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UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

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SECURITIES & EXCHANGE COMMISSION

In the Matter of

REILLY, HOFFMAN & CO., INC.
30 Raymond Avenue
Lynbrook, L. I., New York

File No. 8-4932

RECOMMENDED DECISION

Washington, D. C.
February 12, 1962

Irving Schiller
Hearing Examiner

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RECOMMENDED DECISION

BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: Andrew N. Grass, Jr. and William Lerner, Esqs., of the New York Regional Office of the Commission, for the Division of Trading and Exchanges.

Leonard Glass, Esq., of Glass and Greenapple, Esqs., for Reilly, Hoffman & Co., Inc., Thomas J. Reilly and Philip J. Hoffman.

Sidney M. Fruling and Elliott Eisman, Esqs., of Fruling & Eisman, Esqs., for Paul Gordon and Norman S. Grant.

Theodore Kempinski, *pro se*.

These proceedings were instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether to revoke or, pending final determination of the question of revocation, to suspend the registration as a broker and dealer of Reilly, Hoffman & Co., Inc. ("Registrant") and whether, under Section 15A(b)(4) of the Exchange Act Thomas J. Reilly, Philip J. Hoffman, Theodore Kempinski, Robert Campbell, Norman Grant, and Paul Gordon, or any of them are each a cause of any order of revocation which may be issued.[1/]

The order for proceedings alleges that during the period from about May 6, 1959 to about September 30, 1959 registrant, Reilly, Hoffman, Kempinski, Campbell, Grant and Gordon improperly made false and misleading statements of material fact in the offer and sale of the common stock of Glide Control Corporation ("Glide") in violation of the anti-fraud provisions of the Securities Act of 1933

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

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

("Securities Act") and of the Exchange Act[2/]; that registrant, aided and abetted by Reilly and Hoffman, by use of the mails and instrumentalities of interstate commerce employed manipulative, deceptive and other fraudulent devices and contrivances in willful violation of Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-6[3/]; that registrant, Reilly, Hoffman, Kempinski, Campbell, Grant, and Gordon willfully violated Sections 5(a) and (c) of the Securities Act in that they directly and indirectly used the mails and means of instrumentalities of transportation and communication in interstate commerce to offer to sell and to sell the common stock of Glide when no registration statement had been filed with this Commission or was in effect as to such securities[4/]; that registrant, aided and abetted

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2/ The anti-fraud provisions referred to in the order are Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 10b-6 and 15c1-2 (17 CFR 240.10b-5, 10b-6, and 15c1-2) thereunder. The effect of these provisions, as applicable here, is to make unlawful the use of the mails or facilities of interstate commerce in connection with the purchase or sale of any security by means of a device to defraud, an untrue or misleading statement of a material fact, or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by means of any other manipulative or fraudulent device.

3/ See Footnote 2, *supra*.

4/ Sections 5(a) and (c) of the Securities Act, in pertinent part, 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, or to offer to sell a security unless a registration statement has been filed as to such security.

by Reilly and Hoffman, willfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 by making false entries in certain of the books and records of the registrant and failed to make and keep current certain books and records of registrant as required by said rule.

After appropriate notice, hearings were held before the undersigned Hearing Examiner. Proposed findings of fact and conclusions of law and brief in support thereof were filed with the Hearing Examiner by the Division of Trading and Exchanges and by registrant, Reilly and Hoffman.

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

1. Registrant, a New York corporation, was registered with this Commission as a broker and dealer since March of 1956.[5/] Since 1958 Reilly has been listed as President and Director and Hoffman as Secretary-Treasurer and Director of the registrant and each of them was listed as the beneficial owner of 10% or more of the securities of registrant.

Violations of the Anti-fraud Provisions.

2. The record discloses that during the period from May through September 1959 registrant employed Kempinski, Campbell, Grant

5/ Registrant was originally registered as a broker-dealer under the firm name of Hoffman, Reilly & Sweeney, Inc. and reflected a change in the corporate name to Reilly, Hoffman and Co., Inc. by amendment dated June 27, 1958.

and Gordon as securities salesmen (hereinafter sometimes referred to as registrant's salesmen) and engaged in the sale of common stock of Glide by means of false and misleading representations of material fact and omitted to state material facts necessary in order to make the statements made not misleading. Nineteen witnesses testified concerning the representations made to them with respect to Glide stock. All but one of these witnesses testified that they were told by registrant's salesmen that the stock would appreciate in value and their testimony included one or more of the following phrases: "Within a few weeks the stock may rise to approximately $5"; "Go anywhere from 5 to 10"; "Quick profit, stock might double or triple in short period of time"; "No limit for telling what it will be by the end of the year"; "The sky would be the limit"; "Was going to go up, might balloon"; "Sure possibility of stock increasing in value immediately of at least 50%"; "Possibility for gain spectacular"; "Go up from 1 to 8 within a year"; "Stock would go up or at least double"; "Increase in value -- could be expected to double in value within year or two"; "Very aggressive corporation -- hot issue could go to $10"; "Within two weeks price should be between $2.50 and $3.00 per share"; "Stock would be selling at $3 within month, would be $10 by end of December." One of such investors was told in August 1959 that Glide had $600,000 worth of sales and had made $300,000 profit; and another, that Glide was a well financed company and that the financial condition of the company was very good.

3. Seven of the witnesses testified that they were told by respondent's salesmen that the Glide stock would or might be listed on a National Securities Exchange and such statements included the following: "That it was a matter of time for the stock to be listed on an exchange"; "Stock was going to be listed on. . .Exchanges"; "That the stock would be listed. . .by the first of January, 1960"; "Good possibility the stock would be listed. . .in four or five months"; "It was hoped to list the stock on an exchange." Five of such witnesses identified the exchange as the American Stock Exchange and one witness identified the exchange as the New York Stock Exchange.

4. In addition, the record discloses that fifteen witnesses were told by the respondent's salesmen that either the Glide control unit was shortly to be adopted as equipment by some of the leading car manufacturers in this country, or that Glide had or was negotiating contracts with large automotive concerns or that the unit would sell on the market. These representations included the following: "Studebaker and American Motors were going to accept it on all their cars and put it on the market"; The unit was "about to be adopted by Ford and other large companies"; "Lots of contracts with auto companies"; "Actively negotiated with Ford"; There are a "number of pending contracts with large automotive concerns"; "Glide about to make deal with Ford"; "Unit would positively sell on market"; "Large auto company would make big market for product".

5. In addition to the oral representation made by registrant's salesmen at least three of the investor witnesses who testified received

a brochure prepared by registrant recommending purchase of Glide stock as a "speculative vehicle." Though undated it appears to have been mailed in July 1959. Among other things the brochure, under a heading "Capitalization - Finance," states that as of May 31, 1959, giving effect to recent public financing, Glide showed current assets of $292,533 which included $200,702 cash against current liabilities of $39,907. No mention is made therein of the operating results which for the period ended May 31, 1959 reflected a net loss of approximately $10,000. The brochure further states that Glide "is initiating negotiations with an automobile manufacturer toward having 'Glide control' made standard equipment on some models and optional on others." The evidence shows that in July no contact had been made with automobile manufacturers and certainly no negotiations had been initiated with any such concerns.

6. The statements made by registrant's salesmen to prospective investors concerning the increase in the price of the stock, the listing on an exchange, the possible adoption of the Glide product by large automobile manufacturers and the contracts or negotiations by Glide with the automobile industry were unwarranted and without basis. Glide was incorporated in March 1959 for the purpose of marketing an automatic throttle control device for use in automobiles, which device would presumably limit the speed at which a vehicle may be operated to a pre-fixed rate. The record discloses that for the period March 13 to May 31, 1959 Glide had no income and a net loss of approximately

$10,000; that for the period March 13 to June 30, 1959 Glide had gross sales of approximately $29,500, which, after deducting cost of goods sold and all expenses, resulted in a net loss from operations of approximately $6,800; and for the period from March 13 to August 31, 1959 Glide had gross sales of approximately $65,000, which, after deducting cost of goods sold and all expenses, resulted in a net loss from operations of about $6,200; and for the period from March 13 to December 31, 1959 Glide had gross sales of approximately $93,000, which, after deducting cost of goods sold and all expenses, resulted in a net loss from operations of approximately $49,600.[6/]

7. Glide commenced sales of its products some time in June 1959 and by the end of the year had sold approximately 28,000 units to jobbers throughout the country. Glide's president testified, however, that by October 1959 it was evident to Glide that its products were not moving from the jobbers to dealers or from the dealers to the consumer. Moreover, during this period Glide was experiencing mechanical trouble in the installation of its units. Not earlier than November or December of 1959 did Glide first contact the large automobile manufacturers with the hope of interesting them in the Glide product. With respect to one of such concerns Glide made efforts to develop a unit which could be installed as original equipment in its automobiles. However, none of such concerns ever indicated a willingness to purchase the Glide product and certainly no contract had been made nor had any negotiations been undertaken looking toward a contract.

6/ The record discloses that in October of 1960 Glide was in bankrupcy.

8. Glide's president testified and the documentary evidence discloses that Glide kept registrant informed continually orally and in writing of its progress, its operations and its financial condition. It is evident from the record that Glide furnished registrant with copies of its financial statements reflecting continuing operating losses. In the latter part of August Glide informed registrant in writing that its consumer sales and dealer distribution were "practically nil." It is clear from the testimony of the investor witnesses that none of them was informed of Glide's lack of consumer acceptance nor that Glide had net losses from operations practically from its inception.

9. The Commission has held that a prediction by a securities salesman to an investor that a stock is likely to rise implies that there is an adequate foundation for such prediction and that there are no known facts which make such a prediction dangerous and unreliable. 7/ The Hearing Examiner finds that the representations made by registrant's salesmen concerning the increase in the price of Glide stock were without adequate foundation, that registrant knew or was aware of facts which would make such representations dangerous and that such representations constituted a violation of the anti-fraud provisions of the Securities Act and the Exchange Act. Registrant as

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7/ In the Matter of Leonard Burton Corporation, Securities Exchange Act Release No. 5979 (1959).

underwriter of the Glide stock knew that it had just been organized to market a single product. It is evident from the record that from May through September of 1959 when the bulk of Glide stock was sold by registrant it knew or should have known that the Glide product had not been proved, had no public acceptance or consumer demand for its product, that there was no evidence that a market existed for its product, that there was no indication that the Glide product could be marketed and that no automobile manufacturer sought to purchase such product. In fact, Glide had not even made contact with automobile manufacturing concerns until November 1959. Under such circumstances and considering that registrant knew of Glide's continual net losses which it did not disclose to prospective investors the Hearing Examiner concludes that registrant knew of sufficient facts which would make any prediction that the Glide stock would increase, unreliable and dangerous.

10. The Hearing Examiner finds that the representations made by registrant's salesmen relating to acceptance by automobile manufacturers of Glide's product or that there were contracts or negotiations for contracts with such concerns were false and misleading and in violation of the anti-fraud provisions of the Acts. Glide's former president testified that Glide contacted the large automobile manufacturers no earlier than November of 1959 but that none of such companies ever indicated a willingness to purchase Glide's product for either marketing purposes as optional equipment or for initial

installation in its cars. From the correspondence between registrant and Glide it is apparent registrant was kept well informed of Glide's contacts with the automobile manufacturers and the fruitless results thereof. It is evident from the testimony of the prospective investors that they were given the impression either that contracts had been made with automobile manufacturers or that such contracts were imminent by reason of negotiations which were in progress. The Hearing Examiner therefore finds that the statements relating to the status between Glide and the automobile manufacturers were completely unjustified and unwarranted and within the meaning of the anti-fraud provisions of the Acts were materially false.

11. The evidence discloses that Glide never made application for listing on any national securities exchange nor even contacted any such exchange to make inquiry concerning listing. Moreover, from the evidence it is clear that Glide could not qualify for listing on either the New York Stock Exchange or the American Stock Exchange.

12. Registrant contends first that there is no evidence that Reilly or Hoffman made any of the statements which investors testified were made to them, authorized the making of them or knew or should have known they were made and second, that statements by salesmen which were clearly labelled as opinions cannot be the basis of a willful fraud against a registered broker-dealer citing SEC vs. Rapp d/b/a Webster Securities Co., F. Supp. (D.C.N.Y.1961) as authority. The Hearing Examiner rejects both contentions. As pre-

viously noted, Reilly and Hoffman were the principal officers, directors and stockholders of registrant. The evidence shows they each participated and took an active interest in registrant's operations and both of them participated in the negotiations leading to the Glide underwriting contract.

13. The record discloses that both Reilly and Hoffman spent some part of their working day supervising their salesmen. Each of them admitted that they spent "a couple of hours a day" standing in two rooms occupied by salesmen overhearing their conversation with prospective customers and that at least six or seven hours in each day were spent by them in other activities. The supervision by Reilly and Hoffman was hardly adequate or sufficient under the circumstances to determine whether the salesmen were making the type of statements that were attributed to them by the investor witnesses. As officers and directors engaged in managing a brokerage concern selling stock to the public, Reilly and Hoffman had a duty to see to it that misrepresentations of the flagrant character as those made to the investors who testified should not occur. Moreover, they were obligated to make certain that their salesmen use proper and appropriate techniques in their efforts to sell a highly speculative stock such as Glide.[8/] This duty cannot be lightly discharged by merely issuing instructions to salesmen to use only the information in an offering circular

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8/ Cf. Reynold & Co., Securities Exchange Act Release No. 6443 (January 3, 1961); Midland Securities, Inc., Securities Exchange Act Release No. 6524 (April 10, 1961).

without ascertaining exactly what such salesmen were in fact telling prospective investors. If Reilly and Hoffman had instituted adequate supervisory procedures they could have detected the false and misleading type of statements made by their salesmen concerning the increase in the price of the Glide stock, its listing on a securities exchange and the nonexistent contracts with large automotive concerns. Accordingly, the Hearing Examiner finds that registrant knew or should have known that the sale of the Glide stock was being made by means of false and misleading statements.

14. The holding in the Rapp case relied upon by the registrant is distinguishable from the instant case. The Court in the Rapp case dismissed the complaint in an injunction suit after trial for failure of proof stating "Although the complaint with careful specificity set forth the alleged misrepresentations of the salesmen defendants * * *not one of the Commission's six witnesses mentioned any such representations." In the instant case, the alleged representations by the salesmen were fully supported by the testimony of the witnesses, all of which representations the Hearing Examiner has found to be materially false and misleading. With respect to the Court's opinion that statements by salesmen which are labelled as opinions cannot be the basis of a willful fraud, the Hearing Examiner is of the view that such holding is not in accord with the prevailing court decisions in the area of securities transactions. Where a salesman is selling securities he impliedly represents he has knowledge of what he is

offering, is competent to advise and that the customer will be treated fairly.[9/] A representation by such a salesman that a stock will increase in value further implies that there is a reasonable basis in fact and where such statement has no rational basis it becomes false notwithstanding that the salesman states it is his "opinion" particularly where the statement is used to mislead investors.[10/]

15. The Hearing Examiner concludes that with respect to the sale of the Glide stock registrant made false and misleading statements of material facts and omitted to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, in willful violation of Section 17(a) of the Securities Act and Section 10(b) and 15(c)(1) of the Exchange Act and Rule 17 CFR 240.10b-5 and 15c1-2 thereunder.

Record Keeping Violations

16. As previously noted, the order for proceedings alleges that registrant made certain false entries in its records and failed to keep its books and records as required by Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3. The record shows that nine of the investor witnesses who testified received confirmations of their purchases which bore fictitious addresses. All of these witnesses testified that registrant's salesmen gave them varying reasons for not

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9/ Pinsker & Co., Securities Exchange Act Release No. 6401 (1960).

10/ See Knickerbocker Merchandising Co. v. United States, 13 F. 2d 544 (1926); Securities Exchange Commission v. Okin, 137 F. 2d 862, 864 (C.A. 2, 1943).

being able to use their true addresses and either furnished them with a hotel address in New York City[11/] or requested the witness to give the salesman a New York address which could be used in connection with their transaction. All of the witnesses testified that notwithstanding the address on the confirmation they received the same at their correct home address. Registrant contends that there is nothing in the record to support a finding that Reilly or Hoffman knew or should have known that such addresses were fictitious. The Hearing Examiner rejects this contention. The record reflects that of the nine investor witnesses who testified that fictitious addresses were used on their confirmations five were previous clients of the registrant whose correct home addresses were kept on cards at registrant's office. The Hearing Examiner finds that registrant willfully violated the record keeping requirements by placing fictitious addresses on confirmations.

17. The evidence further discloses that the customer ledger sheets of the cash and margin accounts failed to contain the address of the beneficial owner of such account as required by Rule 17 CFR 240.17a-3. In addition, the evidence shows and registrant concedes that a majority of the order tickets or memoranda of brokerage orders of Glide stock prepared during the public offering failed to show the time of entry of such orders. Registrant urges, in this connection, that where shares

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11/ In fact, where hotel addresses were used the witnesses testified they never were registered at such hotels.

are sold at a fixed price pursuant to an underwriting agreement and entered on a daily blotter, the time of receipt of an order is of no relevance and no finding of willful failure to comply with the bookkeeping rules may be made since registrant maintained records from which the relevant and required information could be obtained. These arguments are unacceptable to the Hearing Examiner since the rule requires not only preparation of a memorandum of a brokerage order showing "the time of entry" of the said order but a daily blotter as well. The failure to comply with a requirement for time stamping the order tickets made it impossible to determine when such orders were actually received by the registrant. No exception is made for securities sold at a fixed price pursuant to an underwriting agreement.

18. The evidence shows that the Regulation A offering of Glide was cleared on May 5, 1959 by the Commission's Regional Office in San Francisco and that on May 7, 1959 Hoffman delivered twelve separate sheets of blotter entries of sales of the Glide stock to registrant's cashier for the purpose of having the latter prepare confirmations. The blotters ordinarily maintained by registrant were kept in registrant's cage under the supervision of its cashier. Hoffman admitted that the blotters reflecting the Glide transaction were prepared by him and kept separately in his own office. Registrant admits it maintained separate blotters for the Glide offering but urges that it was for its own convenience in recording sales of Glide shares since the sales constituted a substantial portion of the total volume of business conducted. Such

information is insufficient to excuse registrant's failure to prepare an itemized daily record of all purchases and sales of securities as required by the aforementioned rule. In all of the foregoing respects the Hearing Examiner finds that registrant willfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

Violations of Sections 5(a) and (c).

19. The order for proceedings alleges in substance that registrant, Reilly, Hoffman and registrant's salesmen violated Section 5(a) and (c) of the Securities Act by offering to sell and selling the Glide stock when no registration statement had been filed or was in effect as to such securities. In light of the evidence adduced in the record it is evident that the basis of the allegation is that the claimed exemption pursuant to Section 3(b) of the Securities Act under which registrant purportedly sold the Glide stock was unavailable for failure to comply with the provision of Regulation A promulgated under the said Section. The record discloses that Glide filed a letter of notification and an offering circular pursuant to Regulation A covering a public offering of 300,000 shares of 10¢ par value common stock at an offering price of $1.00 per share naming registrant as underwriter. In August 1959 Glide reported to the Commission on Form 2-A that the above-described offering commenced on May 6, 1959 was completed on May 21, 1959 and that the total amount received from the public was $300,000 from which Glide received, after certain deductions, $221,500. 12/

12/ The information relating to the commencement and termination dates of the offering and the total amount received from the public was admittedly furnished to Glide by registrant.

The evidence shows and registrant admits that during the period May 6 to May 21, 1959 it took down into its trading account at least 10,000 shares of the Glide stock for which it paid issuer by check and that during the period May 22 to May 29, 1959 these shares were sold by registrant to public investors at prices ranging from $1 to $1-5/8 per share and that the excess over the $1 per share offering price totaled approximately $6,000. The Commission has consistently held that a distribution of securities "comprises the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public." [13/] It is clear from the record that the public distribution of the Glide securities was not completed on May 21, 1959 since registrant had acquired a block of the Glide stock in its trading account which it intended and did sell to the public within the week after the purported closing date of the offering. Such resales by registrant constituted a continuation of the public distribution. Since many of the resales were in excess of the offering price of $1 per share as set forth in the offering circular the aggregate offering price to the public exceeded the $300,000 maximum prescribed in Section 3(b) of the Securities Act and Regulation A. In light of the fact that the resales were a part of

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13/ Oklahoma - Texas Trust, 21 S.E.C. 764, 769 (1937), aff'd 100 F. 2d 888 (C.A.10, 1939).

the public offering and some were made at prices in excess of the stated offering price, the representation in the offering circular that the public offering price was $1 and that the total offering price to the public was $300,000 were untrue. 14/ Furthermore, the record shows that the notification filed pursuant to Regulation A set for the names of the states in which the Glide stock was to be offered but failed to include the name of at least one state in which the securities were offered and that at least one sale was made in a state not included in said circular. In addition, the Form 2-A report listed the participants in the selling group and registrant admitted at the hearing that the names of three brokers and dealers who were participants in the offering were omitted from said report. The omissions were apparently due to registrant's failure to furnish Glide with such names. It is well settled that the exemption from regulation provided by Regulation A is conditioned upon compliance with the conditions of the Regulation. In light of all the foregoing the Hearing Examiner finds no exemption under Regulation A was available. 15/

20. It is undisputed that no registration statement under the Securities Act was filed with the Commission with respect to the Glide stock and the evidence in the record clearly shows that registrant used

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14/ In addition, the offering circular should have disclosed that the resales at higher prices would have resulted in additional compensation to registrant.

15/ Lewisohn Copper Corp., 38 S.E.C. 226, 234 (1958). See also American Television & Radio Co., Securities Act Release No. 4355 (April 1961).

the mails and instrumentalities of interstate commerce to offer, sell and deliver the said stock. The Hearing Examiner therefore finds that the sales of the Glide stock by registrant were in willful violation of Sections 5(a) and (c) of the Securities Act.

21. Registrant contends that registrant's sales of Glide stock at a time when an apparently valid exemption from registration was in effect precludes a finding of willful violation of Section 5 of the Securities Act. It is well settled that exemption from the registration requirements of the Securities Act are strictly construed against the claimant of such exemption, and the burden is on the claimant to establish that an exemption was available.[16/] The last sentence of Section 3(b) of the Securities Act specifically provides that no issue shall be exempted thereunder where the aggregate amount at which such issue is offered to the public exceeds $300,000. It is quite clear that the determination as to whether the statutory limitation has in fact been met can not be made during the course of a public distribution but must await the completion of the offering. If at any time during the course of a distribution under Regulation A the offering exceeds $300,000 the exemption becomes unavailable and all sales are in violation absent any other exemption under the Securities Act. As noted above the Glide offering exceeded the aforementioned statutory limitation and upon the record no other exemption for the

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16/ S.E.C. v. Ralston Purina Company, 346 U.S. 119 (1953); Gilligan, Will & Co., 38 S.E.C. 388 (1958), aff'd 267 F. 2d 461 (C.A. 2, 1959), Cert. denied 361 U.S. 896.

Glide offering appears to be available. Registrant has failed to establish that an exemption existed under Section 3(b). The Commission has held that willfulness under Section 15(b) of the Exchange Act does not require a finding of intent to do the act which constitutes the violation, it being sufficient for such finding that registrant knew what it was doing. In the instant case the evidence shows that registrant intended to take down a block of Glide stock into its trading account and make a public distribution of such shares at prices in excess of the offering price stated in the offering circular. There can be little doubt that registrant was aware of what it was doing though it may not have appreciated the legal consequences of its acts. Registrant also urges that the Division of Trading and Exchanges contends and the Commission has alleged in its order that registrant's conduct in selling Glide stock was considered to be a willful violation of Section 5 only after the Commission permanently suspended the Regulation A offering by Glide. The argument is not only specious but appears to misconceive the basis on which the Section 5 violation is premised both by the Division and in the Commission's order. Suffice it to say that the Division of Trading and Exchanges makes no such contention and the Commission's order contains no reference to the permanent suspension of the Regulation A offering.

17/ Thompson Ross Securities Co., 6 S.E.C. 1111, 1122-23 (1940); Hughes v. S.E.C. 174 F. 2d 969, 977 (C.A.D.C. 1949).

Findings as to Reilly & Hoffman.

22. It has been previously noted that Reilly and Hoffman were officers, directors and beneficial owners of more than 10% of registrant's securities. As such they were actively in control of registrant's affairs. They were present daily at registrant's place of business, exercised a proprietary interest in the firm, assumed joint responsibility for registrant's operations and during the period registrant was engaged in selling the Glide stock, took an active interest in such activity and had knowledge of the scope of such operations. The Hearing Examiner finds that in the performance of their responsibilities they failed to discharge their duties so as to prevent fraud upon the firm's customers and concludes that Reilly and Hoffman willfully violated Sections 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 17 CFR 240.10b-5 thereunder and that they aided and abetted in registrant's willful violation of Section 15(c)(1) of the Exchange Act and Rule 17 CFR 240.15cl-2 thereunder.

23. In addition, Reilly and Hoffman were primarily responsible for the proper maintenance of registrant's books and records. We have previously noted that a majority of the brokerage orders taken for the Glide stock failed to reflect a time of entry, that the blotters containing the Glide transactions were improperly prepared by Hoffman and that certain confirmations of sale of Glide stock bore fictitious addresses. Reilly and Hoffman had a duty to keep accurate books and

records or at least appropriately supervise registrant's operations so as to assure themselves that registrant's books and records were being properly prepared and maintained in accordance with the Commission's rules. Reilly and Hoffman failed to carry out their responsibilities in this respect and such failure is inexcusable. Accordingly, the Hearing Examiner finds that Reilly and Hoffman participated in or aided, and abetted in registrant's willful violation of Section 17(a) of the Exchange Act and Rule 240.17a-3 thereunder.

Findings as to Kempinski, Campbell, Grant and Gordon.

24. Kempinski, in addition to selling Glide stock also acted as sales manager of registrant. In this capacity he exercised supervision over registrant's salesmen and had some responsibility in connection with the manner in which they performed their duties. The record discloses that Kempinski sold to six of the investors who testified representing to five of them that the Glide stock would increase and to two investors specifically stated that the price could go as high as $10 a share. He represented to three of the said investors that the Glide stock would be listed on the American Stock Exchange and to a fourth investor on the New York Stock Exchange. In addition, he made representations to investors that large automobile manufacturers had pending contracts with Glide for its product. In the case of two investors Kempinski prepared or had prepared confirmations which set forth fictitious addresses. There was no basis for Kempinski's representations concerning the rise in the price of the

Glide stock, its listing on an Exchange or the pendancy of contracts with large automobile manufacturers. The evidence is clear that Kempinski knew that Glide had been recently organized and at the time he was engaged in selling the stock he should have been aware that Glide had not as yet produced sufficient units to warrant a representation that the price of the stock would increase to as much as $10 a share. While it may be true that Kempinski had high hopes for the future success of Glide such hopes are hardly sufficient to provide a basis for a prediction that the stock would increase to $10 a share. Kempinski had no knowledge or any assurance at the time he was selling the Glide stock that the company's product would be accepted by any automobile manufacturer. As to the representations that Glide had pending contracts with large automobile concerns it is clear from the record that from May through September when Kempinski made his sales that Glide had not even contacted the large automobile manufacturers. Here again, Kempinski was converting a hope that automobile manufacturers would be interested in the Glide product into a fact that contracts were pending. The evidence shows that it was not until November, 1959 that contacts were first made with automobile concerns. Any representation by Kempinski prior to that date relating to contracts with automobile manufacturers had no basis in fact. In addition, Kempinski had no possible basis on which he could rely to represent to prospective investors that the Glide stock would ever be listed

on any Exchange. Kempinski knew or should have known that Glide had never filed an application for registration on any Exchange. Such representation to prospective investors was a complete fabrication.

25. Three of the investor witnesses who testified stated that Campbell had sold them Glide stock representing that the stock would increase in value mentioning to one customer the figure of $10 a share and to another that the stock might double or triple in a short period of time. In addition, Campbell represented to two of the investors that the Glide product would be accepted as equipment on all of the cars of two of the large automobile manufacturers and to another investor that such acceptance would result in increased financial condition of the company. Two of the three investors received confirmations with fictitious addresses. Each of such witnesses testified that the fictitious address was suggested by Campbell and that such confirmations were received by the witness at their correct home addresses. The record is clear that Campbell prepared or caused the preparation of the confirmations containing fictitious addresses and that he never intended to mail such confirmations to the addresses stated thereon but rather to the correct home address of the investor. The evidence further shows that Campbell had no basis upon which to predict that the Glide stock would double or triple or increase to $10 a share. Campbell's sales occurred in the months of May and July, 1959 and it is evident from the record that Campbell knew that Glide had recently been organized and should have been aware that it had

insufficient sales of its product to warrant a representation that the price of the stock would increase. The representation by Campbell that automobile manufacturers were going to use the Glide product was completely without foundation.

26. Four investor witnesses testified that Grant sold them Glide stock representing that the price of the stock would rise to $8 a share or at least double in value and to one of such investors that there was a possibility that Glide would pay dividends. To one of such witnesses Grant Represented that Glide had $600,000 worth of sales and had made $300,000 in profits. To another, Grant represented that the stock would be listed on the American Stock Exchange. Grant represented to one of the investors that Glide had lots of contacts with automobile companies and, to another, that the Glide unit was about to be adopted by one of the leading automobile manufacturers and other large automobile companies would do likewise. In addition, Grant prepared, or had prepared, confirmations reflecting fictitious addresses for two of the investors. Each of such investors testified that the suggestion for the use of the fictitious addresses emanated from Grant. The evidence is clear that Grant had no basis upon which to predict that the stock would rise to $8 a share or double in value. Grant's sales were effected in May, July and August of 1959 and it is evident that Grant knew that Glide had recently been organized, and should have been aware that its sales were so insignificant that no prediction could be made as to any increase in the price of the stock. Moreover, the representa-

tion as to the amount of sales and the profits appears to have been a complete fabrication. During the period in which grant effected his sales no contracts with automobile concerns had been made or were pending.

27. Of the six investor witnesses who testified that Gordon sold them the stock four of them testified that the stock would appreciate in value, that it would reach approximately $5 per share within a few weeks, that the sky would be the limit and that the stock might baloon. To one of such witnesses Gordon represented that it was hoped to list the stock on the American Stock Exchange in a few months. Gordon represented to one of the witnesses that Glide was dickering to have the Glide unit utilized by some automobile company; to another, that a leading automobile company was considering using the Glide unit and to a third, that a large automobile company would make a big market for the Glide product. The record further shows that in connection with the sale of stock to three of the investors Gordon prepared, or had prepared, confirmations bearing fictitious addresses.

28. As in the case of registrant's other salesmen, there was no basis for the representation by Gordon that the price of the Glide stock would increase. Gordon, the only salesman who testified in his own behalf, admitted telling investors that the stock would be "good for 1½ or 2½" but stated that such statements were made in response to questions by investors. Gordon further testified that the information concerning the company came from Reilly and Hoffman and that his

representation that the stock could be very profitable came from the same source. He also testified he had no knowledge that Glide was operating at a loss or that it had problems in connection with distributing its product. Gordon never saw any profit and loss statements of Glide. Gordon also testified that he and other salesmen attended a meeting in which the Glide product was extolled by Glide's president who indicated that the future potential of the company looked excellent. With respect to the use of fictitious addresses on the confirmations, Gordon testified that he was told by Reilly and Hoffman that when securities were sold in certain states he would have to get New York addresses from the customers. Gordon, like the other salesmen, knew that Glide was in its infancy, that in May, July and August when he sold the Glide stock he knew or could have ascertained that sales of the Glide product were insignificant and should have been aware that the Glide product had not been accepted by the automotive industry or the public. The information which Gordon received from Glide's president concerning the future potential of the company was insufficient to warrant the prognostication which Gordon admittedly made to investors that the stock would reach $5 a share. There was no basis on which to predict that the stock would go sky high or that it might baloon. Any representation to investors that the Glide product would be accepted by the automobile industry without disclosing the fact that between May and August, 1959 none of the automobile manufacturers had been approached was false.

29. With respect to the use of fictitious addresses on confirmations, it is clear that Gordon knew such addresses were incorrect and that the confirmations would be mailed to the correct home addresses of the investors. Moreover, the record shows that two of such investors were previous customers of registrant whose addresses were known to Gordon or could certainly have been ascertained.

30. From the testimony of all of the witnesses it is evident that none of them was ever told of Glide's operating losses nor is there any evidence that any of registrant's salesmen made any efforts to ascertain registrant's financial condition or whether Glide's products were being sold in the market to consumers or whether any automobile concern had in fact accepted the Glide product. From the Hearing Examiner's observation of the witnesses and their demeanor he gives evidence to their testimony that representations were made to them as to an increase in the price of the Glide stock, its listing on an Exchange and that contracts existed or were pending with large automobile concerns for using or marketing the Glide product.

31. The Hearing Examiner finds that Kempinski, Campbell, Grant and Gordon willfully violated the anti-fraud provisions of the Securities Act and the Exchange Act. With respect to Kempinski, Campbell and Grant, the Hearing Examiner takes into consideration the fact that none of them took the stand to testify in their own behalf or make any effort to deny or controvert the testimony given by the investor witnesses. Such failure is of substantial significance. It

is well settled that the failure of a party to testify in a non-criminal case, in explanation of suspicious facts and circumstances peculiarly within his knowledge, fairly warrants the inference that his testimony, if produced, would have been adverse.[18/] The Hearing Examiner further finds that Kempinski, Campbell, Grant and Gordon, to the extent that each of them were involved in the use of fictitious addresses on confirmations sent to investors, aided and abetted registrant in its willful violation of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3.

Violations of Section 10(b) of the Exchange Act.

32. The Commission's order for proceedings alleges that registrant willfully violated Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-6 thereunder and that Reilly and Hoffman aided and abetted in such violation. The gravamen of these allegations appear to be the registrant represented to investors that it was selling the common stock of Glide "at the market" when in fact the registrant knew and omitted to state that the prices paid by such persons for the said stock were not prices established by a free, open and competitive market, but were prices artifically established by the registrant through certain described activities. The record fails to contain any evidence in respect of the foregoing allegations. Neither in its proposed find-

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18/ In the Matter of N. Sims Organ & Co., Inc., Securities Exchange Act Release No. 6495, aff'd 293 F. 2nd 1958 (C.A.2, 1961).

ings of fact or brief in support thereof has the staff urged any finding of violation of Section 10(b) of the Exchange Act. The Hearing Examiner finds that the record fails to establish facts in support of an alleged violation of Section 10(b) of the Exchange Act and recommends that the Commission make no finding of violation with respect thereto.

Public Interest.

33. The sole remaining question is whether it is in the public interest to revoke registrant's registration as a broker and dealer. Registrant contends that in taking the 10,000 shares of Glide stock in its trading account it was unaware of any illegality and the subsequent distribution was without intent or attempt to hide such act. Registrant points out that the shares so taken down involved approximately 3% of the total offering and the distribution thereof made at a time when the applicable law was not clear. The Hearing Examiner does not consider that these factors militate against revocation of registrant's revocation. It is well settled that an intention to violate the law is not necessary to finding of willfulness within the meaning of Section 15(b) of the Exchange Act; it is sufficient that "the person charged with a duty know what he is doing." [19/] It is evident from the record that at least in this sense registrant's violations were willful. Moreover, the law has been well settled since at least 1939 [20/] that a distribution of

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19/ Hughes v. S.E.C., 174 F. 2d 969, 977 (C.A.D.C. 1949); Shuck v. S.E.C. 264 F. 2d 358 (C.A.D.C. 1958).

20/ See Oklahoma-Texas Trust, supra, Footnote 13.

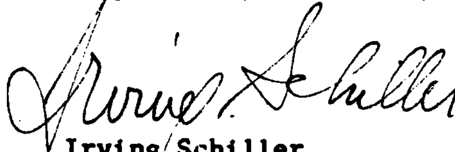
securities has not been accomplished until the securities ultimately come to rest in the hands of the investing public. It is evident from the evidence that registrant took down the block of 10,000 shares of Glide stock with the purpose of making a further distribution thereof to the investing public at prices in excess of the offering price. Registrant further urges that even if it is found that Reilly and Hoffman did not sufficiently supervise their sales personnel that revocation under such circumstances is too severe a sanction. In this connection, registrant cites two prior opinions of the Commission in which it argues the Commission suspended a broker-dealer who failed to supervise its personnel in a manner similar to the instant case. The facts in the two cases relied upon by registrant are distinguishable from those in the instant case. It is apparent from the testimony of the investor witnesses that the representations made by all of registrant's salesmen followed a pattern of making false and misleading statements over an extended period of time to investors in many states regarding an increase in the price of the Glide stock, it's registration on a national securities exchange and that contracts had been or were about to be made with leading automobile manufacturing concerns. The techniques used by registrant's salesmen primarily on the long distance telephone demonstrate that registrant disregarded the basic standards of fair and honest dealing with the public. For such activities alone revocation would be required. In addition, the evidence shows that registrant failed to keep required records and failed to adequately supervise its salesmen in the performance of their functions and in their dealings with the invest-

ment public. In this connection registrant urges that although underwriters have a duty to use due diligence in the selection of their offerings, such duty extends to the selection and supervision of salesmen who act as their registered representatives but that such brokers and dealers are not guarantors of the success of the companies they underwrite. The Hearing Examiner is of the view that a broker and dealer who undertakes to act as an underwriter of securities to be sold to the public assumes certain responsibilities including using due diligence in the selection of their offerings appropriate and adequate investigation of the issuer whose securities it proposes to sell and to supervise its salesmen so as to prevent the type of false and misleading representation made to the prospective investors who testified in this case. While it may be true that underwriters are not guarantors of the success of companies they underwrite they owe a duty to persons to whom they are recommending purchase of securities to deal with such persons fairly and honestly. To so deal with prospective investors does not encompass representations that a stock would increase substantially without furnishing the basis, if any, for such predictions; nor does it encompass a representation that the securities they are recommending will shortly be listed on a national securities exchange when such representation is completely without foundation. The license of brokers and dealers who engage in such activities should be revoked. The Hearing Examiner finds that the registrant has conducted its business in such a fraudulent and irresponsible manner as would warrant the Commission in revoking its license as a broker and dealer.

RECOMMENDATION

In view of the willful violations found it is respectfully recommended that the Commission enter an order finding it is in the public interest to revoke registrant's registration as a broker and dealer and expel it from membership in the NASD. It is further recommended that the Commission also find that Reilly, Hoffman, Kempinski, Campbell,[21/] Grant and Gordon willfully participated in, or aided and abetted in, registrant's willful violation of the designated provisions of the Securities Act and the Exchange Act and the respective rules thereunder and that such individuals were each a cause of such order of revocation.[22/]

Respectfully submitted,



Irving Schiller
Hearing Examiner

21/ Though Campbell did not appear at the hearings the record discloses that a copy of the Commission's order for proceedings and the order fixing the time and place of such hearing were duly served on him by registered mail. The Hearing Examiner finds that under the provision of Rule 15b-9(b) (17 CFR 240.15b-9(b)) Campbell was given appropriate notice and opportunity for hearing.

22/ To the extent that proposed findings and conclusions submitted by the Division of Trading and Exchanges, registrant, Reilly and Hoffman are in accord with the views set forth herein they are sustained and to the extent they are inconsistent therewith they are expressly overruled.

Washington, D. C.
February 12, 1962