IN THE MATTER OF

COMMONWEALTH SECURITIES CORPORATION

HERBERT BECK

File No. 8-6739. Promulgated July 23, 1968

Securities Exchange Act of 1934—Sections 15(b) and 15A

BROKER-DEALER PROCEEDINGS

Grounds for Revocation of Registration

Fraud in Offer and Sale of Securities

Failure to Amend Registration Application

Failure to Comply with Records Requirements

Failure to Comply with Net Capital Requirements

Where registred broker-dealer, in offer and sale of securities, made false and misleading representations concerning, among other things, use of proceeds of offerings, business history, earnings and assets of issuer's parent, and future dividends and increase in market of issuer's stock; and failed promptly to amend application for registration and to comply with books and records and net capital requirements, *held*, in public interest to revoke broker-dealer's registration.

Where salesman of broker dealer, in offer and sale of securities, made false and misleading representations concerning, among other things, safety of investment in issuer's stock, future market price and listing of such stock, dividends to be paid, and opportunities for resale without investment in issuer's stock, future market price and listing of such stock, dividends to be paid, and opportunities for resale without loss, *held*, salesman cause of revocation of broker-dealer but in view of mitigating factors it is in public interest that finding not operate to preclude subsequent supervised employment in securities business.

APPEARANCES:

Thomas B. Hart, of the Chicago Regional Office of the Commission, and *Hyman Braham, John W. Vogel, Charles E. Cook*, and *David A. Tenewich*, of the Cleveland Branch Office of the Commission, for the Division of Trading and Markets.

Lyman Brownfield, of Brownfield, Kosydor, Folk, Yearling & Dilenschneider, for Commonwealth Securities Corporation, Certified Credit Corporation and Houston Financial Corporation.

David J. Young and *Richard R. Murphey, Jr.*, of Dunbar, Kienzle & Murphey, for Herbert Beck.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed a recommended decision in which he concluded, among other things, that the registration as a broker and dealer of Commonwealth Securities Corporation ("registrant") should be revoked and that Herbert Beck, who was a salesman of registrant, should be found a cause of such revocation with the proviso that such findings should not operate to preclude Beck's employment in the securities business after four months upon an appropriate showing that he would be adequately supervised.

No exceptions were taken to the hearing examiner's recommended decision by registrant, which the examiner found had willfully violated anti-fraud provisions in the offer and sale of securities of Certified Credit Corporation ("CCC") and various companies under common control with CCC and with registrant and also willfully violated various other provisions of the securities acts.[1] Beck, who was charged with and found by the examiner solely to have willfully violated the anti-fraud provisions in the offer and sale of securities of certified Credit and Thrift Corporation ("CCT"), filed exceptions and a supporting brief. A reply brief was filed by our Division of Trading and Markets ("Division"). Our findings are based upon an independent review of the record.

Violations by Registrant

Registrant was formed in 1958 by controlling persons of CCC, which was in the small loan business and invested in insurance companies and conducted real estate operations, and it engaged principally in handling underwritings of securities of CCC subsidiaries. Such underwritings included offerings of stock of Certified Mortgage Corporation ("CMC") in 1958 and 1959; an offering of stock of Certified Life Corporation ("CLC") in 1958; and offering of stock of CCT commencing in June 1960. In the course of these

[1] Certain of the officers and principals of registrant have pursuant to their consent been barred from association with any broker or dealer, and various other persons who appear to have been associated with registrant have been barred from association with any broker or dealer with provisos that they might return to the securities business after six months upon appropriate showings that they would be adequately supervised. Securities Exchange Act Releases Nos. 7915, 7921, 7970 and 8034 (July 11, July 19 and October 6, 1966, and February 10, 1967).

offerings registrant participated in or was responsible for the preparation and use of prospectuses and other materials which contained false and misleading statements. As found by the hearing examiner, by such conduct registrant willfully violated Sections 17(a) of the Securities Act of 1933 ("Securities Act") and sections 10(b) and (15(c)(1) of the Exchange Act and Rules 10b–5 and 15c1–2 thereunder.

Thus the prospectus used by registrant in connection with the first CMC offering represented that the proceeds would be used to start CMC in the business of making loans and investing in mortgages and home improvement loan paper, and that used during the second CMC offering stated that the company was conducting a real estate mortgage and home improvement loan business and had invested $1,045,000. The prospectus for the CLC offering stated that the proceeds would be invested in life insurance stocks, and that for the CCT offering stated that the greater part of the proceeds would be used in conducting a loan business.

During the CCT offering, registrant also furnished its salesmen with materials that they used in connection with the sale of CCT shares, which depicted CCC as a growing company whose assets had increased from $200,000 in 1950 to over $13,000,000 in 1960 and whose profits had increased during each of those years except one from $2,000 to $210,000, and painted an extremely optimistic picture of investments in small loan companies. The use of these materials implied that CCC as an affiliate of CCT would aid the latter in a successful conduct of its small loan business. The materials further showed price increases and dividends paid on stocks of selected finance companies during 1935–1960 as comparing favorably with stocks of well-known corporations in other industries, and it was set forth that dividends paid by a certain finance company had increased from 1.89 percent of original capital in 1919 to 349.65 percent in 1954 and that $1,000 invested in that company was now worth approximately $309,460.

These representations were materially false and misleading. The offerings were for the most part devices for raising funds for CCC and not, as the prospectuses represented, initiating new enterprises. Most of the proceeds were remitted directly to CCC, whose financial condition was precarious, or invested in CCC debentures.[2] CMC transacted little actual business; it made one $300,000 construction loan and had only $28,000 in mortgage and

[2] CCC was in this manner the recipient of $1,700,000 out of a $2,200,000 realized from the CMC offerings, $177,000 out of $195,000 realized from the CLC offering, and $910,000 of $925,000 realized from the CCT offering.

home improvement loans outstanding as of the end of 1959. CLC did not make any investments in securities of life insurance companies and, with the exception of a $7,000 loan to CMC, was entirely dormant. CCT never entered the small loan business.

CCC did not earn a profit during any year after 1954, and its loan operations showed losses of at least $60,000, $53,000 and $77,000 in 1958, 1959 and 1960, respectively. It sustained itself by siphoning off subsidiaries' funds, and it resorted to false bookkeeping to create an appearance of profitability. Its stated income was inflated by including overstated charges for services and supplies to affiliates, which in many instances were unable to make payment;[3] accounts receivable and total assets were overstated by approximately $300,000 because no adequate reserve was provided for bad debts; and cash received after the reporting period was included in at least three annual balance sheets, about $85,000 of such cash being shown as of December 31, 1959.[4] Under these circumstances, it was clearly fraudulent to describe CCC as a successful company, and to compare its business with that of established companies.

We further find, as did the hearing examiner, that registrant willfully violated:

(1) Section 15(b) of the Exchange Act and Rule 15b3–1 thereunder by failing promptly to file amendments correcting inaccurate information in its application for registration. Registrant's application, which was filed on July 21, 1958, represented that each of two individuals owned half of its equity securities. In fact each of four persons owned 25 percent of such securities, and a correct application would have disclosed that by virtue of the control position of the two unnamed owners registrant and CCC were under common control. However, no correcting amendment was submitted until March 12, 1959. In addition, registrant did not promptly file amendments reporting the election of ten persons to the positions of treasurer, assistant treasurer and assistant secretary between April 17, 1958 and October 11, 1961.

(2) Setion 17(a) of the Exchange Act and Rule 17a–3 thereunder (17 CFR 240.17a–3) by failing to maintain current books and records during a period beginning prior to February 6, 1962 and continuing through May 7, 1962. An inspection by our staff on the earlier date showed that registrant's books had not been properly

[3] Of the gross income as shown by CCC's books of $1,051,061 in 1959 and $1,167,813 in 1960, $666,078 and $761,405, respectively, were attributable to the charges to affiliated companies.

[4] CCC developed a cash deficit in 1962 and a trustee in bankruptcy was appointed shortly thereafter.

closed for six months and no trial balance had been taken during that period, and the general ledger could not be balanced with other records and accounts. These conditions had not been remedied as of the May 7 date.

(3) Section 15(c)(3) of the Exchange Act and Rule 15c3–1 thereunder by effecting securities transactions when its net capital was less than the minimum specified by the rule, such deficiency being $37,038 as of April 30, 1962.

VIOLATIONS BY BECK

Beck willfully violated the cited anti-fraud provisions by making false and misleading representations in the offer and sale of CCT stock. Persons to whom he sold such stock testified that he represented to them that the loan business was profitable, that CCT stock would be an "absolutely secure" investment and "as good as United States Savings Bonds," that there was "no chance to lose," and that the purchasers would be able to sell or cash in their CCT stock after six months or upon six month's notice. In addition, Beck assured such purchasers that they would receive 6 percent on their investment with payments being made every six months, and compared CCT stock with the securities of a company that had increased in price from $10 to $60 per share within 10 years. He also stated that CCT stock would be listed on the American Stock Exchange and that CCT would merge with CCC and that the latter's stock would be listed on an exchange.

Whether or not Beck had any reason to suspect CCC's financial difficulties, there was no reasonable basis for his representations. His assurances of the safety of an investment in CCT stock and of a 6 percent return were directly contrary to statements in the prospectus relating to the offering of that stock that payment of any dividends necessarily would depend upon earnings and other factors and there was no assurance of any dividend payments, that there was no established market in the CCT stock, that the offering price had been arbitrarily determined, that the finance business was competitive, that new finance offices generally operate at a loss for some time, that as a newcomer in that business CCT might operate at a disadvantage vis-a-vis established lending institutions, and that such operations would be of a "speculative nature." Beck is not aided by the fact that principals in registrant told him it would make a market in CCT stock after the comple-

tion of the offering and that CCT would be merged into CCC and the latter's stock would be submitted for listing on the American Stock Exchange.[5] Those statements could not, particularly in view of the adverse factors set forth in the prospectus, furnish an adequate basis for Beck's unqualified representations to customers that they would be able to recoup their full investments and that a listing would be obtained. And Beck's comparison of CCT stock with securities that had increased in price six times within ten years was also clearly unwarranted and fraudulent.

Nor is any excuse afforded by Beck's claim that certain of the customers who testified to his misrepresentations to them realized that CCT was speculative and that dividends were contingent upon earnings. It is irrelevant that customers to whom fraudulent representations are made are aware of the speculative nature of the security they are induced to buy,[6] or do not rely on such representations.[7]

We find that Beck's false and misleading representations, made as part of registrant's selling activities in connection with the CCT offering, constitute in themselves, entirely apart from the other violations by registrant, a willful violation of the anti-fraud provisions requiring revocation of its registration in the public interest. We further find that by virtue of Beck's willful violations he is a cause of such revocation.

We reject Beck's contention that he was denied a fair hearing. He was not, as he claims, prejudiced by the introduction into evidence of certain testimony and exhibits adduced in criminal proceedings against persons associated with CCC. Entirely aside from the propriety of the admission and use of such evidence as a basis for findings on issues to which they were relevant, our findings of willful violations by Beck and our conclusion that he is a

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[5] See *J. P. Howell & Co.*, 43 S.E.C. 325, 328 (1967), where we stated: "The information in a prospectus furnishes a background against which a registrant and its salesmen can test the representations they are making, and those who sell securities by means of misrepresentations inconsistent with the information in the prospectus do so at their peril." See also *Lawrence Securities, Inc.*, 41 S.E.C. 652, 656 (1963); *Underhill Securities Corporation*, 42 S.E.C. 689, 694 (1965).

[6] See *Alfred Miller*, 43 S.E.C. 233, 237 (1966), *aff'd* C.A. 2, Docket No. 31270 (January 4, 1968); *Underhill Securities Corporation, supra*, p. 694.

[7] See *A. T. Brod & Co.*, 43 S.E.C. 289, 291 (1967); *Hamilton Waters & Co., Inc.*, 42 S.E.C. 784, 790 (1965).

cause of registrant's revocation are not based on that evidence.[8] Rather they rest entirely upon the relevant testimony in these proceedings of customer witnesses who were cross-examined by Beck's counsel which was credited by the hearing examiner, and upon the contents of the CCT prospectus which is in our official files.

There was no error in the hearing examiner's denial of Beck's counsel's request to examine prior to the hearings investigative testimony and statements of witnesses theretofore made. It is well settled that such material need not be furnished to respondents until direct examination of such witnesses has been completed.[9] Moreover, the statements were made available on the first day of the hearings before any witnesses were called and in view of the fact that the Division presented its witnesses over a four-day period it is clear that Beck's counsel had ample time to examine these statements before cross-examination.

We also think it was entirely appropriate, despite the argument Beck's counsel makes to the contrary, for the examiner to permit the severance of the proceedings with respect to another respondent who was the subject of a criminal conviction from which an appeal was then pending, and to permit a continuance to avoid the possibility that evidence detrimental to that appeal might be adduced.[10] Moreover, the allegations against Beck were confined to fraud in the offer and sale of CCT stock and there is no basis for his claim that he was forced to assume the burden of defending registrant. In fact, he made no serious attempt to defend registrant against any charge. And the examiner's denial of

[8] The admission of the evidence in question, which we have considered in making the findings against registrant other than those relating to Beck, was in keeping with the generally accepted view favoring liberality in the introduction of evidence in an administrative proceeding. See *Samuel H. Moss, Inc.* v. *F.T.C.*, 148 F.2d 378 (C.A. 2, 1945), *cert. denied*, 326 U.S. 734; see also *Hyun* v. *Landon*, 219 F.2d 404, 408 (C.A. 9, 1955), *aff'd.* 350 U.S. 990. Moreover, it may be noted that the evidence was introduced with the approval of registrant's counsel, with the understanding that the Division would upon request call for cross-examination any person whose testimony was so introduced; and that at the request of Beck's counsel two such persons were thus called and were cross-examined by him. Nor did the fact that in part the evidence constituted hearsay preclude its use in proceedings such as these where it is not weighed by a jury that could be unduly influenced but by a hearing examiner who is legally trained and judicially oriented. See *Clinton Engines Corporation*, 41 S.E.C. 408, 411 (1963), and cases there cited. Under Section 7(c) of the Administrative Procedure Act (now 5 U.S.C. 556(d)), findings may be based on "reliable, probative and substantial" evidence, even if such evidence is inadmissible under technical common law rules of evidence. See 2 Davis, *Administrative Law Treatise*, pp. 303–4 (1958). *Cf. Ellers* v. *Railroad Retirement Board*, 132 F.2d 636, 639 (C.A. 2, 1943); *Marmon* v. *Railroad Retirement Board*, 218 F.2d 716, 717 (C.A. 3, 1955); Montana Power Co. v. F.P.C., 185 F.2d 491, 497–8 (C.A.D.C., 1950), *cert. denied*, 340 U.S. 947. Beck has not specifically objected to the reliability, probative value, or substantiality of any item of the evidence in question.

[9] See *F. S. Johns & Co., Inc.*, 43 S.E.C. 124, 141 (1966), *aff'd* 373 F.2d 107, 110 (C.A. 2, 1967); Morris J. Reiter, 39 S.E.C. 484 (1959) and cases cited at 486, n. 1.

[10] See *Silver* v. *McCamey*, 221 F.2d 873 (C.A.D.C., 1955); *U.S.* v. *Parrott*, 248 F. Supp. 196, 199–202 (D.D.C. 1965).

Beck's subsequent motion for a continuance was justified by the fact that the hearings, which had been scheduled to begin on May 31, 1966, had already been postponed until August 22, 1966. We have also considered Beck's objection to the length of time between the activities in question and the institution of these proceedings on April 2, 1963 and to the time involved in the conduct of these proceedings, and are of the opinion that under all the circumstances no prejudice to Beck has been shown.[11]

PUBLIC INTEREST

We agree with the hearing examiner that registrant's registration as a broker-dealer should be revoked. The violations we have found include extensive fraud in the offer and sale of securities as well as gross indifference to the requirements of the securities laws. In addition, on March 3, 1966 registrant was convicted on charges of violations of anti-fraud provisions of Section 17(a) of the Securities Act and the mail fraud and conspiracy statutes in connection with the offer and sale of securities of CCC, CCT and CMC.[12]

We have found, as did the hearing examiner, that Beck is a cause of registrant's revocation, in that his fraudulent conduct in selling securities on behalf of registrant itself warrants such revocation. The hearing examiner's further conclusion that the cause finding should not operate to prevent Beck's supervised employment in the securities business after four months took into account various mitigative factors urged by Beck including the fact that registrant was Beck's first employer in the securities industry and did not train him properly, that following Beck's disassociation from registrant he received appropriate training from a securities firm which has employed him since August 1962 and there have been no complaints concerning his conduct in that employment, and that Beck cooperated in the criminal prosecution of certain principals of CCC. Beck also states that a sanction would be particularly onerous because he is over 62 years of age and has already suffered materially as a result of these proceedings. The Division has recommended that we sustain the hearing examiner's conclusion. In most cases we would view conduct such as we have

[11] *Cf. Irish* v. *S.E.C.*, 367 F.2d 637, 639 (C.A. 9, 1966), *cert. denied*, 386 U.S. 911; *Costello* v. *U.S.* 365 U.S. 265, 281–284 (1961).

[12] Registrant also was the subject of earlier disciplinary proceedings. The Division of Securities of Ohio suspended registrant's license as a securities dealer on March 26, 1962 on the basis of a finding of failure to maintain satisfactory books and records, and revoked such license on September 10, 1962 after finding that registrant's net worth was inadequate. In 1963 registrant was expelled from the National Association of Securities Dealers, Inc. on the basis of findings of refusal to honor contracts, violation of Regulation T, and failure to keep proper books and records and to exercise appropriate supervision over its registered representatives. See Securities Exchange Act Release No. 7322 (May 22, 1964).

found Beck engaged in as requiring in the public interest a longer exclusion from the securities business, and we cannot agree with Beck that the factors cited by him warrant greater leniency[13] Upon careful consideration of all the circumstances, however, we are of the opinion that it is appropriate in this case to accept the conclusion of the hearing examiner, as recommended by the Division.

An appropriate order will issue.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT and SMITH).

[13] Beck is not correct in his assertion that the sanction is more severe than in comparable cases. Moreover, as we stated in *Martin A. Fleishman*, 43 S.E.C. 185, 190 (1966), "the remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other areas."

There is also no merit in Beck's further contention that the sanction in these proceedings is penal rather than remedial in nature. See, *e.g.*, *Associated Securities Corp.* v. *S.E.C.* 283 F.2d 773, 775 (C.A. 10, 1960); *Pierce* v. *S.E.C.*, 239 F.2d 160, 163 (C.A. 9, 1956); *Norman Pollisky*, 43 S.E.C. 458, 459 (1967).