the earnings were very good, that it was going to show a profit and that it was a good investment.

Eleven witnesses testified they were told that the money invested in Gob Shops stock would be used for expansion and that only a limited supply of stock was available.

4. According to the evidence presented there was no basis for predicting that the Gob Shops stock would double or triple or that there would be an increase in market value of the said stock or that there would be a payment of a cash dividend, nor was there any basis for the other representations as to which the customer witnesses testified. Gob Shops, a Rhode Island corporation, was organized in 1950 as a small chain of Army-Navy stores. The company is engaged in retailing sporting goods, company equipment, men's and boys' work and play clothing and shoes. In 1955 Gob Shops owned five retail stores and had developed a chain of thirty-three franchised stores owned by independent operators who are required to purchase their merchandise exclusively from Gob Shops. Early in 1956 the company also operated leased departments in a number of discount department stores. Gob Shops' past earnings record had been poor. For the 9 months ending January 31, 1956 the company sustained a loss from operations of $25,432 and a net loss of $19,477. For the fiscal years ending January 31, 1957 Gob Shops had an operating profit of $3,150, a loss from operations of $28,596 and a net loss of $36,751. The evidence shows that during the period September 1956 and March 1957 the company was not financially capable of declaring a cash dividend. None of the investor witnesses were told of the Gob Shops' losses nor of its inability to pay a cash dividend.

5. The record further discloses that in the fall of 1956 there was no justification for representing that the Gob Shops stock would be listed. In the summer of 1956 Gob Shops inquired of the American Stock Exchange concerning possible listing and was informed that it did not qualify. In September of that year the Board of Gob Shops was so advised. No application was ever filed to list the said stock on any national securities exchange. The investor witnesses who testified they were told that Gob Shops was expanding and specifically informed or given the impression that their funds were to be used for such purposes were not informed that none of the proceeds of sale were to be furnished to the company or used by it for expansion purposes.

6. It is well settled that recommendations by a securities dealer to a prospective customer concerning a particular security should have a reasonable basis and should be accompanied by the disclosure of known or clearly ascertainable facts bearing upon the justification for the recommendation.[5/] In the light of the operating losses sustained by Gob Shops, as previously noted, there was no reasonable basis for the representations made by registrant concerning an increase in the price of the Gob Shops stock or the payment of dividends. Basic to the formulation of any recommendation concerning an increase in the value of the Gob Shops stock or payment of a dividend,

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5/ N. Pinsker & Co., Inc., Securities Exchange Act Release No. 6401 (October 21, 1960); Barnett & Co., Inc., Securities Exchange Act Release No. 6310 (July 5, 1960)

particularly where such recommendation is to be given to prospective purchasers who are being urged to purchase the stock, would be knowledge of the financial condition and results of operation of the said company. Such financial information could have been easily secured and would be most essential to have in order to even be in a position to determine whether to recommend to investors the desirability of their purchasing Gob Shops stock. Thus any request of either Gob Shops' president or Coleman after May 1956 when, the record shows, financial statements of the company were available, for such statements would have uncovered the fact that the company was operating at a loss. There is no evidence that registrant requested or made any effort to obtain such financial statements. In addition, any inquiry after September 20, 1956 of the president of Gob Shops would have informed registrant that Gob Shops could not qualify for and had no intention of then listing its securities on an exchange or any inquiry of the American Stock Exchange in the fall of 1956 would have informed registrant that Gob Shops was advised by the Exchange that it could not qualify for listing.

7. The conclusion is inescapable that registrant in making its representations as to price increase and dividends relied on information it had obtained when it participated in the Regulation A distribution approximately a year prior to its November 1956 sales campaign and made no more than perfunctory inquiry, if that, concerning Gob Shops' operations before it again urged customers to buy Gob Shops. It is evident from the testimony of registrant's president that he was impressed with the fact that the Bruns, a

member of the New York Stock Exchange, was soliciting registrant's aid in distributing the Gob Shops stock and registrant did not deem it necessary or essential to make any independent inquiry into the operations or business of Gob Shops. This is made even more apparent by the fact that the record discloses that in order to aid and bolster the oral misrepresentations being made by its salesmen registrant distributed to its customers sales literature of a fraudulent nature, which material emanated for the most part from Bruns. The sales material included a reprint of a statement made by Gob Shops' president secured from Coleman, at least two circulars supplied by and on the letterhead of Bruns and other material prepared by registrant from information obtained basically from Bruns and its two partners. In essence, the literature referred to a stock dividend paid by Gob Shops, the past growth and expected expansion and profits for investors, stated that "sales of all units combined are running at $3 million plus, and we hope for volume of $4 million in 1957," and referred to the addition of two units with gross sales of $600,000 and $300,000 respectively "on which a profit of 10% may be realized."

8. The sales literature was false and misleading. The $3 million sales figure appearing in the sales literature referred to combined the sales of Gob Shops' own stores and by, rather than to, the franchise stores to which it sells its merchandise at a discount of approximately 27% from retail selling price. Prospective investors would be more concerned with Gob Shops' net sales. In

addition, by contrasting the $3 million sales figure in at least one of the circulars to smaller sales volume for earlier fiscal periods, it was indicated that current sales were about 50% higher than during the earlier period. The impression thus given was that Gob Shops was a growth company having a record of good performance and affording uncommon opportunity for dividends. However, no disclosure was made in these circulars of the company's poor earnings record particularly the losses sustained for the nine month's period ending January 31, 1956 and for the fiscal year ending January 31, 1957. Moreover, the statement in some of the material that two units showed a 10% net profit gave the further impression of a profitable venture and failed to reflect that general overhead and administrative expenses were not included in the percentage figure. Lastly, with respect to the stock dividend statement in the sales literature the impression was given to prospective investors that the company had earnings and from other statements in the literature concerning growth and expansion investors were led to believe that earnings could be expected to continue. No disclosure was made that the 3% stock dividend paid in December 1956 was charged to capital surplus and that Gob Shops' earned surplus was insufficient to support the said stock dividend.

9. Registrant urges that its representations to the investors were based on its opinion that Gob Shops was a good investment, that such opinion was formed as a result of information it had obtained from Coleman and Lubin who were familiar with the company's

operations and on its board of directors and that registrant exercised due diligence in obtaining actual knowledge. The record fails to support these arguments nor are they sufficient to relieve registrant of its responsibility for the false and misleading statements made by its salesmen and of the false and misleading literature distributed by it. As previously noted it is evident from the record that whatever opinion registrant formed was based on information obtained the prior year when it distributed the Gob Shops stock under the Regulation A offering and it is equally evident from the record that registrant by its failure to secure financial and other information covering Gob Shops did not exercise due diligence in obtaining actual knowledge. Registrant undertook to offer and sell Gob Shops stock on the basis of incomplete information and lack of knowledge. Judge Learned Hand, in an opinion preceding the Securities Acts, held "Some utterances are in such form as to imply knowledge at first hand, and the utterer may be liable, even though he believes them, if he has no knowledge on the subject." Knickerbocker Merchandising Co. v. United States, 13 F. 2d 544, 546 (C.A.2, 1926). Registrant's reliance on statements furnished by Bruns when even a most superficial investigation would have disclosed the nature of Gob Shops' operations, its financial condition, its net losses, was at the best reckless and misplaced and not consistent with the existence of a responsible relationship between securities dealers and customers.[6/] The Commission has held that basic to the relationship between a broker or dealer and

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6/ See A. N. Bellin Securities Corp., 39 S.E.C. 178 (1959)

his customers is the representation that the latter will be dealt with fairly in accordance with the standards of the profession and that where a broker or dealer engages in the sale of securities to the public by making representations without reasonable basis, couched in terms of either opinion or fact and designed to induce purchases, the conduct of such broker or dealer is contrary to the basic obligation of fair dealing. MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962). The manner in which registrant embarked on a sales campaign to induce investors to purchase Gob Shops stock by means of false and misleading literature and oral representations without any basis in fact leads to the conclusion that registrant did not carry out its basic obligation of dealing fairly with the public. Registrant urges that it offered the Gob Shops stock to customers because of its belief, based on actual knowledge and careful consideration, that the investment was sound, that, considering the activity in the discount business, there would be a rise in the price of the said stock. The argument is rejected since it is contrary to the Commission's decisions 7/ and the facts in the instant case. The Commission has held that faith in the ultimate success of a business enterprise is not the measure of responsibility under the federal securities laws and has repeatedly held that it is inconsistent with principles of fair dealing and violative of the securities laws for a broker or dealer to induce the purchase of securities by means of representations unsupported by a reasonable factual basis and without

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7/ See B. Fennekohl & Co., Securities Exchange Act Release No. 6898 (September 18, 1962).

disclosure of known or reasonably available information necessary to provide the investor with a fair picture of the security being offered.[8/] We have previously noted there was no basis for registrant's representation and that information was reasonably available to provide to investors the material necessary to evaluate the security being offered.

10. We note further that the only testimony in the record to controvert the statements made by the investor witnesses was given by Winston who testified that he and Gilbert "supervised" and the two Bernsteins "monitored" the salesman and that while all of them constantly listened to the salesman they never heard them make any of the statements attributed to such salesmen by the investor witnesses. On the basis of the Hearing Examiner's observations of the demeanor of the investor witnesses he credits their testimony. It is quite evident from the testimony of all of the investor witnesses that the various representations which such investors testified were made to them by the salesmen bear a striking similarity and it would tax the credulity of the Hearing Examiner to believe that the representations concerning price increase, promise of dividends, earnings and profits and the growth prospects of Gob Shops' business were never made to such investors. None of the salesmen were produced by registrant to deny the representations attributed to them nor was their absence

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8/ D. F. Bernheimer & Co., Inc., Securities Exchange Act Release No. 7000 (January 23, 1963).

explained. Their failure to testify and the failure of Gilbert and the two Bernsteins to testify as to what, in fact, they heard the salesmen tell investors warrants the inference that all of their testimony, if produced, would have been adverse.[9/]

11. Registrant further contends it cannot be either a guarantor of each stock it recommends, or, under the circumstances of this case, an insurer against the admitted conspiracy and bad faith of Bruns, Coleman and Lubin. Neither of these contentions have merit. No charge is made that registrant was a guarantor of the Gob Shops stock nor has any such finding been made. Rather, the issue to be determined is whether registrant discharged its responsibilities under the Acts as a broker or dealer to make adequate and proper inquiry concerning Gob Shops whose securities it was about to publicly distribute and was adequate and necessary information furnished to investors to permit the making of an informed evaluation of the securities of the said company. This responsibility, the record shows, was not adequately discharged by registrant and the information furnished to investors, both orally and in writing, was misleading and false. As to the argument that registrant was not an insurer against the admitted conspiracy and bad faith of Bruns, Coleman and Lubin the record indicates that registrant knowingly undertook to commence an active retail sales campaign, relied on Bruns, Coleman and Lubin,

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9/ Heft, Kahn & Infante, Inc., Securities Exchange Act Release No. 7020 (February 16, 1962); N. Sims Organ & Co. v. Securities and Exchange Commission, 293 F. 2d 78, 80-81 (C.A. 3, 1961) cert. denied 82 S.Ct.440.

accepted without question the information and sales material furnished by Bruns and Coleman, failed to make its own adequate investigation, and in effect became a participant in the conspiracy to distribute the Gob Shops stock in the manner indicated above.

12. The Hearing Examiner finds that registrant willfully violated Section 17(a) of the Securities Act, and Sections 10(b) and 15 (c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder.

Sale of Securities at Unfair Prices

13. The Commission order alleges that between May 1 and August 1, 1960 registrant sold certain securities to customers at prices far in excess of prevailing market prices as indicated by registrant's contemporaneous costs for such securities and failed to disclose to such customers information as to the prevailing market price.

14. The evidence in the record relating to registrant's pricing practices concerns the securities of seven companies. During the period in question of 222 dealer transactions involving sales of the said securities to customers of registrant the evidence shows that such sales were made at spreads ranging from 6.3% to 20% of which 125 sales were made at spreads ranging from 10% to 20% and 97 sales were made at spreads ranging from 6.3% to 9.5%.[10/] According to the

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10/ The transactions considered were those relating to the securities of the seven companies mentioned in the text and effected on the dates agreed upon between counsel. In addition, no consideration was given by the Hearing Examiner to eight additional transactions since no evidence was furnished indicating registrant's cost of securities.

evidence in 216 of such transactions registrant effected purchases and sales of the same security on the same day, though not in similar amounts.[11/] The spread represents the difference between the price paid by registrant in purchasing the security in question on a particular day and the price which registrant charged its customer for the same security on the same day. With respect to the price paid by registrant for its purchases, a securities investigator employed by the Commission testified he used the price first paid to a dealer or professional on a particular day and if no dealer was found he used the price paid to a customer.

15. The Commission has consistently held that it is a fraud and deceit upon customers to effect transactions at prices not reasonably related to current market prices without disclosing that fact and that a dealer's contemporaneous cost, in the absence of countervailing evidence, is the best evidence of current market price.[12/] The key issue in the instant case revolves about the meaning of the phrase "current market price." Registrant argues strenuously that in a fraud proceeding, the current or prevailing market price where there is an independent market, must be determined by the quoted

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11/ With respect to the remaining six transactions, there was no evidence of purchases on certain dates of sales of the same security and the spread was computed by using prices paid for securities purchased either the day before or the day after the sales in question. In light of the overwhelming number of transactions in which purchases and sales were effected on the same day the Hearing Examiner sees no need to consider these six transactions.

12/ Manthos Moss & Co., Inc., Securities Exchange Act Release No.6471 (February 15, 1961); Paul Carroll Ferguson, 39 S.E.C. 260 (1959). Charles Hughes & Co., Inc., v S.E.C., 139 F. 2d 434 (C.A.2, 1943), cert. denied 321 U.S.786; William Harrison Keller, Jr., 38 S.E.C. 900 (1959).

high asked prices appearing in the quotation sheets published by the National Daily Quotation Service and not by a dealer's contemporaneous cost. The Hearing Examiner rejects this argument. While it may be true that quotations in the sheets furnish some indication of the prevailing market price in dealer transactions with the public, such quotations are not regarded as conclusively determining prevailing market price.[13/] Where the evidence shows that a broker or dealer effected purchases on the same day he made sales the best evidence of market price, for purposes of determining the amount of a mark-up or spread charged the customer, is the price paid for a security on the same day the dealer sold the same, though not necessarily the identical, security to the customer.[14/] In the Keller case supra the Commission held that a dealer's cost prices, which in practically every instance were closely contemporaneous with the sale of the same securities to the customers, represented the prevailing market prices of such securities. In the instant case it is clear that in all the transactions considered by the Hearing Examiner, registrant, in 50 out of the total of 54 trading dates agreed upon between the parties as relevant, purchased the securities of the seven companies heretofore mentioned the same day it sold the securities of the said companies to its customers. Registrant's own contemporaneous cost is better evidence of current market price than the bid and ask quotations in

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13/ Allendar Company, Incorporated, 9 S.E.C. 1043, 1058 (1941)

14/ Managed Investment Programs, et al, 37 S.E.C. 783, 786 (1957)

the sheets. In view of the fact that registrant's sales were effected concurrently with its purchase of the same security the Hearing Examiner accepts the prices paid by registrant in substantially contemporaneous purchases as the best evidence of current market prices in the absence of countervailing evidence.

16. Registrant also urges that it is not fraud to obtain "unreasonable and excessive profits" because of excessive mark-up over contemporaneous costs of such securities and that fraud occurs only where securities are sold at prices substantially over those prevailing in the over-the-counter market. This argument is contrary to the opinions of the Commission and the Courts.[15/] Registrant's theory of fraud would thus ignore completely evidence of actual transactions at specified prices as indicative of market price and would require in all cases where there are quotations in the sheets, which are at best merely indications of prices at which dealers may be willing to buy and sell, to use the high offer for purposes of determining whether a mark-up is reasonable. Evidence of quoted prices in the sheets may be used as an indication of prevailing market prices where there is no evidence to the contrary. In the instant case the evidence to the contrary is the actual price paid by registrant in a purchase on the same day it sold the same security to a customer in a market which was relatively stable and not fluctuating. Registrant further contends

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15/ See cases cited in Footnote 12.

that the Division fails to distinguish between cases concerning fraud and policies of the NASD. Registrant's suggestion that the principles governing the determination of whether a mark-up is unfair should be different where fraud is charged than when the mark-up is considered under the NASD policy on pricing is untenable.[16/] In considering whether a mark-up is unreasonable the Commission does not apply one standard in NASD disciplinary proceedings and another in revocation or denial proceedings under Section 15(b) of the Act.[17/]

17. We next consider whether the spread or mark-up charged by registrant is excessive. As previously noted, registrant's spread ranged from 6.3% to 20%. An analysis of the transactions in the record reveals that it was registrant's general practice during the period May through July 1960 to charge a spread of 1/2 point on all of its dealer transactions. Thus, the record shows the following: on 15 trading days during the period May 5 through June 22, 1960 registrant effected 51 purchases and 46 concurrent sales transactions in Hudson Radio and Television Corporation ("Hudson") stock and on all

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16/ The NASD's policy on markup was announced in 1943 as a guide in determining whether a price is fair and stated that profits in principal transactions should normally not exceed 5%. See National Association of Securities Dealers, Inc., 17 S.E.C. 459, 472 (1944). It was noted that 5% or even a lower rate is not always justified but that in the case of low-priced securities, such as those selling below $10 per share, a "somewhat higher" percentage may sometimes be justified.

17/ See Ross Securities, Inc., Securities Exchange Act Release No. 6765 (March 28, 1962).

but two occasions purchased the said stock at 6 and sold the said stock at 6-1/2; on 19 of 20 trading days during the period May 3 through July 18, 1960 registrant effected 52 purchases and 48 concurrent sales transactions in Sta-Brite Fluorescent Manufacturing Co. ("Sta-Brite") stock and consistently (with some few minor exceptions) purchased the said stock at 5-1/4 and consistently sold the said stock at 5-3/4; on 15 of 16 trading dates during the period May 3 through July 21, 1960 registrant effected 35 purchases and 40 concurrent sales transactions in General Aluminum Fabricators, Inc. ("General Aluminum") and purchased the said stock at 4-1/4, 4-3/8 and 4-1/2 and sold the said stock at 4-3/4, 4-7/8 and 5 respectively with one exception; on 9 trading dates during the period May 2 through June 30, 1960 registrant effected 20 purchases and 16 concurrent sales transactions in Metallurgical Processing Corp. ("Metallurgical") and purchased the said stock at 3-1/2 with two exceptions and sold the said stock at 4; on 4 trading days during the period May 5 through July 20, 1960, registrant effected 8 purchases and 5 concurrent sales transactions in Worldmark Press, Inc. ("Worldmark") stock and purchased the said stock at 1-7/8 and sold the said stock at 2-1/4; on 12 of 15 trading days during the period June 1 through July 13, 1960 registrant effected 112 purchases and 162 concurrent sales transactions in Keystone Electronics ("Keystone") stock and purchased the said stock at 4-1/4, 4-1/2, and 5-1/4 and sold the stock at 4-3/4, 5, and 5-3/4 respectively and on 27 trading days during the period May 3 through July 20, 1960 registrant effected 142 purchases and 274 concurrent

sales transactions in Cosmos Industries, Inc. ("Cosmos") stock and purchased the said stock at 3-3/4, 4, 4-1/2, 4-3/4 and 5 and sold the said stock at 4-1/4, 4-1/2, 5, 5-1/4 and 5-1/2 respectively. The foregoing evidence prepared by registrant shows in summary that during the period May through July 1960 registrant effected a total of 431 purchases and 591 concurrent sales transactions in the securities of the seven companies and that registrant's consistent practice in principal transactions was to charge its customers a spread of 1/2 point without regard to the price of the security, the number of shares or the amount of money involved in each transactions. The Commission has held in a number of cases that a mark-up or spread ranging from 6% to 30% is excessive. Thus in the Keller case supra mark-ups ranging from 6.25% to 10% in 9 sales and from 10% to 20% in 19 sales were included among spreads held to be unreasonable and excessive; in Maryland Securities Co., Inc., Securities Exchange Act Release No. 6442 (December 30, 1960) mark-ups computed on the basis of same-day purchases of 7.6% in two transactions, 11.1% in five transactions, 13.3% in 13 sales 17.6% in one transaction and 20% in two transactions were included in spreads held to be unreasonable and excessive and in Boren & Co., Securities Exchange Act Release No. 6367 (September 19, 1960) a mark-up of 7% in a $212.50 sale at $10-5/8 per share and mark-ups ranging from 11.9% to 19% were included in spreads held to be unreasonable. Respondent urges that no consideration be given to the government's computation of the spread since the testimony of its securities investigator concerning his method of

selecting the purchase price of securities was arbitrary and unreliable and failed to give consideration to whether there was evidence indicating that registrant paid higher prices for any of the securities involved on any particular day in question. This argument is without merit. It is abundantly clear from the exhibits prepared by registrant and received in evidence that registrant followed the practice of arbitrarily charging a spread of 1/2 point in a preponderance of the 591 sales transactions referred to above. The Hearing Examiner finds that the arbitrary spreads charged by registrant for the securities of the above-named seven companies where the sale prices ranged below $7 per share were unreasonable and excessive particularly where no justification is furnished.for charging a price in excess of the normal 5%. Registrant conceded at the hearing that none of the customers who purchased the securities of the seven companies mentioned heretofore were informed of registrant's purchase price of the said securities nor were they informed of the difference between such price and the price at which the same securities were being sold to customers. It is clear from the record that the mails were used in connection with the transactions mentioned above.

18. The Hearing Examiner finds that registrant by charging its customers prices not reasonably related to current market prices without disclosing such fact as set forth above wilfully violated Section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 17 CFR 240.10b-5 and 17 CFR 240.15c-1-2 thereunder.

Ruling on Evidence

19. During the course of the hearing counsel for the Division of Trading and Exchanges offered in evidence three certified copies of indictments pending in the United States District Court for the Southern District of New York which named registrant and the persons named as possible causes in the instant proceeding as defendants. The registrant in its brief states that the indictments contain allegations of criminal violations involving offers and sales of securities and conspiracy to commit the alleged crimes. At the time the documents were proffered counsel for the Division stated that the purpose of the offer was not to put in issue the substance of the said indictments but that they were being offered for the limited purpose of permitting consideration to be given to such indictments in the event the violations alleged in the order for proceedings were found to have been committed and it became necessary to determine whether it is in the public interest to invoke any sanction against registrant. Registrant vigorously objected to the receipt of the said indictments in evidence and the Hearing Examiner reserved decision on the said offer.

20. Registrant contends that it is a violation of the procedural guaranties of the due process clause of the Fifth Amendment to admit and consider evidence which is not rebuttable because its source is unknown and that the indictments are mere heresay assertions concerning registrant's alleged behavior. Moreover, registrant argues that if the indictments are admitted the issues in the instant hearing are broadened and it becomes "impossible adequately to prepare a case

in defense." The Hearing Examiner cannot accept these arguments. Congress has imposed upon the Commission under the Exchange Act a responsibility to determine whether violations of that Act have occurred and if so whether it is in the public interest to impose upon the violators one or more of the sanctions set forth in the said Act. Consideration of the appropriate sanction to be invoked involves an exercise of discretion in light of the purposes of the Act and requires a determination to be made keeping in mind the public interest and protection of investors. To permit a proper exercise of discretion the Commission should have available to it whatever information is extant bearing upon the conduct and business practices of a broker and dealer. The weight to be accorded to such information is a completely separate and distinct matter. The Commission acting in its quasi-judicial capacity is unquestionably able to evaluate the documents in context of the entire case. Even if little weight is ultimately given to the fact that an indictment is pending the admissibility of the document is not affected. It is clear from the record that the indictments were offered for the limited purpose of establishing the fact that registrant and the other principals were indicted by a grand jury for alleged violations concerning the offer and sale of securities.and the substance of the charges are not at issue in the instant proceeding. The admission of such documents does not violate the Fifth Amendment since registrant is fully advised of the basic nature of the matters relating to the indictments which will be considered and may refute such matters by furnishing

whatever explanation or evidence it desires. Nor is there substance to the argument that the issues in the proceeding are broadened and preparation of a defense becomes impossible. Registrant was advised at the outset by the Commission's order that certain violations are alleged and that if such violations are established consideration would be given to the nature of the sanctions to be imposed. Consideration, if any, to be given to the indictments relate solely to the invocation of the appropriate sanction. The Commission in two recent opinions considered whether evidence of the nature sought to be introduced here is admissable and held in one case that in connection with public interest it was permissible to admit evidence of 22 arrests since such conduct was deemed relevant in connection with a broker's fitness to engage in the securities business.[18/] In another case involving a broker-dealer revocation proceeding the Commission noted that in addition to the fact that one of the promoters in an enterprise had twice been found guilty of securities violations he was also indicted.[19/] Registrant further contends that the Grubman case supra is distinguishable since there an application for a broker-dealer license was involved and not a revocation of a broker-dealer registration and registrant argues that all the procedural safeguards which are essential where a privilege is sought to be revoked are not necessarily required where a person is seeking a privilege. Such contentions are untenable. Standards of

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18/ Irving Grubman, Securities Exchange Act Release No. 6546 (May 5, 1961).

19/ Brown, Barton & Engel, Securities Exchange Act Release No. 6821 (June 8, 1962).

conduct are no different in determining whether to grant a license to engage in the brokerage business than in determining whether to revoke the registration of a broker-dealer already licensed since basic to both is the statutory aim of safeguarding investors. Registrant's theory would indeed create an anomalous situation since it suggests that a dealer could properly be denied a license for certain misconduct where the same standard of misconduct should not provide a basis for revoking such license or that some greater standard should be applied because the dealer is already in the securities business. Nor is such a double standard envisioned in the Exchange Act. Section 15 of the Act provides that the Commission shall, after appropriate notice and opportunity for hearing, deny registration to or revoke the registration of a broker or dealer if it finds that such denial or revocation is in the public interest and the broker or dealer has committed certain acts or engaged in certain practices prior or subsequent to becoming such a broker or dealer. It is manifest from the Act itself that conduct sufficient to invoke a sanction of denial of registration is equally sufficient to revoke a license already granted. The Hearing Examiner overrules the objection to the offer of the three indictments referred to above in evidence and such documents will be deemed received in evidence.

Public Interest

21. Having determined that registrant violated the securities laws as indicated above the remaining question is whether it is in the public interest and for the protection of investors to revoke the registration of registrant or to suspend for a period not exceeding

twelve months or to expel registrant from membership in the NASD. Registrant urges that public interest does not require the revocation of its registration or its expulsion from the NASD. To properly evaluate such contention a review of the evidence in the record with respect to the manner in which registrant carried on its business activities would be helpful. During the period from November 1956 through March 1957 when registrant sold Gob Shops stock its selling techniques had all of the characteristics of "boiler room" procedures. High pressure efforts by telephone were used to sell a large volume of speculative securities to prospective investors. Several of the investor witnesses testified they were never asked information as to their income, investment needs or objectives and registrant manifested no concern for the suitability of the Gob Shops stock in light of such investors' needs. Oral representations were made of Gob Shops, earnings, predictions were made of market price rises, representations were made of Gob Shops listing on an exchange and other statements made painting a bright picture of Gob Shops' future all of which lacked an adequate basis. No disclosure was made to such prospective investors of reasonably ascertainably adverse information nor caution given as to the risks involved. Investors had no opportunity for careful consideration of factors essential to permit formulation of an opinion as to the merits of an investment in the said stock. In addition customers were given various pieces of sales literature some of which registrant received and accepted from Bruns without inquiry which was false and misleading and designed to create the impression

that a purchase of Gob Shops stock would be a sound investment. Such selling methods are contrary to the basic obligation of fair dealing which those who engage in selling securities to the public must observe.[20/] In addition, the failure of registrant's salesmen to inquire of customers as to their financial situation and needs is contrary to the Rules of Fair Practice adopted by the NASD.[21/] Registrant was a member of such organization and its salesmen were registered with it as representatives and presumably familiar with such rules.

22. The record further shows and the Hearing Examiner found that during the period May through July 1960 registrant violated the Exchange Act by charging its customers prices not reasonably related to the prevailing market price without disclosing such fact. Registrant's method of conducting business during this period further demonstrates its failure to disclose material information and its failure to deal fairly with its customers. Five witnesses testified concerning their relationship and business dealings with registrant particularly with respect to their purchases of securities of some of the seven companies mentioned above. From their testimony and demeanor at the hearing it is evident that four of them lacked sophistication, were uninformed on

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20/ Leonard Burton Corporation, Securities Exchange Act Release No. 5978 (June 4, 1959).

21/ Section 2 of the Rules of Fair Practice adopted by the NASD provides:

> "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

securities markets and placed great confidence in and relied upon advice given them by registrant's salesmen concerning the securities eventually purchased by them. No disclosure was made to such customers of registrant's pricing practices as indicated above nor were they informed of the market price or registrant's cost of said securities. It is well settled that inherent in the dealer-customer relationship is the implied representation that the customer will be dealt with honestly and fairly and in accordance with the establishment standards of the profession. This vital representation works a fraud or deceit upon customers when a dealer charges prices not reasonably related to prevailing market prices without disclosing that fact.[22/] Registrant's argument that it relied on its attorney's advice in formulation of its pricing practices does not preclude a finding of willfulness within the meaning of Section 15(b) of the Exchange Act.[23/] Nor does such finding require an intention to violate the law.[24/] Registrant's purported advice by persons other than its attorney concerning its pricing practices in general is not substantial by the record. Winston testified he consulted two persons about problems regarding his pricing practice concerning a particular security (not related to the instant proceeding) and incidentally

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23/ David Joel Benjamin, 38 S.E.C. 614 (1958)

24/ Hughes v Securities and Exchange Commission, 174 F. 2d 969, 977 (C.A.D.C. 1949)

22/ Duker v Duker, 6 S.E.C. 386 (1939)

reviewed all of his pricing practices with them receiving their assurance it met the standards under the Act. However, this latter testimony relating to conferences concerning registrant's general pricing practices was vague as to the time such advice was sought, indefinite and unconvincing as to the subject matter discussed and is given no credence. Neither of these two persons were produced at the hearing to verify Winston's testimony. Moreover, Gilbert who was present at the hearing and who Winston also testified advised on pricing practices did not testify.

23. Registrant points to the fact that the "penalty imposed against Bruns in connection with its Gob Shops activities was suspension from the NASD for a period of 60 days and the penalties against Coleman and Lubin were suspensions from the New York Stock Exchange and the American Stock Exchange for periods of 90 and 60 days respectively. Registrant urges that "the only possible grounds for differences in administrative penalty would be Bruns' offer of restitution" which offer registrant noted one commissioner in a dissenting opinion felt he could not attach as much mitigative weight as the majority. Registrant pleads that penalties more stringent than those imposed on Bruns cannot be justified. The Hearing Examiner has given serious consideration to the sanctions imposed in the Bruns decision and is of the view restitution was considered by the majority of the Commission as a significant mitigating factor. In the instant case registrant gave no consideration to treating its defrauded customers in similar fashion. However, apart from restitution there are other vital factors in Bruns which are not present in the instant case.

Thus, in Bruns the Commission considered whether it is consistent with the public interest to accept an offer of settlement made by the firm or reject it and return the case to "the time consuming process of an adversary proceeding." In that connection consideration was given to a number of mitigating factors and the Commission noted that Bruns already suffered severely in loss of customers and accounts resulting from the Gob Shops suspension proceedings and the revocation proceeding against it, that the firm had been in business approximately 40 years and Coleman and Lubin had been associated with New York Stock Exchange member firm upward of 35 years and never subject to complaints or proceedings involving any transactions in securities, that Bruns was primarily a commission house engaged in transacting agency business on various stock exchanges, that the firm never handled a Regulation A underwriting prior to Gob Shops and not one since and had agreed in effect not to act in such capacity for a period of 5 years, and finally that all salesmen who participated in the Gob Shops stock distribution were no longer employed and that those then employed would be subject to closer supervision. The Commission after considering particularly the nature of registrant's primary business and being satisfied that the situation complained of would not recur and taking into account all of the foregoing imposed the sanctions noted above. Suffice it to say that the record in the instant proceeding is barren of any of the mitigating factors considered by the Commission in the Bruns case.

24. In summary, the evidence indicates that registrant made false and misleading representations in connection with the sale of Gob Shops stock, failed to make a diligent and reasonable investigation of the issuer immediately prior to the period it started its sales campaign to sell the said stock to the public, accepted without inquiry and distributed sales literature in connection with the sale of the aforesaid stock which material was false and misleading, engaged in selling methods bearing the familiar characteristics of a "boiler room" operation, followed a pricing practice which was not calculated to deal fairly and honestly with investors and contrary to the standards of the profession and by all of the foregoing has demonstrated that it has engaged in a course of conduct inimical to the best interest of investors. The Hearing Examiner finds it is in the public interest to revoke registrant's registration as a broker and dealer and that it be expelled from the NASD.[26/] 25)

25. As previously noted Winston, Gilbert and the two Bernsteins were officers, directors and owners of 10% or more of registrant's stock. The evidence shows that all four principals shared equal responsibility for management of all phases of registrant's operation. Thus it is evident from the record that all four principals

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[26/] In arriving at this conclusion the Hearing Examiner is of the opinion that the seriousness of the violations found and the manner in which registrant is conducting its business are adequate and sufficient grounds for determining it is in the public interest to impose the sanctions noted above. Under the circumstances the Hearing Examiner does not feel it is necessary to consider or give weight to the pending indictments against registrant and the four principals named as defendants therein and involved in these proceedings and has refrained from so doing.

were present daily at registrant's offices (except for occasional trips), had knowledge of registrant's activities, exercised supervision over registrant's salesmen, listened to their conversations with customers, and when necessary purportedly reprimanded salesmen they felt were making unauthorized statements. Their assumption of active supervisory functions in this respect and indeed with respect to all of the affairs of registrant is unchallenged. The Hearing Examiner finds that as officers and directors the four principals failed to properly manage registrant's business failed adequately to discharge their duties and responsibilities to supervise registrant's employees in such a manner as to prevent fraud upon the firm's customers and failed to establish proper standards regarding registrant's pricing policies. 27/ Under the circumstances the Hearing Examiner concludes that Messrs. Winston, Gilbert, I. Bernstein and A. Bernstein participated in, or aided and abetted in all of registrant's violations as noted above and that each should be named a cause of any order of revocation, suspension or expulsion which may be entered therein.

27/ Cf. Alexander Reid & Co., Inc., Securities Exchange Act Release No. 7016 (February 7, 1963); Midland Securities, Inc., Securities Exchange Act Release No. 6524 (April 10, 1961).

Recommendation

In view of the willful and serious violations found it is respectfully recommended that the Commission enter an order finding it is in the public interest and for the protection of investors to revoke the registration of registrant as a broker and dealer and expel it from membership in the NASD.

It is further recommended that the Commission also find that Winston, Gilbert, I. Bernstein and A. Bernstein willfully participated in, or aided and abetted in the willful violations of the above designated provisions of the Securities Act and the Exchange Act and the respective rules thereunder and that each of the said individuals is a cause of such order of revocation and expulsion.[28/] [27/]

Respectfully submitted,

Irving Schiller

[27/] [28/] To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are sustained, and to the extent they are inconsistent therewith they are expressly overruled.

Washington, D. C.
March 8, 1963