ADMINISTRATIVE PROCEEDING
FILE NO. 3-533

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC. (8-8427)

A. DANA HODGDON
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
JAMES L. ROPER
HARVEY A. BASKIN

INITIAL DECISION

Sidney Gross
Hearing Examiner

Washington, D. C.
May 15, 1969

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Before: Sidney Gross, Hearing Examiner

Appearances: Sidney Dickstein and David I. Shapiro of Dickstein, Shapiro and Galligan and Harry Heller of Simpson, Thacher & Bartlett for Hodgdon & Co., Inc., now known as Haight & Co., Inc., A. Dana Hodgdon, James F. Haight, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis and Robert F. Kibler.

Louis E. Shomette, Jr. for Louis S. Amann.

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

Paul F. Leonard, Harold Webb, Wallace L. Timmeny, William R. Schief, Barton H. Finkelstein and Herbert E. Milstein for the Division of Trading and Markets.

This proceeding is brought pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), by order of the Securities and Exchange Commission ("Commission") dated March 2, 1966, to determine what, if any, remedial action is appropriate in the public interest as a result of alleged willful violations of the securities laws during the period from approximately May 1960 to June 1964 ("the relevant period") with respect to Hodgdon & Co., Inc., now known as Haight & Co., Inc. ("registrant") and various of its officers, directors and registered representatives.[1/]

The order for proceedings contains a multitude of charges. Taken together with the "More Definite Statement" filed by the Division of Trading and Markets ("Division"), the order alleges that during the relevant period the respondents, singly and in concert, willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 15c1-2, and 15c1-4 thereunder.[2/]

1/ Registrant's name was changed, as of June 1, 1966, to Hodgdon, Haight & Co., Inc. Its name was further changed, as of September 30, 1967, to Haight & Co., Inc.

2/ The composite effect of Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10-5 and 15c1-2 thereunder, as applicable to this case, is to make unlawful the use of the mails or means of interstate commerce in connection with the purchase or sale of any security by the use of a device to defraud, an untrue or misleading statement of material fact or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by the use of any other manipulative, deceptive or fraudulent device. Rule 15c1-4 includes, within the meaning of the phrase "manipulative, deceptive or fraudulent device," the failure of a broker or dealer, at or before completion of each security transaction, to furnish the customer written notification disclosing, in effect, whether it is acting as broker for the customer, as dealer for his own account, as broker for some other person or as broker for both the customer and some other person.

Sections 5(a) and 5(c) of the Securities Act; 3/ Section 17(a) of the Exchange Act and Rule 17a-3 thereunder; 4/ Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder; 5/ and Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder 6/ and willfully aided and abetted violations of all the aforementioned sections and rules. 7/

During the course of the hearing, on the Division's motion, the order for proceedings was amended

(1) to add subdivision (N) to Section IIB(14) to allege that registrant's customers were not advised that registrant was not authorized to sell the stock of

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3/ Sections 5(a) and 5(c) of the Securities Act, as applicable here, make it unlawful to use the mails or interstate facilities to sell or deliver a security unless a registration statement is in effect as to such security.

4/ Section 17(a) of the Exchange Act, as pertinent here, requires brokers and dealers to make and keep current such books and records as the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records which must be maintained and kept current. The requirement that records be kept "obviously intends that such records be true records, and that the entries shall not be false or fictitious." Lowell, Neibuhr & Co., Inc., 18 S.E.C. 471, 475 (1945); John T. Pollard & Co., Inc., 38 S.E.C. 594 (1958); Continental Bond & Share Corporation, Securities Exchange Act Release No. 7135 (September 9, 1963).

5/ As relevant here, Section 15(c)(2) and Rule 15c2-4 require a broker or dealer participating in a distribution of securities to promptly transmit the money or other consideration received to the persons entitled thereto.

6/ Section 15(b) and Rule 15b3-1 require a broker or dealer to promptly file a correcting amendment to his application for registration if any information contained therein is or becomes inaccurate.

7/ Apart from the fraud allegations, not all respondents are charged in respect of each allegation.

Van Pak, Inc. within the State of Virginia and the reasons therefor; and

(2) to add a new section designated Section IIB(15) to allege the making of false and fictitious entries by registrant in connection with the offer and sale of Van Pak, Inc. securities in the State of Virginia, and

(3) to add a new subdivision IIE(1) to allege that during the relevant period all the respondents except Harvey E. Baskin, singly and in concert, willfully violated and aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that they made false and fictitious entries in books and records required to be kept under said rule with regard to the sale of Van Pak, Inc. stock in the State of Virginia.

All respondents were represented by counsel. Proposed findings of fact and conclusions of law and briefs have been filed by the Division and on behalf of all respondents. Division has also filed a reply brief.

On the basis of the record in the proceeding, including the documentary evidence, the testimony of the witnesses and the proposed findings of fact and conclusions of law, the Hearing Examiner makes the following findings and conclusions.

The Respondents

Hodgdon & Co. was organized by A. Dana Hodgdon ("Hodgdon") as a sole proprietorship in 1955. It maintained its offices in Washington, D.C. In 1956 it became a partnership consisting of Hodgdon,

his wife and W. Lyles Carr ("Carr"). Registrant was incorporated in 1960 and registered as a broker and dealer with the Commission on May 1, 1960. Registrant is a member of the National Association of Securities Dealers ("NASD") and the Philadelphia-Baltimore-Washington Stock Exchange ("PBW").

Subsequent to registrant's incorporation and during the relevant period Hodgdon was registrant's president, treasurer, a director and the major holder of registrant's stock. Before commencing business as a sole proprietorship Hodgdon had been employed for about three years as a registered representative by two member firms of the New York Stock Exchange ("NYSE").

James F. Haight ("Haight") was employed by Hodgdon & Co. in 1957. Prior thereto, between 1952 and 1954, he was employed by a securities dealer engaged in the sale of mutual funds and a plan for acquiring the stock of a local utility company. He became a 1% partner of Hodgdon & Co. in 1958. Upon registrant's incorporation he was made a vice-president in charge of sales and training and a director. Haight instituted the basic training course for new salesmen which will be discussed below and delivered about 80% of the lectures in that course. In 1963 he was appointed executive vice-president and assumed additional executive duties to be exercised in Hodgdon's absence. He was also a registered representative.

Carr, as indicated above, became Hodgdon's partner in 1956. He had no previous experience in the securities business. Upon registrant's formation he became senior vice-president, secretary and a member

of the board of directors. He also owned 10% or more of registrant's stock. Carr lectured during the training course for new salesmen on sales techniques and real estate. Together with Hodgdon and Haight, Carr regularly interviewed applicants for employment with registrant as salesmen. He was also a registered representative.

Louis S. Amann ("Amann") joined Hodgdon & Co. as a registered representative in 1956. Before coming to registrant he was a salesman and officer of a registered broker-dealer for about 3½ years. He became a vice-president and director of registrant in 1960 upon registrant's incorporation and held 1% of registrant's stock. In July 1961 Amann resigned, involuntarily, from registrant. He was re-employed as a salesman by registrant within several months thereafter and continued as a registered representative until October 1965.

Burton Kitain ("Kitain") commenced employment with Hodgdon & Co. in 1959. Apart from a five or six month training program with a member firm of the NYSE he had no earlier association in the securities field. In September 1960 registrant appointed Kitain manager of its newly opened branch office in Bethesda, Maryland. He continued in that capacity until August 1964 when the branch office was closed.

David M. Adam, Jr. ("Adam") was employed by registrant in 1960. His prior experience was limited to a training course with a firm engaged in the sale of mutual funds for some months prior to joining registrant. He became an assistant vice president of registrant early in 1963. Prior thereto, in 1962, Adam had been selected as registrant's specialist in the field of research and analysis of securities and was also appointed

a group manager. The system of group managers was introduced to registrant in or about 1962. It was intended to reduce the need for constant direct communication between the salesmen and top management through the development of middle management but was short-lived.

James W. Harper III ("Harper") joined registrant in 1961. Earlier, he had been a trainee with a NYSE firm. He became a registrant representative and, thereafter, in 1962, a co-specialist in oil and gas investments. He also lectured on such investments during the training programs. In 1963 he was appointed assistant vice-president.

Henry A. Baskin ("Baskin") commenced employment with registrant in the fall of 1961 without any previous experience in the securities business and became a registered representative. In February 1963 he was appointed assistant to the president. In December 1963 he acquired something less than 3% of registrant's stock. Baskin resigned from registrant in June 1964. Registrant purchased his stock.

Homer E. Davis ("Davis") had no experience in the securities business before he joined registrant in 1957 as a registered representative. He was transferred to registrant's Bethesda office when it opened. Davis' name appeared on a list of specialists posted by registrant for its salesmen's use, as a specialist in real estate.

Robert F. Kibler ("Kibler") started his association with registrant in 1960 without previous securities experience. He is a

registered representative.[8/]

I. REGISTRANT'S PRACTICES AND COURSE OF BUSINESS

Throughout the relevant period Hodgdon was in overall charge of registrant's operations.[9/] From the outset it was Hodgdon's philosophy that "there never developed a tradition of financial planning on the part of Wall Street vis-a-vis the public." In his view, as he communicated it to registrant's salesmen during training course lectures, an investment program should be predicated upon the concept of financial planning which should include among its goals protection against inflation through ownership of equities whether in the form of common stocks or equities in real estate; diversification, in order to insure safety; professional supervision of investments; and the need for discipline so that investors would hold their investments and maintain periodic investment plans.

Registrant's initial approach to a potential customer would propose that he become a financial planning client. This would require that he furnish the salesman complete information regarding his financial condition including his life insurance and securities portfolio, his income, his family responsibilities and ultimate investment objectives. Such data was usually acquired by having the customer fill out registrant's

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8/ James L. Roper ("Roper"), the remaining respondent named in the order for proceeding, failed to file an answer as required by the order and was in default. Accordingly, the Commission issued an order barring Roper from future association with a broker or dealer; Securities Exchange Act Release No. 7895, May 27, 1966.

9/ Registrant used the mails and means and instruments of interstate commerce while engaged in the offer and sale of securities referred to herein.

"Confidential Financial Planning Worksheet". The ultimate financial plan was predicated on the customers' investment funds and objectives.

The financial planning concept, as described to registrant's clients, contemplated that the client would follow a ratio system pursuant to which he would place at least 50% of his investment funds in professionally managed securities, i.e., mutual funds, the top category. The remaining 50% would be divided between "blue chips," real estate syndications and programs for the development and operation of gas and oil leaseholds, all of which constituted the middle category, and "speculations" or "special situations" which made up the last category. Usually the ratio figures for the middle and last categories were fixed at about 40% - 10% or 30% - 20%. 10/ It was intended that the ratios remain flexible, depending upon the client's preferences and predilections in securities investments.

Prospective salesmen were interviewed for employment by Hodgdon, Haight, and Carr. Most of the salesmen recruited by registrant had no previous experience in the securities field. Registrant's predecessor had instituted a formal basic training course which registrant continued. It was mandatory that salesmen attend. The course was given over a period of about two months, five days a week and about two hours each day. The purposes of the course, generally stated, was to acquaint salesmen with the rules governing the sales of securities including the statutes, rules of conduct, the rules of the NASD and

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10/ Hereafter, references to the ratio system in terms, for example, of 50-30-20 will refer to the various categories in the order described above.

to prepare them for the NASD examination. It also included instruction in mutual funds, sales techniques and, of course, the philosophy behind financial planning. Salesmen were paid no compensation and were not permitted to sell securities until they had passed the NASD examination. Haight taught most of the basic training course supplemented by an occasional lecture by Hodgdon, who made it a point to address every basic training course on his financial planning concept, by Carr and by outside talent brought in by registrant.

Following the basic training course salesmen were offered an advance training course. Here the lectures were given primarily by persons in the registrant's firm designated as "specialists" in their particular field.

With one exception 11/ the "specialists" had become such by exhibiting, while at registrant, an interest in their respective fields and by extensive reading. None had actual experience in their fields other than that acquired through their activities at registrant. These areas included real estate, trusts, estates, wills, taxation, gas and oil and insurance. The advanced training course emphasized the tax savings to be realized from investments in real estate partnerships and corporations, gas and oil developments, the judicious use of charitable trusts and wills and, depending upon the circumstances, the treatment of existing life insurance policies in order to make additional funds available for investment purposes.

11/ Terrence J. Smith, who had been a life insurance agent prior to joining registrant.

The latter could be accomplished either through loans on the policies, the taking of cash surrender values or the modification of policies to reduce premium payments, presumably without loss of adequate coverage.

Continuing training was also part of registrant's regular Tuesday morning sales meetings where, in addition to the discussion of registrant's securities business, its salesmen were exposed to lectures on new subject matter or on old subjects where management deemed a refresher to be in order. Management also offered to their salesmen the opportunity to take courses offered by outside institutions at registrant's expense.

Primary attention during the salesmen's course of training was given to acquiring the financial planning customer. 12/ The salesmen were required to make at least forty cold calls each day and to set up at least two interviews each day with prospective customers. Names of prospective customers were obtained from directories, including those of government agencies. A "canned" presentation was prepared for the initial telephone contact which was directed solely toward obtaining an interview. At the interview the entire financial planning concept was presented as a unique service. Prospective customers were informed of the availability of specialists in the various fields and the availability of all types of securities. The techniques employed here including the seeking for information as to the prospect's complete financial resources make it readily apparent that the entire procedure was designed to attract the naive and unsophisticated investor.

12/ The terms "customer" and "client" are used interchangeably.

Moreover, certain aspects of the advice and instructions offered to registrant's salesmen by Carr and Haight during the lectures promulgated a fraudulent course of conduct in the offer and sale of securities. Carr's instruction to new salesmen, many of whom were completely inexperienced, that where a customer desires to cancel an order the salesman is to say, "sure you can cancel if you like, but I think it is good. In fact, I think you should have doubled your order" 13/ is, manifestly, a direction to preserve the sale under any circumstances and teaches a flagrantly improper practice. Carr's further instruction that customers requesting a prospectus before making a purchase be put off with the suggestion that they buy first and cancel later if they wish, is equally outside the bounds of fair dealing. The purpose of the prospectus is to furnish the investor with information which may form the basis of an investment judgment, not from the point of view of one who has already purchased the security, but unfettered by the necessity of reversing his decision if the prospectus does not meet his expectations. Haight's teaching to salesmen to give only those facts necessary to close a sale, but not all the facts, is manifestly inconsistent with the requirements for full disclosure.

Registrant extensively advertised its financial planning concept during the relevant period through sponsorship of a news program over radio station WGMS in Washington, D.C. Some of its

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13/ Carr's instruction on this subject lacks any reference to the nature of the security, its suitability for the customer or any other factor which may be pertinent to a considered investment judgment.

broadcasts stated that registrant has been sponsoring WGMS news five days a week. The broadcasts included references to registrant's staff of experts; to its expertise in financial planning; to its vast experience in the financial field; to its men as thoroughly experienced in financial planning; to its trained investment analysts; to its research staff; and to its ability to avoid risk for its customers through its "clear knowledge of the present market and its future course." These advertisements were intended to cause prospective customers to believe that respondents had special skill, knowledge and experience in financial planning and the investment of securities. But each of the foregoing representations involve either deliberate misstatements, exaggeration or improper implications. "Registrant's staff of experts" and its "thoroughly experienced" men included salesmen who had no prior experience in the securities business before joining registrant and who were fresh from completion of their training courses. These were the same salesmen represented as having clear knowledge of the present market and its future course. Since its references to its vast experience in the financial field came in 1961, it was a patent exaggeration. Further, registrant admits it had no research staff.

Other general observations regarding the sincerity of registrant's policies and instructions may be made before reaching its transactions with specific customers. Despite registrant's instructions that if a customer's investment assets reach the neighborhood of $100,000 recommendation should be made to him to consider a [illegible]

of investment counsel, there is no evidence that this was ever followed. Although it was represented to customers that "blue chip" securities would make up part of the middle area of their investment ratio, registrant was aware that the recommendation of such securities to clients by its salesmen was the exception rather than the rule. Indeed, on January 30, 1961, Carr and Haight issued a memorandum to "Officers - Hodgdon & Co., Inc." entitled "Thoughts for Discussion" which reflects registrant's attitude toward "blue chip" recommendations by its salesmen. It reads, in pertinent part:

1. Emphasis and Direction in the Individual Stock Area

   a. Listed - At present time representatives seem to be at a loss to recommend or to know how to go about finding individual listed stocks to recommend to clients or prospects who request them.

      It is well understood by representatives that the individual "blue chip" area should be handled by the professional management of Investment Companies or thru the David Babson Investment Counseling firm. But in initial conversations with prospects it is important to be able to discuss intelligently selected listed securities.

      We don't think a great deal of listed securities would be sold because 1) of low commissions and 2) greater emphasis in other situations, but, it would show that we didn't have only high commission situations.

   Recommendation:

      Occasionally short talks at meetings telling what "blue chip" securities the Investment Companies are buying and selling or what Hodgdon & Co. recommends. Information for such a meeting gained from Wiesenberger, etc. and more importantly thru personal contact with the funds.

Moreover, no valid reason appears for the inclusion of interests in gas and oil development leases in the same category with blue chips. Hodgdon defined a blue chip security as a share of a major corporation which has performed very well in the last five or ten years. Gas and oil development investments are highly speculative and unseasoned. There is little alternative to the conclusion that these securities 14/ were bracketed with blue chips to encourage the inference that they were of the same quality, especially by the inexperienced financial planning client who relied upon registrant for guidance.

It is arguable whether the interests in real estate limited partnership syndications 15/ were speculative. However, they undoubtedly were unseasoned and lacked blue chip characteristics.

Although the main thrust of registrant's appeal to customers was its financial planning concept, registrant made no attempt to supervise its financial planning accounts to assure that its registered representatives were adhering to the ratio systems which they had established for their clients or were otherwise pursuing registrant's policies in respect of such accounts. Haight's responsibilities included supervision of salesmen. The extent of his supervision, however, was to review summary worksheets he directed the men to file and to review order tickets, both from an activity point of view. Manifestly, his principal interest was to assure that the salesmen were working hard enough, doing enough business. He admits that registrant

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14/ Registrant was part of the selling group of the gas and oil programs it recommended.

15/ All such interests were new issues of which registrant was the underwriter.

had set up no machinery which would enable it to ascertain whether the financial plans were being properly administered. Salesmen were required to present financial plans for review only for the first year after completion of the basic training course. Thereafter, the submission for review of such plans as may have involved complex problems was left to the salesmen's discretion. Specialists' and group managers' activities were unsupervised.

Nor did Hodgdon attempt to supervise financial plans. His activities were directed primarily toward supervision of the firm's trading, the consideration of all offers for underwritings and the daily review of order tickets.

In November 1962 registrant instituted a sales quota requiring salesmen to sell $18,000 in mutual funds or earn net commissions "to himself" of $600 per month from the sale of "high-quality," as defined by registrant. Memoranda were distributed by registrant containing lists of securities for the salesmen's consideration. The lists consisted, substantially, if not almost entirely, of securities in registrant's trading account. Although the sales quota memorandum included a supplement stating that it was not intended to cause the representative to feel any undue pressure and was directed primarily to those who "are not working", the message was clear.

During the relevant period real estate offerings were one of registrant's major activities including both interests in real estate limited partnership syndications and real estate stocks. Between 1960 and 1964 registrant was the underwriter or a participant in a selling group of issues totalling about $21,000,000. Of that amount

real estate limited partnership syndications represented about $8,000,000 and real estate stocks about $6,000,000.

Because of the extensive purchases by registrant's financial planning and other customers of real estate syndications arising out of salesmen's recommendations and representations as to the "yield" or "income" or "return" which the customer might expect to receive from such investments, it is advisable to consider, at this time, the propriety of these representations. 16/ Some of the real estate partnership syndications principally involved here and the dates of their respective prospectuses are:

Rock Creek Forest Apartment Associated ("Rock Creek"), March 31, 1961

Falls Plaza Limited Partnership ("Falls Plaza") March 31, 1961

Toledo Plaza Limited Partnership ("Toledo Plaza"), June 15, 1961

Cheverly Terrace Limited Partnership ("Cheverly Terrace"), February 8, 1962

Westfalls Shopping Center Limited Partnership ("Westfalls"), July 20, 1962 17/

The impetus to investment in real estate is found in the provisions of the Internal Revenue Code permitting the use of accelerated depreciation on real property and the deduction of such depreciation in determining Federal income taxes. The prospectuses of the above-named syndications disclose that each proposes to take the advantage offered by accelerated depreciation, thus providing

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16/ Real estate stocks will be discussed hereafter, as the occasion arises.

17/ Registrant was the underwriter of each of these issues. Other syndications will be discussed infra.

for a substantially larger cash flow for distribution to its investors than would otherwise be available.

But this cash flow is not entirely income in the accepted sense. Instead, it is made up, in whole or in part, of a return of capital which is free from Federal income taxes. The Special Study 18/ had occasion to distinguish between cash flow and income:

> "When the syndicator refers to 'earnings' from the syndicated property, he usually means a 'cash flow' available for distribution to the investors. The cash flow is that amount by which the gross revenues from the property exceed (a) expenses of operating the property, plus (b) amortization payments required under mortgages on the property. Cash flow is not the same amount as the taxable net income from the property, because of the depreciation deduction."

In Franchard Corporation, 19/ the Commission made the same distinction in its consideration of a cash flow real estate company and its problems in relation to the requirement for full disclosure of the nature of its distribution in its prospectus. The Commission said:

> "Depreciation deductions do not represent an actual cash outflow. To the extent that they (and other non-cash tax deductible items) exceed mortgage amortization payments and other non-deductible cash expenditures, the company derives tax-free cash from its operations. If this cash is distributed to stockholders, since it does not represent the tax counterpart of corporate earnings, the distribution is not taxable income to the recipients but is treated as a tax-free return of capital. These factors accounted in large measure for the relatively high rates of cash distributions which cash flow real estate securities offered until quite recently. The amount in excess of actual earnings is not a return on investment but a return of capital and in no sense to be equated to yield on investment."

18/ Report of the Special Study of Securities Markets of the Securities and Exchange Commission, Part I, p. 581.

19/ Securities Act Release No. 4710 (July 31, 1964).

The representations by salesmen referred to above as to anticipated "return," "income," or "yield" 20/ were usually accompanied by specific percentage figures, i.e., "10% yield," and were sometimes accompanied by the description "tax-sheltered" i.e., "10% yield, tax sheltered." But none of the prospectuses attempted to anticipate its distribution. The Rock Creek and Toledo Plaza prospectuses specifically disclaimed any such representations. Westfalls and Falls Plaza stated that distributions would be made "to the extent practicable." The Cheverly Terrace prospectus provides for distribution of "net distributable cash" which it then defines, using no figures. 21/

Manifestly, the prospectuses negate a reasonable basis in fact for the representations of yields of specific percentages or indeed, of any yield, whether or not tax sheltered. Hodgdon testified that in most instances he furnished the registered representatives with a probable cash distribution figure based upon his own investigation of each property. But Hodgdon's testimony offers only general statements relating to such matters as value, good location of the property, his consultation with experts and the amount of the mortgage money the banks were willing to offer. The record is devoid of any concrete evidence which would support the yield representations. Rather, Hodgdon's testimony appears to have been intended as a defense to the Division's charge that the real estate syndication interests purchased by registrant's clients were speculative

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20/ To avoid repetition the word "yield" may be used at this point in the initial decision to represent either of the three terms.

21/ During the relevant period all distributions by the aforementioned syndications constituted a return of capital in whole or in part.

securities which should have been relegated to the bottom rung of the financial plan ratio.

Most of the registrant's customers who appeared as witnesses in this proceeding and who purchased interests in the real estate syndications were unsophisticated investors and were known to be such by their salesmen. Some had never before invested in securities or had engaged in few securities transactions. With few exceptions, all relied on their registered representatives. To the average investor and even to the more sophisticated investor who has had no experience in real estate investments, the words "yield," "income," or "return" usually connote true income, a profit on his investment. 22/ The Commission commented on this aspect in its opinion in Franchard, supra:

> "This crucial difference between the returns from investments in the securities of cash flow real estate companies and normal corporate dividends is sometimes misunderstood by unwary investors."

The Special Study also remarked, in respect of the "technical tax concepts" involved in real estate securities, that they "should be

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22/ See Lese and Lee, Cash Flow; Misleading Connotations of Dividend Distributions, 31 Clev-Mar. L. Rev. 267, 272 (1964) where it is stated: "Three disclosure problems arise in connection with cash flow. The first and most obvious one is that of disclosing to an investor who is neither an accountant nor a lawyer that a deduction taken for tax purposes has given rise to a distribution which amounts to a return of capital."

clearly understood by the real estate security buyer, but often are not." 23/

It follows that the aforesaid representations of "yield" were unwarranted even if "yield" were deemed synonymous with "distribution." Moreover, the ordinary meaning of the words "yield," "income, and "return" denote a profit on investment, a taxable net income, "the counterpart of corporate earnings" and does not encompass a return of capital. Except, therefore, in the few instances where a sophisticated investor was made to understand that the yield would include a return of capital, the representations constituted misstatements.

Where so complex an investment is involved, it is the registered representative's responsibility, consistent with the obligation of full disclosure and fair dealing, to be certain that the customer is fully aware that the return on his investment will constitute a return of capital. 24/

23/ At p. 581.

24/ "To enable investors to appraise the real nature and the long run viability of those apparently generous returns (from cash flow real estate companies) a complex of circumstances must be brought to their attention lucidly and forcefully." Franchard Corporation, supra, p. 27.

Financial Planning and Other Accounts

Adam

Dr. G.Y.G. is an anesthesiologist who was 35 years of age and unmarried when she opened her account with registrant in or about August 1960. She came to Adam with a portfolio of securities listed on the NYSE and valued at slightly less than $30,000 which she had obtained from a trust established by her parents. She also owned a fully paid $40,000 life insurance annuity and $7,000 in cash. She informed Adam that her income was about $14,000 per year, that she had a dependent mother who might become disabled and that her investment objective was to acquire sufficient funds and income for ultimate retirement.

G.Y.G. had no experience as an investor in securities. She relied on Adam and followed his recommendations. Adam's note to Hodgdon furnishing a list of his discretionary accounts stated, in reference to G.Y. G.: "Account is set up in this manner due to complete lack of knowledge of investments and Financial Planning." Adam testified that G.Y.G. relied on him for recommendations.

Adam's original financial plan for G.Y.G. dated August 26, 1960, fixed a 60-30-10 ratio. It is pertinent that the 10% ratio figure for speculations was accompanied by the comment: "This figure not to be exceeded as capital once lost is difficult to regain under today's confiscatory tax rates (10% = 7500)." The finan-

cial plan recommended cashing of the $40,000 annuity,[25] the immediate sale of securities valued at $8,400 out of G.Y.G.'s portfolio and the retention of the balance of about $21,000 in securities. The proceeds of the annuity and of the $8,400 in securities to be sold were to be invested as follows: $35,000 in two mutual funds[26] and $5,000 in two units of a real estate syndication. The balance of the proceeds, something under $10,000, was to be retained for future real estate syndication investments.

Shortly after the financial plan was prepared Adam ascertained that G.Y.G.'s income was nearer to $20,000 per year than the $14,000 amount appearing in that document. He also learned that her mother was not then a dependent although she was ill and might become the subject of G.Y.G.'s support. After discussion with Haight, Adam changed her investment ratio to 50-20-30 thereby increasing the so-called speculative area of her financial plan by 20% and decreasing the mutual fund and blue chip areas each by 10%. Adam described this modification as a change to a more aggressive investment program predicated upon the new information. But G.Y.G.'s stated objectives, her expressed desire for a substantial degree of safety in investments to assure adequate funds for her

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25/ Prior thereto Adam had discussed G.Y.G.'s annuity with registrant's insurance specialist who advised that course of action.

26/ The financial plan included, among other things, a recommendation that G.Y.G. invest $100 per month in each of the mutual funds. She followed this recommendation more or less religiously.

ultimate goal, taken together with his own admonition against increasing speculations beyond 10%, hardly justify such drastic emphasis on speculations.

On September 23, 1960 G.Y.G. paid into her account with registrant approximately $37,000 representing the proceeds of her insurance annuity. $5,000 of these funds were used to purchase two units of Rock Creek. Registrant's insurance specialist had stressed in his training lectures that the proceeds of cashed insurance policies or loans made on insurance policies should be invested only in mutual funds under professional management, "* * * not in whimseys. It is not speculative or venture capital." Nevertheless, Adam recommended the investment of part of the proceeds of insurance in securities other than mutual funds.

Between November 1960 and February 3, 1961, in three transactions, registrant sold out of G.Y.G.'s original portfolio over $12,000 in securities or about $4,000 more than the $8,400 recommended for immediate sale in the financial plan. $11,000 of these proceeds were used for the purchase, pursuant to Adam's recommendation, of 2,000 shares of the stock of Paragon Electrical Manufacturing Corporation, a purported private placement. Adam agrees these securities were a rank speculation. Haight states that in making this recommendation and purchase Adam failed to follow G.Y.G.'s plan. In April 1961, about $14,000 of G.Y.G.'s original portfolio of securities was sold. Manifestly, Adam disregarded his own financial plan for G.Y.G. since about 70% of

the securities to be "held" were sold within a few months after those designated in the plan for immediate sale.[27/] In the same month, after G.Y.G. had rejected an investment in Lord of the Flies, a motion picture production and a highly speculative security, as too risky for her, she purchased six units in the production for $3,000 on Adam's recommendation.

G.Y.G. invested over $16,000 in real estate syndications.[28/] G.Y.G. did not understand Adam's explanations of the distinction between income and the return of capital, as Adam should have recognized. She was aware only that the income tax to be paid on distributions from her real estate investments would be less than the tax payable on returns realized from other types of securities. Her inability to comprehend these matters becomes material in respect of Adam's analyses of her account dated January 24, 1963 and March 17, 1964. These documents designated as "estimated income" Adam's projection of future distributions, which included the return of capital, from six real estate syndication investments. Despite reductions in the distributions from G.Y.G.'s syndication investments, Adam valued each such investment at cost. Further, the January 24, 1963 analysis showed losses in the speculative ratio area of $4,893. But that figure

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27/ Adam attempts to defend the April 1961 sale of 100 shares of American Smelting & Refining Co. stock through testimony relating to a telephone conversation with G.Y.G.'s father, a former employee of American Smelting, who advised that he saw no reason for a turn around in the company's poor earnings record and could not disagree with Adam's decision to sell that stock. However, this is inconsistent with Adam's retention of an additional 100 shares of the same stock in G.Y.G.'s account until January, 1962.

28/ This includes the purchase of one unit of Toledo Plaza from her mother for $2,500 in 1962 on Adam's recommendation. This transaction does not appear on registrant's books.

totally ignored G.Y.G.'s total loss of her $11,000 Paragon investment which registrant advised, in December 1962, she could write off completely for tax purposes. At the end of the analysis which showed both cost and current value of G.Y.G.'s securities at about $61,000 without regard to the Paragon and other losses, Adam commented: "Georgiana, you must be congratulated on the overall performance to date." In the letter accompanying his March 17, 1964 analysis which showed total cost of securities of $65,700 and total value of $72,000 (with Paragon loss still omitted and real estate syndications still valued at cost) Adam wrote: "Georgiana, during the next 5 to 10 years your net worth could easily amount to $120,000 minimum * * *."

During the relevant period G.Y.G. sold over $32,000 of the securities she owned on opening her account with registrant. She invested, pursuant to Adam's recommendations, approximately $50,000 in securities.[29/] Except for three minor purchases totalling about $2,500, each security purchased by G.Y.G. was an issue of which registrant was either the underwriter, co-underwriter, member of the selling group or which the registrant sold out of its trading account, as principal. This factor takes on special significance in the light of the complete absence of any blue chip acquisitions by G.Y.G. and the fact that the commissions charged customers and earned by both registrant and the salesmen are higher on underwritings and principal transactions than on transactions in either listed or over-the-counter securities on an agency basis.

29/ This does not include over $29,000 in mutual funds or $12,500 in a gas and oil program. Adam had described gas and oil units to G.Y.G. as low risk investments.

C.A.S. is a naval officer for whom Adam prepared a financial plan on December 2, 1960. He had a portfolio of securities valued at about $113,000, $68,000 of which consisted of investments in two mutual funds. His original investment objective was to accumulate capital gains. The financial plan fixed a 60-30-10 ratio and stated that "Special situations and speculations should be kept to a minimum of 10% because of the large degree of risk involved." Early in 1961 C.A.S. had an indication that if he did not receive a promotion he would be required to retire. He decided that his objective should be changed and his investments directed toward the production of income.

C.A.S. had engaged in securities transactions before he came to registrant and had an account with another broker-dealer at the same time he maintained the account with registrant. Nevertheless, he was not knowledgeable or sophisticated in the securities field, could not distinguish between a principal and agency transaction and did not know the difference between a return of capital and a return based upon profits. He testified that he followed the vast majority, if not all, of Adam's recommendations and depended entirely on Adam to advise him with respect to the purchase and sale of securities. The Hearing Examiner credits his testimony.

C.A.S. invested about $11,000 in units of Capital Properties, Inc. a real estate company. Each $1,000 unit consisted of a $1,000 9½% debenture and 20 shares of common stock. The issue was underwritten by registrant. Adam represented to C.A.S. that the stock attached to

the bond units would be worth more than the bonds themselves in the very near future. The prospectus indicates that the issuer allocated only $20 of the proceeds of the sale of each unit to the payment of the 20 shares of common stock.

The Division asserts that Capital Properties was a new small company, the security was unconventional, entailed high risk and, therefore, was unseasoned and speculative. Respondents state that the security was unseasoned, that the issuer was engaged in a relatively unconventional operation and its debentures involved a higher degree of risk than would have been the case in respect of senior debt securities of larger companies. Adam testified that the 9½% interest rate on the debentures was indicative of high risk when compared with the 5% or 6% rate offered by other debentures. It is apparent that if the issuer had not been engaged in real estate activities the security would be deemed to fall within the speculative ratio area.

Upon Adam's recommendations C.A.S. purchased 880 shares of Wise Homes in four separate transactions at prices ranging downward from 23½ to 4½ between February 1961 and November 1961. Registrant acted as principal in all these transactions. In October 1961 C.A.S. purchased 200 shares of Wise Homes at 5-3/4. In November 1961 he purchased 265 additional shares at 4½. On the same day in November 1961 Adam advised G.Y.G. to sell her Wise Homes stock since he had received adverse information regarding the company. Adam's statement

that he was averaging down for C.A.S. deserves short shrift since he fails to explain why one would average down in a stock whose prospects were poor even at the lower price. Nor, for the same reason, would his explanation that it was bought so that higher cost Wise Homes shares could be sold for a tax loss, be acceptable.[30/]

C.A.S. invested in three real estate syndications, $3,000 in Falls Plaza, $7,500 in Toledo Plaza and $13,500 in Cheverly Terrace. As to each such investment Adam represented to C.A.S. that he would receive a high rate of income -- in two instances 10% -- that there was a tax shelter and that in about 5 years the property could be sold at a substantial capital gain. It is apparent from the testimony of C.A.S. regarding Adam's explanation of real estate syndication investments that he had no clear understanding that part of the income to which Adam referred would be a return of capital.

In a letter to C.A.S. dated September 18, 1962, Adam stated that all income from real estate is estimated to be tax free and non-reportable during the next several years. Further, in Adam's "Investment Summary" of May 24, 1963 which he furnished to C.A.S., Adam used cost as value in respect of C.A.S.'s real estate syndication investments without making any effort to ascertain the prices,

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30/ All C.A.S.' Wise Homes stock was eventually sold during the relevant period, the last 465 shares at $.05 per share. His transactions in Wise Homes stock resulted in a total loss of $10,800.

if any, available at that time.[31/]

It is also relevant that the proceeds of certain C.A.S.'s life insurance policies were invested in real estate syndications rather than mutual funds, contrary to registrant's policy. Although Adam testified that C.A.S. suggested such use of the proceeds, the record is devoid of any attempt by Adam to deter C.A.S.

During the relevant period C.A.S. sold about $50,000 of his original portfolio securities. He purchased, upon Adam's recommendations, about $72,000 of securities and sold about $22,000 of those. About $44,000 of the $50,000 in securities he retained represented new issues of which registrant was the underwriter or securities sold by registrant out of its trading account as principal. Of the $22,000 in securities purchased and sold during the relevant period, over $14,000 of those purchases represented securities sold by registrant as principal.

31/ Although registrant did not make a market in these securities, it did attempt to dispose of them where purchasers could be obtained and to that extent maintained a record of sales and purchases in each of the syndications of which it was the underwriter.

Carr

G.C.A. has known Carr over 25 years and became Carr's client in 1958. He is a general officer in the U. S. Marine Corps and an attorney.

The objectives of G.C.A.'s original financial plan were to provide an income for his wife for life and funds for the college education of his two sons. However, late in 1960 he suffered substantial business losses and changed his investment policy in an attempt to achieve greater returns to offset his losses. Although G.C.A. had investment experience prior to opening his account with registrant and decided the direction of his investments, he relied on Carr to keep him informed as to what was available in the securities market for his purpose. Prior to the relevant period he had given Carr discretionary authority over his account.

Apart from mutual funds, Carr's purchase recommendations during the relevant period reveal his inordinate concentration on securities of which registrant was the underwriter. In 20 separate purchase transactions by G.C.A. amounting to over $33,500, only four purchases totalling about $4,000 represented securities not underwritten by registrant.

H.C.F. opened an account with registrant through Carr in the fall of 1961. He was an officer in the armed forces stationed in Korea and had been recommended to Carr by a brother officer. Until the late summer or fall of 1962, when he returned to the United States,

all his communications with Carr were through the mails.

Between October 1961 and March 1962 Carr sold ten of H.C.F.'s original portfolio securities for about $7,700. In that period Carr invested $1,000 in a mutual fund, $1,000 in a real estate investment trust and about $4,700 in five speculative securities. Except for the $1,000 mutual fund investment and one security purchased for $850, every acquisition by Carr for H.C.F.'s account was a security of a new issue of which registrant was the underwriter.

Kibler

D.B.S. has been a widow since 1947. She was 70 years old when she testified in 1966. She had her first transaction with Kibler in August 1962 when she telephoned him to purchase a security. Thereafter, in October 1962, she conferred with Kibler regarding financial planning after furnishing him a financial planning worksheet.

D.B.S. had no dependents, no one to whom she desired to leave her estate, a portfolio consisting largely of seasoned, listed securities having a value of over $35,000 and an annual income from securities of about $1700 - $1900. Her investment objective was to obtain a larger income and safety. A summary of the conference, prepared by Kibler on October 30, 1962, reflected the objectives of D.B.S. to include "increase quality of portfolio through elimination of weaker issues" and "increase dividend income."

Here, the client's objective for "increase(d) dividend income" was achieved through the initiation of a systematic withdrawal plan from her mutual fund investment, clearly a return of capital, and from distributions from her real estate investments, similarly a return of capital in large part. But D.B.S. testified that she understood that her mutual fund shares would be reduced by her withdrawals. Although she could not define the difference between a return based on profits

and a return of capital, she testified she understood when Kibler represented to her that Richmond Motor Lodge Associates ("Richmond") and Castaway Motor Lodge ("Castaway") 32/ would yield between 7% and 9%, tax sheltered and First National Real Estate Trust ("FNR") would pay between 7% and 9%, that some of these monies included a return of capital.

D.B.S.' testimony in this respect was surrounded with an atmosphere of uncertainty. Nevertheless it agrees with and supports Kibler's purpose to acquire more "spendable dollars" for D.B.S. without regard to true income. 33/

But the foregoing in no way detracts from the implications to be drawn from the fact that during the relevant period D.B.S. sold about $25,000 of the securities she owned when she came to Kibler. She purchased over $30,400 in securities, upon Kibler's recommendations, of which sum almost $30,000 represented new issues of which registrant was the underwriter and securities sold out of registrant's trading account, as principal.

32/ Both real estate limited partnership syndications.

33/ "Q. 'And is my understanding correct that your prime objective when you went to Mr. Kibler was to get more spendable dollars from the securities you had in your portfolio?

A. Yes sir.'"

Kibler acquired K.F.J. as a client through a cold call. He obtained a financial planning worksheet from K.F.J. and held at least two meetings with him, one attended by his wife. K.F.J.'s objective was to achieve the best possible return for his retirement.

K.F.J. and his wife earned about $16,000 annually. He had $6,800 in cash, $7,000 in Government bonds and a portfolio valued at about $18,000, of which about $15,000 represented securities listed on the NYSE. The financial plan prepared by Kibler on April 5, 1962 recommended investment of 31% of K.F.J.'s investment capital in mutual funds, "17% in federally regulated real estate trust shares," 32% in blue chips and 20% in "special situations," here synonymous with speculations. However, after the last meeting with K.F.J. and his wife, Kibler concluded that the 20% figure for speculations was too extreme for his clients and reduced it to 10%.

K.F.J. was not a sophisticated investor. He had dealt with one broker-dealer prior to registrant. He did not know the difference between an agency and a principal transaction. He could not distinguish between a return of capital and a return based on profits. He "struggled mightily" with prospectuses but, apparently, in vain. He followed Kibler's recommendations.

Kibler represented to K.F.J. in respect of his purchase of Westfalls that he could expect something between a 7% and 9% return; in respect of Richmond, that there would be a return of 7% to 9% which would be tax sheltered; in respect of Kent-Washington, a corporation engaged in real estate activities, in substance, that it

provided a tax sheltered income.

During the relevant period all K.F.J.'s original portfolio securities were sold, and he made purchases of securities totalling about $33,700 [34/] pursuant to Kibler's recommendations. Between May 1962, when he opened his account with registrant, and September 1963, K.F.J.'s purchases totalled $25,500. Every security was either a new issue of which registrant was the underwriter or a security sold by registrant out of its trading account as principal. On April 29, 1964 K.F.J. purchased four blue chip securities for a total of about $8,200.

34/ Including about $10,000 in mutual funds.

Kitain

D.G.Y. is a housewife who met Kitain when both Kitain and her husband were in the foreign service. They had a number of discussions during which Kitain learned that D.G.Y. and her husband owned property in Vermont which they wished to develop into a resort. She told Kitain that she had inherited a portfolio of securities, was interested in a program which offered liquidity and would be sensative to their needs in developing the Vermont resort.

Kitain agrees he was informed that D.G.Y. had no experience in the securities field, knew very little about stocks and found things difficult when she was overseas with her husband on his assignments. Kitain also agrees that D.G.Y. accepted all his recommendations.

D.G.Y. furnished Kitain with a list of her securities consisting largely, if not entirely, of high grade listed stocks.[35/] Kitain analyzed the portfolio,determined that some of the securities were "doubtful" and that the problem of the management of her investments could best be solved by putting the bulk of them into mutual funds. He split the securities into three groups -- those for immediate liquidation amounting to about $30,000 in value, those for sale in the medium future and those to be held.

35/ The Division values the portfolio at $90,000 to $100,000 to which respondents do not object.

Kitain presented a plan to D.G.Y. whereby the proceeds of the stocks for immediate liquidation would be utilized to accomplish the following:

1) Invest $25,000 in the Aberdeen Fund, a mutual fund.[36/] Since $25,000 was above the "breakpoint", D.G.Y. would be entitled to a reduction of 1% of the cost of the purchase.

2) Invest $5,000 in the Putnam Growth Mutual Fund, at the same time signing a letter of intent to increase her investment above the breakpoint thus entitling her to a 1% reduction in the cost of the Putnam purchase.

3) Withdraw 90% of the Aberdeen investment and invest the proceeds of the withdrawal in Putnam.

4) Sell part of the securities in the medium range future category within one year and replace the withdrawal from Aberdeen to maintain her right to the reduced cost of the Aberdeen investment.

Steps 1 through 3 were accomplished. Registrant realized commissions of 6% on the initial $25,000 Aberdeen investment, the $5,000 Putnam investment and the $20,000 Putnam investment resulting from the withdrawal from Aberdeen.[37/] Kitain's commissions on these transactions amounted to about $1,500.

36/ Hodgdon had an indirect interest in Aberdeen Fund which was one of the mutual funds recommended consistently by registrant's salesmen.

37/ D.G.Y. became disenchanted with mutual funds and did not replace the withdrawal from Aberdeen.

The sale of D.G.Y.'s securities to enter into the mutual funds transactions resulted in capital gains of about $15,000 and a capital gains tax of about $3,500.[38/] The consternation this unanticipated tax caused D.G.Y. raises considerable doubt that she would have consented to go forward with the sale of her securities had Kitain not agreed that the resulting capital gains tax could be offset. Moreover, registrant had a firm policy against switching mutual funds. Although Kitain protests that the policy did not apply to this situation, it is significant that he did not advise registrant's management of the transactions.

In June 1961 Kitain purchased for D.G.Y. 4 units of Toledo Plaza for $10,000. Since this security was not readily marketable,[39/]

38/ D.G.Y. attempted to offset these capital gains against certain expenses connected with the construction program of the Vermont resort. She had indicated her intent to do so to Kitain when they first considered the sale of her portfolio securities and anticipated that capital gains would be realized. Kitain agreed that such a course would be appropriate. He was not a tax expert and should not have approved or agreed to it. Internal Revenue disallowed the offset. The fact that an accountant prepared the client's tax return does not excuse Kitain on whom D.G.Y. relied.

39/ The cover page of the Toledo Plaza prospectus stated there was no market for the units and it is probable that the only market would be through registrant or its co-underwriter. The prospectuses of all the syndications mentioned above contain statements indicating that the units were not readily marketable.

its purchase was contrary to D.G.Y.'s objective of liquidity. D.G.Y. testified Kitain told her, in a telephone conversation,[40/] that Toledo Plaza had a guaranteed 10% income which was tax sheltered and although not as liquid as stocks, would nevertheless be marketable. Kitain also recommended that D.G.Y. borrow the funds with which to purchase the units. He had advised her, earlier, that a loan would cost 6% and with it she could acquire an investment producing a 10% income thus profiting to the extent of 4%.

Kitain denies that he told D.G.Y. that Toledo had a guaranteed income of 10%. He asserts he said that the real estate syndication would have cash flow and tax shelter in excess of the amount she would pay as interest on her loan. D.G.Y.'s testimony is credited. However, even if Kitain's testimony were accepted, his comparison of interest on a loan with a return of capital was unjustified. "Spendable dollars" was not this client's objective.

Between February 17, 1961 and February 24, 1961 D.G.Y. sold over $36,000 of her original portfolio securities.

A.H.R., a foreign service officer, has been Kitain's close friend since 1952. He became Kitain's client in 1959.

Although he furnished Kitain with the usual financial planning worksheet, Kitain did not indicate a ratio of investments to be

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40/ In May 1961 D.G.Y. and her husband were stationed in Quebec. She gave Kitain written discretionary authority to act for her in securities transactions.

followed. A.H.R.'s testimony discloses that he made his own investment decisions or made them jointly with Kitain. He found it difficult to determine at which point he was taking Kitain's advice. He rejected Kitain's constant recommendations for greater investments in mutual funds, preferring to choose his own time.

In his original discussion with Kitain he indicated his desire to plan for the education of his three small children and for his retirement. He displayed an interest in absolutely safe growth stocks and blue chips. But he had had some success with the stock of Jonkers Business Machine, a speculative security, and was eager for similar opportunities. He noted that the original backers of Jonkers had made a much greater profit than those who came in later, presumably on the public offering.

Registrant's insurance specialist recommended to A.H.R. that certain of his life insurance policies be converted to achieve reduced premiums and the release of cash surrender value for investment purposes, without reducing coverage. It was also suggested that A.H.R. might borrow against his insurance and that, in accordance with registrant's policy, A.H.R. invest the proceeds of such conversion or borrowing in mutual funds. Although A.H.R. did not take the steps recommended by the specialist in respect of his insurance, he did convert one policy which made available about $2,000 and borrowed about $3,000 on a second policy. Kitain was fully aware of the

source of these funds and admits that he made recommendations for their use which A.H.R. followed and which included the purchase of two securities which were unseasoned and speculative.

On six occasions through May 1962 Kitain used A.H.R.'s account for his personal purchases of securities. The first four purchases were made together by Kitain and A.H.R. each owning one-half the number of shares charged to A.H.R.'s account. The last two purchases were exclusively Kitain's. A.H.R.'s account was used for these transactions with his knowledge and consent. He testified that Kitain told him he used A.H.R.'s account because Hodgdon objected to the purchase of certain securities by salesmen or because the Commission would not approve. Kitain testified that Hodgdon specifically prohibited salesmen from purchasing one security of which registrant was part of the selling group and rejected Kitain's personal request to be excepted. In his prehearing testimony on July 14, 1965, Kitain admitted there was a prohibition by registrant against the use of customers' accounts, as nominee, by salesmen. The Hearing Examiner accepts this testimony over Kitain's testimony at the hearing that he cannot recall any specific written or oral statement on the subject.

A.H.R. went overseas in June 1962 and gave Kitain written discretionary authority over his account. In December 1962 Kitain purchased 100 shares of Van Pak. The transaction appeared in A.H.R.'s account. Upon receiving his statement from registrant, A.H.R. protested

vigorously against the purchase of that security. In response, Kitain advised him that the purchase was not for A.H.R.'s account, that Kitain had to execute a sale for another customer to establish a tax loss and had utilized A.H.R.'s account rather than his own because he "was suffering from a case of the 'shorts'."

At the end of 1959 A.L.A. was recommended to Kitain by A.H.R., her son-in-law. She met with Kitain in December 1959 and again, together with her husband, in January 1960. She advised Kitain that she had a married dependent son who had a family, that she wanted to maintain her income at its current level (of about $5,000) or, if possible, to realize a little more, and that she was interested in growth. Although A.L.A.'s financial planning worksheet offered little information, she told Kitain that her financial resources consisted of about $76,000 in a trust fund, $50,000 in savings and loan institutions, $10,000 in Government bonds and about $28,000 in securities. Although virtually all the securities were listed and high grade, Kitain assured her that he could do better and would invest in such a way as to give her a better income, growth and safety.

Kitain established a financial planning ratio of 50% - 30% - 20%. After learning more about A.L.A. he reduced the latter figure to 10%. A.L.A.'s first transaction with Kitain was in mutual funds. Kitain recommended the investment of a larger sum but A.L.A., who "was not too enthused about mutual funds," agreed to invest $15,000 in Aberdeen. On Kitain's recommendation A.L.A. instituted a plan pursuant to which she withdrew $125 every three months from her Aberdeen investment.

A.L.A. testified Kitain stated to her that the interest and dividends to be reinvested in her Aberdeen accounts would cover the amount of her withdrawals. It is evident from the difficulty Kitain displayed in answering questions which attempted to establish whether he advised A.L.A. that at least part of her withdrawal from Aberdeen would constitute a return of capital, that he failed to do so. This conclusion is supported by A.L.A.'s cancellation of the withdrawals when she realized that she was using her principal.

Pursuant to Kitain's recommendations A.L.A. invested $10,000 in Rock Creek, $5,000 in Toledo Plaza and $10,000 in the 6½% cumulative convertible preferred stock of Apache Realty Corp. Registrant was part of the Apache selling group. Apache was a real estate company which had been organized less than a year before the public offering. Respondents agree that after deduction of depreciation and other expenses, Apache would have no earnings and that dividends paid on the preferred stock would constitute a return of capital.

In recommending the real estate syndications to A.L.A., Kitain told her that the units were not readily marketable and that she would have to hold them for about eight years. She also testified that Kitain represented to her that Rock Creek would give her a tax sheltered income of 8%. Kitain testified he told her Rock Creek would return from 7% to 9%. A.L.A. received the prospectus and read it but relied mostly on what Kitain said. On purchasing Toledo Plaza, A.L.A. testified Kitain told her it was a better investment than

Rock Creek since it would yield 9%, was tax sheltered[41] and safe.

Kitain testified that he fully explained return of capital distributions to A.L.A. at their first meeting and again when she purchased Rock Creek. But that explanation, quoted below,[42] offers little in furtherance of Kitain's position. It says, in effect, that it's better to receive the return of your own capital, tax free, than to realize a taxable profit. That on cross-examination A.L.A. could not say that the words "income" or "yield" were used, does not aid Kitain where the matter is so complex that even sophisticated investors are unable to fully comprehend the intricacies of such investments. And even if Kitain had properly advised A.L.A. that all or part of the Rock Creek and Toledo distributions would include a return of capital, it is impossible to reconcile these recommendations

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41/ Her testimony demonstrates her confused understanding of "tax shelter":

"It was a tax sheltered income and after this was diminished the owner as a rule would sell the building and then I would get my money plus whatever it would sell for back."

"It was explained to me. I could not explain it to you, but every year, instead of an interest payment I would have a certain amount of deductions from my income tax."

42/ Here Kitain testified he explained to A.L.A. that "from the point of view of an investor, a tax free at the time of payment return would be a better return than the same number of dollars if they came as fully taxable income."

with A.L.A.'s income objective, especially since A.L.A. made withdrawals from her savings and loan accounts to acquire these syndications and Apache Realty, thus sacrificing true income.

In inducing A.L.A. to purchase the stock of Wise Homes, Kitain told her that it was better than Jim Walters, another company in the shell home industry, the price of whose stock had risen substantially. A.L.A. also testified, and Kitain does not deny, that when the price of the Wise Homes stock went down and A.L.A. called Kitain to inquire what was wrong, he replied that they wanted the stock to go down because they wanted to put all their people into this stock.

Between April and November 1960 A.L.A. sold about $11,500 of her original portfolio securities. From April 1960 through November 1961 A.L.A. purchased about $34,500 [43/] in securities other than mutual funds. It is pertinent that of this total about $28,800 or over 83% represented the purchase of new issues in which registrant was the underwriter or part of the selling group or securities sold by registrant out of its trading account as principal.

43/ This includes four securities which A.L.A. purchased for a total of $1,750 and sold.

Haight

F.E.T. is an unmarried woman who was about 67 years of age in 1960. During a meeting with F.E.T. in July or August 1960 Haight learned that she had no dependents, she was employed by the Navy at a salary of about $8700, was due for retirement, uncertain of her income and desired to increase it. She owned $2500 in U. S. Government bonds, $18,000 in savings and loan deposits and a portfolio of securities valued at about $61,000. With the exception of a mutual fund stock and one unlisted stock, all E.E.T.'s securities were listed on the NYSE and virtually all were dividend paying.

Undoubtedly F.E.T. was an experienced investor having been active in the securities field since the 1920's. It is also plain, however, that she considered Haight trustworthy, believed she could rely on him and placed substantial weight on his recommendations. She named him co-trustee of two charitable trusts she created at his suggestion.

Those securities sold from her original portfolio were sold either upon her own choice or upon Haight's recommendation with her considered agreement. The areas for concern, however, are the purchases rather than the sales. It has been stipulated that all purchases in F.E.T.'s account were made pursuant to Haight's recommendations.

F.E.T.'s account, under Haight's guidance, must be considered in the light of Haight's financial plan for F.E.T. dated August

1960 in which he established a ratio of 50% in mutual funds, 35% in blue chip, real estate and individual securities and 15% in speculations. The plan included a chart representing F.E.T.'s "completed investment program after adoption of present and future recommendations" in which the 35% or middle bracket is presented as including investments in electronics, utilities, chemicals, real estate and gas and oil.

In persuading F.E.T. to purchase real estate syndications Haight admittedly represented to her that he hoped for returns of about 7% to 9% from Rock Creek and that Cheverly Terrace could return 7% to 9%.

At the end of the relevant period F.E.T. had securities which were purchased for a total of about $53,000.[44/] An additional amount of $7,100 in securities, mostly "wild speculations," were purchased during the relevant period and sold to establish tax losses. All but about $700 of the $60,000 total represented purchases of new issues of which registrant was underwriter or sales by registrant out of its trading account as principal. In view of F.E.T.'s objective to increase her income, it should be noted that $44,000 were invested in real estate securities, the distributions from all of which consisted in whole or substantially part of a return of capital and about $10,000 in speculations. Moreover, F.E.T.'s purchases include none of the

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44/ Exclusive of $12,000 invested in Aberdeen.

investments in electronics, utilities or chemicals referred to in Haight's financial plan for F.E.T.

G.M.B. had her first meeting with Haight at her home in the fall of 1962. She was interested in the Richmond real estate syndication and purchased 10 units for a total of $10,000 at that meeting. Haight told her that, hopefully, Richmond would return about 13%.

Although urged to do so, G.M.B. did not furnish Haight information regarding her resources until about March of 1963 when she informed him that she had a portfolio of substantial, high quality securities valued at $36,500 together with $45,000 in U. S. Treasury notes and industrial bonds amounting to $21,000. One of G.M.B.'s principal objectives was to increase her income from investments.

In March 1963 Haight prepared a financial plan for G.M.B. which established a ratio of 50% - 40% - 10%. The plan noted that her income from investments for 1962 had been $3100. In early April 1963, at a meeting with G.M.B. Haight varied the ratio to 30% - 40% in mutual funds, 30% in blue chip securities and 30% in "real estate."

Prior thereto and in March 1963, 45/ at Haight's recommendation, G.M.B. purchased 1 unit of Falls Plaza for $1050, 2 units of Cheverly Terrace for $5670 and 1 unit of Toledo Plaza for $2500, all resales

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45/ G.M.B.'s account reflects no transactions between her Richmond purchase in October 1962 and the transactions here related in March 1963.

by other investors. In each instance the purchase price included a mark-up of 5% on the buyer's side and a mark-down of 5% on the seller's side, thus affording registrant a commission of 10%, of which Haight received half. Although the Toledo Plaza purchase price was the same as the original offering price, it, nevertheless, included the mark-up because of a reduction in its value due to storm damage to the property. Haight stated at the hearing that he told G.M.B. of the mark-ups. But his earlier testimony during the Commission's investigation of the case negates this testimony.

Haight testified that he told G.M.B. that he expected a distribution of about 7% from Falls Plaza, all not reportable, and that he expected a distribution of 7 - 9%, tax sheltered, from Cheverly Terrace. Respondent's brief admits that during the conversations attendant the Richmond purchase in October 1962, there is uncertainty whether Haight used the word "distribution" or "income" or "return". But regardless of which word he actually used, the conclusion is inescapable that at that time of the aforesaid purchases G.M.B. did not understand that the distributions from these syndications were not true income.

It is asserted that because G.M.B. had invested in real estate earlier, had rented all or part of her home from time to time and was aware of a depreciation factor in that connection, Haight's reference to "income" and "return" would not have been misleading. But the substance of G.M.B.'s testimony regarding tax benefits related to the renting of her home appears to be limited,

principally, to deductions for expenses incurred in operating the property. Haight also testified that, having explained the meaning of a distribution to G.M.B. at least twice, he used the word "income" or "return" satisfied that she understood he was referring to "distribution". However, G.M.B.'s testimony discloses that at the time of the Richmond purchase she was unable to distinguish between a return of capital and a return based on profits. Moreover, she first became aware that "tax shelter" was in some way related to depreciation in preparing her tax return after she had purchased real estate units, other than the first Richmond purchase. (She made four such purchases in 1963.) She then asked Haight about it and he explained it to her. This is consistent with Haight's testimony that G.M.B. complained about "having to fill out the forms," and indicated confusion as to the difference between the amount of a distribution that would be taxable and that "which would be offsetable as a net tax loss."

In a report to G.M.B. dated October 1963, Haight estimated $5155 as G.M.B.'s "income from investments during 1964." Haight knew that the income of $3,100 on investments referred to in G.M.B.'s financial plan represented true income. It is clear that Haight's estimated increase in "income" would consist of distributions which were largely return of capital. Haight's notes disclose that on November 18, 1963, not more than one month after his $5155 income prediction for 1964, he "told her I expected her income to be in excess

of $7,000 the next year."[46/]

The proceeds of over $52,000 of G.M.B.'s securities sold during the relevant period were used to purchase about $64,000 in securities.[47/] $58,000 thereof represented new issues of which registrant was underwriter or securities sold to G.M.B. as principal out of registrant's trading account and of the latter figure $47,500 represented purchases of real estate securities.

46/ At this time G.M.B.'s account included only mutual funds and real estate securities in addition to some of the securities she owned on opening her account with registrant.

47/ Excluding a $10,000 investment in Aberdeen.

Harper

C.J.M. met Harper through a real estate broker in 1961 while she was seeking to purchase real property as an investment. Both she and her husband had been born in Germany and had come to the United States in 1952. Her income in 1961 was $3,000 to $4,000. Her husband had just started a new business and drew from it $80 to $100 a week. C.J.M.'s resources consisted of about $20,000 in savings and loan accounts, real estate in Florida valued at about $5,000, $1,100 in mutual funds and a second trust note in the amount of $5,000.

C.J.M.'s objective, stated to Harper, was to improve her retirement income through profitable investment, to achieve a high return on her investment and growth. She also indicated, as she did many times thereafter, that she needed to keep a certain liquidity for emergencies in her husband's business and in the lives of her mother and mother-in-law both of whom were dependent on her and her husband.

She advised Harper that she had no experience in the securities field. Indeed, her only previous securities transaction was the $1,100 investment in mutual funds. Harper assured C.J.M. that "they" were counsellors, their specialty was financial planning for people who wanted to increase their returns that that she should "consider him like my doctor * * * to kind of diagnose my financial potentials and possibilities." She testified that she reacted with confidence. Although she occasionally failed to follow Harper's recommendation because, infrequently, she "had some

hesitation" about it or didn't have the funds or had other plans for the funds, the record is abundantly clear that C.J.M. and her husband both relied on Harper as their financial counsellor, as he had urged them to do.

C.J.M. was discouraged by her single experience with mutual funds and rejected Harper's early recommendations in that direction although she did invest in mutual funds later. Her first purchase was a unit of Toledo Plaza for $2,500. She testified Harper represented to her that it probably would yield 9%, that she would benefit from depreciation and amortization, that she could rely on a high yield and also on appreciation in value after about a decade. C.J.M. asked if she could sell the unit on short notice and Harper replied that she might be able to sell it within 24 hours -- there was always that possibility. When C.J.M. purchased one unit of Cheverly Terrace for $2,700 Harper told her that it was similar to Toledo Plaza, a high yield of 9% and that she would benefit from any appreciation when the property was sold later -- perhaps in ten years. Of Westfalls, in which C.J.M. invested $1,000, Harper said there would be a good yield -- she doesn't remember the percentage. She invested $1,000 in the Richmond. Harper said it would pay a high return of 11%. C.J.M. does not recall whether Harper used the word "dividend," "return" or "yield."

Harper offered no denial of C.J.M.'s testimony as to the yield she might expect on these investments.

It is also relevant that in recommending that C.J.M. invest in Lord of the Flies, Harper represented to her that she probably could double her money within two or three years. Harper succeeded in causing C.J.M. to make this purchase only after telephoning her several times because she felt insecure about it.

A review of C.J.M.'s account with registrant discloses that out of total purchases of approximately $27,700 [48/] about $21,000 were purchases of either real estate syndications or real estate corporations pursuant to Harper's recommendation. With the exception of one such purchase in the amount of $862.00 which came out of registrant's trading account, every real estate security was a new issue in which registrant was the underwriter. Further, of the $27,700 total, all but about $1,150 represented either new issues of which registrant was the underwriter or securities transactions in which registrant acted as principal.

A.K.D. was a retired social worker. She was divorced and had one dependent son who was Harper's friend. She lived in Frederick, Maryland where Harper also resided. Early in 1961 Harper asked to look over her portfolio. She acquiesced and Harper prepared a list of her securities. They consisted of high quality stocks of banks, utilities, railroads, and some of the largest industrial enterprises in the country together with a small amount of bonds. The portfolio had been acquired

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48/ About $2,000 of such purchases were sold during the relevant period.

through inheritance and gifts from A.K.D.'s parents and had a value of about $200,000.

In addition to the income from her securities, A.K.D. received alimony payments amounting to $2,400 per year. She was fearful, however, that these payments would stop. Her investment objective, therefore, included increased income. Further, as she expressed herself to Harper many times both orally and in correspondence, she insisted on safety in her investments. Harper was aware that A.K.D. had no previous experience in the securities field, and was an entirely unsophisticated investor.

During their initial conversation Harper assured her that she would have expert advice, that she would not have to be concerned about securities -- he would do that for her -- and that "they" specialize in estate planning. At a later conversation in August 1961, she made it plain to Harper she would have to rely on his advice to which he responded that she let him do the worrying. During her testimony she said: "What he recommended, I bought."

On August 23, 1961, A.K.D. wrote Harper saying that it frightens me "to turn over such a large amount of money." She insisted, "It's a must that I play it safe. * * * I just must safeguard all I have." The letter resulted from her conversation with Harper in which he offered a plan involving the sale of 25 to 35 of her portfolio stocks which Harper said were low yields, overly priced and that she should move into something less risky. Harper's response of August 25, 1961 is replete

with reassurance. He sees nothing in her portfolio but "safe-guards." He is pleased that she "could see the need of acting" and "understands." He can assure her of $1,000,000 if she were willing to take risks but "we are now keeping you comfortable and moving toward the $500,000 -- $750,000 level." He urges her to stop worrying. He has reduced the period of rearrangement of her portfolio from seven years to three years putting them ahead of schedule. "You are 50% better off today than you were Sunday."

By August 23, 1961, the date of A.K.D.'s letter described above, Harper had already sold about $25,000 of her securities and she had purchased an approximately equal amount of securities with the proceeds. With the exception of $500 invested in Lord of the Flies, all the purchases represented real estate syndications or real estate stocks, all were new issues and in all but one instance, registrant was the underwriter. In the single exception registrant was a member of the selling group.

A.K.D. testified Harper urged her to go along with the plan and believe in it. She was "scared" but accepted it. The plan, as it was presented in writing on October 5, 1961, presented a ratio of 50% high grade, 30% special situation and 20% speculation. But high grade, in this plan, in addition to $20,000 A.K.D. had already invested in Aberdeen, included the real estate syndications she had purchased and an $8,200 investment in Capital Properties. "Special situations" included all of A.K.D.'s as yet unsold high quality original portfolio securities

and the "speculation" area included a unit of Apache Canadian Gas and Oil Program 1961 purchased for $5,000. Among the type of securities the plan purports to consider for future purchase are "reasonably priced utilities," "reasonably priced consumer products companies," "reasonably priced bank stocks" and "reasonably priced insurance stocks."

An examination of the transactions in A.K.D.'s account readily establishes that Harper could not have had any intention of carrying out the plan he presented. Thus, through January 1964 when the account ends, A.K.D. realized from Harper's sale of her original portfolio about $122,000 and purchased about $89,000 in securities.[49/] The account includes no utilities, no bank stocks, one consumer product stock purchased in January 1964 for $3,800, and two purchases of the same insurance company stock for about $3,800, one a new issue of which registrant was the underwriter and the second a principal transaction.

Further, out of a total of about $103,000 in securities acquired by A.K.D.,[50/] Harper purchased for her about $72,500 in real estate syndications and real estate stocks. Out of that $103,000 total, every such security but one for $3,800 represented a new issue in which registrant was either the underwriter or a member of the selling group or represented a transaction in which registrant acted as principal.

49/ This figure does not include the $20,000 investment in Aberdeen or the Apache oil program purchase which, with assessments, amounted to about $14,500. These did not pass through registrant's books.

50/ Excluding Aberdeen, but including the Apache oil program.

Other aspects of Harper's administration of this account require attention. Without regard to A.K.D.'s demonstrated fear and her pleas for safety in her investments, Harper put her into the Apache oil program, the highest type of speculation.[51] Harper explains this investment by pointing to the substantial tax deductions it offers to offset about $31,000 in capital gains, which he had anticipated, resulting from the sale of A.K.D.'s original portfolio securities. But his reason for the purchase does not warrant the risk of complete loss involved in this type of security for a client whose objectives were fraught with demands for safe investments.

Harper's various reports to A.K.D. regarding the status of her account furnish clear evidence of lulling misrepresentations in respect of her objective for increased income. His report to A.K.D. of February 8,1962 included the following yields:[52]

Falls Plaza	9%
Glenn Ross	8.9%
Toledo Plaza	10%
Capital Properties	4.75%
First Nat'l. R.	8%
Kent Washington	6%[53]

51/ Haight agreed that A.K.D.'s investment in an oil program was "an error of judgment" on Harper's part.

52/ His plan of October 5, 1961 contained similar "yields."

53/ The Glenn Ross prospectus, dated March 31, 1961, anticipates distribution to the extent practicable. Kent Washington is admittedly a speculative security and the Capital Properties debenture, as shown above, was a high risk security.

As previously shown, the real estate syndications distribution were either all or in part returns of capital as were the distributions of the other securities set forth above. A.K.D. did not know the difference between a return of capital and a return based on profits. Her attitude toward returns of capital is demonstrated by the results of Harper's suggestion that she commence periodic withdrawals of $200 per month from her Aberdeen investment in July 1963. When she realized that her withdrawals resulted in depletion of the amount of her shares, she promptly cancelled the withdrawals.

Harper's letter of September 28, 1962 responded to A.K.D.'s letter of September 27, 1962, indicating disappointment that her total gain in income (even as defined by Harper) for the first nine months of 1962 was only $168.27 over that for the same period of 1961. In addition to telling A.K.D. she is much better off than $168.27 because of tax freedom and other reasons, he states "I still stand by our projection of a $15,000 to $18,000 income by 1964." Similarly, his letter of January 30, 1963 to A.K.D. which is a "memorandum of tax protected items" refers to the real estate syndications investments as "most of income tax protected" or "mostly tax free."

Harper did not advise A.K.D. whose investment capital exceeded $100,000 to seek the assistance of a professional investment adviser in accordance with registrant's policy. Further, Harper's insistence that A.K.D. advise him of the substance of her testimony before the Commission during its investigation does him little credit.[54/]

Dr. C.E.B. had known Harper since the latter was 8 or 9 years old. Harper and C.E.B.'s son were friends. Harper considered C.E.B.'s home as "his second home."

At Harper's suggestion C.E.B. opened an account with registrant early in 1961.[55/] During the conversations that occurred at that time, C.E.B. informed Harper that his financial objectives were to set up an estate, for income purposes and for retirement. He owned a portfolio of securities which he had bought "years ago" and which eventually brought about $19,000 when sold between 1962 and 1964, but did not advise Harper of the portfolio until sometime in 1962.

54/ Respondent's proposed findings of fact contain the following footnote:

> "Following her testimony in this case, Mrs. Daffin instituted suit in the United States District Court for the District of Maryland seeking $500,000 in compensatory damages and an additional $500,000 in exemplary damages (Civil Action File No. 17789). Thereafter defendants offered to repurchase all securities retained by Mrs. Daffin (including the oil program and all real estate limited partnership units) at the price she had paid for them, the offer was accepted and the suit was dismissed. Since such repayments may be deemed relevant as matters of public interest (Cf. Tr. 7756), respondents request the Division to stipulate to and/or concede the facts stated herein."

55/ Although accounts were opened both in C.E.B.'s name and jointly with his wife, they will be treated as one account.

C.E.B. was an inexperienced and unsophisticated investor. He placed complete reliance on Harper who agrees that virtually all C.E.B.'s purchases were made on his recommendation. During an illness C.E.B. gave Harper written discretionary authority over his account. Harper is named as co-executor in C.E.B.'s will.

Harper prepared a financial plan for C.E.B. similar in its categories to that prepared for A.K.D. Harper's reports to C.E.B. present his concept of the ideal portfolio, i.e., "High Grade," 50%; "Special Situations," 30%; and "Speculation" 20%. An examination of the first progress report dated August 3, 1962, and the last progress report in evidence dated February 24, 1964, indicate Harper's failure to adhere to his plan for C.E.B. The August 3, 1962 report states that C.E.B.'s account presently has this appearance: High Grade 46%, Special Situations 42% and Speculation 11%. By February 24, 1964 Harper's report shows a drastic drop in the high grade category to 15% and an increase in the special situation category to 81% with speculations at 4%. 56/ It is also pertinent that the February 1964 report shows special situation stocks at a cost of about $37,000 and a value of over $78,000. But $34,000 of that increase in value is represented by estimates of the value of C.E.B.'s three oil programs. As shown elsewhere in this decision, the $30,000 estimated value of the Apache Canadian 1961 oil program had no reasonable basis in fact. 57/

56/ These figures are based on current value. If cost were used it would reflect high grade 23%, special situations 58% and speculations 12%.

57/ No evidence was introduced as to Apache's 1962 and 1963 programs which C.E.B. purchased.

C.E.B.'s purchases included units of real estate syndications and a number of real estate stocks. Although he received prospectuses, he found them hard to digest and relied on Harper. The latter's report of August 3, 1962 presents a "yield" of 10% each for Cheverly Terrace, Toledo Plaza and Westfalls and 9.5% for Falls Plaza. Harper's report of February 24, 1964 continued the 10% "yield" figure for Toledo Plaza and Cheverly Terrace but reduced Falls Plaza to 7% and Westfalls to 9%. 58/ The actual distributions for Toledo Plaza during the relevant period reached 10% only for 1962 and fell woefully short for the other three years. Cheverly Terrace's distribution never reached 10% and Westfalls never reached 9%. Harper must have known or should have known the actual figures. As an owner of real property, C.E.B. apparently had some understanding of the meaning of "return of capital." Whatever relevance this might have to his original purchase of the syndications, it cannot cure the misrepresentations presented by Harper's reports.

The record also discloses that between mid-December 1963 and early February 1964, Harper allowed C.E.B. to sell three mutual funds securities despite registrant's rigid policy against it. The reason offered is that C.E.B. needed money and, indeed, at that time another substantial sale was made. But this is not consistent with a purchase on December 20, 1963 of $1,000 of the stock of Southeast Mortgage Investment Trust, a new issue underwritten by registrant.

58/ In this report Harper designates dollar amounts as "income" and the percentage which those amounts bear to the amount of the investments as "yield".

During the relevant period Harper made over 50 purchases of securities, all of which were sold within that time. The great majority of these purchases were resold within about one month, some in a matter of days. Harper's testimony that C.E.B. wanted to take several thousand dollars to use for purposes of speculation satisfactorily explains these activities. However, out of $36,500 in purchases of securities remaining in C.E.B.'s portfolio at the end of the relevant period,[59/] about $24,500 represented purchases of securities which were new issues underwritten by registrant or in which registrant was part of the selling group, or sales by registrant out of its trading account as principal.

59/ Excluding the gas and oil programs.

Davis

W.B.C. is a naval officer stationed overseas who wrote to Davis in January 1961, stating that Davis had been highly recommended to him and requesting that Davis furnish him "the necessary cards to open an account." As a result, W.B.C. executed a power of attorney or discretionary authority, authorizing Davis to act for him in securities transactions.

W.B.C.'s objective was to be as speculative as possible. There would, therefore, be no purpose in considering the quality of the securities Davis purchased for his account. However, an examination of the source of such securities is appropriate, especially since they were purchased without W.B.C.'s prior knowledge under the discretionary authority. About $10,300 in securities remained in W.B.C.'s account at the end of the relevant period of which about $9,500 represented the purchase of new issues underwritten by registrant or sales out of registrant's trading account as principal. Davis also purchased about $4,500 in securities which were sold during that period. All of those purchases were either new issues which registrant was the underwriter or securities sold out of registrant trading account as principal.

M.McM. opened an account with Davis in 1958. She and her husband had their first counselling discussion with him in January of 1960. At that time they had about $4,000 in savings and loan deposits, a 50% interest in real estate valued at about $10,000 and about $2,800 in securities which M.McM. had previously purchased through Davis.

The McM.s were newly married, in their late twenties. Their investment objective was to achieve financial independence in the future. Davis assured them that registrant would "be behind" anything he recommended and have "good knowledge of it," that in most cases Hodgdon would be a director and know well what was going on[60/] and that he, Davis, would not tell them to invest in anything he himself didn't own. Davis said they would have to have complete confidence in him, confide in him totally, have faith in his judgment and that even as small investors, the McM.s would have available to them the services of registrant's experts.

Neither of the McM.s had any prior experience in the securities field and the record is clear that Davis gained their confidence. They followed his recommendations and relied on him totally. They did not, generally, read prospectuses. Davis had told them that these documents always painted a bleak and sad picture and if people based their investment decisions on the prospectuses, no one would ever buy anything.

60/ Such representations were repeated from time to time in connection with recommendations for the purchase of securities.

M.McM. purchased eight real estate stocks and syndications for a total of over $10,000. Invariably Davis' presentation of these securities was made in terms of "yield" or "high yield." Despite Davis' testimony that he made a full explanation of the tax sheltered return to M.McM. at the time she purchased one of the syndication units, it is plain that to her "yield" meant only income in its true sense.[61/] Indeed, Davis' suggestion that M.McM. use her Putnam shares as collateral for a bank loan at 5½% to purchase Toledo Plaza which would yield 9½% "and that we would really gain" would certainly tend to support M.McM.'s conclusion that the funds she would receive from her Toledo Plaza investment would be "income" which "we would not be reporting for tax purposes."

Davis represented to M.McM. that the stock of Orbit Industries, a new issue which he recommended at $4, would sell up one to three points in three to six months. The portion of the Orbit prospectus entitled "Speculative Aspects of the Offering" readily indicates[62/] that his predictions had no reasonable basis in fact.

During the relevant period M.McM. made purchases totalling about $24,500. The last two purchases in her account were blue

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61/ "***where Mr. Davis would say, you know, that this is a 9 percent yield or this will be 9 to 13 percent yield, this indicated to me a regular income from this at that percentage."

62/ Davis was aware that M.McM. took notes of many of her conversations with him. She admits that she had difficulty where Davis employed technical language or phraseology. Davis has been given the benefit of any reasonable doubt where M.McM.'s notes might be in error for that reason.

chip securities purchased at her insistence for a total of about $4100.[63/] Of the remaining $20,400 all but one purchase for $436 were new issues of which registrant was the underwriter or securities sold out of registrant's trading account as principal.

63/ Davis advised M.McM. that no one ever got rich on blue chips; that the speculative securities would be the blue chips of tomorrow.

Hodgdon

A.S.W. met Hodgdon in 1959. She was the beneficiary of a trust fund and owned securities which were maintained in a custodial account. A Boston bank managed both the trust fund and the custodial account.

A.S.W. informed Hodgdon she would like to increase her income. At Hodgdon's suggestion, the bank transferred municipal bonds having a face value of $110,000 to her account at registrant. A.S.W. was an inexperienced and unsophisticated investor. She relied on Hodgdon and recalls no instance in which she did not follow Hodgdon's recommendation.

During the relevant period and pursuant to Hodgdon's recommendations, A.S.W. sold some of her municipal bonds and utilized the proceeds thereof to purchase $40,000 in securities. At least $30,000 of that amount represented new issues of which registrant was the underwriter or a member of the selling group. 64/

64/ It would appear from Hodgdon's testimony, "I think at that time I had available . . . a very small block of Buckingham . . ." that an additional sum of $4,500 represented the sale of Buckingham securities by registrant out of its trading account as principal.

Others

Mr. and Mrs. E.M.B. opened an account with Harry Ware, one of registrant's salesmen, in May 1960. They advised Ware that their investment objective was to prepare for their retirement and to put two children through college. Their discussions with Ware continued until about February 1961 when their account became active. Prior thereto they had made one relatively small purchase in May 1960. Ware constantly visited their home where he discussed securities with them. He knew they had a portfolio of securities valued at about $40,000 which they had bought over a period of years.

During the relevant period the B.'s had four different salesmen at registrant's firm. Ware left in the late summer or fall of 1961 and was replaced by Robert Scheutz. William Flynn became their registered representative in 1962 and was succeeded by a Mr. Parks in 1964. 65/

E.M.B. was not a naive investor. She had dealt with broker-dealers before coming to registrant and maintained accounts with other broker-dealer firms while doing business with registrant. Nevertheless, with two exceptions which were her own selections, all her purchases through Ware and Schuetz were the result of their recommendations. E.M.B. purchased about $14,500 in real estate syndications and real estate stocks. It is abundantly clear, however, that at the time of these purchases E.M.B. had no conception of

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65/ E.M.B. made no purchases through Flynn or Parks during the relevant period.

the nature of distributions from these securities.

When E.M.B. purchases two units of Rock Creek for $5,000 in September 1960, Ware told her she would receive a 10% dividend, tax free, that it possibly could be sold in 5 to 7 years and they would be able to realize nice capital gains. E.M.B. knew that this security could not be traded as freely as an ordinary stock. But Ware said they could sell it at any time. In April 1961, Ware recommended Falls Plaza and E.M.B. purchased four units for $4,000. Ware said it would yield 8% to 13% in dividends, tax free and that in 5 to 7 years the property would be sold and she would receive capital gains. E.M.B. had also purchased several real estate stocks in connection with each of which she was informed that she would receive a tax exempt dividend or a tax-sheltered retu rn or a tax free dividend. It was not until December 1963, upon receiving a communications from the issuer of one of her real estate securities, that E.M.B. realized for the first time that the payments she received included a return of capital.

In August 1961, at Ware's recommendation, E.M.B. purchased over $2,200 of units of Canandaigua Enterprises consisting of 7% convertible debentures plus common stock. The principal activity of the issuer was the proposed establishment of a race track. E.M.B. told Ware the funds to be used for this purchase were the proceeds of an insurance policy which had been set aside as an educational fund for her daughter, that the funds were not to be risked and had to be available in two years. Ware assured E.M.B. that she would

have a 7% income, the common stock would go up and if anything happened she was preferred and couldn't lose.

E.M.B. testified that when Parks took over her account in 1964 he declared it was the worst list of securities he ever saw and showed it to Haight who agreed. Even respondents are impelled to acknowledge, in their proposed findings of fact and conclusions of law, not only that the recommendations of both Ware and Schuetz were not suitable for E.M.B., but also that registrant's supervisory procedures were deficient.

Between January 1961 and January 1962 E.M.B. sold $40,700 of her original portfolio securities. between May 1960 and February 1963 E.M.B. made purchases of securities through registrant totalling about $55,000. $38,000 of that represented new issues of which registrant was the underwriter or sales by registrant out of its trading account as principal. About $14,400 of the remaining $17,000 represented securities purchased by E.M.B. at her own suggestion and selection rather than upon the recommendation of either Ware or Scheutz.

Mrs. M.I.B., a widow, started doing business with Ware in May 1961. At that time she owned 100 shares of South Georgia Natural Gas Co., had about $5,000 or $6,000 in savings and earned about $5,000 a year as a secretary of the Department of Commerce. She expected to retire in about two years and her objective, stated to Ware, was to obtain extra income through investment. M.I.B. mentioned $100 a month and Ware told her this could be easily realized.

During the relevant period M.I.B. dealt with three different salesmen at registrant. Fray Johns succeeded Ware in the fall of 1961. After Johns left registrant, M.I.B. met a Mr. Resnick at registrant's office. He became her registered representative.

M.I.B. was an unsophisticated investor who relied entirely on her registered representatives. She had engaged in no securities transactions other than her purchase of South Georgia when she came to registrant. Although she received prospectuses, she relied on the oral representations made by Ware, Johns and Resnick. She was unable to distinguish between a return of capital and a return based on profits.

M.I.B. purchased 2 units of Toledo Plaza for a total of $5,000 in June and July 1961 on Ware's recommendation. He represented to M.I.B. that there would be a 10% return, tax sheltered, that it couldn't miss and was bound to go up. She purchased 1 unit of Cheverly Terrace in February 1962 for $2,700 and was told by Johns that the return would be 10%, tax sheltered. When she visited registrant's offices in 1963 because she was concerned over her losses in earlier purchases, Resnick assured her she could recoup those losses.

Perusal of M.I.B.'s account discloses that during the relevant period she made purchases of securities totalling over $19,000. Every security purchased by M.I.B. represented either a new issue in which registrant was underwriter or a security sold out of registrant's trading account as principal. About $14,000 were used to acquire real estate syndications or real estate stocks, $2,500 went to purchase a mutual fund stock and $2,500 to buy speculative securities.

It has long been established that the relationship of a securities dealer or a salesman to an uninformed client is one of trust and confidence which approaches and perhaps equals that of a fiduciary. It arises out of the superior sophistication of the dealer, the reposal of special confidence by the customer in the dealer as specially qualified in the securities field and the dealer's acceptance of this reliance. It imposes upon the dealer the responsibility and duty to act in the customer's best interest in effecting transactions in his account.[66/]

The circumstances surrounding the opening and subsequent administration of the accounts of the customers referred to above establish the creation of the relationship of trust and confidence between these customers and the respondents with whom they dealt. In most instances the testimony of the customers readily establishes that they were inexperienced and unsophisticated and reposed reliance and confidence in their registered representatives. In two cases where such testimony is lacking,[67/] the clients' disclosures to Kitain and Haight of their financial resources and clients' acceptance of the financial plans prepared for them demonstrates the relationship of trust and confidence.[68/] In three instances involving two of

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66/ Lawrence R. Leehy, 13 S.E.C. 499, 505 (1943); Mason, Moran & Co., 35 S.E.C. 84, 89 (1953); Looper and Company, 38 S.E.C. 294, 300 (1958). See also Haley & Company, Inc., 37 S.E.C. 100, 106 (1956).

67/ Kitain's client, A.L.A; Haight's client, G.M.B.

68/ The Ramey Kelly Corporation, 39 S.E.C. 756, 761 (1960).

Carr's customers[69] and one of Davis',[70] all members of the armed forces, a fiduciary relationship is implicit in the existence and utilization of written powers of attorney authorizing Carr and Davis to act in their behalf. Registrant taught its salesmen the practice of inducing customers to repose complete trust and reliance in it. Having successfully achieved the relationship of trust and confidence, registrant and its salesmen took flagrant advantage of their customers and failed to act in their best interests.[71]

The accounts of Adam's clients[72] reveal that 95% and 80%, respectively, of their total purchases of securities during the relevant period represented registrant's underwritings or sales out of its trading account as principal. The accounts of Carr's clients[73] reflect 85% and 87% respectively of such purchases; Kibler's two clients'[74] accounts show 98% and 76%; Kitain's client's[75] account, 83%; Haight's clients'[76] accounts, 98% and 90%; Harper's clients'[77] accounts,

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69/ G.C.A. and H.C.F.

70/ W.B.C.

71/ Cf. J. Logan & Co., 41 S.E.C. 88 (1962).

72/ G.Y.G. and C.A.S.

73/ G.C.A. and H.C.F.

74/ D.B.S. and K.F.J.

75/ A.L.A.

76/ F.E.T. and G.M.B.

77/ C.J.M., A.K.D. and C.E.B.

95%, 96% and 67%;[78] Davis' clients'[79] accounts 95% and 97%; Hodgdon's client's[80] account, at least 75%; two accounts[81] of salesmen not named as respondents, 94% and 100%.

The foreoing demonstrates registrant's inordinate concentration[82] on recommendations and selections of securities for its clients from which it could derive the greatest amount of compensation. Certainly, registrant's recommendations could have been made from the virtually unlimited choice available to it on the exchanges and over-the-counter. In that event, of course, registrant would have been restricted to the lesser compensation to be realized from agency transactions.

Moreover, the representations of some of the respondents in relation to anticipated returns from real estate syndication

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78/ This figure does not take into account the cost of C.E.B.'s purchases of a unit of Canadian Apache 1961 gas and oil program or the cost of one-half interests in two other gas and oil programs.

79/ W.B.C. and M.McM.

80/ A.S.W.

81/ E.M.B. and M.I.B.

82/ The Hearing Examiner has attempted to compute only those purchases which passed through registrant's books. This would exclude, for example, mutual fund purchases such as Aberdeen but would include purchases of Putnam.

purchases constituted misrepresentations of material[83/] facts and omissions to state material facts. As shown above, Adam, Kibler, Kitain, Haight, Harper, Davis and others not named as respondents represented to their clients, in recommending the purchase of interests in real estate syndications,[84/] that they could expect various percentages of return on their investments ranging from 7% to 10% and in one instance as high as 13%, or they represented in reports or analyses to thier clients on the status of their accounts that they might expect yields, returns or income of similar percentages. As previously demonstrated, these representations had no reasonable basis in fact either in any of the prospectuses or elsewhere. And

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83/ "The basic test of materiality * * * is whether a reasonable man would attach importance * * * in determining his choice of action in the transaction in question." List v. Fashion Park, Inc., 340 F. 2d 457 (C.A. 2, 1963); restated in S.E.C. v. Texas Gulf Sulphur Company, ___F. 2d____, (C.A. 2, 1968): C.C.H. Fed. Sec. L. Rep. ¶ 92,251. Information disclosing that all or part of the realization from an investment would be a return of capital must be deemed important.

84/ No reference has been made, heretofore, to the pertinent portion of the Richmond prospectus. It anticipated that limited partners should receive annual cash distributions of $130 on each $1,000 unit, based upon the operations of the issuer during the preceding year. It includes the caveat that the anticipation is neither a promise nor a guarantee. The prospectus breaks down the $130 figure into taxable income for Federal tax purposes and the return of capital, the latter category constituting the larger portion through the first three years, but cautions against construing the breakdown as the actual relationship that will exist with respect to future anticipated cash distributions.

even assuming that the prospectus of Richmond would support the 7% - 9% representation by Kibler or the "high return" representation by Harper, these statements would, nevertheless, be unwarranted since the customers were not furnished with the information contained in the prospectus as to the portion of the anticipated return which would constitute a return of capital.[85/]

This conclusion is reached without regard to the inability of the clients to comprehand the complexities which make "tax shelter" possible and give rise to the return of capital. It is also pertinent in that connection that, with the exception of Davis, each of the respondents named above as persons making representations as to a percentage return on syndications had at least one client whose stated objective was either to acquire or to increase his income from investments. Returns of capital do not take the place of true income. Further, Adam's investment summary to C.A.S. stating all income from real estate to be tax free; Haight's report to G.M.B. estimating an increase in income which would, in fact, consist of distributions from real estate investments; Harper's reports to C.E.B. of "yields" from such investments and to A.K.D. of tax free income emphasize the utilization of distributions as a substitute for true income.

Manifestly, Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are each singly culpable of a breach of their relationship of trust and confidence with the aforesaid clients in selecting

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85/ Mutual Real Estate Investors, 41 S.E.C. 557 (1963).

so abnormal an amount of securities from which they and registrant would profit most. All except Carr have also singly breached that relationship in their representations to those clients of returns from real estate syndications. As charged in the order for proceedings, they each, together with registrant, engaged in practices which operated as a fraudulent course of conduct in that they induced these customers to repose trust and confidence in them in the belief that they would act in the customer's best interests.

In addition, the consistently high percentage of self-enriching recommendations for security purchases among seven respondents, four of whom were officers of registrant and one a branch manager, and the substantially similar representations of returns from real estate syndications by six of these respondents, discredits coincidence and impels the conclusion that registrant and the above-named respondents engaged in a scheme to defraud.[86/]

Other representations and activities sustain the allegations of the order for proceedings as to respondents' breach of trust and confidence, lulling and the sale of clients' seasoned securities to purchase unseasoned securities to the benefit of respondent.

Despite Adam's statements in G.Y.G.'s financial plan of the need to keep speculation below 10%, he unjustifiably increased that area to 20%. Although G.Y.G. desired safety in investments, he

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86/ Cf. Century Securities Company, Securities Exchange Act Release No. 8123 (July 14, 1967); James DeMammos, Securities Exchange Act Release No. 8090 (June 2, 1967).

recommended and she purchased $11,000 of Paragon stock and $3,000 of Lord of the Flies stock, both rank speculations. His "congratulations" to G.Y.G. on the state of her account were obviously premature and lulling, as was his extravagant prediction of an increase in the net worth of G.Y.G.'s investments to $120,000 minimum in the next 5 or 10 years. He recommended the purchase of Wise Homes stock to C.A.S. on the same day he recommended that G.Y.G. sell that stock. He represented to C.A.S. that the syndication properties could be sold in about five years at substantial capital gains, obviously without reasonable basis in fact. His reports to C.A.S., referring to tax free income in respect of syndication investments and his valuation of such investments at cost without attempting to ascertain current prices were attempts to lull the client into a false sense of security.

Kitain's explanation for switching D.G.Y.'s Aberdeen Fund investments to Putnam to achieve the $25,000 break-point benefits is not persuasive, especially since the sale of the Aberdeen shares involved a loss to D.Y.G. of about $880. Obviously, the switch assured Kitain commissions on two transactions without awaiting consummation of the second or risking a change of mind by D.G.Y. In fact, D.G.Y. refused to replace the withdrawal in Aberdeen with the result that Kitain realized commissions on total investments of $50,000 whereas only $30,000 of mutual fund securities had been purchased. D.G.Y. required liquidity in investments. Nevertheless, Kitain not only

recommended she invest $10,000 in units of Toledo Plaza but also misrepresented that the units would be marketable. Kitain utilized A.H.R.'s account for his own transactions without A.H.R.'s knowledge. Protestations of friendship hardly absolve this action. His representation to A.L.A. that Wise Homes was better than Jim Walters was unjustified.[87/] His lulling response to A.L.A.'s inquiry about Wise Homes, i.e., that they wanted the stock to go down, needs no further comment.

Haight failed to recommend to F.E.T. the purchase of any electronics, utilities, or chemical securities in contradiction of the financial plan he proposed. Nor was there any justification for the concentration of real estate securities - over 70% - in F.E.T.'s purchases. Haight's written and oral statements to G.M.B. of increases in income for 1964 to $5,115 and $7,000, respectively, predicated upon distributions from real estate investments, was patently lulling. His failure to inform G.M.B. that registrant acted for both the seller and the buyer in respect of her purchases of Falls Plaza, Cheverly Terrace and Toledo Plaza and to advise her of the remuneration or commission received by registrant constituted a violation of Rule 15c1-4 promulgated under the Exchange Act.

Harper's representations to C.J.M. that a real estate syndication unit might be sold in twenty-four hours, that she could benefit

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87/ Martin A. Fleishman, Securities Exchange Act Release No. 8002 (December 7, 1966).

from appreciation when the property would be sold in ten years and that she could probably double her money on Lord of the Flies were clearly without reasonable factual bases. The concentration of about 75% of C.J.N.'s total purchases and about 70% of A.K.D.'s total purchases in real estate securities was abnormal. Harper failed to follow his own financial plan for A.K.D. in neglecting to purchase utilities or bank stocks and making only minimal purchases in other categories he stressed. He purchased highly speculative oil programs despite the client's insistence on safety in investments. He lulled her with assurances of huge profits, i.e., "we'll keep you comfortable at the $500,000 to $750,000 level";[88/] with projections, on September 28, 1962, of income of $15,000 to $18,000 by 1964 in the face of actual income of about $5,200 for the period January through September 1962; with reports of "yields" and distributions from real estate as tax protected income. For reasons similar to those stated in respect to A.K.D., Harper failed to adhere to his financial plan for C.E.B. He also lulled C.E.B. with reports of "yields" from real estate distributions.

Davis' misguided advice to M.McM. to ignore prospectuses as a basis for investment decision was patently inconsistent with his duty to her. His representation that the stock of Orbit would rise 1 to 3 points in 6 months had no reasonable basis in fact.

88/ A.K.D. had a portfolio of securities valued at about $200,000. The account had just been opened.

Ware's statements to E.M.B. in respect of her Canandaigua purchase present a glaring fraud.

Hodgdon created registrant's method of operations and as principal stockholder benefitted most from its activities. He was in over-all charge of its affairs. He prepared the registrant's advertising material which was designed to entice the unsophisticated investor.[89/] He selected its underwritings and the securities in which it traded and knew or should have known of the magnitude of the purchases by registrant's customers of such underwritings and securities. Indeed, much of the teachings of the training courses under the guise of tax savings, were designed to foster the sale of real estate and gas and oil securities either underwritten by registrant or of which registrant was part of the selling group. It is noteworthy that between 1960 and 1962 inclusive, during which period a substantial portion if not most of the transactions here involved occurred, registrant averaged 47% of its income from underwritings alone. The more definite statement filed by the Division omits to name Hodgdon as one of the respondents, singly, who failed to supervise. But, in addition to his activities set forth above in respect of his client, Hodgdon "must share responsibility for the fraud by virtue of his knowledge of and participation in managing registrant's affairs."[90/]

89/ "T)he Commission's duty to protect the gullible is apparent. And, we have held it is not improper to judge advertisements by their impact on the segment of the public at which they are aimed." Marketlines, Inc. v. S.E.C. 384 F. 2d 264 (1967); cert. den.390 U.S. 947.

90/ Cf. Melvin Hiller, Securities Act Release No. 8476 (December 24, 1968).

Haight was vice-president in charge of sales throughout the relevant period. Carr was senior vice president, a member of the board of directors, owner of more than 10% of registrant's stock, conducted training sessions on sales techniques and real estate and was available for consultation on financial plans. In addition to culpability for their activities in respect of their clients' accounts described above, both are responsible, as charged, for failure reasonably to supervise registrant's registered representatives with a view to preventing the fraudulent course of conduct found above. 91/

Registrant, of course, is responsible for the acts of its agents. 92/

Accordingly, it is concluded 93/ that in the offer and sale of securities, registrant, Hodgdon, Haight, Carr, Kibler, Kitain, Adam, Harper, and Davis willfully 94/ violated and aided and abetted willful violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder; and registrant, Haight and Carr willfully violated Section 15(b)(5)(E) of the Exchange Act.

91/ Kitain, although designated a branch manager, was not assigned any supervisory functions.

92/ Armstrong, Jones and Company, Securities Act Release No. 8478 (December 27, 1968).

93/ Proof by a preponderance of the evidence is "the standard consistently used in broker-dealer administrative proceedings." Norman Pollisky, Securities Exchange Act Release No. 8381 (August 13, 1968), and the standard of proof used in making and reaching the findings of fact and conclusions of law in this initial decision. Respondents' implicit suggestion that a different standard may apply is untenable.

94/ A finding of willful violation does not require a showing of intent to violate the law. "It is sufficient that the person charged with a duty intends to do the act which is violative of the statute." Norman Pollisky, supra.

Sale of Unregistered Securities

A. U. S. Infrared Corporation

U. S. Infrared Corporation ("USI")was incorporated in the District of Columbia in August 1960 by Amann and others,as promoters, to develop and produce an infrared radiation detection device which had been invented by Patrick McCarthy ("McCarthy"). The principal purpose of the device was to detect overheating in mechanisms. At the time of USI's incorporation, McCarthy was engaged in discussions with the Pennsylvania Railroad regarding the detection of overheated railroad hotboxes.

Amann was then a vice president of registrant. He brought USI to Hodgdon's attention and suggested that registrant undertake sale of USI stock as a private placement.[95/] Hodgdon spoke with McCarthy and reviewed the USI situation. He then advised Amann that he was unimpressed with McCarthy and found USI unattractive. Other officers of registrant, including Haight, also attempted to discourage Amann from continuing with the USI project. Upon Amann's insistance that he was already committed and had interested some of registrant's salesmen, Hodgdon agreed to allow Amann to proceed with a private placement of USI stock, but admonished that he was not to commit or involve registrant in the future without Hodgdon's knowledge.

95/ Sections 5(a) and 5(c) of the Securities Act, as applicable here, make it unlawful to use the mails or interstate facilities to sell or deliver, or offer to buy or sell a security unless a registration statement is in effect as to such security. Under Section 4 of the Securities Act, the provisions of Section 5 do not apply to transactions by an issuer not involving any public offering.

Nevertheless, Hodgdon issued a memorandum directed to all registered representatives dated August 19, 1960, before any sales of stock had been effected, advising that commitments had been made in respect of USI without the approval of registrant's management and that rather than embarrass the member concerned by terminating his relationship with USI, the salesmen should consider the following before offering USI stock to their clients:

> "1. It is our opinion that Infra Red is a gross speculation. There is no semblance of a management team and none in sight.
>
> 2. Thousands of companies with interesting products in the scientific and electronic domain have gone bankrupt.
>
> 3. We take a dim view of time spent on projects which do not meet with the approval of the firm."

The memorandum also requested each salesman to submit a list of customers he intended to approach and warned that in order to pass as a private placement the combined total number of purchasers must not exceed 25 persons. It also stated that all salesmen were to inform their clients that registrant regards this situation as too speculative to merit approval at this time. All salesmen interested in offering USI stock to their clients were required to sign the letter of August 19, 1960. Hodgdon caused the price of the USI stock to be increased from $1.00 per share to $1.10 per share, the increase to represent registrant's compensation. Between August 30, 1960 and October 7, 1960 registrant sold 45,430 USI shares at $1.10 per share to 18 purchasers.

Registrant received its compensation of $.10 per share. 96/

It is readily apparent from Amann's testimony 97/ that USI was insolvent at its inception. It is unnecessary to recount the various problems USI met during its short existence, both financial and technical, in the development of its devices. It is sufficient to state that neither the infrared pistol, later known as the Telerad, nor the various other infrared devices which USI attempted to develop to meet the requirements of the Pennsylvania Railroad ever found acceptance by the railraod or succeeded as a marketable item. McCarthy died in December 1960 and operation of USI was taken over by Phillip Luckhardt who had been hired earlier as a marketing and management expert with the title vice president and secretary. The enterprise collapsed in the late fall of 1961. Efforts to sell its products to other electronic firms on a royalty basis were unsuccessful.

During its existence USI was financed through two purported private offerings in addition to the sale of the 45,430 shares referred to above. In a memorandum dated April 20, 1961, directed to "Stockholders, U.S. Infrared Corporation, signed by Amann, "Chairman, Executive Committee" and Luckhardt, "Vice President and Secretary of the Corporation," USI offered stockholders the right to purchase "one share for each three shares now held, at a price of $1.25 per share." The statement of income attached to the memorandum

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96/ Respondents admit that no registration statement was filed in respect of USI.

97/ Amann testified, in substance, that prior to the organization of USI, McCarthy worked out of Ford Studebaker's shop on funds advanced by Studebaker.

disclosed a net loss of $11,806 for the period August 18, 1960 through April 19, 1961. USI succeeded in raising $8,000 through this offering.

Finding itself again in need of funds, USI issued a letter dated July 21, 1961 advising stockholders that it had signed an underwriting agreement with a Washington investment firm for the public sale of 130,000 shares at $2 per share. The letter offered its stockholders unsecured $1,000 convertible debentures. It also stated that the stock to be acquired by debenture holders through conversion of the debentures "will be registered with the S.E.C. under a 'long form' registration, and thus immediately liquidable [sic] upon going public." The letter was signed by Amann as "Chairman, Executive Committee, U. S. Infrared Corporation, Vice President, Hodgdon & Co." A progress report accompanying this letter included a memorandum by Amann dated July 19, 1961, entitled "To Interim Financial Interests," signed by him as "Vice President, Hodgdon & Co., Chairman, Executive Committee U. S. Infrared." This memorandum assured a public underwriting "so that the interim financial interests can liquidate at market prices immediately upon the public offering." It also refers to the corporation as having "two ready products for military and commercial use."[98/]

When the letters referred to above were brought to Hodgdon's attention he discharged Amann from registrant and sent a telegram to purchasers of USI stock stating that the letters of July 19, 1961

98/ USI realized $15,000 from the sale of these debentures.

and July 21, 1961 were not submitted to registrant for approval, that registrant disavows all literature sent to customers since Amann had no "right or reason" to write as vice president of registrant and indicated Amann is resigning from registrant.

At or about the time of the first offering Amann received 25,000 Class B Shares[99/] of USI for services rendered, 5000 of which he turned over to registrant. A total of 58,000 Class B shares had been distributed among Amann, McCarthy, Ford Studebaker, who had financed McCarthy before the organization of USI, counsel for the corporation, and the corporation's accountants, all for services rendered. During its existence every balance sheet issued by USI showed a deficit or net loss. The Statement of Income for the period August 18, 1960 through April 19, 1961 showed a net loss of $11,806. USI's balance sheet as of May 31, 1961, showed a deficit of $21,467; as of June 30, 1961 a net loss of $19,072.31;[100/] as of July 31, 1961 a net loss of $24,940.89.

Four of Amann's customers testified to purchases of about 9,500 shares of USI stock and a $10,000 debenture.

J.A.R. had become a client of Amann's in the fall of 1959 as the result of a cold call. He testified that at Amann's recommenda-

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99/ The difference between the Class A and Class B shares was that the latter would not share in any dividends or liquidation for a period of one year.

100/ The reduction in net loss for June 30, 1961 from the May 31, 1961 figures arises from USI's sales of a product known as Acquitrol for which it had become the distribution agency. It soon developed, however, that problems with the product caused cancellation of so many of its sales that the experiment was short-lived and sales of Acquitrol reflected in the June 30, 1961 figure were substantially unrealized.

tion he purchased 2,000 shares of USI stock in late August 1960. Although Amann explained the infrared device to J.A.R. he furnished no literature regarding USI and told J.A.R. nothing of the distribution or proposed distribution of USI Class B shares to promoters, management and others for services rendered.

S.L. bought 2,000 shares of the original USI issue as a result of Amann's recommendation. He knew that the stock was not registered but received no literature relating to USI and no information regarding the distribution of USI shares to promoters, management and others for services. S.L. also purchased 2,667 shares of USI stock as a result of the April 1961 solicitation and received the USI offer relating to the sale of debentures in July 1961.

I.J.W. purchased 1,820 shares of USI in August 1960. Amann explained the infrared pistol and that it was not yet fully developed. I.J.W. received no brochure on USI but believes there may have been some indication that McCarthy and others were receiving stock in consideration for services rendered.

A.P.S. bought convertible debentures totalling $10,000 in July 1961 through Amann. He did not receive a brochure or other literature and since he was not a stockholder of USI he did not receive the solicitation letter of July 21, 1961.

Although F.C. did not testify, the record discloses that Amann sold 1,000 shares of USI to him at the time of the original offering. Amann refers to F.C. as one of the people who

"bought stock behind me." Apparently this description also includes others who purchased about 4200 shares.

Amann approached Davis, one of the respondents herein, who invested a total of about $1,800 on three different occasions. Davis' testimony discloses that at the time of the first purported offering of USI stock Amann told him about the device, the purposes of the company and the use to which they proposed to put the device in relation to railroads and fire detection. Davis never saw a demonstration of the device nor is there any indication in his testimony that he received any literature or any advice regarding the distribution of shares to promoters, management and others for services rendered.

Kitain sold about 6,200 shares of USI stock to four customers.

A.H.R. was one of Kitain's financial planning clients. He bought 1,500 shares in August 1960 and an additional 500 shares during the April 1961 offering. A.H.R. testified that he received no literature. Although Kitain stated that A.H.R. received a report, the document to which he refers consisted of a description of the devices USI proposed to develop, the proposed use of the proceeds of the sale of stock and a description of management personnel. The report lacked financial data and any reference to the distribution of Class B stock to management and others. It is sufficient that respondent's brief admits that " . . . Kitain did not go into [USI's] financial situation and did not state that management had received

stock in consideration for services rendered . . ."

A.R.M., to whom Kitain sold 1,200 shares during the first offering and an additional 400 shares during the second offering in April 1961, saw a copy of the same report Kitain insisted had been shown A.H.R. Even accepting Kitain's testimony that he had informed A.R.M. that McCarthy had received Class B stock, the record contains no indication that he was advised that other shares had been distributed.

Kitain also sold 1,000 shares to D., his father-in-law and 2,000 shares to B. through the mails. Neither appeared as a witness. Kitain's testimony that the necessary information on USI was transmitted to B. in a two or three page handwritten letter hardly compels the conclusion that B. was furnished all pertinent information.

W.D.S. was Roper's customer. He had attended a meeting in registrant's offices at which the device was tested. He purchased 2,000 shares of USI in September 1960 but received no literature and no information regarding USI's financial condition.

A.A.C.R. purchased 1,000 shares of USI through Roper in August 1960. Roper told him little, if anything, about the company except the proposed use of the device.

R.M.O., a salesman of Apache's oil programs, purchased 2,300 shares of USI through Freed in August 1960. Freed furnished R.M.O. with a report on USI, but the report contained neither financial information nor advice as to the distribution of Class B shares to promoters and others.

M.K. and B.B. were both members of an investment club. Freed addressed one of the club's meetings as a result of which the club purchased 1,000 shares of USI on September 1, 1960. They were furnished nothing beyond Freed's oral statements regarding the device and its potential.

B. Paragon

Paragon Electric Manufacturing Corporation ("Paragon") was organized as a Maryland corporation in February 1960 to develop, produce and market for the building trade a reusable crimp type wire connector known as the Bucap or Dycap. The Bucap and the Bucapper, a companion tool used to crimp the Bucap, were both developed by Stephen R. Buchanan ("Buchanan").

The promoters of Paragon were Buchanan, who had little proficiency as a business man, Carl Gentry, who operated a machine shop but had no experience in the electrical field, George W. Owens ("Owens"), his employee and Leo Goodwin, Jr. ("Goodwin"), a wealthy official of an insurance company. Late in 1960 Paragon sought to raise capital. After initial discussions between Haight and the promoters, registrant was furnished financial statements and projections of operations and sales. The projections were optimistic, but the company had done no market testing.

In December 1960 the promoters met with Hodgdon, Haight and Guy Luttrell, registrant's executive vice president, at registrant's offices. Luttrell's functions included the investigation of real estate and industrial situations to determine whether registrant should undertake underwritings. Registrant was made aware that

Paragon had no tools or production parts. Samples of the products had been prepared from temporary molds. The Bucap design was stable but the Bucapper or tool had many bugs.101/ The company had orders, for the Bucap only, amounting in all to several hundred dollars. Goodwin had made loans to the company when its initial funds were exhausted. During the discussions with registrant "it was determined that finances were in short supply." The company had been subsisting on the funds borrowed from Goodwin totalling $40,000.

Hodgdon sought assurance from Goodwin that if registrant decided to sell the Paragon stock, the proceeds thereof would not be used to repay his loans. Goodwin rejected Hodgdon's request that he sign an agreement to that effect but indicated, orally, that he had no intention of collecting the indebtedness at that time.

On January 17, 1961, registrant undertook to privately place 20,000 Paragon shares at $5.50 per share.102/ All the shares were sold between February 3, 1961 and February 27, 1961 to thirteen purchasers. Paragon never got off the ground and in April 1963 filed a voluntary petition in bankruptcy. An investigation of Paragon's affairs authorized by and at the expense of registrant, after the bankruptcy, disclosed that $39,699 of the proceeds of the private placement had been used to repay the Goodwin indebtedness. Although

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101/ Eventually, it was abandoned.

102/ No registration statement was ever filed.

Luttrell had maintained liaison with Paragon, registrant first learned of the repayment of the Goodwin indebtedness as a result of the investigation.

Several witnesses to whom a total of 8,550 shares of Paragon were sold by registrant's representatives testified to the circumstances surrounding their purchases.

Carr sold 2,000 shares of Paragon stock to D.B.A. and a similar amount to G.E.A., a financial planning client. D.B.A. was furnished no information of any kind, financial or otherwise, beyond a description of the device Paragon proposed to develop. Although G.E.A. read extensive material on Paragon's management personnel, it is apparent that he was furnished no financial data and knew nothing of the company's indebtedness to Goodwin.

Four customers[103]/ purchased 4,500 shares of Paragon stock through three of registrant's representatives. None of these customers were furnished any financial or other information regarding Paragon other than a description of the devices proposed to be developed. One saw a pamphlet containing pictures of the Bucap and Bucapper and visited Paragon's plant prior to his purchase.

C. Data Processing Corporation of America

Data Processing Corporation of America ("DPCA") was organized by H. Jefferson Mills, Jr. ("Mills") in 1959. As expressed in certain literature prepared for DPCA, its primary objective was to establish and operate data processing service centers in various metropolitan areas serving business, industry and government.

103/ M.S., A.A.C., W.D.S. and A.H.C.R.

At Mills' request, Amann commenced advising Mills as to methods of financing DPCA. Amann anticipated receiving a finders fee of ½ of 1% and an agreement to that effect was prepared but never signed by DPCA. Later it was agreed that "founders stock" would serve as Amann's fee in place of cash.

In 1960 Amann introduced Mills to Hodgdon for the purpose of having registrant consider the underwriting of an issue of DPCA stock. In March 1961, DPCA prepared a brochure offering 4,000 shares at $3.50 per share "on a private basis only," for a total of $14,000. Mills and Hodgdon met again in March and June 1961. At the last meeting Hodgdon refused to underwrite a DPCA issue but advised Mills that registrant would be interested in becoming a member of a selling group if a major broker-dealer would be the underwriter.

DPCA's main prospect lay in its negotiations with Aberdeen Fund for the furnishing of data processing services but they proved fruitless. The enterprise failed. 104/ No public offering was ever made. In February 1964 DPCA's counsel advised that DPCA had no assets.

From March through May 1961, before Mills' final conference with Hodgdon, Amann commenced purchasing DPCA shares. He also interested registrant's registered representatives who purchased the stock for themselves and their customers. Admittedly, no registration statement had been filed with respect to DPCA's shares.

104/ A document dated June 30, 1961, prepared to induce an underwriting of an issue of DPCA stock, includes a statement of financial condition which discloses deficits as of December 1960 and May 31, 1961.

Amann bought 3,500 shares of DPCA stock, some at $2 and some at $3.50 for a total of $8,400. He retained 1,100 shares, sold 400 shares to his customers, 1,800 shares to Kitain, 100 shares to Haight and 100 shares to Freed. All checks covering purchases of DPCA stock were made to Amann's order and the proceeds paid over by Amann to DPCA. 105/

Amann testified that he showed some of the purchasers the March 1961 brochure prepared for the purported private offering of 4,000 shares. He did not name these purchasers. The brochure describes business, management, aspirations, capitalization and stock ownership of the corporation, but contains no financial statements or other financial information. Amann agrees that he did not tell purchasers of DPCA's financial condition. Indeed, his proposed findings state only that he "spoke to Burton Kitain and Homer Davis about DPCA stock" and "suggested to James F. Haight and Samuel A. Freed that each of them may want to purchase 100 shares of DPCA."

Amann approached Kitain and furnished him with the March 1961 brochure. Kitain purchased 600 shares of DPCA for his own account and, in addition, sold 100 shares to D. and 100 shares each to two customers, A.H.R. and A.L.A., whose accounts have been discussed supra. Neither was furnished any literature or financial

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105/ None of the DPCA transactions were put through registrant's books. Every effort was made by Amann and other registered representatives who sold DPCA shares to keep Hodgdon in ignorance of these transactions. When they were brought to his attention in February 1962 inadvertently, through the complaint of a customer, he severely rebuked all those involved.

information regarding DPCA. Kitain asserts that he told A.H.R. all he knew. But he saw only the March 1961 brochure which contained no financial data. His proposed finding in respect of A.L.A. indicates he told her only that the investment was highly speculative.

Davis utilized his discretionary authority to sell 100 shares of DPCA to W.B.C. The record discloses only that Amann "spoke to * * * Davis about DPCA stock" as shown above.

It is well settled that the exemption from registration by an issuer provided by the former Section 4(1) of the Securities Act,106/ which exempted transactions not involving any public offering of securities, is not available unless the persons to whom the offer is made are shown to have the same kind of information in respect of the issuer as would have been disclosed by a registration statement or to have access to such information.107/ Moreover, the burden of proving entitlement to the exemption from registration is not only on the issuer,108/ but also on the broker-dealer who claims the benefit of the exemption.109/

It is abundantly clear that none of the persons to whom respondents sold the stock of USI, Paragon or DPCA were furnished the necessary financial or other information. The literature a few such customers received contained no financial data. None of the

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106/ Now Section 4(2).

107/ S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); Gilligan Will & Co. v. S.E.C., 267 F.2d 461 (C.A. 2, 1959), cert. den. 361 U.S. 896. Strathmore Securities, Inc., Securities Exchange Act Release No. 8207 (November 13, 1967).

108/ S.E.C. v. Ralston Purina Co., supra.

109/ Gilligan Will & Co. v. S.E.C., supra.

purchasers of USI stock, with one exception, was informed of the substantial number of the issuer's shares held by promoters and others. The vague statement to that exception, i.e., that McCarthy and others were receiving shares, is hardly adequate. **None of the purchasers of Paragon stock were advised of the obligation to Goodwin** which constituted about 40% of the proceeds of the offering or that the proceeds would be used to repay that obligation. Nor can the technique of mechanically obtaining investment letters from some of the purchasers frustrate the basic policy of registration under the **Securities Act.**110/ Such investment letters are "necessarily self-serving and not conclusive as to their actual intent." 111/ Indeed, Amann signed such a letter in USI but, nevertheless, sold some of his shares to his customers.

Since respondents have not sustained the burden of proof that the purchasers of the three offerings were able to fend for themselves,112/ it is concluded that they were public offerings requiring registration under the Securities Act.

Respondents urge that since none of the three unregistered securities were offered to more than 25 persons, the statutory exemption provided by the former Section 4(1) of the Securities Act was available to them. This position is predicated upon the publication

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110/ Elliot & Company, 38 S.E.C. 381, 395 (1958).

111/ Strathmore Securities, Inc., supra, See also B.F. Bernheimer & Co., Inc., 41 S.E.C. 358, 363 (1963).

112/ S.E.C. v. Ralston Purina Co., supra, p. 125.

in the Federal Register (11 Fed. Reg. 10952, 1946) of a letter form of release by the General Counsel written in 1935 113/ which stated, in substance, that the Commission had previously expressed the opinion that an offering to an "insubstantial number of persons" is an exempted transaction under Section 4(1) and that an offering to "not more than approximately twenty-five persons is not an offering to a substantial number and presumably does not involve a public offering." Respondents assert, that the release had not been revoked or amended at the time of the three purported private offerings and was, therefore, binding on the Commission.

However, respondents overlook the fact that the portion of the release on which they rely was merely an introduction to the Commission's interpretation of the availability of the Section 4(1) exemption. It was not intended to, and did not in fact, represent the Commission's position as is demonstrated by the excerpts set forth below which follow the introduction and which negate respondents' position.

> "I would call your attention to the fact that in previous opinions it has been expressly recognized 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. I conceive that the following factors in particular should be considered in determining whether a public offering is involved in a given transaction." (underscoring supplied)

The release then raises a number of factual circumstances which would give rise to serious question regarding the availability of

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113/ Securities Act Release No. 285, January 24, 1935.

the exemption regardless of the number of persons to whom the security may be offered,114/ including the statement:

> "I also regard as significant the relationship between the issuer and the offerees. Thus, an offering to the members of a class who should have special knowledge of the issuer is less likely to be a public offering than is an offering to the members of a class of the same size who do not have this advantage. This factor would be particularly important in offerings to employees, where a class of high executive officers would have a special relationship to the issuer which subordinate employees would not enjoy."
> 115/

Accordingly, respondent's contention is rejected.

The more definite statement furnished by the Division omits the names of Hodgdon and Haight in designating those charged "singly" with violation of Sections 5(a) and 5(c) of the Securities Act. Division, nevertheless, seeks a finding that Hodgdon and Haight also violated those sections.

Despite Amann's attempt to conceal the DPCA transactions from registrant it cannot escape responsibility for the actions of the registered representatives. Amann was an officer of registrant. Its

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114/ Cf. S.E.C. v. Ralston Purina Co., supra, stating: "But the statute would seem to apply to a public offering whether to few or many." p. 125.

115/ In his article, "Some Observations on the Administration of the Securities Laws, 42 Minn. L. Rev. 25 (1957), former Commissioner Orrick referred to a "rule of thumb" that "an offering made to not more than 25 or 30 persons who take the securities for investment and not for distribution, is generally a private transaction not requiring registration." But the "rule of thumb" offers little comfort to respondents since Commissioner Orrick surrounds that statement with assertions that the principal test is not numbers, but wheth the offerees need the protection afforded by registration.

registered representatives sold DPCA stock to registrant's customers. Haight, a vice president, purchased DPCA stock for his own account and therefore was aware of the offering and of Amann's activities. The offices of registrant were undoubtedly used in effecting sales of the stock. Registrant, therefore, is responsible for the acts of its agents in the sale of DPCA stock as well as the stock of USI and Paragon. Hodgdon, having selected USI and Paragon as private offerings to be sold by registrant and by virtue of his position in management bears responsibility for the sale of those issues. In addition, for the reasons set forth above in respect of respondents' failure to act in the best interests of their clients, Haight and Carr also bear responsibility, as charged, for failure reasonably to supervise registrant's salesmen with a view to preventing these violations.

It is concluded, therefore, that registrant and Hodgdon, together with Carr in the offer and sale of the stock of Paragon and with Amann and Kitain in the offer and sale of the stock of USI, willfully violated Sections 5(a) and 5(c) of the Securities Act, and that registrant together with Amann, Kitain and Davis willfully violated that statute in the offer and sale of the stock of DPCA. It is concluded, further, that Haight and Carr willfully violated Section 15(b)(5)(E) of the Exchange Act in connection with the offer and sale of the stock of Paragon and USI and that Haight willfully violated that section in respect of the offer and sale of the stock of DPCA.

Misrepresentations and Omissions of Material Facts

USI

Although Amann's customers were made aware that the U.S.I. stock was highly speculative, he, admittedly, does not believe he showed registrant's memorandum of August 19, 1960 to all his USI investors.[116] At least one denied being informed of registrant's poor opinion of the stock and was told by Amann that the device was well received by the railroad and that the results were excellent. None were advised of USI's financial condition and at least two[117] had no information regarding the distribution of Class B stock to promoters and others. Amann represented to one customer that U.S.I. had tremendous potential and offered the customer an opportunity to get in on the ground floor before the company went public through registrant who might be interested in it later.[118] Amann's letter of July 21, 1961, soliciting purchasers for USI's convertible debenture, stated that the stock to be acquired upon conversion of the debentures "will be registered" and "immediately [become] liquidable."[119] The purchaser of the $10,000 debenture[120] was not told by Amann, in advance of his purchase, that

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116/ J.A.R.

117/ J.A.R., S.L.

118/ S.L.

119/ S.L. received this letter.

120/ A.P.S.

the bond was unsecured or that Amann personally would receive a commission of 10% on the transaction. Moreover, Amann represented to him that he had received an engineering report on the device that was "fantastic"; that it was made by foreign engineers which would give the product a potential foreign market and that USI had only a small amount of stock outstanding and he visualized the common stock (to which the bonds were convertible) as "really rising."

Two witnesses testified to purchases of USI stock from Kitain.[121/] Both knew that this was a speculative venture but neither was informed of USI's financial condition. A.H.R. was told nothing regarding the Class B shares distributed to promoters while A.R.M. was informed only of McCarthy's shares. Kitain does not deny that A.H.R. invested "with the understanding that my investment would ultimately, when the issue went public, be translated into securities at a certain price." Kitain represented to A.R.M. that the venture would be profitable, that USI would go public at a higher price later and that the customer was coming in on the ground floor. Kitain testified he stated, instead, that the company would have to have some kind of an offering sometime in the future to establish a market. But the customer's testimony in respect of Kitain's representation at the time of his second purchase of 400 shares during the April 1961

121/ A.H.R., A.R.M.

offering, that this was an opportunity to come in at a more favorable price since there would be a public offering at a higher price later, remains uncontradicted.

Two of Roper's customers, [122] to whom he sold a total of 3,000 shares,were furnished no information relating to USI's financial condition or to the Class B shares distributed to promoters. W.D.S. was not advised of the contents of registrant's memorandum of August 19, 1960.

R.M.O.,to whom Freed sold 2,300 shares,was not furnished financial information or advice regarding the distribution of Class B shares. He was not made aware of registrant's attitude toward this venture. Moreover, an investment club which Freed addressed and which purchased 1,000 shares lacked the same information Freed failed to furnish R.M.O. In addition, Freed represented that the company would have insurance on McCarthy's life. The application for such insurance was rejected.

122/ W.D.S. and A.A.C.R.

In making the optimistic representations, by Amann in respect of USI's tremendous potential, by Kitain as to its prospective profitability and by both as to the advantages to be gained by purchasing before USI went public, Amann and Kitain impliedly represented the existence of an adequate basis therefor.[123/] In the light of the facts set forth above, it is manifest that at the time of USI's first offering there was no basis in fact for such representations. Registrant's memorandum of August 19, 1960 must have put them on notice of the lack of foundation for their statements. Nor did USI's situation improve with the passing of time. It remained insolvent. Its deficiencies and losses merely increased. Their representations were, therefore, contrary to the basic obligation of fair dealing imposed on those who engage in the sale of securities to the public. The "fantastic" report to which Amann referred was non-existent and his visualization of the price of the stock "really rising" was misleading and fraudulent.[124/]

In addition, Amann and Kitain omitted to inform their customers of USI's adverse financial condition,[125/] of the Class B

123/ Aircraft Dynamics International Corp., 41 S.E.C. 566, 570 (1963).

124/ MacRobbins & Co., Inc., 41 S.E.C. 116, 119 (1962), aff'd sub. nom. Berko v. S.E.C., 316 F. 2d 137 (C.A. 2, 1963).

125/ Cf. Sanford H. Bickart, Securities Exchange Act Release No. 8269 (March 8, 1968).

shares which had been issued to USI's promotors and others and of registrant's memorandum of August 19, 1960. These omissions constituted further violations of the anti-fraud provisions of the securities laws.[126/] Known or easily ascertainable facts bearing on the justification for the recommendation should accompany it.[127/] The misrepresentations are not less improper because the customers were advised that the stock was speculative[128/] or because Amann and Kitain, themselves, purchased USI stock.[129/]

Other salesmen of registrant omitted to advise their customers of registrant's financial condition, the contents of registrant's memorandum of August 19, 1960 and the distribution of Class B stock and one salesman falsely stated that USI had insured McCarthy's life. Moreover, Hodgdon's undertaking to sell the USI stock despite his unfavorable attitude toward the company indicates his willingness to disregard the basic requirement for fair dealing in favor of a profit.

Paragon

Carr represented to D.B.A. that the Bucap would be distributed by General Electric and Westinghouse; that the customer should buy before Paragon went public and he would make a profit

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126/ N. Pinsker & Co., Inc., 40 S.E.C. 285, 291 (1960)

127/ Martin A. Fleishman, Securities Exchange Act Release No. 8002 (December 7, 1966); Albert J. DiGiacomo, Securities Exchange Act Release No. 7572 (April 12, 1965).

128/ Commonwealth Securities Corporation, Securities Exchange Act Release No. 8360 (July 23, 1968)

129/ Alfred Miller, Securities Exchange Act Release No. 8012 (December 28, 1966)

after it went public; that there had been talk of a stock split before the public offering. Carr's testimony failed to refute any of these statements. Carr failed to advise D.B.A. of Paragon's adverse financial condition.

Goldberg, one of registrant's salesmen, represented to M.S. that Paragon's devices would have good market reception, that the items were patented and that the Navy would set up a small plant to handle the items. M.S. was not furnished financial information.

Registrant's confidential report on Paragon dated January 17, 1961, directed to "All Representatives", carried references to the distribution of Paragon's products to be made "through already well established dealers in the trade;" and asserted that "although the stock is speculative, projected profits seems (sic) suitable as well as realistic and market potential appears sufficiently significant to insure a good return on an investment in this Corporation."

Owens testified that Paragon never attempted to publicly offer its stock, that it had no licensing agreements with any company with respect to any of its products and that a split of Paragon stock was never proposed. Carr's statements of distribution of Paragon's products by General Electric and Westinghouse, of a forthcoming public offering[130/] and talk of a stock split were unjustified

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130/ Cf. Charles P. Lawrence, Securities Exchange Act Release No. 8213 (December 19, 1967).

misrepresentations, having no reasonable basis in fact. His failure to inform his customer of Paragon's poor financial condition also violated the duty of a dealer in securities to fully disclose all the material facts.

Goldberg's and Roper's representations were equally unwarranted. There had been no discussions regarding a plant with the Navy and Paragon's products were not patentable.

Registrant's confidential report to its salesmen was an unsupportably over-optimistic evaluation of the facts available to it, prepared for the sole purpose of stimulating the sale of Paragon stock. Further, Hodgdon was not justified, in the absence of a firm agreement with Goodwin, in assuming that the proceeds of the offering would not be used to repay Goodwin's loan.

DPCA

Kitain represented to A.H.R., who purchased 100 shares of DPCA stock, that there was a good possibility that DPCA would get a contract from Aberdeen Fund.

Amann sold R.S. 100 shares in May 1961. He represented to this customer that DPCA was working diligently on a public offering.

Davis purchased 100 shares of DPCA stock for W.B.C., a member of the armed forces who had given Davis discretionary authority over his account. Davis wrote W.B.C. in June 1961 that "there

will be an initial public underwriting late this year or early next year. This also will be a small limited public offering. Those buying at that time will no doubt have to pay considerably more than the $3.50 which represents our cost base."

The above named respondents had no reasonable bases for the statements and predictions they made. DPCA's negotiations with Aberdeen never reached the point where an agreement for DPCA's services could reasonably have been anticipated or even described as a "good possibility" and the representation was, therefore, misleading.[131/] Mills' intermittent casting about for an underwriter of DPCA securities hardly justified either assurance of a public offering or the implication of such assurance present in the representation that DPCA was "working diligently" toward that end and these statements were unjustified. Even assuming a reasonable expectation of a public offering, the prediction that the price of the stock on the future offering would exceed the original purchase price was utterly without foundation and, in view of the unseasoned and speculative nature of the stock, could not be justified.[132/]

131/ Cf. Albion Securities Company, Inc., Securities Exchange Act Release No. 7561 (March 24, 1965).

132/ Cf. Linder, Bilotti & Co., Inc., Securities Exchange Act Release No. 7460 (November 13, 1964).

Van Pak, Inc.

Van Pak was incorporated under Iowa law in August 1959. It was the successor to a firm of the same name that had been certified as an Interstate Commerce Commission carrier and had become inactive in 1957. Charles N. Barrett ("Barrett"), Van Pak's president, had been a principal of its predecessor. In 1952 he commenced experimenting with a containerized method of shipping and storing household goods. Van Pak was organized to operate as a containerized freight forwarder of household goods. A forwarder assumes full responsibility to the shipper but purchases its transportation through a network of agents from common carriers.

On February 20, 1962 Van Pak commenced a public offering of 80,000 of its common shares at $5.00 a share through registrant, as underwriter. Registrant sold the entire offering by April 18, 1962.

At the time of the offering substantially all of Van Pak's business was with the Government, forwarding the household goods of military personnel. In December 1961, Military Traffic Management Agency ("MTMA"), an instrumentality of the United States Government, had approved Van Pak's tender of service as a result of which it submitted its door-to-door tariff or rates to approximately 580 military installations within the continental United States and to overseas installations. A Department of Defense regulation provides that only those carriers will be used which furnish high quality service at lowest overall cost to the Government. Van Pak was in direct competition not only with van line movers, many having larger financial resources, but also with the MTMA. It is pertinent that the

Van Pak prospectus clearly states that Van Pak did not originate the containerized transportation method and that it is likely that others will use it.

Barrett testified that Van Pak had no contracts with the Defense Department, the State Department or any other government agency. He never told registrant that Van Pak anticipated government contracts. Van Pak had no guarantee of income as a result of its tender of service. While the registration was in preparation and thereafter, Van Pak furnished registrant with its financial data.

In February 1962, the lifting of a freeze on the movements of military dependents caused considerable optimism. Barrett addressed two meetings of registrant's personnel in March 1962. It is evident from the testimony of some of those present at the meetings that Barrett projected Van-Pak's earnings to between $1 to $1.50 per share. The pro forma statements prepared by Van Pak indicated substantial increases in net income for 1962 through 1964.

Prior to the offering Van Pak sought to register its shares in the State of Virginia. The Virginia authorities requested Van Pak to withdraw its application since Virginia law [133/] would deny effectiveness to the registration statement of an insolvent issuer and the financial statements in its prospectus disclosed that Van Pak was insolvent. [134/]

133/ Code of Virginia, Section 13.1-513(a)(5).

134/ Respondents urge that insolvency resulted from the Commission's insistence that Van Pak write off $208,007 in development costs which it, theretofore, had carried on its books as an asset.

In April 1962, Hodgdon sold 3,000 shares of Van Pak to Mrs. A.S.W., a woman who had opened an account with him in 1959 and who recalls no instance in which she did not follow his recommendations. She testified that Hodgdon represented to her that Van Pak was a good investment; had a new type of container, had or would be obtaining government contracts and should therefore grow rapidly; would realize profits in a short time, and expected to start paying dividends. Nothing was said of Van Pak's financial condition. Hodgdon agrees this customer would be willing to take his recommendation. He states that he told the customer that this was a real flyer, a wild and wooly situation that held promise and he was quite high on it, but otherwise went into very little detail. The Hearing Examiner credits the customer's testimony. But even Hodgdon's testimony indicates his failure to advise A.S.W. of Van Pak's insolvent condition.

Haight sold 40 shares of Van Pak stock to Mrs. I.H. to whom he stated that when the price doubled she could sell half and regain her original investment. Haight told her nothing of Van Pak's financial condition.

Haight told E.W.C. who purchased 50 shares of Van Pak that the company had defense contracts and should have a bright future. He said nothing of the fact that the stock could not be sold in Virginia.

On Kitain's recommendation A.H.R., a financial planning client, bought 50 shares of Van Pak. A.H.R. was advised that the stock was a speculation. Kitain represented further, however, that the company had great prospects and that the president of Van Pak had told him that there were possibilities for getting a Defense Department contract.

To P.J.K., to whom Kitain sold 50 shares of Van Pak stock, he said the company was not making a profit but the stock had fine prospects of doubling itself in about 6 to 9 months.

C.A.P. and R.S.H. purchased 100 shares and 50 of Van Pak stock, respectively, but Kitain told neither of them anything of Van Pak's financial condition.

R.W.B. purchased 100 shares of Van Pak in February 1962 on Carr's recommendation before seeing the prospectus because of Carr's insistence that immediate action was urgent since very few shares were left. In fact, the issue was not sold out until April. Carr also represented to the customer that the company had developed a new type of shipping container, that there was a great demand for the product, that he was certain the stock would appreciate and make money, that it could double or better in 6 months. Carr said nothing about Van Pak's financial condition.

Carr sold 200 shares of Van Pak stock to L.E.C. to whom he represented that the stock was one of the most promising issues that

had come to his attention and that it couldn't miss. Carr did not disclose that the stock could not be sold in Virginia.

Carr failed to disclose any information regarding Van Pak's financial condition to G.C.C. or J.R.I., both purchasers of 100 shares of Van Pak. He did not advise J.R.I. that the stock could not be sold in Virginia.

C.A.S., a financial planning client, purchased 740 shares of Van Pak on Adam's recommendations in two transactions. Adam represented that Van Pak was about to get a contract with the Defense Department and that the stock had an excellent chance of appreciation in a short time. Adam did not tell the customer that the stock could not be sold in Virginia nor did he mention Van Pak's financial condition.

N.B. III purchased 100 shares of Van Pak through Kibler who represented that Van Pak had developed a new containerized method of shipment; that Van Pak had or expected contracts with the Defense Department and other government agencies; that in all probability the stock would increase a point or two by fall. H.S.Q. bought 200 shares of Van Pak after being told by Kibler that Van Pak was engaged, with government contracts, in overseas hauling of household goods in a new form of container. Kibler said nothing about Van Pak's financial condition or that the stock could not be sold in Virginia.

D.R.B. purchased 100 shares of Van Pak through Davis. Davis represented that this was going to be a terrific investment; that the customer could not afford to pass it up; that Van Pak had a new

process of storage or moving; that Van Pak expected to get substantial contracts that would materially increase the value of the stock and that it was likely to appreciate 2 or 3 or 4 times in a very short period. Davis said nothing about Van Pak's financial condition. M.McM., a financial planning client, purchased 50 shares of Van Pak on Davis' recommendation. She was told that Van Pak had a revolutionary new process of containerized moving and that Van Pak was going to have contracts with the Government. Davis also sold 100 shares of Van Pak to M.B. He said he had a rather hot item in Van Pak; that Van Pak had a relatively new item, a steel container; that they expected to make $250,000 in the forthcoming year. M.B. asked for a prospectus but Davis advised he was out of them. When the customer said he would wait, Davis urged immediate action saying that if he didn't take it then it would no longer be available.

Harper represented to C.J.M., a financial planning client to whom he sold 100 shares of Van Pak, that she might be able to sell the stock at a much higher price and get a high return.

Harper told A.K.D., to whom he sold 100 shares, that Van Pak had a new method of moving. He said nothing of Van Pak's financial condition.

Roper represented to R.C.S. that Van Pak was going into a new phase of containerized freight and failed to disclose that Van Pak could not be sold in Virginia. He told H.H.H., who bought fifty shares of Van Pak, that the company had a new concept in packing

household goods and they ought to make money on it. Roper did not advise H.H.H. that Van Pak stock could not be sold in Virginia.

Flynn represented to O.L. that Van Pak had an entirely new concept in containerized shipping and that it might double in a year and one-half or two years. Flynn stressed that the available stock was limited because folks were buying it in large blocks and urged the customer to quick action. He also stated that growth potential of the stock was good because of the government contracts they expected.

Schentz sold J.E.C. 50 shares of Van Pak but omitted to inform the purchaser of the Van Pak's financial condition.

Roley, a registered representative, omitted to advise J.I.S., to whom he sold 100 shares, that Van Pak stock could not be sold in Virginia. He told L.K.H., to whom he sold 100 shares, that an officer of registrant had said that at the end of the year the stock would be more valuable than any one they could choose. He neglected to say that the stock could not be sold in Virginia.

Allan Altschull, a registered representative, sold T.P. 40 shares of Van Pak stock after representing to her that Van Pak was expecting to get defense contracts. He said nothing regarding Van Pak's financial condition or that the stock could not be sold in Virginia.

Luttrell sold E.N.H. 400 shares of Van Pak stock after stating they had plans for big contracts with the Government. Nothing was said about the company's inability to sell its stock in Virginia.

The predictions of profits and price rises had no reasonable basis in fact.[135] The Commission has held repeatedly that predictions of substantial increases in the price of speculative securities within short periods of time cannot be justified and are inherently fraudulent.[136] The representations as to the existence or anticipation of contracts with the government or its agencies were clearly false and fraudulent.[137] The representations that Van Pak had a new or revolutionary type of container, or a new concept, or a new containerized method of shipment or a new process were equally misleading.[138] Additional representations including "hot item," expectation of dividends, the need for immediate action by customer when the issue was selling slowly, "can't miss," and "can't afford to pass it up" were patently false. Further, respondents' failure to inform customers of Van Pak's insolvency and of the refusal of the State of Virginia to accept its registration (which obviated the need to explain the reason for the refusal) were contrary to registrant's obligation of fair dealing.[139 & 140]

135/ Shearson, Hamill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965).

136/ Norman Pollisky, Securities Exchange Act Release No. 8381 (August 13, 1968).

137/ Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962).

138/ R. Baruch and Company, Securities Act Release No. 7932 (August 9, 1966)

139 & 140/ Martin A. Fleishman, supra.

Respondent's arguments in justification of their activities in the sale of Van Pak stock have been considered and found wanting. The "bullish feeling" which respondents contend was justified by favorable reports from issuer hardly warrants predictions of price rises which, even if stated as opinion, bear the hallmark of fraud.[141/] The contentions that witnesses might have transmuted Van Pak's actual relationship with the government to "government contracts" cannot stand in the face of the testimony of at least ten witnesses that representations of existing or anticipated government contracts were made. Respondents' assertion that the salesmen's various statements representing that Van Pak had a new and revolutionary process or method of shipment were merely innocuous claims that Van Pak was doing something different has little merit. Such representations present to the investor prospects of profits to be derived from the advantage to be gained, at least temporarily, from a virtual monopoly.

141/ Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962).

Apache Canadian Gas and Oil Program 1961

Commencing in August 1961, registrant participated in the offering of Apache Canadian Gas and Oil Program 1961 ("Apache Canadian") at the price of $5,000 per unit. The proceeds of the offering were to be used for the exploration and development of Canadian gas and oil leaseholds. The cover page of the prospectus stated that each unit is subject to completion costs which cannot exceed $2,500. Elsewhere in the prospectus it was indicated that if any well drilled has encountered reserves of gas and oil in commercial quantities, Apache Corporation ("Apache") will impose additional assessments.

In September 1961 Harper sold a unit of Apache Canadian to A.K.D., a financial planning client. A.K.D. was entirely inexperienced in the securities field and relied upon Harper completely.[142/]

Apache advised registrant and the latter informed its salesmen of Apache's policy that investors who assume the risks inherent in gas and oil exploration should be in the 48% tax bracket and in a position to sustain that bracket, prospectively, for at least five years. Harper was aware of this policy which registrant adopted. He had no reason to assume that A.K.D. could qualify. His belief that extensive capital gains over a period of two years might place her in the 48% bracket for those years does not meet the policy. Harper's statement that he told A.K.D. about the 48% tax bracket at the time of her purchase of the oil program (albeit, without adding the need for sustaining that bracket for at least 5 years) is not credited. But

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142/ "What he recommended, I bought."

even if accepted, it would not justify his recommendation in the face of A.K.D.'s inexperience and reliance upon him.

Harper told A.K.D. that the investment would really grow into something profitable and that the tax benefits inherent in the investment would affect, at least in part, the customers' capital gains arising out of the sale of securities.

It is readily apparent from A.K.D.'s correspondence with Harper, even apart from her testimony as to conversations with him, that she was informed only of the initial $5,000 cost of the unit. Harper did not advise her of either the $2,500 assessment for completion costs to each unit or the additional assessments which might be made, as set forth in the prospectus. Harper's assertion that the additional assessments 143/ came as a surprise to him and caused him to protest the assessments is not supported by the record which contains only references to communications with the issuer relating to the Harper's mistaken impression that Apache would handle financing of investors' assessments beyond the $7,500 figure.

Some few months after her purchase of the program, A.K.D. indicated to Harper her displeasure with the investment and its continuing obligations and commenced a series of requests that it be sold. On various occasions, however, Harper assured her that it would be a mistake to get out; that she was lucky to be in it; that he knew of several anxious buyers; that it had a fine potential and over a period of years she could ultimately realize $125,000 or as much as $250,000.

143/ A.K.D.'s investment in this program increased to about $15,000 by 1964 due to additional assessments.

In addition, in periodic written analyses of A.K.D.'s portfolio Harper ascribed various values to the unit and commented on its future potential. On February 8, 1962, he used "$7,500/," the amount representing the actual cost of the program, "until a full evaluation is completed." He noted, however, that "Bids have run as high as $25,000 per unit. This may be considered under evaluation." The value figure in his analysis of January 8, 1963 is not decipherable. But he stated there: "Also, the estimated income should run as much as $40,000 within the next 15 - 20 years." The analysis of August 4, 1964 carried a value of $24,120 and later Harper increased that sum to $35,000.

Some time in February or March 1962, Harper told C.E.B., another of his financial planning clients, that Apache Canadian looked like one of the best programs Apache ever had, but that it was too late to acquire one in the usual way since they were no longer available from Apache.[144/] This was merely a prelude to his recommendation that C.E.B. purchase a unit of Apache Canadian from Roper who was now offering for sale a unit he had previously acquired. Harper arranged the sale from Roper to C.E.B. for the sum of $12,050.00,[145/] on which Roper made a profit of $5,000.

At the time, in 1962, when he recommended the program so

144/ C.E.B. was not in the 48% tax bracket. Harper testified that C.E.B. was reluctant to reveal his income for some time and that he didn't know about C.E.B.'s bracket.

145/ It would appear, despite a document entitled "Sale and Trust Agreement dated January 1, 1962," that the sale did not occur until December 1962 and the earlier document was prepared to assure that C.E.B. would be entitled to tax benefits accruing from ownership of the unit during the year 1962. Thus, a letter from Roper to C.E.B. dated December 12, 1962 refers to C.E.B.'s "option to buy" the program and Harper's review of C.E.B.'s portfolio in August 1962 makes no mention of the unit.
C.E.B.'s total payments in December 1962 were $15,250, of which Roper received $12,050, the balance representing additional assessments.

highly to C.E.B., Harper was hardly in a position to have sufficient concrete information to warrant his representation. The program had been offered on August 21, 1961. In his evaluation of the program for A.K.D. on February 8, 1962, Harper used merely cost plus as value because it was too early to make an evaluation.

In July 1962, Apache advised Roper, by letter, that it offered him the sum of $9,700 for the unit, assuming the most recent assessment had been paid, which would bring total payments up to $9,500.[146/] Without regard to the ambiguous testimony by C.E.B. as to whether he was informed of Apache's bid, Harper must have seen Apache's letter before the transaction was completed despite his testimony, first denying it and later expressing uncertainty. Whether, in view of the various discount factors applied by Apache, the bid was indicative of the value of Roper's unit is not controlling. Inasmuch as it was the only bid for Roper's interest, Harper should have given it some consideration in evaluating his recommendation to C.E.B. which brought Roper a 40% profit on his investment. Even without the discount factors, but predicated on the fact that Roper had not paid the most recent assessment of $2,500, Apache's valuation would fall far short of the $12,050 paid by C.E.B.

In Harper's various analyses of C.E.B.'s property and portfolio and in other correspondence, Harper valued C.E.B.'s Apache's Canadian program on January 3, 1963 at $22,000; on February 24, 1964 at $30,000; and on February 27, 1964 he advised C.E.B. that according to the president of Apache it had a possible worth of $100,000.

146/ Apache's bid is predicated upon a discount of 5% plus a second discount of 20% "for risk and profit." Apache reserved a right of first refusal to purchase investors' interests.

A vice president of Apache Corporation testified there was no basis for the valuation of $22,000 as of June 1963 or of $30,000 and $100,000 as of February 1964. In a letter from Apache to Harper and Richardson dated May 7, 1964,Apache gave an admittedly ultra-conservative evaluation of $7,054.00 to the Canadian Apache Program.

Harper asserts he obtained the valuation figures, income projections and other data appearing in his analyses of A.K.D.'s and C.E.B.'s accounts from Apache. Some of the documents on which Harper relies to support representations of value are program reports by Apache to participants, none of which contain any estimate of value. Other Apache reports contain estimates of "ultimate gross income" which, of course, is not commensurate with current value. All the reports are replete with caveats. Harper points, in addition, to Apache's letter of December 11, 1962, which refers to an expectation of "a future income in excess of $20,000" and continues:

> "Were one to sell a unit at the present time I would think the investor would hope to realize $15,000 to $20,000 from it. A liquidating figure would be somewhat less than this figure."

But the letter is self-defeating for Harper's purposes. "Future income"is too indefinite as to time to warrant a plausible estimate of current value of an amount equal or nearly equal to that ascribed to future income, especially where income is the sine qua non of value. Harper should not have relied on it.

Harper also places reliance on an undated typewritten bid directed to Haight in the amount of $15,000 for his unit. The figures

"6/62" appear in ink at the top of the letter. Harper states the date is in his handwriting and that he saw the document in the middle of June 1962. But he cannot recall when he wrote the date. Since he must have had a special reason for inserting the date, his failure to recall when he wrote it is discredited as is the existence of the letter at that time.

In any event neither of the aforesaid letters would justify, as fair and reasonable, his recommendation in February or March 1962 that C.E.B. purchase this unit at $5,000 over Roper's cost.

The Hearing Examiner credits Harper's testimony of July 1965, taken during the course of the investigation, that he is sure he told Hodgdon, Haight and Carr of the Roper-C.E.B. transaction as against his testimony at the hearing that he can't be certain that he mentioned it to anyone at registrant.

Harper's activities in respect of the sale of Canadian Apache to these two clients and his representations to them thereafter in respect of the value and future realizations from that security presents a reckless disregard of his duty and responsibility of fair dealing.147/ To recapitulate briefly, he put A.K.D. into tne security despite her inadequate tax bracket. He did not know whether C.E.B. qualified in that respect. His recommendation that C.E.B. purchase Roper's shares at a price $5,000 in excess of Roper's investment without any reliable evidence of its value constituted a palpable fraud on C.E.B. for Roper's benefit. He failed to advise A.K.D., a particularly unsophisticated investor, of her additional financial obligations under the program over and above its initial cost. The testimony of Apache's vice president discredits any reasonable basis for Harper's predications of ultimate realizations of $125,000 to $250,000 to A.K.D. and $100,000 to C.E.B. and for the various valuations he assigned to the program in his analyses to both clients.

Roseville-Detroit Limited Partnership

The Roseville-Detroit Limited Partnership (Roseville-Detroit) was organized in December 1963 by Hodgdon and Baskin, as general partners and promoters, to acquire title to a department store property in Roseville, Michigan. Limited partnership interests were offered to the public pursuant to full registration at $1,000 per unit commencing March 2, 1964. Registrant was the underwriter.

147/ J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964).

The initial registration statement filed with the Commission stated the intention "to provide for a return to the Limited Partners equal to 9% of their cash capital contribution." Thereafter, a letter of comment by the Commission's Division of Corporation Finance pointed out that "inasmuch as distributions made to the Limited Partners will represent both investment income and a return of capital, the references to a 9% return on capital contributions should be deleted to avoid statements which seriously overstate the true rate of return on the proposed investment." The letter also suggested that the prospectus point out that, based on tabular presentations in the registration statement, "the true rate of return on invested capital is approximately 4% for the first year."

Although Hodgdon, Baskin and their counsel disagreed with the comment set forth above, the initial prospectus was revised and that issued on March 2, 1964 stated that $40 of the first year's distribution of $90 "will be a taxable return on investment (representing a 4% return on invested capital during the first year), while $50 will represent tax-free return of capital (generated from the excess of the provision for depreciation of fixed assets over amortization of mortgage principal)". The prospectus also disclosed that upon the completion of the offering no market will be established for the limited partnership interests and that no broker-dealer activity or market can be expected to develop other than isolated brokerage transactions effected through registrant.

Sales meetings of registered representatives at which the Roseville-Detroit offering was discussed were addressed by Hodgdon,

Haight and Baskin. The registered representatives were informed that the return or income or yield would be either $90 or 9% or both. A summary of information in respect of the Roseville - Detroit offering entitled GEM STORE - DETROIT, MICHIGAN was distributed to the salesmen. The summary contained the following statement:

"WHAT YOU GET - (1) Income @ 9% payable quarterly."

Haight sold to G.M.B., a financial planning client 5 units of Roseville-Detroit. G.M.B. testified Haight said she would receive a high rate of return of 7 to 8% or 7 to 9% and a tax shelter. Haight testified he told G.M.B. the expected payout was 9% or $90 per unit or both.

B.B.N. purchased 5 units through Kitain. He testified Kitain said that the rate of return would be about 9% of which 50% would be non-taxable. Kitain says he told B.B.N. that the distribution would be at least $90 per unit. In either case B.B.N. was not told that the distribution on his investment would be,in part,a return of capital. B.B.N. considered the distributions received from his investment the same as a dividend from General Motors stock.

J.R.W., Jr. bought one unit of Roseville-Detroit on Harper's recommendation. Harper informed him that Roseville-Detroit had an income provision of approximately 9%. Nothing was said about marketability or tax advantages. J.R.W. was not informed that part of the funds he received would be a return of capital.

R.W.B. purchased two Roseville-Detroit units through Kibler who said he would receive a 9% return on his investment and more.

Kibler testified, he stated, in addition, that the customer could anticipate the return would be tax-sheltered and had explained the meaning of the term to R.W.B. on earlier occasions.

In letters by Adam to G.Y.G., a financial planning client, and to two other customers relating to the Roseville-Detroit offering, Adam stated, variously, that it "yields 9% with about one-half of it tax sheltered" and "we get a 9% return".

Resnick told M.I.B., who bought one Roseville-Detroit unit, that there was a guaranteed 9% return and it had income tax shelter.

John F. Saffer, Jr. wrote to three customers describing the Roseville-Detroit offering and in each letter he stated: "This investment is designed to return 9%, part of which is tax sheltered."

As one of the general partners of Roseville-Detroit, Baskin was directly interested in assuring completion of the distribution of the issue. Baskin attended registrant's sales meetings at which the Roseville-Detroit underwriting was discussed and agreed he addressed those meetings once or twice. Regardless of whether he, Hodgdon or Haight actually informed the salesmen that the rate of return on a Roseville-Detroit unit would be $90.00 or 9%, or whether Baskin actually furnished the information from which the memorandum distributed to salesmen stating "Income @9% payable quarterly" was prepared, he was present at the meeting and must have been aware of the memorandum.

Baskin asserts that the only allegation charged against him "singly" is not supported by the record. The allegation is found in subparagraph IIB(12) of the order for proceeding which asserts, in substance, a failure of supervision. Baskin's position has merit. He did not function as a vice president or director.148/ His position as assistant to the president required him to do, in effect, whatever Hodgdon asked him to do. The record does not establish that this included any supervisory duties other than to review correspondence after it had been forwarded, from the end of 1963 to early 1964.149/

But Baskin is also charged by the order for proceedings with acting "in concert" with other respondents in the making of untrue and misleading statements of material fact and in omitting to state material facts regarding the rate of return on the Roseville-Detroit securities. He was present when oral statements were made to registrant's representatives as to the rate of return. He knew of the written material distributed to registrant's salesmen and he knew that both the oral and written material were intended for repetition by the salesmen to prospective purchasers. He knew that the registrant's predictions as to return and income were in direct contradiction of the letter of comment by the Division of Corporation Finance with which he disagreed, but which was followed in Roseville-Detroit's final registration statement. These factors constrain the conclusion that he acted, in participation with the others responsible, in a scheme to defraud.150/

148/ Division's reply brief states "no objection" to Baskin's proposed findings to that effect.

149/ Cf. Schmidt, Sharp, McCabe & Company, Incorporated, Securities Exchange Act Release No. 7690 (August 30, 1965).

150/ Billings Associates, Inc., Securities Exchange Act Release No. 8217 (December 28, 1967), p. 5.

Baskin urges that the existence of an agreement is essential to establish a scheme to defraud. He concedes that "the 'agreement' can either be expressed, or inferred from the conduct of the parties charged," but contends that even such an agreement is absent here. It is too plain to require extended discussion that, even granting that Baskin neither made the oral statements referred to above nor prepared the summary distributed to salesmen, his knowledge of both, without protest, demonstrate his tacit approval from which his agreement to these activities may properly be inferred. " * * * [P]articipation in a scheme may be shown from the surrounding circumstances if they should have alerted the persons to the existence of such scheme." 151/

Baskin contends, further, that even if 9% were represented as the true rate of return it would not be a misrepresentation; that neither 4% nor 9% may be characterized as a rate of return; that as a sound economic fact, it is impossible to ascertain the "true" rate of return until the property has been sold because depreciation allowances taken by the owners of real property do not represent the actual degree to which the property may have depreciated. He argues that Division's position that "taxable return" and "true return" are equivalent is untenable, pointing to the provisions for "recapture" in the Internal Revenue Code which provide for upward adjustment of underestimated taxable returns reported in previous periods.

151/ Billings Associates, Inc.; supra.

But even the acceptance, arguendo, of these "economic realties" would not aid Baskin's case. Rather, they would mark as premature, without reasonable basis in fact and, therefore, as misrepresentation, the 9% return which registrant represented to its salesmen at the Roseville-Detroit sales meeting. Moreover, Baskin completely overlooks the reference to "Income at 9% * * *" in the memorandum distributed to salesmen. Certainly "income" cannot be said to denote any of the concepts Baskin would attribute to "return". 152/

152/ At the close of Division's case Baskin moved to dismiss the order for proceedings as to him. The Hearing Examiner reserved decision since, under Rule 11(e) of the Commission's Rules of Practice, a ruling by a Hearing Examiner which disposes of all or part of a proceeding may be made only in his intial decision. The motion is denied.

The representations set forth above in respect of the offer and sale of units of Roseville-Detroit constituted violations of the anti-fraud statutes of the securities laws. Full disclosure would have required that customers be informed not only of the anticipated 9% or $90 distribution, but also that, as indicated in the prospectus, $40 thereof would represent taxable income on the investment and, as an adverse factor which might affect the customer's investment decision,153/ that the balance of $50 would constitute a return of capital. The statement by Kitain to his customer that 50% of the return would be non-taxable is hardly adequate. Moreover, the fact that some of these customers may have received prospectuses does not cure the misrepresentation.154/ Further, they had no conception of the meaning of the tax-free return of capital referred to in the prospectus, of which their salesmen were aware. The lack of understanding on the part of G.M.B., Haight's client, has been demonstrated above. She understood tax shelter to mean she paid less taxes. G.Y.G., Adam's client, had, in Adam's words, "complete lack of knowledge of investments." M.I.B. was a completely unsophisticated investor. B.B.N., Kitain's client, considered his distributions from Roseville-Detroit the same as dividends from General Motors. The testimony of R.W.B., Kibler's client, displays utter confusion. Harper's representations of anticipated income of 9% to J.R.W. needs no further comment. In view of the background of the ultimate language in the prospectus, registrant's statement predicting income at 9% in its written summary was flagrantly fraudulent.

153/ Cf. Charles P. Lawrence, supra; Richard J. Buck & Co., Securities Exchange Release No. 8482 (December 31, 1968).

154/ J.P. Howell & Co., Inc., Securities Exchange Act Release No. 8087 (June 1, 1967) p. 4.

It has been found above that Baskin participated "with the others responsible" in a scheme to defraud in the offer and sale of the Roseville-Detroit security. Hodgdon and Haight had the same knowledge ascribed to Baskin in reaching that determination and are "the others responsible" for the scheme to defraud.

It is concluded, therefore, that Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act, and Rules 10b-5 and 15c1-2 thereunder, were wilfully violated by the registrant in the offer and sale of all the securities set forth below and by the individual respondents in the offer and sale of the securities indicated below as pertaining to them, and said individual respondents aided and abetted registrant's wilful violations of the aforesaid sections and rules.

As to USI; Amann and Kitain.
As to Paragon; Carr.
As to DPCA: Amann, Kitain and Davis.
As to Van Pak; Hodgdon, Haight, Kitain, Carr, Adam, Kibler, Davis and Harper.
As to Apache Canadian; Harper.
As to Roseville-Detroit; Haight, Kitain, Harper, Kibler, Adam and Baskin.

Further, for the reasons set forth above, Hodgdon is found to have wilfully violated the aforesaid sections and rules in the offer and sale of all of the aforesaid issues except DPCA, by virtue of his position and responsibilities in connection with the management of registrant. Registrant, Haight and Carr wilfully violated Section 15(b)(5)(E) of the Exchange Act in failing to reasonably discharge their supervisory duties. Carr, however, is not responsible as to DPCA.

II. Books and Records - Failure to send Confirmations

Van Pak

Upon learning that the stock of Van Pak could not be registered in Virginia, Hodgdon announced to registrant's salesmen that counsel had advised that sales to Virginia residents were unobjectionable if made outside of that state; that, if possible, it would be preferable to use a legitimate address of the customer outside of Virginia to which to mail confirmations; that if the sale was not made in Virginia the confirmation must be marked "unsolicited."[155/] Hodgdon stated that he knew registrant could not solicit "on a large concerted scale" in a state in which the security was not registered. Although he did not define a "legitimate address," he advised the registered representatives that they could solicit at business addresses of prospective purchasers outside of Virginia. Apparently, he considered federal installations as "outside of Virginia," even if located in Virginia.

Registrant's order clerk testified that during the Van Pak distribution the trading department was instructed that confirmations directed to Virginia residents were to be marked as unsolicited orders. Since even the order tickets of salesmen who testified they were not aware of the problem contained the "unsolicited" notation, the instruction must have been construed to include order tickets.

155/ Several different terms or words were used in marking order tickets and confirmations to denote that the order had not been solicited. For simplification, the term "unsolicited" will be used to represent all these variations.

Respondents contend that the term "unsolicited" was intended to mean not solicited in the State of Virginia. But this interpretation is inconsistent with Hodgdon's preference that an address outside of Virginia be used for confirmations. Under respondents' professed understanding of the meaning of the term, that device would have been entirely superfluous.[156/] Moreover, the record contains instances in which Virginia residents were actually solicited in Virginia, yet their confirmations were marked "unsolicited."[157/]

Since the record does not establish that the order tickets were marked "unsolicited" by the salesmen,[158/] they cannot be said to have aided and abetted in the making of false entries in registrant's records. Having instructed the registered representatives and the trading department as to the procedure to be followed, Hodgdon shares responsibility with registrant for the fictitious entries.

Amann and Kitain sold shares of USI, which they had purchased, to a Mr. C. and to A.H.R., respectively. Both were clients of registrant.[159/] A.H.R. made his check payable to Kitain because

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156/ This was not the first time the registrant faced this problem. In connection with the Watson distribution in which registrant was underwriter, confirmations of sales to some Virginia residents were forwarded to the office of an attorney in Washington, D.C. The practice ceased when he protested.

157/ It is unnecessary to discuss the propriety of registrant's assumption that solicitation of Virginia residents made outside of Virginia was proper.

158/ Except Carr who marked an order which was, in fact, unsolicited.

159/ C. did not testify.

Kitain asked that it be done that way. Amann testified C. was one of the persons who bought "behind me". A.P.S., who purchased the convertible debenture, thought he was dealing with registrant but acceded to the request of Amann, an officer of registrant, to make the check payable to **USI** and send it to registrant, to Amann's attention. None of these transactions passed through registrant's books. None of these customers received a confirmation. It does not appear that at least A.H.R. and A.P.S. had reason to believe they were not dealing with registrant.

Kitain sold **DPCA** shares to one of his customers and Davis to four. All were clients of registrant. Registrant's stationery and facilities were used by the salesmen in effecting these transactions. The customers did not receive confirmations.

These circumstances, compel the finding that the aforesaid transactions in the stock of **USI and DPCA were effected by** registrant.160/

Accordingly, it is concluded that registrant, aided and abetted by Hodgdon wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder; and that registrant, aided and abetted by Amann , Kitain, and Davis, wilfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder.

160/ Cf. R.D. Bayly & Company, 19 S.E.C. 773, 786 (1945).

III. Failure to Amend B-D Application

During the relevant period registrant failed to file amendments to its application as a broker-dealer reflecting Amann's election as a vice president in February 1960 and as director in March 1960, Luttrell's election as executive vice president and director in late 1960 and Louis E. Shomette Jr's election as a vice president and director in May 1962. Respondents urge that the function of preparing such amendments was delegated to Hodgdon's secretary. Neither that delegation nor the fact that the registrant's minute books reflect these changes either excuse the violation or refute "wilfulness". Obviously, if Hodgdon delegated the function,he was aware of the necessity for its proper performance and assumed the responsibility therefor. Any other interpretation would, in effect, nullify the rule.

Accordingly it is concluded that registrant, aided and abetted by Hodgdon, willfully violated Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

Division seeks to charge Haight, Carr and Amann with the same violation presumably on the theory that each of them was an officer of registrant at the time one of the changes in officers and directors, set forth above, occurred. Since these respondents had no responsibility in this area,[161/] the allegation is dismissed as to them.

161/ Schmidt, Sharp, McCabe & Company, Incorporated, Securities Exchange Act Release No. 7690 (August 30, 1965), Midwest Planned Investment, Inc., Securities Exchange Act Release No. 7564 (March 26, 1965).

IV. Failure To Transmit Funds Promptly

Registrant, as underwriter, engaged in the sale of Southeastern Mortgage Investment Trust shares. The record shows substantial delays in the transmission to the issuer of funds registrant received from the sale of these shares in respect of over 170 transactions during January and February 1964. Most transmissions were made within 6 to 10 days after receipt of the funds. Some delays were within the 11 to 22 day range. Registrant admits it failed to place the funds in escrow as required. 162/

Registrant's cashier was responsible for the transmission of funds received on shares sold pursuant to an underwriting. His general practice had been to transmit such funds within 48 to 72 hours after settlement of the transactions. It appears, however, that during the period when the transmission of funds was delayed, registrant was in the midst of converting its accounting system and the cashier was running two parallel operations and was deluged with work. Everything he did in his own installation had to be repeated for the new equipment or service.

Registrant's practice of transmitting funds in 48 to 72 hours in other underwritings is a ready indication that it must have known it held the fund's overlong. Any reasonable construction of the term "promptly" would require a finding that the rule was violated.

162/ Rule 15c2-4 under the Exchange Act.

It is concluded therefore that registrant wilfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

Public Interest

In July 1964 (directly following the end of the relevant period) Hodgdon's stock ownership in registrant was substantially reduced by registrant's acquisition of part of his holdings and he ceased participation in day to day management. His remaining stock, between 30-40%, was redeemed by registrant in December 1965. As of the close of the hearings he was no longer engaged in the securities business. When Hodgdon left management in July 1964, Haight became president and owner of about 35% of registrant's stock; Carr owned over 10% of registrant's stock and was elected a vice president; Kitain became a vice president and 8% stockholder and Adam became a vice president and stockholder.[163/]

Division urges that public investors should no longer be endangered by these respondents and recommends that the broker-dealer registration of registrant be revoked and that all individual respondents be barred from association with any broker or dealer.

Various factors have been urged by the respondents[164/] in mitigation as warranting the imposition of no sanction. Due to the adverse

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163/ These figures are furnished by respondents' proposed findings.

164/ These include all respondents except Amann and Baskin. Until they are specifically named, Amann and Baskin are not referred to in this portion of the initial decision.

publicity stemming from the institution of these proceedings registrant has suffered damage to its reputation, loss of personnel and a severe decline in its business. The defense of this proceeding has involved great expense. Since July 1964 registrant has altered its policies and practices. It does not engage in private placements. Its listed business has increased to 58% of its sources of income. Registrant no longer underwrites real estate limited partnerships or small speculative industrial enterprises. As of 1966 participation as an underwriter or selling group member represented about 5% of its gross volume. Securities research is now provided by member firms of the NYSE. Further, registrant has imposed more stringent controls over its personnel, has taken other steps to assure adequate supervision of customers' accounts, adherence to financial plans and no excessive activity or large commitments in speculative securities. It has installed a system for monitoring telephone calls, permits no discretionary accounts except under extraordinary circumstances and has employed an attorney on a full time basis whose functions relate to regulatory matters and to assist Haight in the supervision of sales activities. Haight now devotes 80% of his time to managerial duties.

Hodgdon was the architect of registrant's operations. He selected all its underwritings and the securities in which it traded. He prepared its advertising and radio broadcast material. His methods sought and achieved the relationship of trust and confidence with registrant's clients and his complete indifference

to supervision led to the abuse of that relationship. He allowed registrant to proceed with the USI offering despite his own poor opinion of it. He permitted the distribution of false memoranda on Paragon and Roseville-Detroit to salesmen. He furnished his salesmen the unjustified rate of return predictions on the real estate syndication units. The entire record of this proceeding discloses that he gave mere lip service to the benefits of financial planning. Hodgdon should be barred from association with any broker or dealer.

In imposing sanctions as to the remaining individual respondents the Hearing Examiner has considered, in addition to the foregoing mitigative factors, that they were under the direction of Hodgdon who was in sole control of registrant, that, with the exception of Haight, their employment by registrant was their first association as registered representatives qualified to sell securities with a broker-dealer. No prior disciplinary proceedings have been instituted against any of them or against Haight. The Hearing Examiner has also considered that during the relevant period, the sale of real estate limited partnerships was a relatively new field of activity in the securities business. Absent these considerations and the extensive changes made by registrant's new management, which are designed to more closely control their activities, the misconduct of virtually all these respondents would require a permanent bar. This does not mean, however, that all can escape permanent bar or that those that do so can escape without severe sanctions. The offenses were too grave.

Haight's culpability is too serious and extensive to warrant less than permanent bar. Haight was employed by a broker-dealer for about two years before joining registrant. Despite Hodgdon's control, Haight, as vice president in charge of sales, had direct responsibility for supervision and failed to properly supervise registrant's salesmen. He must have acquiesced in Hodgdon's obviously deliberate inertia in that direction which led, among other things, to the loading of customers' accounts with securities from which registrant and its salesmen gained most and in which Haight and all these respondents participated. Haight and each of them, except Carr, also misrepresented anticipated returns from real estate syndication units which could not be supported by the prospectuses.[165/] They should not have relied blindly on Hodgdon's rate of return.[166/] Moreover, the record discloses that Haight's activities included conspicuous mistreatment of financial planning customers' accounts in other respects, improper conduct in respect of the sale of Van Pak shares and participation in the dissemination by registrant of improper information to its salesmen in connection with the Roseville-Detroit offering, with knowledge of the exchange of letters between registrant and the Division of Corporation Finance.[167/]

165/ "[T]he information in a prospectus furnishes a background against which a registrant and its salesmen can test the representations they are making, and those who sell securities by means of representations inconsistent with the information in the prospectus 'do so at their peril'." J.P. Howell & Co., Inc., supra.

166/ Walker v. S.E.C., 383 F.2d 344 (C.A. 2, 1962).

167/ Registrant's salesmen were not told of these letters.

Haight should be barred from association with any broker or dealer.

Carr's culpability is not as great. His responsibility for failure of supervision of registrant's salesmen stems from his position as senior vice president, his regular attendance at meetings, his constant availability to registered representatives for consultation and the general knowledge of registrant's operations which must be imputed to him, rather than from the assignment of a particular function. Nevertheless, he should have been aware of and is answerable for registrant's improper operations. Carr had no direct involvement with the sale of real estate syndications. However, like the others, he caused his financial planning customers to purchase too much of registrant's underwritings and trading securities. He also made misrepresentations in the sale of Paragon and Van Pak stock. Carr should be suspended from association with any broker or dealer for ten months.

Kitain furnished misleading and improper advice and is chargeable with various other improprieties in his treatment of the accounts of his financial planning customers over and above "loading" and real estate "return" misrepresentations. Moreover, he has demonstrated a propensity for ignoring registrant's policies and instructions in respect of the investment of the proceeds of insurance policies, the

use of a client's account for his own transactions and the sale of DPCA stock. The mutual fund "breakpoint" transactions were highly improper. His sale of USI and Van Pak stock were accompanied by misrepresentations.

Kitain should be suspended from association with any broker or dealer for one year.

Davis' misguided assurances to his financial planning client that Hodgdon would be behind everything exceeded the bounds of fair dealing. He also "loaded" clients' accounts and misrepresented real estate returns. His advice to the client to disregard prospectuses and his unjustified comparison to the unsophisticated investor of interest payable on a loan with the distributions to be received from real estate syndication investments were unconscionable,as were his extravagant predictions in respect of Van Pak and its stock.

Davis should be suspended from association with any broker or dealer for one year.

Kibler's financial planning accounts were "loaded" and he misrepresented real estate returns. The record shows no other misconduct in respect of these clients. But he also made serious misrepresentations in the sale of Van Pak stock. He should be barred from association with any broker or dealer for five months.

Adam's and Harper's flagrant abuse of the confidence of their unsophisticated financial planning clients,who trusted them completely, was so grossly reprehensible as to warrant a permanent bar despite the mitigative considerations set forth above. Adam's handling of

two financial planning accounts constitute a reckless disregard of his obligations to his clients. He ignored his own financial plan, he recommended highly speculative securities despite his client's insistence on safety in investments. His reports to his clients were false and misleading in eliminating losses and in representing real estate syndication distributions as income. He presented great exaggerations of prospective profits. He falsely represented the value of securities he recommended and gave contradictory recommendations to two clients regarding the same security. He also made fraudulent representations and omissions regarding the securities of Van Pak.

Harper's assurances of expertise and devotion to their interests to two of his clients, in order to obtain their confidence, were magnified far beyond reasonable bounds. He estimated monumentally extravagant profits shortly after an account was opened. He ignored his own financial plan. He purchased highly speculative securities in complete disregard of his clients' pleas for safety and made highly excessive and unreasonable projections of future income. He falsely predicted appreciation of real estate syndication investments and represented distributions from such syndications as income. In addition,he made fraudulent representations in the sale of Lord of the Flies and Van Pak and excessive predictions as to future value of Canadian Apache. He caused a client to purchase a unit of Canadian

Apache from a fellow salesman at an exorbitant profit to the latter. He misrepresented the distribution expected from Roseville-Detroit as "income". Adam and Harper should be barred from any association with a broker or dealer.

Amann shares chief responsibility with registrant for the sale of the unregistered securities of USI and is mainly responsible for the violation of the registration requirements in respect of DPCA. Since Amann was advised by counsel, at the time of the USI offering, that "no longer is the twenty-five person rule of thumb sacrosanct", he is deemed to have proceeded with both the USI and DPCA offerings in deliberate violation of the statute. Moreover, Amann has exhibited a proclivity for the involvement of himself and his clients in highly speculative promotions and, as his brief admits, without adequate investigation. His use of his position with registrant in connection with the third offering of USI and the DPCA offering constituted a misrepresentation that registrant sponsored those offerings. His association with the DPCA offering came after he had already been upbraided by registrant for the USI promotion. Further, he made serious misrepresentations and omissions in the sale of the stock of USI, DPCA and Van Pak.

Amann urges that he has suffered enough through adverse publicity, that he has never before been the subject of any disciplinary proceeding, that he believed in the merits of USI and DPCA offerings and

invested his personal and family funds in them. However, Amann had been in the securities business both as a registered representative and as an officer of a broker-dealer for about three and one-half years before his association with registrant. Neither his belief the future of USI and DPCA nor his willingness to speculate with his own funds justify or excuse the activities related herein.[168/] Amann's persistent refusal to accept direction or instruction indicates that he requires close supervision. He should be excluded from association with any broker or dealer for nine months and should be allowed to resume such association after that period only if adequately supervised.

Baskin came to registrant directly following his graduation from college. The record as to him relates solely to his activities in connection with registrant's preparations for the sale of the Roseville-Detroit syndication units. Baskin shares responsibility for the misinformation registrant furnished its salesmen in respect of Roseville-Detroit. He was fully aware of the changes in Roseville-Detroit's initial registration statement, based upon the letter of comment by the Division of Corporation Finance. Under these circumstances Baskin should be suspended from association with any broker or dealer for fifteen days.

168/ Richard J. Buck & Co., Inc., supra; Alexander Reid & Co., Inc. 41 S.E.C. 373 (1963).

In view of the changes made by registrant in its policies and practices it may be allowed to remain in business. But the serious nature of its violations of the securities laws committed by the respondents herein and by other salesmen constrain the imposition of substantial sanctions. Registrant's membership in the NASD and PBW should be suspended for four months.[169/] Accordingly,

IT IS ORDERED that Hodgdon & Co., Inc., now known as Haight & Co., Inc. be, and it hereby is, suspended from the National Association of Securities Dealers, Inc. and the Philadelphia-Baltimore-Washington Stock Exchange for four months; and

IT IS FURTHER ORDERED that A. Dana Hodgdon, James F. Haight, David M. Adam, Jr. and James W. Harper III be, and they hereby are, barred from being associated with any broker or dealer; and

IT IS FURTHER ORDERED that Louis S. Amann be, and he hereby is, barred from being associated with any broker or dealer with the understanding that upon an appropriate showing he may become associated with a broker or dealer in a supervised capacity after nine months; and

IT IS FURTHER ORDERED that Burtain Kitain and Homer E. Davis be, and they hereby are, suspended from association with any broker

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169/ "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." Century Securities Company; supra.

or dealer for one year; **W. Lyles Carr** be, and he hereby is, suspended from association with any broker or dealer for ten months; Robert F. Kibler be, and he hereby is, suspended from association with any broker or dealer for five months and Harvey A. Baskin be, and he hereby is, suspended from association with any broker or dealer for fifteen days.[170/]

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.

Sidney Gross
Hearing Examiner

Washington, D. C.
May 15, 1969

170/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.