IN THE MATTERS OF

HAIGHT & COMPANY, INC. ET AL.*

File No. 3-533. Promulgated February 19, 1971

Securities Exchange Act of 1934—Section 15(b), 15A and 19(a)(3)

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Action

Fraud in Offer and Sale of Securities

Sale of Unregistered Securities

Falsification of Records

Failure to Amend Application for Broker-Dealer Registration

Failure to Transmit Proceeds of Offering Promptly

*A. Dana Hodgon; James F. Haight; Burton Kitain; W. Lyles Carr, Jr.; David M. Adam, Jr.; James W. Harper III; Homer E. Davis; Robert F. Kibler; Louis S. Amann; Harvey A. Baskin.

Where registered broker-dealer and associated persons represented themselves to be financial planning experts who would choose the best securities for their clients but, contrary to such representation, substantially limited their recommendations to securities yielding respondents greatest profits, made false and misleading representations in sale of various securities, sold unregistered securities, and falsified certain of registrant's records; and where registrant failed to amend application for broker-dealer registration to disclose election of certain officers and directors, and, while acting as underwriter, failed to transmit promptly to issuer proceeds of sale of issuer's stock, *held*, willful violations of securities acts, and in public interest to revoke registration of broker-dealer, expel it from memberhip in national securities exchange and registered securities association, and bar associated persons who participated in such violations from association with any broker-dealer.

Practice and Procedure

Respondents' contentions that, among other things, discussion of certain of their activities in Commission's Special Study report evidenced prejudgment, that Commission improperly refused to make proceedings private, that Commission staff suppressed evidence favorable to their defense, that they were prejudiced because of sweeping nature of allegations against them, that institution of proceedings was unduly delayed, and that hearing examiner's initial decision did not comply with Administrative Procedure Act, *rejected.*

APPEARANCES:

Alexander J. Brown, Jr., William R. Schief, Paul F. Leonard,

Harold Webb, Wallace L. Timmeny, and *Charles McCarthy, Jr.,* for the Division of Trading and Markets of the Commission.

Sidney Dickstein and *David I. Shapiro,* of Dickstein, Shapiro & Galligan, and *Harry Heller,* of Simpson Thacher & Bartlett, for Haight & Co., Inc., James F. Haight, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper III, Burton Kitain, Homer E. Davis and Robert F. Kibler.

Harold P. Green, Richard Schifter, and *David E. Birenbaum,* of Strasser, Spiegelberg, Fried, Frank & Kampelman, for A. Dana Hodgdon.

Louis E. Shomette, Jr., of Shafer, Shomette & Stanhagen, for Louis S. Amann.

Robert B. Hirsch and *Allen G. Siegel,* of Arent, Fox, Kintner, Plotkin & Kahn, for Harvey A. Baskin.

FINDINGS AND OPINION OF THE COMMISSION

Following extensive hearings in these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that Haight & Co., Inc. ("registrant"), a registered broker-dealer which operated under the name Hodgdon & Co., Inc. during the relevant period, should be suspended from membership on the Philadelphia-Baltimore-Washington Stock Exchange ("PBW") and in the National Association of Securities Dealers, Inc. ("NASD") for four months, and that A. Dana Hodgdon, who was president of registrant, James F. Haight, his successor as president, and David M. Adam, Jr. and James W. Harper III, vice-presidents, sould be barred from association with any broker or dealer. He further concluded that certain lesser sanctions should be imposed upon Louis S. Amann, who was a vice-president of registrant, W. Lyles Carr, Jr., treasurer, Burton Kitain, secretary, Harvey A. Baskin, who was Hodgdon's assistant, and Homer E. Davis and Robert F. Kibler salesmen. We granted petitions for review filed by respondents and our Division of Trading and Markets ("Division") as to certain issues, and, pursuant to Rule 17(c) of our Rules of Practice, ordered review of the examiner's decision with respect to all other issues which were before him concerning respondents.[1] Respondents and the Division filed briefs

[1] Thus, contrary to respondents' contention, the Division was free to object to findings and conclusions in the initial decision although not excepted to in its petition for review.

and we heard oral argument. Our findings are based upon an independent review of the record.

FRAUD IN SECURITIES TRANSACTIONS

1. Scheme to Defraud "Financial Planning" Clients

Between May 1960 and June 1964, registrant, together with or willfully aided and abetted by Hodgdon, Haight, Carr, Adam, Harper, Kitain, Davis and Kibler, engaged in a scheme to defraud customers who utilized registrant's financial planning services in the purchase and sale of securities, in willful violation of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b–5 and 15c1–2 thereunder. The record shows that the gist of the scheme was respondents' holding themselves out as financial planners who would exercise their talents to make the best choices for their clients from all available securities, when in fact their efforts were directed at liquidating clients' portfolios and utilizing the proceeds and their clients' other assets to purchase securities which would yield respondents the greatest profits, in some instances in complete disregard of their clients' stated investment objectives. This scheme was implemented by, among other things, registrant's advertising and by its training course for salesmen.

a. Advertising and Sales Training and Instructions

During the period in question, frequent advertisements extolling the virtues of registrant's financial planning services and obviously designed to attract unsophisticated investors were broadcast over a local radio station. Representative advertisements, prepared by public relations counsel with Hodgdon's assistance, were:

> "We would like to issue a special invitation to *new investors* . . . [W]hen you talk with a Hodgdon & Company representative about investments, your eyes will really be opened to a fascinating field of financial opportunities—for long range gain, immediate gain—whatever best suits your individual needs."
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> "[Y]ou'll be welcomed by a counsellor who is an expert in financial planning in the field of securities . . . a man to . . . trust implicitly."
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> "Hodgdon and Company has . . . a research staff that has thoroughly and competently analyzed the probable course of the market."
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> "With proper strategy . . . you [can be guided] to a life of financial security."
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> "Trained investment analysts are on hand to go over your present portfolio and make worthwhile suggestions."
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> "Registered representatives at Hodgdon are always alert for new opportunities for investment, while never foretting long-established stocks, bonds, mutual funds ad the like. In short, a balance is maintained between the new and the tried-and-true."
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> "Call in an investment expert, one of the many informed specialists at Hodgdon and Company."
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> "It is entirely probable that [the next twelve months] could bring

prosperity . . . if you take the counsel that is available to you—free of charge." [2]

In fact, registrant had no research staff, and its "expert counsellors in financial planning" included inexperienced salesmen who, after about a year's employment at registrant, were allowed to formulate financial plans for clients without supervision. Haight admitted that registrant's so-called "Specialists" in various fields had "something less than expert or professional knowledge," [3] and, as discussed below, registrant largely ignored "long-established" stocks and bonds.

Registrant conducted its training course for new salesmen largely through Haight who, as a vice-president and later executive vice-president, was in charge of training and sales. Salesmen were instructed to tell prospects about registrant's "unique" financial planning service under which securities would be purchased in proportions designed to meet the clients' objectives, with about 50 percent of their funds being placed in mutual fund shares, 30 percent in a middle category lumping "blue chips" and real estate securities, and 20 percent in speculations and/or "special situations." [4]

Despite registrant's emphasis on the availability of all types of securities and the respresentation that high-grade securities or "blue-chips" would be included in the middle category of clients' investments, recommendations of listed securities were infrequent. Instead, registrant stressed securities on which it and the salesmen could make more money, i.e., mutual fund shares and underwritten offerings on which high commissions are charged, and unlisted securities, particularly those in registrant's inventory, that could be sold at a markup.[5] Registrant's policy was reflected in a January 1961 memorandum from Haight and Carr, who was then senior vice-president,

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[2] Registrant's radio advertising also suggested that listeners request a copy of its brochure, "Action Makes the Difference," which was written by Hodgdon and used by the firm's sales staff in soliciting new clients. The brochure stated, among other things, that "the 'haves' hold wealth in the form of stocks, real estate and oil, the 'have-nots' . . . in the form of insurance savings, Government Bonds, and deposits in lending institutions," and that financial counselling could help the "have-nots" become "haves" and "provide [the best] financial blueprint for the future."

[3] Several salesmen testified that they did not find the "specialists" who were supposed to assist them in their dealings with clients to be particularly knowledgeable or helpful, and stopped using them.

[4] "Special situations" referred to companies assertedly having a special potential for growth such as a patent or a new process. Carr and Kitain both testified that a "special situation" involved high risk.

[5] Hodgdon testified that registrant's salesmen had only minor activity in listed securities because they were "not attuned to trading back and forth in this type of thing." Carr instructed salesmen to tell prospective clients that registrant handled stocks on "all the Exchanges," but stated to the salesmen that he very seldom recommended blue chip or listed stocks since investors "became discouraged and didn't understand" if the stocks failed to appreciate in value. He told the salesmen that "professionals" (apparently referring to mutual funds) could pick a blue chip stock better than they, and that in recommending securities they should consider the commission to be earned.

secretary and a substantial stockholder, to the other officers of the firm. It recommended that the salesmen be told occasionally what "blue chip" securities investment companies were buying and selling or registrant was recommending so that in "initial" conversations with prospects the salesmen could "discuss" them and thereby show that the firm did not deal in only "high commission situations," but stated that a great deal of listed securities would probably not be sold because of low commissions and greater emphasis on other situations. The lumping of real estate securities, a high percentage of which were underwritten by registrant, with blue chips was, as the examiner found, improper and designed to encourage the inference that such securities were of the same high quality as blue chips.

Various requirements and inducements were created by registrant to make salesmen produce a volume of transactions that would earn a high return. Salesmen were instructed to try to obtain clients who would follow the investment programs suggested by registrant, and were told to make at least 40 telephone calls daily to develop new clients, using lists of names obtained from telephone directories or elsewhere, and to conduct at least two interviews a day. Each salesman who had been with the firm for a year or longer was required either to sell $18,000 in mutual fund shares or the equivalent each month, or five mutual fund contractual plans in each two-month period, or to earn commissions netting him $600 per month from sales of securities designated as "high quality" by registrant, which included most of registrant's underwritings and securities in its inventory.[6] Failure to meet these quotas was ground for and did occasion dismissal. Salesmen were issued lists of "preferred" mutual funds, all of which gave registrant reciprocal business, and registrant paid bonuses semi-annually for sales of $30,000 or more of the shares of those funds. The fund which was most stressed, and most recommended and sold, was Aberdeen Fund of whose distributor Hodgdon was a director and stockholder until sometime in 1963.[7] When registrant engaged in an underwriting, salesmen were asked to indicate the amount of the issue they thought they could sell, and pressure was applied if they failed to

[6] The salesmen's compensation from registrant was based solely on their sales.

[7] The Aberdeen Fund shares were sold either on a contractual plan with a front-end load, or on a lump sum basis.

dispose of the indicated quantity.[8] At weekly staff meetings, salesmen were given a list of securities in inventory, the number of shares registrant wished the salesmen to sell, and the commissions for selling them. If the firm's position in a security became larger than desirable, the sales commission was increased.

Registrant's sales staff was taught by Haight, Carr, Hodgdon and others to utilize a variety of high pressure and fraudulent tactics to obtain financial planning clients and then induce them to convert their assets, including their portfolios, into securities yielding respondents high profits. For example, Haight told salesmen to appeal to the prospect's fears[9] and greed, to give clients only such facts as were necessary to support a sales presentation, and to dominate the interview, dramatize the facts, appeal to the client's sense of prestige,[10] create a sense of urgency, and attempt to make each sale worth more. Another instructor taught the salesmen always to assume a sale when attempting to make one, and to use the "physical action close" in selling mutual funds, which meant to start filling out the application form in front of the client before he had expressed a willingness to buy.

Carr suggested to the salesmen various reasons that could be given to clients to induce them to sell their portfolio securities so as to free funds or investment in securities recommended by registrant. He told salesmen to recommend securities in an area where registrant had something to sell, or try to sell the client whatever was "easiest ." He taught that, in selling, emotion was more important than logic, and that, "An ounce of enthusiasm at the proper time is worth a pound of knowledge." [11] He suggested that if a customer wanted to read a prospectus the salesman should make him buy first by stating that the order could be cancelled later, since once a person owned a stock he read the prospectus differently. However, if the customer later did decide to cancel, Carr told

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[8] Hodgdon had a proprietary interest in several of registrant's underwritings. He told one salesman, who did not want to sell one of such underwritings because he considered it "an extremely high risk," that his cooperation on the underwriting was "vital to the interests of the firm" and that he was expected to do his part.

[9] Among other things, salesmen were told to stress the impact of inflation on savings and to dramatize the need for higher returns by citing "statistics" such as "54 men out of every 100 are living on friends, relatives and charity" and "50 percent of all Connecticut doctors who died in the last 10 years died bankrupt."

[10] One of registrant's instructors suggested that, in the sale of a gas and oil security, clients be told that they were being offered the opportunity of associating with the extremely wealthy in offsetting income and reducing tax obligations.

[11] Carr told the salesmen they should "hit [the] 'hot button' ", which he defined as stressing the objective "dearest to [a client's] heart."

the salesman to say, "What cancel! You should have doubled your order."

Another asset of customers stressed in salesmen's training as a source of money for securities purchases was the life insurance policy. The salesmen were instructed by registrant's insurance "specialist," with whom they were required to consult before recommending to clients any changes in their insurance holdings, to "Get [the client's] cash first, then go after insurance, our only purpose in discussing insurance is to free more monies." This instruction stands in stark contrast to the statement in registrant's financial planning brochure that the firm's "insurance counselling service" was "the most important opportunity we can offer the average person who has only seen his protection program from the point of view of the life insurance salesman who sold it to him." In connection with one of registrant's underwritings, Carr told the sales staff to "find the easiest money first, such as savings and loan money [and the] cash value of life insurance policies."

b. Transactions with Clients

We now discuss the manner in which registrant's salesmen, as well as officers, applied the fraudulent techniques described above in their dealings with financial planning clients.

Adam

Adam, who joined registrant as a salesman in 1960, became a "group manager" in 1962, supervising about five salesmen, and in 1963 was appointed an assistant vice-president.

Dr. G, an anaesthesiologist, became a financial planning client of Adam in August 1960. At that time she owned listed securities worth about $30,000 and had a life insurance annuity purchased for $40,000 and $7,000 in cash. In December 1960, at Adam's request, Dr. G gave him discretionary authority over her account, because, according to Adam, she had a "complete lack of knowledge of investments and Financial Planning." At his suggestion, she deposited all dividend checks in her account with registrant for reinvestment as Adam saw fit.

In January 1963 and March 1964, Adam sent to Dr. G analyses of her account under his stewardship. The 1963 report showed a net loss of about $200 on purchases effected up to that time which was attributed to a severe market decline in 1962, but congratulated Dr. G on the overall performance to date. It concluded, "as we continue to work together over the years, we are planning to double the amount of invested

capital." The 1964 report showed there had been a profit of about $7,000;[12] and, in an accompanying letter, Adam wrote, "During the next 5–10 years your net worth could easily amount to $120,000 minimum rather than the present $75,000. Let's keep it up." However, neither report took into account or mentioned Dr. G's total loss in 1962 of her $11,000 investment in a speculative security purchased at Adam's suggestion.

During the relevant period, Adam caused Dr. G to sell her entire portfolio of listed securities and cash in her annuity, and to purchase securities with the proceeds. Her total purchases consisted of about $30,000 in Aberdeen and another mutual fund, $12,500 in highly speculative gas and oil programs, and about $50,000 in other securities,[13] almost all of which were new issues that registrant was underwriting or for which it was acting as a member of the selling group, and stocks which registrant sold as principal at a markup.

Capt. S had a portfolio of individual securities valued at $45,567, in addition to shares in two mutual funds, when he became a financial planning client of Adam in 1960. Acting entirely on Adam's advice, Capt. S sold all but about $1,600 worth of his original portfolio aside from the mutual fund shares to buy other securities recommended by Adam, cashed in two life insurance policies to buy into one of registrant's real estate syndications, and obtained three bank loans totaling $12,400 to finance other securities purchases. Of a total of around $71,000 in securities purchased on Adam's recommendations, $61,000 represented securities sold by registrant as underwriter or principal.[14] In September 1962, Adam sent Capt. S a progress report which showed losses in every category of investment except in the two mutual funds in his original portfolio. Adam nevertheless wrote, "You must be complimented on your successful accumulation of wealth over the years. This success places you within the top 4% of all individuals in the country!"

Harper

Harper joined registrant as a salesman about the end of

[12] In a note, the report stated that the client's purchases of gas and oil programs for $7,000 in 1963 and 1964 were not reflected, but no indication was given of the value of those securities.

[13] These figures represent total purchases, including purchases paid for with proceeds of the sale of other securities purchased during the period. This is also the case with respect to the purchases in a number of other customer accounts described below.

[14] In November 1961, Capt. S purchased additional shares of a speculative security, which he had previously purchased at Adam's suggestion at a higher price, on Adam's recommendation that he should average down his cost per share, Adam representing that he had received word that the stock "was still a good buy." On the same day, however, Adam had advised Dr. G to sell the same security, in part because of adverse information he had received concerning the company.

1960. In about 1962, he was designated a "specialist" in the gas and oil programs offered by registrant to investors and he lectured to trainees in that area. He was appointed an assistant vice-president of registrant in 1963.

In about April 1961, Mrs. D, a divorcee with a dependent son, became a financial planning client of Harper. At that time she had a portfolio of high grade securities worth about $200,000 which she had acquired through inheritance and gifts. Her yearly income consisted of about $7,500 from her securities, and $2,400 in alimony which she told Harper she was fearful of losing and which she needed "to sustain herself." She also told Harper that she would like to increase the income from her portfolio but that any changes were to be into safeand well-seasoned stocks. As Harper was aware, Mrs. D was a wholly unsophisticated investor. He told her that registrant specialized in "estate planning," and that she need not be concerned about stocks and bonds since she would have "expert advice." In August 1961, at a time when Mrs. D had already followed Harper's recommendations in selling about $25,000 worth of her portfolio and purchasing about the same amount of securities with the proceeds, Harper suggested a plan which involved the sale of a large additional portion of her portfolio. He told her that the securities to be sold had low yields and were overpriced and that she should move into "less risky" investments. Mrs. D agreed to the plan with with Harper's assurance that his suggested changes made her position more secure.[15] Mrs. D was forced to use proceeds from the sale of securities to pay the capital gains tax with respect to the portfolio securities she sold in 1961. The written financial plan which Harper submitted to her in October of that year placed in the "high grade" investment category registrant's unseasoned real estate syndications which Harper had sold her.

At the end of September 1962, Mrs. D wrote to Harper that her primary reason for making such drastic changes in her portfolio had been additional income, and yet her 1962 income to date, $5,194, had been only $168 more than for the comparable period in 1961. Harper replied that she was much "better off" than $168 and that he still stood by "our projection of $15,000 to $18,000 income by 1964."

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[15] Harper wrote to Mrs. D that if she were willing to take risks, he could assure her of $1 million but "we are now keeping you comfortable and moving you towards the $500,000—$750,000 level . . . You are 50 percent better off today than you were [six days earlier] . . . G.M. and Merck could now collapse and you would not be hurt."

During the relevant period, Mrs. D, upon Harper's recommendation, sold more than $122,000 worth of securities from her original portfolio. On his advice she effected purchases of $20,000 in Aberdeen, $2,200 in another mutual fund, about $14,600 in a highly speculative gas and oil program, and about $87,000 in other securities, more than $82,000 of which registrant sold as under writer, selling group member or principal. Of the latter amount, about $69,000 was placed in new issues which registrant was underwriting or for which it was acting as selling group member, notwithstanding her pleas for well-seasoned and safe investments.

Harper told Mrs. M, an inexperienced investor whose goal was retirement income, that she should consider him like a doctor who would be able to diagnose her financial potential. She testified that she relied on Harper and usually followed his recommendations. Although Mrs. M stressed her desire for liquidity, Harper recommended and sold to her limited partnership interests in various real estate syndications which registrant was underwriting, assuring her that, in the event of an emergency, she could get her money out in a relatively short time. However, registrant only maintained "work-out" markets for such securities in which an investor could not dispose of them unless there were a buyer available. When some of the syndications ran into difficulties, registrant was unable to find buyers for all those who wished to sell. After the distributions were reduced on two of the syndications purchased by Mrs. M, she expressed a desire to dispose of them but Harper dissuaded her from attempting to do so. He called her several times before persuading her to buy another security which was highly speculative and about which Mrs. M felt "very insecure," representing to her that she could probably double her money in two or three years. Mr. M's total purchases through Harper amounted to about $27,700. Mutual fund shares accounted for about $2,500 of this amount, and new issues which registrant was underwriting and securities sold by registrant as principal accounted for nearly all of the remainder.

In progress reports to another client, Dr. B, Harper placed Dr. B's investments in registrant's real estate syndications in the "high grade" category along with the client's mutual fund holdings, and in one such report placed a gas and oil program which he had sold Dr. B into that category. On Harper's recommendations, Dr. B sold securities initially held by him for about $19,000, and thereafter effected purchases of about

$26,000 in gas and oil programs, $11,000 in mutual funds and $73,000 in other securities, of which latter amount about $50,000 represented securities underwritten by registrant or sold as principal.

Kitain

Kitain joined a registrant in 1959. In the following year he was appointed manager of a new suburban branch office, and in 1963 became an assistant vice-president.

Mrs. Y became a financial planning client of Kitain early in 1961. At that time she had a diversified portfolio of high grade stocks and bonds valued at between $90,000 and $100,000, the management of which until then had been entrusted to relatives who paid her a quarterly allowance from the dividends and reinvested the remainder. She felt that her portfolio was not being given enough attention, and wanted "closer consultation" with a knowledgeable adviser since she herself was "ill informed" as to investments. Kitain told her that many of her stocks were of doubtful quality, that her portfolio was too conservatively invested for someone who was not dependent on the income, and that she should sell the bulk of it and divide $50,000 of the proceeds equally between Aberdeen and another mutual fund which were more growth oriented. In partial fulfillment of Kitain's plan, Mrs. Y sold more than $30,000 of her portfolio and invested $30,000 in the two mutual funds. She was not told that the mutual fund purchases entailed commission costs substantially higher than those charged on the purchase of listed securities, nor was she advised of the large tax liability on the profits she would realize from the sale of her portfolio stocks.

Mr. R was a foreign service officer, married and with three small children. He had an annual salary of $10,000, a mortgaged home, $4,500 in cash and Government bonds, and small holdings of three listed securities. He told Kitain that his objectives were to provide for the college education of his children and to supplement his retirement income. Although Mr. R had been successful with one speculation and was interested in similar opportunities, he told Kitain that "generally speaking" he wished to continue buying safe growth stocks like those he already held. However, Kitain discouraged Mr. R from purchasing listed securities, recommending instead that he buy Aberdeen and another mutual fund. He also told Mr. R that he could afford to speculate, and that it would be possible to convert his life insurance policies to lower-cost insurance which would give the necessary protection and still

free capital to invest in speculative situations. Mr. R converted certain insurance policies and borrowed on others, investing at least part of the proceeds in securities, including two of a speculative nature recommended by Kitain. He also on Kitain's advice made bank borrowings to effect securities purchases.

Mrs. A, another financial planning client of Kitain with a very limited knowledge of securities, had prior to purchasing $15,000 worth of Aberdeen Fund shares pursuant to his recommendation complained that withdrawal of that amount from her savings and loan account would mean a yearly loss of about $600 in interest. Kitain advised that she could make quarterly withdrawals of $125 from her Aberdeen shares which would be covered by the fund's dividends. In fact, those dividends only partially covered the withdrawals and when Mrs. A discovered, after three withdrawals, that she was consuming principal, she stopped the withdrawals. As of the date of her last withdrawal, the price per share was slightly lower than it had been at the time of her purchase. Kitain recommended and sold one speculative stock to Mrs. A on the representation that it was a better investment than the stock of another company in the same industry that had had a rapid rise in value. When the market price of the stock dropped she asked Kitain what was wrong and he replied, according to his testimony, that his firm was "not concerned" and a number of clients who had not had an opportunity to purchase the security could now purchase it at the lower price. Of the $34,500 worth of securities in addition to Aberdeen that Mrs. A purchased through Kitain, all but about $6,000 represented new issues sold by registrant as underwriter or selling group member and securities which it sold as principal.

Davis

Davis joined registrant as a salesman in 1957. Mr. and Mrs. M, who were inexperienced investors with investment objectives of long-term growth with a view to future financial independence, became financial planning clients of Davis early in 1960. Davis explained the concept of financial planning to them and told them that they "would have to have complete confidence in him [and] confide in him totally," and that with his expert help and that of registrant's staff of experts, the proper type of investments would be made for them. He recommended mutual funds and also told the M's they could afford to buy speculative issues, stating that he did not know of anyone who ever got rich on blue chips because such stocks

just varied a few points, and that the speculative securities he recommended would be "the blue chips of tomorrow."

In recommendng investments to the M's, Davis represented that they would make great profits, generally within a specified time. He stated, for example, that one speculative security would double in value in about two years and that another security being issued at $4 would rise 1 to 3 points. As a rule, the M's did not receive a prospectus on new issues which they purchased until they got their confirmations, and relied on Davis' representations. On one occasion, however, Mr. M insisted on seeing a prospectus before purchasing a speculative issue Davis was recommending. Davis reluctantly agreed, stating "I will send it, but don't pay attention to it. It will not reflect what the situation truly is." When Mr. M read the prospectus and told Davis that the stock looked "dreadful," Davis replied that he should ignore the prospectus, that prospectuses always painted a very bleak picture and that if people based their investment decisions on them "no one would ever put a cent into anything."

Davis and registrant's insurance "specialist" also advised the M's to cash in their life insurance and purchase lower-cost term insurance, telling them that they would be notified when, with proper investments, they had become self-insured, at which point they could cancel their term insurance as well. The M's followed the advice, purchasing term insurance through registrant's specialist, and investing the proceeds obtained by surrendering their original policies in securities which Davis recommended. Again acting on Davis' advice, they borrowed $5,200 for investment in two of registrant's real estate syndications and abandoned their original intention of purchasing a farm, Davis telling them that they were better off investing in things that "would be making [them] money." Apart from two purchases of listed securities initiated by the M's, virtually all of their total securities purchases of $22,574 effected upon Davis' recommendation represented mutual funds, new issues underwritten by registrant, and securities which registrant sold as principal.

Davis had discretionary authority with respect to the financial planning account of Cdr. C, a naval aviator stationed overseas. Consistent with respondents' scheme, of total purchases of $14,981 in that account, $13,256 represented new issues of which registrant was the underwriter and secuities which it sold as principal.

Kibler

Kibler joined registrant as a salesman in 1960. Mrs. S, an elderly widow with a portfolio consisting largely of listed securities having a value of about $50,000, became his client in 1962. Her stated objectives were greater income and safety, which, according to Kibler and as he advised her, were to be achieved by raising portfolio quality through elimination of weaker issues, increasing the efficiency of management by reducing the number of securities held, and placing the proceeds of sales in "high quality, diversified, and professionally managed investments." Acting on Kibler's advice, Mrs. S sold more than half of her portfolio and invested about $12,500 in mutual fund shares and $19,500 in other securities, of which all but one small purchase were new issue which registrant was underwriting and securities which it sold as principal.

Dr. J, a federally-employed veterinarian, had a portfolio consisting of $7,000 invested in Government bonds and about $18,000 in high-grade securities. The financial plan which Kibler prepared for him specified a minimum financial goal of $87,000 to be accumulated by age 65, and safety as one objective. It recommended, among other things, that the Government bonds be sold, and that Dr. J's life insurance policies be converted to decreasing term insurance "to increase death protection coverage during period of growth of investment program." Among other things, Kibler told Dr. J that registrant's real estate syndications which he recommended would be "easily marketable," and that this Commission required that prospectuses "not be particularly glowing" and "play down the future or well being" of the company whose securities were being offered. Dr. J sold his Government bonds and other securities and reinvested the proceeds pursuant to Kibler's recommendations. During the relevant period, apart from the replacement of a few of the listed securities in his portfolio with other listed securities, Dr. J invested about $25,500 in mutual fund shares, new issues which registrant was underwriting, and stocks which registrant sold as principal.

Hodgdon

Mrs. W, who lacked investment experience, owned securities in a custodial account managed by a bank. She told Hodgdon that she was dissatisfied with the income from that account and, at his suggestion, transferred a substantial amount of municipal bonds from the bank to her account with registrant so that Hodgdon could sell them and reinvest the proceeds.

During the relevant period, Mrs. W, acting on Hodgdon's recommendation, sold about $33,000 worth of municipal bonds and purchased $35,000 worth of other securities, of which $30,000 was invested in two speculative new stock issues that registrant was underwriting, and the remainder in stocks which registrant sold as principal. The yield on the securities purchased at Hodgdon's recommendation was "a good deal less" than she had been receving before transferring the bonds from her custodial account.

Haight

Miss T, an elderly woman with a high-grade diversified securities portfolio worth about $62,000, became a financial planning client of Haight in 1960. She told him she wanted increased income for her impending retirement. The financial plan which Haight prepared recommended, among other things, that 50 percent of Miss T's investment capital be placed in Aberdeen and another fund, 35 percent in individual securities and real estate "all having outstanding quality characteristics," [16] and 15 percent in "special situations and/or intelligent speculations." He told Miss T that "investment companies were safer than having everything in stocks." Miss T sold about $28,000 worth of securities from her original portfolio. She purchased shares of Aberdeen and another mutual fund totaling $17,000, and other securities totaling $55,500, of which all but about $700 represented new issues being underwritten by registrant and securities sold by registrant as principal.

Miss B, also an elderly woman, witha portfolio of high-grade securities worth $120,500, sold mainly on Haight's advice over $52,000 worth of that portfolio. On his recommendation, she purchased shares of Aberdeen and another mutual fund totaling $20,000, and other securities totaling about $54,000, over $48,000 of which represented new issues which registrant was underwriting and securities which registrant sold as principal.

Carr

In 1961, Col. F, who was stationed overseas and had limited means, gave Carr discretionary authority over his financial planning account. All of the 10 stocks in his portfolio were sold for about $7,800 and replaced with securities selected by Carr which, except for one minor purchase, consisted of Aberdeen

[16] In his testimony, Haight attempted to make a distinction between the "real estate" referred to in the financial plan and the limited partnership interests in registrant's real estate syndications which he sold to Miss T, and took the position that his characterization of "outstanding quality characteristics" applied to the real estate, not to the security interests in such real estate. We find this distinction unacceptable.

shares and five new issues registrant was underwriting. Although all the securities purchased declined in value, Carr in 1962 advised their retention and suggested additional securities purchases before the market rose again. In 1963, after a further decline, Carr stated that the outlook for those securities was still hopeful and that he did not recommend any change. He also suggested that the client borrow on his life insurance to make an investment in a real estate syndication, but this advice was not followed. On Carr's recommendations to another client, Gen. A, certain stocks in his portfolio were sold, and he invested $2,500 in Aberdeen, and more than $33,000 in other securities consisting of new issues underwritten by registrant and stocks which it sold as principal.

Other Salesmen

Testimony was received with respect to two other financial planning accounts serviced by non-respondent salesmen which exhibited characteristics similar to those already described. In both accounts the customers were induced, by representations that they would fare much better, to sell securities they owned, worth about $40,000 and $19,000, respectively, and in one instance including mutual fund shares, and to buy other mutual fund shares and securities being underwritten or sold as principal by registrant.

c. Conclusions

It is abundantly clear from this record that under the guise of comprehensive "financial planning" encompassing the purchase of varied securities, including listed securities, the above respondents induced customers, who were generally inexperienced and unsophisiticated, to believe that their best interests would be served by following the investment program designed for them by respondents. In fact, such programs were designed to sell securities that would provide the greatest gain to respondents, rather than to promote the customers' interests; indeed, in some instances, the recommendations were directly contrary to the customers' expressed investment needs and objectives. Moreover, various representations were made to clients to lull them into a feeling of security or to believe that their complaints were unjustified, and thereby sustain their confidence for further recommendations. Such conduct was

clearly contrary to the basic obligation of professionals in the securities business to deal fairly with the investing public.[17]

Respondents contend that they did not engage in a scheme to defraud since the evidence does not establish any "agreement" to defraud clients, but, at most, non-fraudulent parallel action. Hodgdon in addition contends that mutual fund sales, which were required by registrant's financial planning approach, may not be treated as "self-enriching" recommendations for purposes of determining whether a scheme to defraud existed, and he and other respondents argue that it is not possible to derive any pattern or draw any inferences from the "handful of cases" considered by the examiner.

There is no merit in these contentions. No express "agreement" is necessary to establish the existence of a scheme to defraud. It is enough that each of the individual respondents knowingly joined or participated in a common undertaking that he knew or should have known was fraudulent.[18] As we have seen, registrant conducted training programs and staff meetings where instruction was given in the sales techniques which we have described and which were used by respondents to obtain clients and induce them to purchase certain types of securities. Since, as we have concluded, these sales techniques were designed and operated to defraud clients, it is clear that registrant and the individual respondents engaged in a scheme to defraud investors. The fact that mutual fund share may be considered a desirable investment does not militate against our conclusion that such shares, as well as other securities, were recommended to clients for the primary purpose of obtaining greater compensation for respondents, which was the gist of the scheme we have found. Nor is the finding of a scheme to defraud precluded because of the absence of evidence as to respondents' transactions with clients who were not called as witnesses, with respect to which transactions respondents assert they were misled into not adducing evidence. Such evidence would not have derogated from the pattern of conduct that was established not merely by the

[17] See *Mac Robbins & Co., Inc.*, 41 S.E.C. 116, 117-19 (1962), *aff'd sub nom. Berko* v. *S.E.C.*, 316 F.2d 137 (C.A. 2, 1963); *J. Logan & Co.*, 41 S.E.C. 88, 98 (1962). See also *Richard N. Cea*, 44 S.E.C. 8, 18, (1969): "Although the customers described their financial situations and objectives to these respondent salesmen, the salesmen recommended purchases of securities that were far from commensurate with the investment objectives disclosed by such customers. It was incumbent on the salesmen in these circumstances, as part of their basic obligation to deal fairly with the investing public, to make only such recommendations as they had reasonable grounds to believe met the customers' expressed needs and objectives."

[18] See *Blue* v. *U.S.*, 138 F.2d 351, 358, 360 (C.A. 6, 1943), *cert. denied* 322 U.S. 736; *Oliver* v. *U.S.*, 121 F.2d 245, 249 (C.A. 10, 1941), *cert. denied* 314 U.S. 66.

testimony of the clients who were called as witnesses by the staff, but also by registrant's entire method of operation including its training program. We do not hold that the "cold calls" to prospects and the obtaining of financial information from them were fraudulent *per se*, and do not interpret the examiner as so holding, as respondents contend he did, but that these were merely elements in the overall fraudulent scheme.

Hodgdon's assertion that there is "a paucity of evidence" implicating him in the fraudulent scheme is particularly untenable. He was in active charge of registrant's business, held weekly officers' meetings at which every aspect of running the firm was discussed, and instituted the "financial planning" program. He assisted in preparing the firm's fraudulent radio advertising, wrote its financial planning brochure, a blatant "come-on" for the unsophisticated investor, and participated in registrant's training program. He attended the firm's staff meetings at which particular securities were recommended to the salesmen for sale to clients and the firm's underwritings, which he selected, were described to the salesmen and their indications of interest taken. Although the radio advertising stated that registrant, while alert for new opportunities, never forgot "long-established stocks," and registrant's ratio system placed blue chips in the middle category of the financial plans drawn up for its clients, he fostered a negative attitude towards recommendations of listed securities. Finally, he treated Mrs. W's financial planning account in the same manner as registrant's salesmen were trained to deal with their clients' accounts, causing her to sell high-grade securities from her portfolio and reinvest the bulk of the proceeds in new and speculative issues that registrant was underwriting. We think it evident that Hodgdon was not only fully cognizant of but directed the fraudulent scheme we have found here.

Finally, respondents contend that the hearing examiner applied improper standards in determining that their securities recommendations to clients were unsuitable. This contention reflects a misapprehension of the examiner's decision. Neither the examiner's conclusions, nor our own, as is evident from the foregoing discussion, rest on a determination that the securities recommended and sold were "unsuitable."

We discuss now materially false and misleading statements made by various respondents in the offer and sale of particular securities.

2. Fraudulent Representations in Sale of Securities

a. Van-Pak, Inc.

Van-Pak, Inc. was organized in 1959 to operate as a freight forwarder of individuals' household goods by the so-called "containerization" method, primarily to and from overseas military installations. In February 1962, pursuant to a registration statement filed under the Securities Act, the company commenced a public offering of 80,000 shares of its common stock at $5 per share through registrant as underwriter. The State of Virginia refused to allow the issue to be sold there because it found Van-Pak to be insolvent, and Hodgdon so advised registrant's other officers and the salesmen. Registrant had difficulty in disposing of the shares and the offering was not completed until mid-April 1962.

In the offer and sale of Van-Pak stock, Hodgdon represented to a financial planning client that Van-Pak had developed a new type of container, that it had or expected to get government contracts and should therefore grow rapidly, that it expected to start paying dividends, and that the client would realize a good profit in a short time. Haight told one customer that "when" the price of Van-Pak doubled, she could sell half of her stock and regain her original investment, and represented to another that Van-Pak had defense contracts and should have a bright future. He did not disclose to the latter customer, a Virginia resident, that Van-Pak stock was disqualified from sale in that state because of Virginia's finding of insolvency.

Carr told a customer, in February 1962, that Van-Pak had developed a new type of shipping container for which there was a great demand, and that he felt certain that the stock would appreciate considerably and would "double or better" in six months. The customer asked for a prospectus but Carr told him that it was "fairly urgent" that he make up his mind at once since there was only a very limited number of shares left. The customer then purchased 100 shares.[19] Carr told another customer, a Virginia resident, that Van-Pak was "one of the most promising issues that had come to his attention" and that "it couldn't miss." He did not disclose that Van-Pak could not be sold in Virginia on the ground of insolvency.

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[19] When the customer received the prospectus, he called Carr and told him he was upset by the financial condition of the company and the fact that the prospectus said nothing about Van-Pak manufacturing containers. Carr replied that he could cancel if he wished, but that it was Carr's judgment that Van-Pak was going to "come out of the red" and do well in the manufacture and sale of its container.

Davis stated to one customer that Van-Pak had a new process of storage or moving and expected to get substantial Government contracts that would materially increase the value of its stock, and that it was a "real hot issue" and would be a "terrific" and sound investment that was likely to appreciate 2 or 3 or 4 times in a very short period. He told a second customer of Van-Pak's "revolutionary" moving process and that it expected Government contracts, and another, that Van-Pak had a virtual monopoly on transporting the effects of military people to and from overseas installations. Kibler represented to two customers that Van-Pak had Government contracts for the transportation of household goods in a new type of container developed by it. He told one that the stock was an "excellent buy," and in all probability would increase in price a point or two by late fall and rather rapidly within a year or two. He did not disclose to the other, a Virginia resident, that the stock could not be sold in Virginia on the ground of the company's insolvency. Harper told one financial planning client that Van-Pak had a new system of transportation and that she might be able to sell the stock later at a much higher price, and another that Van-Pak was very progressive with new methods of moving, and looked like it had a very good future. Kitain represented to one customer that the president of Van-Pak had stated there were possibilities of getting a Defense Department contract, and to a second, that Van-Pak stock "had very fine prospects of doubling itself" in about 6 to 9 months.

Respondents' representations were entirely at variance with the picture given in the Van-Pak prospectus. That document stated that the containerization method of shipment was not new in the industry and had not been originated by Van-Pak, that the Military Traffic Management Agency had approved the company's tender of service which, however, merely authorized Van-Pak to compete for business at various military installations, that the company was in competition not only with vanline movers, many of which had larger financial resources, but also with the Military Sea Transport Service, an instrumentality of the Government, and that Van-Pak had never paid any dividends nor did it presently intend to do so. The prospectus did not refer to the manufacturing of containers for sale. It merely stated that Van-Pak had leased some of its containers to industry, which operation had not accounted for a significant percentage of total revenue, and that the company had plans to pursue this business further.

Finally, the prospectus revealed that Van-Pak was insolvent by an amount exceeding $100,000. Van-Pak's president testified that his company had no contracts with the Defense Department or any other Government agency and that he never told any representative of registrant that it had or anticipated getting any, and that approval of Van-Pak's tender of service did not guarantee it any income.

Respondents are not aided by their assertion that they were justified in expressing optimism concerning Van-Pak because of its improved business for the five months ending February 1962, the lifting of certain travel restrictions on military dependents by the Government, and a number of favorable factors occurring after the prospectus was written. Such factors could not justify the outright falsehoods and the extravagant predictions which they made, particularly in view of Van-Pak's insolvency. Moreover, we have repeatedly held that price predictions of the kind made here are inherently fraudulent.[20] Nor is there any merit to respondents' contention that the hearing examiner improperly credited the testimony of customers instead of their own. The hearing examiner heard the witnesses, observed their demeanor, and noted that at least ten customers had testified to similar representations being made to them concerning Van-Pak Government contracts. We find nothing in the record to warrant overturning the examiner's determination to credit the customers' testimony.

We find that in the offer and sale of Van-Pak stock, fraud of a serious nature was practiced on registrant's customers, and conclude that, in connection therewith, registrant, together with or willfully aided and abetted by Hodgdon, Haight, Carr, Harper, Kitain, Davis and Kibler, willfully violated the above cited antifraud provisions.

b. U.S. Infrared Corporation

U.S. Infrared Corporation ("USI") was incorporated in August 1960 to develop and manufacture an infrared heat detector for use chiefly in spotting railroad "hot boxes." Amann, then a vice-president of registrant, was one of the promoters of USI and sought to interest Hodgdon in having registrant undertake a private offering of the company's stock. Hodgdon investigated the situation and was unimpressed, and he, Haight and other officers of the firm sought to dissuade Amann from proceeding with this venture. However, upon

[20] See, *e.g.*, *Richard N. Cea*, 44 S.E.C. 8, 14 (1969); *Kennedy, Cabot & Co., Inc.*, 44 S.E.C. 215, 221 (1970).

Amann's representation that he had made a commitment to obtain financing for USI, Hodgdon agreed to allow a "private placement" of the company's stock through registrant, although he issued a memorandum to all salesmen stating that USI was a gross speculation and directing any of them who wished to offer USI stock to their clients to tell them that registrant regarded it as too speculative to merit approval at that time. Between August 30 and October 7, 1960, registrant sold 45,430 shares of USI stock at $1.10 per share to 18 customers. Thereafter, in July 1961, USI solicited its stockholders, by a letter and accompanying memorandum which were signed by Amann as both chairman of USI's executive committee and vice-president of registrant, to purchase USI convertible debentures. When Hodgdon saw these documents, he sent out telegrams stating that Amann had not been authorized to sign the documents on behalf of registrant and that registrant disavowed them, and discharged Amann.[21]

In the stock offering, Amann represented to one customer that USI's device was being well received by the railroads, that the results of their tests were excellent, and that registrant might subsequently underwrite a public offering of USI stock at $4 per share. This customer was not told of registrant's unfavorable opinion of USI, and he testified that he would not have bought the stock if he had been told. Amann stated to another customer that USI's device had tremendous potential, and that he was being given an opportunity to buy at a low price before USI made a public offering through registrant. A third investor, who purchased a $10,000 convertible debenture in July 1961, was told by Amann that he had received a "fantastic" report on USI's device by a group of engineers that included foreigners, which would give the product a potential foreign as well as a domestic market, that it was a good time to buy since there was a large potential market for the product, and that Amann visualized the common stock into which the debenture was convertible as "really rising." Amann did not inform the investor that by then USI was in desperate financial straits.

Kitain told a customer during the private stock offering that an investment in USI would be profitable, and that the customer would be coming in on the ground floor since USI would go public at a higher price later on.

There was no reasonable basis for the representations made.

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[21] Amann was reemployed by registrant as a salesman in October 1961.

USI's infrared device was never placed in production or successfully marketed. Amann admitted that every time the device was shown to the railroads, at whom it was primarily aimed, it was found to require further refinement.[22] USI never made a profit and experienced continual losses. In September 1961, it became inactive for lack of funds to carry on its business. There was no justification for representations that a highly favorable engineering report had been received, that USI would be profitable, that there would be a public offering through registrant as underwriter, or that the offering price would be higher than the current sales price.

We conclude that in the offer and sale of USI stock, registrant, together with or willfully aided and abetted by Amann and Kitain, willfully violated the above cited antifraud provisions.

c. Paragon Electrical Manufacturing Corporation

Paragon Electrical Manufacturing Corporation was incorporated in 1960 to develop and market a resuable crimp-type wire connector and its related tool. In January 1961, registrant undertook to place privately 20,000 shares of Paragon stock at $5.50 per share.

Carr represented to a customer that Paragon had agreements with General Electric Co. and Westinghouse Electric Co. for the distribution of its wire connector, that the customer would make a very nice profit after the stock was offered publicly, and that there was even talk of a 3 for 1 stock split prior to such offering. There was no basis for these representations. Although the two named electric companies purchased some connectors from Paragon, they had no distribution agreements with it. Paragon never made a public offering of its stock and, while the possibility of such an offering may have been discussed, there was no justification for the statement made to the customer which assumed it would take place. Nor was a stock split ever contemplated.

We conclude that in the offer and sale of Paragon stock, registrant, together with or willfully aided and abetted by Carr, willfully violated the cited antifraud provisions.

d. Apache Canadian Gas and Oil Program 1961

Registrant, beginning in August 1961, participated in a

[22] A USI progress report of February 24, 1961 stated that sales visits to two railroads indicated that its heat detector was not sufficiently engineered for any particular applications to be of great value. USI eventually obtained orders for two of its devices, but they were never delivered because the company lacked the production capability.

registered offering of 100 units of Apache Canadian Gas and Oil Program 1961 at $5,000 per unit. The proceeds of the offering were to be used for the acquisition, exploration and development of gas and oil leaseholds in Canada.

Harper sold an Apache unit to Mrs. D, a financial planning client. Mrs. D soon became dissatisfied with her investment and tried several times to get Harper to sell it for her, but Harper dissuaded her, stating with strong emphasis that it would be a grave error to do so and that he knew of anxious buyers for the units. In his February 1962 report to Mrs. D on the status of her account, Harper listed her investment in Apache at $7,500 (representing the cost price of $5,000 for one unit and assessments of $2,500) followed by a plus sign, with the notation that such figure might be considered an undervaluation since bids had run as high as $25,000 per unit. He also told Mrs. D that a unit would be valued higher than $25,000. In August 1964, he represented to Mrs. D that the value of her investment was $35,000, advising her that several buyers "would pay that price," and that it would be "a great mistake" to sell. Harper made similar lulling representations to Dr. B, a financial planning client, who had purchased an Apache unit for $12,050 subsequent to the offering. In a January 1963 report to Dr. B, Harper valued the unit at $22,000, and in February 1964 he represented the value to be $30,000 with a potential worth of $100,000.

Harper asserted that he obtained his valuation figures from the corporate sponsor of the Apache program. An officer of the sponsor testified, however, that there was no basis for the figures which Harper supplied to his clients. It is obvious from Harper's testimony, moreover, that the figures he used were the sponsor's estimates of total future income per unit. We conclude that registrant, together with or willfully aided and abetted by Harper, willfully violated the above antifraud provisions.

e. Data Processing Corporation of America

Davis, in connection with a transaction in 1961 in the stock of Data Processing Corporation of America ("DPCA"), which had been organized two years earlier to establish and operate data processing service centers, wrote to his customer that there would shortly be a public offering of the stock at a price considerably more than the $3.50 per share paid by him and that market interest should make the price behave favorably after the public offering.

There was no reasonable basis for these representations. As Davis admittedly was aware, a DPCA underwriting was only in the talking stage and there was no assurance that there would be a public offering. We conclude that Davis willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder. We make no adverse finding as to registrant in this respect because Davis' transactions, like other transactions in DPCA stock by Amann, Kitain, and another salesman, were concealed from registrant and not recorded on its books. The participation of Amann, Kitain, and Davis in sales of the stock on behalf of DPCA in alleged violation of the registration provisions of the Securities Act is treated below.

SALES OF UNREGISTERED SECURITIES

The examiner found that the offer and sale of unregistered USI, DPCA and Paragon stock discussed above did not qualify for the claimed "private offering" exemption from registration, and that, accordingly, registrant and the various respondents who participated willfully violated the registration provisions of the Securities Act.

Respondents assert that the investors in these three stocks understood the nature of the issuers' businesses and the speculative and venture capital quality of their investment, and that under the circumstances the offerings qualified for the exemption. They additionally contend that they relied on a 1935 Commission interpretation, published in the Federal Register in 1946 and assertedly applicable at the time of the offerings in question, which they claim exempted from registration all offerings, including the ones in question, made to less than 25 persons.

We agree with the examiner that there was no basis for the claimed exemption. The USI, DPCA and Paragon offerings were made to various inadequately informed persons who clearly did not occupy a relationship to the issuers giving them access to the same kind of information that a registration statement under the Securities Act would have supplied, nor did they possess such information. Under such circumstances, as held by the Supreme Court in *S.E.C.* v. *Ralston Purina Co.*,[23] the small number of offerees is not determinative of whether an offering is private. And, as one Court has recently

[23] 346 U.S. 119 (1953). See also *Gilligan, Will & Co.* v. *S.E.C.*, 267 F.2d 461 (C.A. 2, 1959), *cert. denied* 361 U.S. 896.

pointed out, "Sophistication is not a substitute for 'access to the kind of information which registration would disclose.' " [24]

Aside from the fact that the landmark *Ralston Purina* decision was issued in 1953, long before the transactions at issue here, respondents' asserted reliance on the interpretation published in the 1946 Federal Register was wholly misplaced since it was based on an excerpt taken out of context. That interpretation specifically states that "the determination of what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees." [25] Nor was Amann relieved of responsibility by the reliance he assertedly placed on the advice of counsel and Hodgdon.[26]

Hodgon approved the sale of the USI and Paragon offerings through registrant and reviewed lists of prospective offerees which he required the salesmen to submit to him. He should have been aware that no private offering exemption was available.[27] We conclude that registrant and Hodgdon, together with Amann and Kitain in the offer and sale of USI stock, and with Carr in the offer and sale of Paragon stock, willfully violated Sections 5(a) and 5(c) of the Securities Act, and that Amann, Kitain and Davis willfully violated those provisions in the offer and sale of DPCA stock.

OTHER VIOLATIONS

a. False Records

When Hodgdon learned that the State of Virginia had banned sales of Van-Pak stock, he told registrant's salesmen that, in the opinion of counsel, sales could be made to Virginia residents provided they were solicited outside the state, and that, if possible, legitimate non-Virginia business addresses for such customers should be used for purposes of such transactions, since it was desired to have "as little occasion as possible to irritate anybody in the Virginia Securities Commission." Where an address out of the State could not be used, the salesmen and registrant's clerical staff were instructed to

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[24] *U.S. v. Custer Channel Wing Corporation*, 376 F.2d 675, 678 (C.A. 4, 1967), *cert. denied* 389 U.S. 850.

[25] Securities Act Release No. 285 (1935), 11 Fed. Reg. 10952 (1946).

[26] *Gearhart & Otis, Inc.*, 42 S.E.C. 1, 28 (1964), *aff'd* 348 F.2d 798 (C.A.D.C. 1965); *Mark E. O'Leary*, 43 S.E.C. 842, 848 (1968).

[27] See *Century Securities Company*, 43 S.E.C. 371, 380–81 (1967), *aff'd sub nom. Vees v. S.E.C.*, 414 F.2d 211, 220 (C.A. 9, 1969). We reject Hodgdon's contention that a violation of the registration provisions cannot be found as to him because the more definite statement of charges furnished by the Division did not name him as having "singly" violated them. That statement did not affect the sufficiency of the allegation in the order for proceedings that he committed such violations "in concert with" others.

mark order tickets and confirmations "unsolicited." Haight and Adam admitted marking order tickets in accordance with this instruction. It is clear that confirmations of transactions with Virginia residents who were solicited outside that state but had only a Virginia address were marked "unsolicited." In addition, the record contains several instances where Virginia residents who were solicited to purchase Van-Pak stock in Virginia received confirmations similarly marked. The record does not show that Hodgdon, Haight or Adam knew or should have known of these latter instances.

Hodgdon argues that the notation "unsolicited" was merely "a shorthand expression" for "not solicited in Virginia" and that inclusion of the term "was of no relevance from the standpoint of the Commission's legitimate interests." We disagree. Without taking any position on whether registrant's sales complied with Virginia law, we think it clear that the use of the term "unsolicited" where the order was in fact solicited constituted a false entry which could hamper this Commission in its investigatory functions.

We conclude that registrant, willfully aided and abetted by Hodgdon, Haight and Adam with respect to sales solicited outside of Virginia, made false entries on its records in willful violation of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder.

b. Failure to Amend Application for Broker-Dealer Registration

During the relevant period, registrant's application for broker-dealer registration was not amended to reflect the election of certain officers and directors. Registrant argues that its failure to amend was inadvertent, and therefore not willful, and Hodgdon points to his testimony that he had delegated responsibility for preparing such amendments to his executive secretary and was unaware that they were not timely filed.

A finding of willfulness within the meaning of Section 15(b) of the Exchange Act does not require a finding of intention to violate the law. Hodgdon was responsible for registrant's compliance with amendment requirements. His delegation of responsibility to a ministerial employee did not relieve him of his obligation to make certain that appropriate filings were made.[28] We conclude that registrant, willfully aided and abetted by Hodgdon, willfully violated Section 15(b) of the Exchange Act and Rule 15b3–1 thereunder.

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[28] See *Sterling Securities Company*, 39 S.E.C. 487, 495 (1959); *Peoples Securities Company*, 39 S.E.C. 641, 645 (1960); *Alfred Miller*, 43 S.E.C. 233, 239–40 (1966).

c. Failure to Transmit Funds Promptly

Rule 15c2–4 under the Exchange Act provides in pertinent part that it is a "fraudulent, deceptive or manipulative act or practice" within the meaning of Section 15(c)(2) of the Act for a broker or dealer participating in a distribution of securities to accept the proceeds thereof unless "promptly transmitted" to the persons entitled thereto.

Registrant was the underwriter on a "best efforts" basis of an offering of stock of Southeastern Mortgage Investors Trust. During the period January 20 to February 28, 1964, registrant transmitted the proceeds of sales of Southeastern stock to the issuer after varying periods of time. Such transmittal, in our view, was not prompt at least with respect to 46 sales where it occurred 11 to 15 days after receipt of the funds.[29] Accordingly, we conclude that registrant willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2–4 thereunder.

OTHER MATTERS

Respondents pursue various contentions that we previously considered and rejected on interlocutory appeals from rulings of the hearing examiner. They argue that we are precluded from imposing sanctions upon them by reasons of prejudgment, chiefly because of the discussion of certain of registrant's activities in the 1963 Report of Special Study of Securities Markets;[30] that respondents' request for production of Special Study memoranda by or between the Commission and its staff relating to respondents was improperly denied; and that we wrongfully rejected their requests to make these proceedings private and to grant oral argument on such requests. These arguments are without merit.

Respondents' contention with respect to prejudgment, if it prevailed, would have the effect of immunizing from administrative proceedings not only every firm named in the Special Study as to which an adverse comment was made, but also

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[29] Contrary to registrant's contention, we consider that it received payment for a purchase upon receipt of a customer's check, not on the settlement date when it merely made the bookkeeping entry. In cases, however, where the customer had a credit balance in his account sufficient to cover the purchase price, we have treated payment as having been received by registrant on the settlement date, when the account was charged with payment.

[30] H. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess., 109–110, 261–2 (1963). The Special Study, after observing that specialization is "in many respects desirable," cited registrant as an example of a broker-dealer who specializes but projects an image to the public of "equal willingness to sell, and equal knowledge about, securities other than those within his specialty." Noting that the firm recommended investments by its customers primarily in real estate syndications, a number of which were promoted by the firm, and mutual funds, with one of which the proprietor of the firm was affiliated, the Special Study stated that "in such instances, specialization strains the broker's obligation to deal fairly with his customer and strains it even further where a relationship of trust and confidence has been developed."

every unnamed firm whose activities were considered in making an adverse comment. There is no basis for such a result, and it certainly was not contemplated by the Congress when, in Section 19(d) of the Exchange Act, it expressly directed the investigation to ascertain the adequacy of investor protection in the securities markets which resulted in the Special Study report. Our letter transmitting that report to the Congress made it clear that the investigation which was made and the writing of the report were the work of a separate staff established within this Commission under the supervision of a director appointed for that purpose, and while the Commission "worked very closely" with the staff and went over its report, "the judgments, analyses and recommendations in the report were those of the staff and not the Commission." [31] Even assuming that consideration of the report played some part in the much later determination to institute these proceedings against respondents,[32] this would in no sense constitute prejudgment of the issues raised herein.[33] The Commission, in carrying out its statutory responsibilities, could hardly be required to ignore the report, the consideration of which would, as recognized by the Administrative Procedure Act ("APA"), be entirely consistent with the dual functions of a prosecutory and adjudicatory nature exercised by the Commission. The Special Study memoranda, being investigatory in character, were properly kept confidential. Finally, it may be noted that none of the present Commissioners was associated with this Commission at the time the Special Study report was prepared and submitted to Congress, and that our decision herein is based solely on the record made by the parties before the hearing examiner.[34]

The determination of whether a proceeding shall be public or private rests within our discretion.[35] In this case we considered

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[31] Special Study, *supra*, p. IV.

[32] Although the report was submitted to Congress in 1963, these proceedings were not instituted until 1966 after a further investigation, initiated in late 1964, had been made by our staff. The allegations in the order for proceedings and the evidence in the record cover a period of time subsequent to the report's submission, and include matters that were not even mentioned in the report.

[33] See *San Francisco Mining Exchange* v. *S.E.C.*, 378 F.2d 162, 167 (C.A. 9, 1967). See also *Federal Trade Commission* v. *Cement Institute*, 333 U.S. 863 (1948); *Pangburn* v. *C.A.B.*, 311 F.2d 349 (C.A. 1, 1962).

[34] As further "evidence" of prejudgment, respondents point to the press release issued when these proceedings were instituted. That release, however, made it clear that the violations were alleged, not found, that the allegations were those of the staff, not the Commission, and that a hearing would be held to determine whether the alleged violations had occurred, and, if so, whether any remedial action should be ordered. Securities Exchange Act Release No. 7833 (March 3, 1966). *Cf. Federal Trade Commission* v. *Cinderella Career and Finishing Schools, Inc.*, 404 F.2d 1308, 1312-15 (C.A.D.C. 1968).

[35] Section 22 of the Exchange Act provides that "hearings may be public," and Rule 11(b) of our Rules of Practice states that all hearings with certain exceptions not applicable here "shall be public unless otherwise ordered by the Commission."

that, in view of the gravity of the charges made against registrant and its management and salesmen, their desire for privacy was outweighed by the general public interest and the interest of investors.[36] These considerations were still applicable when respondents, three months after the proceedings were instituted and after hearings had begun, requested that all further proceedings be kept private.[37] And, in the absence of a statutory requirement, respondents were not entitled to oral argument on the issue of public or private proceedings.[38]

We also reject respondents' further contentions that the Division improperly suppressed evidence favorable to their defense, that these proceedings were unfairly based upon "sweeping allegations," and that "undue delay" in instituting them denied respondents due process and violated the APA.

Respondents cite *Brady* v. *Maryland* [39] for the proposition that prior to the hearings the Division was required to furnish a list of all prospective witnesses, oral and written statements taken from them, summaries or memoranda of staff interviews with such witnesses, and copies of all completed questionnaires received from them. The *Brady* case held that suppression by the prosecution of material evidence favorable to an accused who has requested it is a denial of due process. It did not, however, authorize a wholesale "fishing expedition" into investigative material such as respondents attempted to embark upon here.[40] The Division was not required to furnish the names of its prospective witnesses to respondents.[41] And statements of staff witnesses obtained in the course of an investiga-

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[36] See *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 879, n. 25 (1965), *aff'd* 366 F.2d 446 (C.A. 2, 1966). In *J. H. Goddard & Co., Inc.*, 41 S.E.C. 964, 966 (1964), in setting forth some of the considerations which favor public proceedings, we stated that such proceedings enable investors to institute causes of action against broker-dealers promptly before any of their witnesses have become unavailable, may encourage persons to come forward to testify or to request leave to be heard or to intervene, may alert investors to certain activities of broker-dealers, and inform the industry that the Commission has instituted action with respect to such activities.

[37] Respondents also complain that they were not furnished with a statement they requested of the number of private Commission proceedings within the year prior to institution of the instant proceedings and the nature of the charges involved in such proceedings. Aside from the fact that the request does not appear to have been properly presented to us because it was raised for the first time in a brief seeking review of an examiner's ruling which did not relate to such request, the information sought would not have disclosed the bases for our action making the other cases private.

[38] Neither Section 6 of the APA (5 U.S.C. § 555(b)) which respondents cite nor the statutes administered by us contain such a requirement. See *Morgan* v. *United States*, 298 U.S. 468, 481 (1936); *F.C.C.* v. *WJR*, 377 U.S. 265, 281 (1949); *McGraw Electric Co.* v. *United States*, 120 F. Supp. 354, 358–9 (E.D. Mo., 1954), *aff'd* 348 U.S. 804 (1954).

[39] 373 U.S. 83 (1963).

[40] See *Harris, Clare & Co., Inc.*, 43 S.E.C. 198, 201 (1966).

[41] *Armstrong, Jones & Co.* v. *S.E.C.*, 421 F.2d 359, 364 (C.A. 6, 1970), *cert. denied* 398 U.S. 958, *aff'd Armstrong, Jones & Co.*, Securities Exchange Act Release No. 8420, p. 15 (October 3, 1968); *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967), *aff'd F. S. Johns & Company, Inc.*, 43 S.E.C. 124, 141 (1966); *Richard N. Cea*, 44 S.E.C. 8, 22 (1969).

tion are confidential except that after such witnesses' direct testimony in the principal proceedings, any respondent may request and obtain production of such statements for the purpose of impeaching their testimony.[42] The charges against respondents were necessarily broad since they encompassed registrant's whole method of operation. However, respondents' motion for a more definite statement of such charges was in large part granted, and a vigorous defense was presented to all of the allegations raised.

Respondents assert that although this proceeding was not instituted until March 1966, the Division, as a result of the investigation conducted by the Special Study staff, had all of the information it needed by 1963. As previously noted, however, the allegations in these proceedings and the evidence introduced cover a period extending until mid-1964, and the Division asserts it did not begin to gather the necessary evidence until the Commission issued its investigative order of November 24, 1964. In any event, the law is clear that the doctrine of laches or estoppel cannot be invoked against the Government acting in a sovereign capacity to protect the public interest.[43] Respondents' position is not supported by their citation of Section 6 of the APA.[44] Moreover, if, as respondents assert, they considered that the memory of any witnesses who testified against them had dimmed, they had ample opportunity to explore their testimony on cross-examination. And the lapse of time did not appear to hamper the recollection of the respondent-witnesses.[45]

PUBLIC INTEREST

In view of the willful violations we have found on the part of registrant and the individual respondents other than Baskin, we must determine what sanctions are necessary or appropri-

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[42] See Rule 11.1 of the Commission's Rules of Practice which codified the Commission's practice with respect to pre-hearing statements of staff witnesses, following the decision in *Jencks* v. *U.S.*, 353 U.S. 657 (1957). See *R. A. Holman & Co., Inc.*, 42 S.E.C. 866, 879, n. 24 (1965), *aff'd* 366 F.2d 446, 455 (C.A. 2, 1966).

[43] See *Richard N. Cea*, S.E.C. 8, 21, and cases cited in n. 18 (1969).

[44] That section merely provides: "With due regard for the convenience and necessity of the parties or their representatives and within a reasonable time, each agency shall proceed to conclude a matter presented to it."

[45] Various respondents also contend that the examiner's initial decision was not in conformity with the requirements of Section 8 of the APA (5 U.S.C. § 557(c)) in that it failed to make appropriate findings with respect to credibility and "other matters," or to rule on each proposed finding and conclusion. Our review of that decision satisfies us that it comports with the standards set forth in the APA. See *Stauffer Laboratories, Inc.* v. *F.T.C.*, 343 F.2d 75, 81-2 (C.A. 9, 1965); *Coyle Lines, Inc.* v. *U.S.*, 115 F. Supp. 272, 276 (E.D. La., 1953); *Norman Pollisky*, 43 S.E.C. 852, 861-62 (1968). We note further as to the examiner's credibility determinations that, aside from his findings with respect to representations made in the sale of Van-Pak stock which we have discussed above, respondents raise specific objections to only three such determinations. None of the evidence as to which those determinations were made is the basis for any of our findings.

ate in the public interest. With respect to Baskin, we were unable to conclude, on the record before us, that he participated in any of the violations found, and accordingly the proceedings with respect to him will be dismissed.[46] As previously mentioned, the hearing examiner determined to suspend registrant from the NASD and PBW for four months, and to bar Hodgdon, Haight, Adam, and Harper. In addition, he concluded that Kitain and Davis should each be suspended from association with any broker or dealer for one year, and Carr and Kibler for ten months and five months, respectively, and that Amann should be barred with the proviso that upon an appropriate showing he might become associated with a broker-dealer in a supervised capacity after nine months.

Various factors have been urged by respondents as warranting the imposition of no sanction or a lesser sanction than was imposed by the examiner. Among other things, they variously assert that the sanctions assessed are "grossly disproportionate" to those imposed for similar offenses in non-"boiler-shop" cases, that to assess sanctions for conduct that occurred so long ago would be "*per se* punitive," and that there is no evidence in this record that respondents are not now or have not been for a number of years "in total compliance with the law." At the least, it is urged these proceedings should be remanded to the examiner to receive the additional evidence "timely proffered" as to "compliance with the law" since the record was closed.

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 cases.[47] In determining the appropriateness of a particular sanction, we consider, among other things, the nature, extent and seriousness of the violations found, whether the firm's officials participated in the misconduct, and the ever-developing standards of the securities industry, as well as any mitigating circumstances presented. The cases cited by respondents to show discrimination in the imposition of sanctions do not support their position, and a number of them involved settlements. In settlement cases, where as a rule there is no admission of violations, we take

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[46] Our references hereinafter to "respondents" will not include Baskin.

[47] See *Winkler* v. *S.E.C.*, 377 F.2d 517, 518 (C.A. 2, 1967); *Dlugash* v. *S.E.C.*, 373 F.2d 107 (C.A. 2, 1967); *Hiller* v. *S.E.C.*, 429 F.2d 856 (C.A. 2, 1970); *Martin A. Fleishman*, 43 S.E.C. 185, 190 (1966); 2 Loss, *Securities Regulation*, (2d ed. 1961), pp. 1323–24.

into account pragmatic considerations such as the avoidance of time- and manpower-consuming adversary proceedings.

The imposition of sanctions here is no less remedial because of the lapse of time since the misconduct occurred. Respondents' argument would in effect require the dismissal of broker-dealer proceedings in any case where an extensive investigation was made, a large number of respondents were involved and the many issues raised were vigorously litigated. The Division was under no duty to adduce evidence that respondents had not complied with the securities laws since the alleged violations occurred. As to respondents' request for a remand of the proceedings so as to adduce evidence of compliance, we note that the evidence referred to had been offered by registrant and Haight merely to show that after the hearings registrant had added supervisory personnel, installed new equipment, and adopted new policies and procedures. We reaffirm our previous ruling which denied such proffer.[48]

Various other factors have also been cited by the examiner or urged by various respondents: the damage suffered as a result of unfavorable publicity; measures adopted by registrant to prevent a recurrence of the alleged violations; the fact that Hodgdon has left the securities business with no intention of return—ng;[49] Hodgdon's direction of other individual respondents; the fact that registrant's employment of Davis, Kibler, Carr, Adam, Harper, and Kitain was their first as registered representatives; the fact that this was the first disciplinary proceeding against the individual respondents; and Amann's belief in the merits of the USI and DPCA offerings and his investment of personal and family funds in them.

We conclude that the various mitigative factors cited are insufficient to overcome the serious fraud and other violations of the respondents. We agree with the hearing examiner's determination that Hodgdon, Haight, Adam and Harper should be barred. We find, however, that the sanctions which

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[48] In our prior ruling we noted that we had in prior cases denied requests to reopen hearings for such purpose. *Norris & Hirshberg, Inc.*, 22 S.E.C. 558, 559 (1946); *Isthmus Steamship & Salvage Co., Inc.*, 42 S.E.C. 465, 469 (1964); *Crow, Brourman & Chatkin, Inc.*, Securities Exchange Act Release No. 7876, p. 2 (April 29, 1966). We further stated the requested reopening would be an inappropriate departure from orderly procedures and an unwarranted prolongation of the proceedings, particularly since the evidence sought to be introduced appeared essentially cumulative.

[49] In July 1964, Hodgdon ceased participation in the day-to-day management of registrant and sold a portion of his shares divesting himself of control. It appears that his association with the firm was completely terminated in December 1965. Haight has been president, a director, and the major stockholder of registrant since July 1964.

the examiner imposed on registrant and the other individual respondents were inadequate in the public interest.

As we have seen, registrant, various of its officers with the exception of Amann, and the other individual respondents participated in a nefarious scheme to defraud financial planning clients and betrayed the trust clients were induced to place in them. Although we have not found that Amann participated in that scheme, he made serious misrepresentations in the sale of USI stock and was to a major degree responsible for the violations of the registration requirements that occurred with respect to the USI and DPCA stock offerings. In addition to Amann, moreover, registrant and the individual respondents other than Adam made fraudulent representations to customers in the offer and sale of various securities, and registrant, Hodgdon, Carr, Kitain and Davis violated the registration provisions of the Securities Act. Although Hodgdon has left registrant, its so-called new management consists of Haight, Carr, Adam, Harper and Kitain, each of whom owns 10 percent or more of the firm's stock.

We conclude that registrant's broker-dealer registration should be revoked, that it should be expelled from NASD and PBW membership, and that Carr, Kitain, Davis, Kibler, and Amann as well as the other individual respondents should be barred. In our judgment the sanctions we are imposing are appropriate in the public interest notwithstanding that we have not affirmed all of the adverse findings made by the hearing examiner with respect to various of the respondents.[50]

An appropriate order will issue.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG).

[50] Among other things, we have not sustained the examiner's findings that fraudulent representations were made with respect to the rate of return on certain real estate securities offered and sold by respondents.

The exceptions to the initial decision of the hearing examiner are overruled to the extent that they are inconsistent with our decision and sustained to the extent that they are in accord therewith.