

FILE COPY

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of

A. J. DAVIS COMPANY
345 Fourth Avenue
Pittsburgh, Pennsylvania 15222

File No. 8-9883

and

TRANSPORT INDUSTRIES, INCORPORATED
126 Pearl Street
Albion, Pennsylvania

File No. 24W-2579

FILED

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SECURITIES & EXCHANGE COMMISSION

RECOMMENDED DECISION

Samuel Binder
Hearing Examiner

Washington, D. C.
November 27, 1964

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BEFORE: Samuel Binder, Hearing Examiner.

APPEARANCES: William R. Schief and Michael J. Stewart, Esqs.,
Washington Regional Office, for the Division of
Trading and Markets.

Hubert Teitelbaum and Martin M. Sheinman, Esqs.,
Pittsburgh, Pennsylvania, for A. J. Davis Company
and Alan J. Davis.

Sanders I. Epstein, Esq., New York, New York,
for Transport Industries, Incorporated.

Alan J. Davis, pro se.

I. THE PROCEEDINGS

These are consolidated public proceedings pursuant to Section 3(b) of the Securities Act of 1933, as amended, ("Securities Act") and Section 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act").

The purpose of these proceedings is to determine:

(1) Whether the Commission should vacate an order issued on January 23, 1964 pursuant to Rule 261 of the General Rules and Regulations under the Securities Act temporarily suspending a Regulation A exemption with respect to a public offering of 75,000 shares of the ten cents par value common stock of Transport Industries, Inc. ("Transport") or enter an order permanently suspending such exemption; (2) whether it is necessary or appropriate in the public interest or for the protection of investors to revoke the broker-dealer registration of A. J. Davis Company ("registrant") and (3) whether within the meaning of Section 15A (b)(4) of the Exchange Act the Commission should find that Alan J. Davis ("Davis") the president and 100 per cent holder of the common stock of registrant is a cause of any order of revocation which may be entered herein against the registrant.

Chronologically stated the procedural facts are as follows:

On January 9, 1964, the Commission issued an order for public proceedings charging that the registrant and Davis had violated Sections 5(a) and (c) and Section 17(a) under the Securities Act and Sections 10(b)(5) and 15(c)(1) under the Exchange Act and Rules 10b-5 and 15c1-2 thereunder in selling and offering for sale the common stock of Transport to the public between April 18, 1962 and approximately June 21, 1962.

On January 23, 1964, the Commission issued an order, pursuant to Rule 261 of the General Rules and Regulations under the Securities Act temporarily suspending the exemption under Regulation A relating to the public offering of the securities of Transport and affording any person having an interest therein an opportunity to request a hearing. Transport filed a written request for such a hearing.

The Commission's order charged that Transport's filings on Forms 1-A and 2-A were not made in conformity with Regulation A, under the Securities Act in that both filings contained materially false and misleading statements.

On January 20, 1964, the registrant and Davis filed a joint answer. In addition, Davis filed separately a notice of appearance pro se. On February 24, 1964, Transport filed its answer.

The joint answer of registrant and Davis contained a general denial as to certain of the charges and a disclaimer of sufficient information upon which to base an answer as to the balance of the charges made against them. Transport's answer denied generally the allegations made against it and asserted that the proceedings were a nullity because the Commission's order stemmed from improper activity by members of its staff in that they had lulled Transport's management into believing that the Commission's investigation was confined to the activities of the registrant and Davis when, in fact, such staff members were at the time also investigating Transport.

On March 12, 1964, the Commission issued an order consolidating the proceedings and directed that a hearing be held. After appropriate notice, such hearing was held in Pittsburgh, Pennsylvania, before the undersigned hearing examiner beginning on June 15, 1964 and concluding on June 18, 1964.

Counsel for the Division of Trading and Markets ("Division"), moved to amend the Commission's order to conform to the proof adduced during the hearing relating to sales and offers to sell Transport's common stock made by the registrant and Davis through August 31, 1963. This motion was granted over objection by the respondents.

All parties were given full opportunity to be heard, to file proposed findings of fact, conclusions of law, and briefs. The Division filed such documents but none was filed by the respondents or Davis.

The following findings and conclusions are based on the record, the documents and exhibits therein, and the hearing examiner's observation of the various witnesses.

1. Transport represented in its filing on Form 1-A that it would manufacture and sell "double air chamber brakes" and that the proceeds of the offering were to be used to enable the company to engage in such business. The double air chamber brake to be manufactured by Transport was described as a braking device for use on trucks and trailers. The company represented that it had been engaged up to the time of its filing with the Commission in research and development and setting up its factory.

2. In substance, the Commission's orders as amended and consolidated alleged that Transport had filed with the Commission a notification and offering circular in purported compliance with Regulation A covering an offering of 75,000 shares of its ten cents par value common stock at \$4.00 per share; that Transport's offering circular was materially false and misleading; that Transport had filed with the Commission a report on Form 2-A dated August 10, 1962 which also was materially false and misleading; that the registrant, a Pennsylvania corporation with its principal place of business at 345 Fourth Avenue, Pittsburgh, Pennsylvania, is registered with this Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act on September 8, 1961, and is still so registered and that such registrant acted as underwriter for this issue of securities and Davis knew, or should have known, that Transport's offering circular was materially false and misleading and wilfully employed such circular in making a public offering of Transport's common stock; and that the respondents and Davis made other false and misleading statements in the offer and sale of such stock and that the respondents had used the means and instruments of transportation and communication in interstate commerce and of the mails in making such offers and sales of Transport's common stock.

3. During the course of the hearing, David Hoppenstand, ("Hoppenstand") president, majority stockholder and chief executive officer of Transport, appeared as a witness pursuant to a subpoena duces

tecum served upon him by the Division to produce the books and records of Transport. Evelyn Mehalko ("Mehalko"), an officer, director, and general office manager of Transport, was also a witness pursuant to a subpoena ad testificandum served upon her, and, in addition, Davis, president, director and owner of 100 per cent of the common stock of the registrant, was called as a witness by counsel for the Division.

4. Hoppenstand, in response to the subpoena duces tecum served upon him, produced several boxes of books and records which he stated were Transport's books and records. However, he produced no correspondence of Transport as called for by the subpoena and although this fact was called to his attention and to the attention of counsel for Transport no explanation was offered for the failure to produce such correspondence. Hoppenstand declined to testify concerning the contents of any of the books and records which he had produced or even to describe such documents except to state that they were the books and records of Transport. Hoppenstand declined also to testify with regard to any aspect of Transport's securities offering to the public or concerning Transport's filings with the Commission and repeatedly invoked the privilege against self-incrimination.

5. Mehalko and Davis when called as witnesses also refused to give any testimony bearing upon the charges made against the respondents and both repeatedly invoked the privilege against self-incrimination.

6. No evidence was presented by these witnesses or any other persons to controvert or rebut any part of the extensive evidence presented by the Division to support the allegations set forth in the Commission's orders, as amended. No inference of guilt of the charges made against the respondents or Davis is attributed to any party by reason of the assertion by these witnesses of their constitutional rights. The facts, nevertheless, are that the evidence presented by the Division was uncontradicted and the credibility of the witnesses who gave testimony in these proceedings was unimpeached. The examiner fully credits the testimony offered by all the Division's witnesses. The uncontradicted facts are entitled to great weight in resolving the issues raised by the pleadings.

II. TRANSPORT INDUSTRIES, INC.

7. Transport, a Pennsylvania company, was incorporated on April 26, 1948 as Hoppenstand Motors, Incorporated. Approximately twelve years later, i.e., on May 9, 1960, by amendment to its certificate of incorporation, its name was changed to Transport Industries, Inc.

8. Approximately two years after it changed its name, Transport filed with the Commission, on February 16, 1962, a notification on Form 1-A and an offering circular for the purpose of obtaining an exemption from the registration requirements under the Securities Act with respect to an offering of 75,000 shares of its ten cents par value common stock at an offering price of \$4.00 per share, for an aggregate amount of \$300,000.

9. The public offering of its common stock began on April 18, 1962. According to Transport's filing under Commission's Form 2-A, such public offering was concluded on June 21, 1962 with a total 18,843 shares reported as sold.

10. No registration statement is or has ever been in effect with respect to the securities of Transport.

11. The issue was underwritten by the registrant on a "best efforts" basis.

12. The documentary evidence particularly Transport's offering circular and Transport's 1962 annual report to its stockholders both of which were used in offering Transport's securities to the public is of the greatest importance in these proceedings and, accordingly, the contents of these documents will be discussed fully.

13. The Commission's orders charged that a balance sheet which was an integral part of Transport's offering circular and which was mailed and otherwise distributed by the registrant and Davis to persons to whom they offered and sold Transport stock was materially false and misleading.

14. The pertinent facts relating to the offering circular and its preparation may be summarized as follows: Michael Bespalko ("Bespalko") a certified public accountant of Pittsburgh, Pennsylvania, who had performed accounting services in the past for the registrant and Davis, was introduced by the latter to Hoppenstand in January 1962. At that time, Hoppenstand requested Bespalko to prepare financial statements in connection with a public offering to be made of Transport's common stock.

Hoppenstand subsequently sent Bespalko a copy of a balance sheet as of December 31, 1961 which had been prepared theretofore by Michael Yarbenet ("Yarbenet"), a certified public accountant of Erie, Pennsylvania, at the request of Transport's management.

15. Shortly thereafter, Bespalko went to the offices of Transport at Albion, Pennsylvania and asked Mehalko for Transport's books of account for the purpose of preparing financial statements for inclusion in Transport's offering circular. Although Transport had, by January 1962, been in existence for approximately 14 years, Mehalko informed Bespalko that the company had no books of account but only had cancelled checks, invoices and correspondence. After his discussion with Mehalko, Bespalko went to see Yarbenet on January 18, 1962 and discussed at length, with him the financial statement which the latter had prepared for Transport shortly before Bespalko's visit. Yarbenet at that time also showed Bespalko his working papers.

16. Yarbenet appeared as a witness in this proceeding and testified that he had told Bespalko that he had been requested by Mehalko in October 1961 to prepare financial statements for Transport and that he had been informed by Mehalko at that time that Transport had no corporate books or records other than cancelled checks, invoices and correspondence. In addition, Yarbenet testified that Mehalko had given him a balance sheet of Transport as of June 15, 1961 which she had prepared herself.

There was no evidence in this record that Mehalko had had any bookkeeping experience or other training in accounting or that the balance sheet prepared by Mehalko was supported by any financial records of Transport. In fact, the evidence was to the contrary because Mehalko told Yarbenet that Transport did not maintain ordinary corporate books of account and that the company only had the meager records already described.

17. Yarbenet also testified that based on the balance sheet prepared by Mehalko and the cancelled checks, invoices, and correspondence which had been furnished to him by her, and on his conversations with her, he prepared a balance sheet for Transport as of September 30, 1961. Yarbenet at the request of Transport also prepared another balance sheet as of December 31, 1961. Yarbenet prepared the latter balance sheet on the basis of the inadequate type of records made available to him when he drafted his earlier balance sheet and without the support of books of account such as are normally maintained by business corporations.

18. Yarbenet testified that he had informed Bepalko of these facts during their meeting on January 18, 1961 and Bepalko corroborated the testimony of Yarbenet in all respects.

19. Bepalko testified that he prepared the balance sheet which was made a part of Transport's offering circular on the basis of the inadequately supported balance sheet prepared by Yarbenet, on the basis of statements made to him by Mehalko and on the basis of examining some cancelled checks, invoices and correspondence and without any support from any other records or books of account.

20. An accountant who was a member of the Commission's staff which had conducted an investigation of the respondents in this case also testified during the hearing that he went to the offices of Transport during the course of the Division's investigation and asked Mehalko to let him look at the books of account of Transport and she informed him that the company did not maintain any books of account. Thus, it appeared that Mehalko had informed all three accountants who testified in this proceeding, namely Yarbenet, Bespalko and the Commission's accountant, that Transport did not maintain any books of account.

21. No testimony was offered to contradict the testimony of Bespalko, Yarbenet or the Commission accountant as to the statements made to them by Mehalko or as to the basis upon which the accountants for Transport prepared the balance sheets of the company.

22. It is clear from the record in these proceedings that the balance sheet contained in the offering circular was prepared by Bespalko without reference or relationship to the books of account produced during the hearing by Hoppenstand. Such books had never been seen by the accountant who prepared the balance sheet contained in the offering circular and they were not employed by him in the drafting of such document. They were irrelevant to the preparation and composition of the balance sheet included in the offering circular.

23. The production of these books of account by Hoppenstand demonstrated, however, that if Transport maintained books of account the management of the company deliberately withheld them from their own accountants and, in fact, specifically misled them by informing them that

no such books of account were in existence at the very time when they employed such accountants for the purpose of preparing a balance sheet for inclusion in an offering circular to be distributed to the public in connection with a securities offering which Transport intended to make. The only clear inference to be drawn from the conduct of Transport's management was that they intended that the financial statement contained in the offering circular be false and misleading.

24. In this connection, it should be noted that the balance sheet which was included in the offering circular was a formal document which included a breakdown of assets under the usual subheadings, such as "Current Assets", "Property, Plant, and Equipment" and "Deferred Charges", and a breakdown of liabilities under subheadings such as, "Current Liabilities", "Long Term Debt" and "Stockholders' Equity." In addition, the balance sheet included elaborate "Notes to Financial Statements", indicating that inventory was "maintained on the basis of first in - first out"; that the "Fixed assets are stated at cost to the company"; and further in this connection, the "Notes to Financial Statements" computed depreciation on the basis of "estimated useful life" of various assets; and stated that the "Deferred Patent Costs" which amounted to over \$84,000 were broken down into seven separate components with specific costs down to the penny ascribed to each component.

25. In addition to these representations in the balance sheet, Transport made representations under the heading "Application of Proceeds" stating how the money received from the offering would be employed by the

company. In this connection, Transport represented that if it did not sell all the shares offered, "the Company will utilize the proceeds proportionately" in accordance with a schedule of expenditures set forth under the heading "Application of Proceeds."

26. The formal appearance and extensive detail of the balance sheet and the statements in the circular under the heading "Application of Proceeds" were strongly indicative of Transport's deliberate intention to mislead readers of the circular into believing that the balance sheet was supported by books of account and other records such as are normally maintained by corporations when in fact the balance sheet was not so supported. It may be observed in this connection that the balance sheet presented fixed assets at \$49,316.26, inventory at \$7,922.48, and deferred charges at \$120,874.88 and there was no accounting or other record evidence to support any of these figures. It should also be noted that there was no evidence that any appraisal of the assets had ever been made, and no explanation was ever made as to how the amounts assigned to fixed assets was determined.

27. It is also noted that when Yarbenet prepared his first balance sheet purporting to show Transport's financial condition as of September 30, 1961 the figure for the cash asset was represented as zero. The evidence also is that when Yarbenet prepared his second balance sheet showing the condition of Transport as of December 31, 1961, the cash asset was stated to be seventy cents and that the second balance sheet prepared by him was not otherwise materially different from the first balance sheet which he

had drafted for Transport.

28. The balance sheets of September 30, 1961 and December 31, 1961 prepared by Yarbenet were presented to Transport's management for review and Hoppenstand approved the December 31, 1961 balance sheet which reflected a cash asset of only seventy cents.

29. Bespalko also prepared a balance sheet for Transport as at December 31, 1961 which was substantially the same as that which had been prepared by Yarbenet and also showed cash assets of only seventy cents.

30. The strikingly poor condition of Transport's financial records was made clear to Bespalko through his examination of such records as were made available to him and through his examination of the balance sheet prepared by Yarbenet and his conversations with Yarbenet and Mehalko.

31. In this connection, Bespalko had a meeting in February 1962 with Davis concerning Transport's balance sheet. At that time, Bespalko told Davis that when he was requested to prepare financial statements for the company he had been informed that the company had its books of account at Albion, Pennsylvania but that when he went to Albion he was informed by Mehalko that the company did not have any such books. Bespalko then told Davis at this meeting that "the books stunk, the company had no books." Thus it was made very clear to Davis before he and the registrant had made any offering of the stock that the company did not have reliable financial records.

32. Bespalko further testified that he did not make any independent inquiry or verification of the inventory of \$7,922.49, as set

forth in the balance sheet and that he was unable "to make a proper determination of Transport Industries' financial condition" because he "didn't have all the tools necessary to give [him] the final answers that were on that balance sheet through books and so forth." In addition, Bespalko stated that he had been informed by Mehalko that the company had not filed Federal or state tax returns for a number of years. In this connection, Bespalko ascertained that there had been no state tax returns filed by Transport since 1960. Mehalko informed him that it was not necessary to file such returns because the company was not in operation. The offering circular not only gave no such information but instead represented that Transport had been actively engaged in research and development for the 14 years preceding the offering.

33. During the February 1962 meeting Davis advised Bespalko that the cash asset of seventy cents as reflected on the balance sheet which the latter had prepared was incorrect and that Transport had an additional \$1,000 in cash. Bespalko telephoned Hoppenstand to verify Davis' statement and Hoppenstand stated that the company had an additional \$1,000 which it obtained as a loan from him. Based upon this representation, Bespalko changed the cash asset on the balance sheet from seventy cents to \$1,000.70. However, the liability to Hoppenstand for this alleged loan was never reflected on the balance sheet. Moreover, this additional cash asset was reflected without reference to or support from any corporate accounting record.

34. Hoppenstand also requested Bespalko on a number of occasions beginning in April or May 1962 for a certification of the financial statements of Transport. Bespalko told Hoppenstand he could not get such a certification from him and Bespalko also said that he doubted he could get it from anybody.

35. In addition to the offering circular, Transport issued and the registrant and Davis mailed and otherwise distributed to investors a document labeled "Transport Industries, Inc. 1962 Annual Report." The document sets forth among other things that Hoppenstand, Mehalko and Davis were members of the board of directors of Transport. In the text of this report, Transport stated, among other things, that:

"Transport, has completed a particularly good year. The plant has completed a number of new models and increased our reputation in the Trucking Industry, this should find Transport in a better position than before to benefit from increased sales activity.

"Reducing the accomplishment to figures, the year 1962 resulted in a five month period, sales of \$55,382.96 and share earnings of .17 per share.

"We can look to a continuing sales and profit expansion with our existing plant and facilities.

"We expect to be in a position to announce in the very near future, perhaps by the time of the annual meeting, the completion of an agreement with a nationwide sales organization to market our products.

"This is a well established company with a good sales record and promise for even better results in the future."

36. This report also included a balance sheet of Transport as at January 31, 1963, i.e., a date thirteen months after the date of the balance sheet contained in the offering circular.

37. A comparison of the balance sheet contained in the offering circular with the statements made in the annual report shows assets stated in the offering circular at \$179,277.24, whereas the assets as set forth in the annual report to stockholders approximately thirteen months later were \$320,488.92. Liabilities, including long-term debt, were stated as having increased from \$53,217.24 as set forth in the offering circular to \$151,910.96 as set forth in the stockholders' annual report and stockholders' equity was stated as having increased from \$126,040 to \$168,577.96.

38. The facts with regard to the preparation of the balance sheet contained in the 1962 annual report to stockholders were as follows. Bespalko prepared a report to be submitted to the officers and directors of Transport as of January 31, 1963. The figures contained in that report were, in major part, the same as the figures contained in the annual report to stockholders. However, as a part of such report, Bespalko attached a letter addressed to the officers and directors of Transport dated February 6, 1963, reading as follows:

"The attached balance sheet and related statements of profit and loss reflect the financial position of Transport Industries, Inc., at January 31, 1963, and the results of its operations for the five months then ended as shown by its accounts, which were maintained by the company on the basis of information furnished me by management.

"In view of the fact that I did not make any independent verification of the Company's assets, liabilities, income, or expense, I am not in a position to assume responsibility for or to express an independent accountant's opinion on the fairness of the representations contained in the statements submitted in this report."

39. In substance, this was a disclaimer of any responsibility for the figures contained in the report. In this connection, it should be noted that on the basis of Bespalko's uncontradicted testimony in this hearing there does not appear to be any support in the books and records of Transport for the figures contained in Bespalko's report to the officers and directors of Transport, and the figures included in the annual report to the stockholders. In view of the evidence that Transport did not maintain ordinary books of account or other financial records such as are usually maintained by business corporations, Bespalko's disclaimer was particularly significant.

40. Another important aspect of Transport's 1962 annual report is that it contained what purported to be a certificate executed by "Michael Bespalko, Certified Public Accountants", as follows:

"MICHAEL BESPALKO

Certified Public Accountant

February 4, 1963

**Board of Directors and Shareholders
Transport Industries, Inc.
Albion, Pennsylvania**

We have examined the balance sheet of Transport Industries, Inc. In our opinion, based upon our examination and upon the reports of other accountants, the accompanying statement presents fairly the financial position of the Transport Industries, Inc. at January 31, 1963, and the results of their operations for the year then ended, in conformity with generally accepted principles applied on a basis consistent with that of the preceding year.

**Michael Bespalko
Certified Public Accountants"**

41. Bespalko testified that Davis gave him a copy of Transport's 1962 annual report to stockholders containing the above quoted accountant's certificate and that was the first time that he became aware of the existence of such certificate. Bespalko testified that he had never executed any such certificate or any other certificate for Transport and he also testified he had never authorized his name to be used in this document and that he had so informed Davis.

42. Another document which was the same as the 1962 annual report was also issued by Transport and employed by Davis. However, this contained an accountant's certificate which used slightly different language but was of the same general import. Bespalko testified that he had not authorized the use of his name or certificate in any Transport document and he was not contradicted.

43. After Davis had shown Bespalko the 1962 annual report, Bespalko telephoned Hoppenstand "that the brochure [i.e., the 1962 annual report to stockholders] was wrong, and that it better be rescinded or I will see the Securities and Exchange Commission." Hoppenstand thereupon told Bespalko that he was "fired."

44. A Commission accountant and investigator testified that he made an examination of such records as were made available to him by the management of Transport. Based on such examination, the uncontradicted testimony of the Commission's accountant was that the annual report was false and misleading in that the report stated that the sales for the five-month period ending January 31, 1961 were \$55,382.96, when, in fact sales were \$1,338.22 for that period, in that the report stated that there was a

gross profit of \$33,093.98 for the period when, in fact, there was a loss of \$14,715 for the period, and in that the report stated that there were earnings per share of \$.17 for the period, when, in fact, there was a loss per share of \$.14 for the period.

45. In addition, the record shows that there was no basis for the statement contained in the offering circular that up to March 29, 1962 the company had succeeded in obtaining orders for future delivery for 544 units [i.e., brakes] at an aggregate sales price of \$26,544.12.

46. In summary, Transport's offering circular contained a formal balance sheet which clearly reflected that it was supported by adequate financial records when, in fact, it was not so supported. Transport's balance sheet also reflected valuations concerning shop machinery and equipment, tools, furniture and other fixed assets which were unsupported and had no reasonable accounting basis. In addition, despite the fact that its balance sheet indicated that Transport followed recognized inventory pricing methods, the company did not follow such methods. Neither the balance sheet nor any other part of the offering circular disclosed that the company had failed to file Federal and state tax returns. Furthermore, the balance sheet contained in the offering circular misrepresented the company's cash position. Moreover, the financial statements contained in the annual report purported to have been certified by Bepalko, a certified public accountant, when, in fact, no such certificate was ever issued by him.

47. It was established beyond question that the financial statements contained in both the offering circular and the annual report issued

by the company and distributed by Davis were grossly false and misleading.

48. It should be emphasized that when financial statements are filed as part of an offering circular, they must be prepared in accordance with generally accepted accounting principles and practices. In this case, we have a situation where a balance sheet which in form and in detail appeared to have been based on financial data supportive of the figures set forth therein when in fact it was prepared without such supporting data. The preparation of financial statements in accordance with generally accepted accounting principles presupposes the maintenance of adequate books, records and vouchers to support or verify entries.

49. The financial statements which were a part of the offering circular and the 1962 annual report to stockholders were prepared without adequate books and records and these financial statements do not meet generally accepted accounting standards and are thereby misleading. ^{1/}

50. On August 10, 1962, Transport filed with the Commission its Form 2-A Report, signed by Hoppenstand, Transport's president. This report was false and misleading in the following respects: the Form 2-A Report stated that the company had disbursed \$1,500 in payment for accounting services when, in fact, it had made no such disbursement. In addition, this report exaggerated the amount of payments it had made in the following respects. The report stated that the company had disbursed \$2,255.87

^{1/} See Weiss, Regulation A under the Securities Act of 1933 - Highways and Byways, p. 84 (1962), Aluminum Top Shingle Corporation, 40 S.E.C. 941, Hart Oil Corporation, 39 S.E.C. 427, S.E.C. Form 1-A, Schedule I, Item II.

for printing and advertising when, in fact, it had only disbursed \$585.33 and owed a balance of \$1,466.36. The Form 2-A Report reflected a disbursement of \$7,596.91 under the category of "Legal (including organizational)" when, in fact, only \$4,834.45 of this expense had been paid and the balance of \$2,762.46 was still owed. The Form 2-A Report reflected the disbursement of \$31,870.79 under the category "Purchase of Raw Materials, Inventories, Supplies, Etc.", when, in fact, the actual disbursement was \$15,941.17.

51. The uncontradicted facts established in these proceedings lead inevitably to the conclusion which the hearing examiner now makes that Transport Industries, Inc. wilfully violated Sections 5(a) and (c) and Section 17(a) of the Securities Act; violated the terms and conditions of Rule 261 of Regulation A of the General Rules and Regulations adopted under the Securities Act; and that it is in the public interest to suspend permanently the exemption under Regulation A of the Securities Act relating to the offering of Transport Industries, Inc.

III. THE REGISTRANT AND DAVIS

52. The registrant and Davis mailed and otherwise distributed to investors and prospective investors copies of Transport's offering circular and Transport's 1962 annual report to its stockholders knowing that both such documents contained the numerous false and misleading statements which have been previously described.

53. The conclusion that the registrant and Davis were fully informed as to the false and misleading character of these documents was buttressed by the testimony of Bespalko that he had informed Davis of the unreliability of the financial statements contained in the offering circular before such circulars were mailed and distributed to investors, by Bespalko's testimony that he had informed Davis that the 1962 annual report to stockholders contained an accountant's certificate purporting to have been signed by him when, in fact, he had never signed such document, or authorized his name to be used, and by the further fact that Bespalko had written a letter to Transport's board of directors disclaiming responsibility for the accounting presentation made in Transport's 1962 stockholders annual report before such document was printed and distributed. In this connection, it should also be kept in mind that Davis was a member of Transport's board of directors.

54. In addition to engaging in the purposeful dissemination of these fraudulent documents to members of the investing public, the registrant and Davis made statements without reasonable basis to persons to whom they offered Transport concerning the payment of dividends by the company and also made wholly unwarranted statements concerning the business prospects of the company including predictions of substantial increases in the market price of Transport's stock.

55. In this connection, it will be recalled that on August 10, 1962, Transport had filed a report dated July 31, 1962 on Form 2-A with the Commission, which stated, among other things, that Transport had terminated the offering of its securities on June 21, 1962 with the sale of 18,843 shares and had received \$75,372 from the public for such securities. The company's report on Form 2-A sets forth that:

"9. The offering was discontinued on June 21, 1962 because of the inability of the underwriter to market additional securities for the issuer."

56. In connection with the use which it made of the money received from the public, Transport stated that it had paid \$10,000 for expenses and \$7,537.20 for underwriting discounts to the registrant, i.e., a total of \$17,537.20; that its total expenses in connection with the making of the offering amounted to \$32,508.17; and that the proceeds to the issuer after these deductions were \$42,863.82.^{2/} Not only that, the Form 2-A showed that as at July 31, 1962 an additional amount of \$13,738.50 of the proceeds received from the public sale of Transport's stock had been used to pay the salaries and fees of two officers and directors of Transport. Thus, the company reported to the Commission that as at July 31, 1962 it had expended approximately 75% of the gross proceeds received from its stock offering for underwriting fees and expenses and other expenses connected with the making of its securities offering and for salaries of Transport's officers.

^{2/} We have already noted that while Transport claimed it had made all the payments listed on its Form 2-A, it had not in fact done so, although to the extent it had not made such payments the company was under an obligation to do so.

57. It should also be observed that the offering circular stated that Transport had a five year employment contract with Hoppenstand under which the company was obligated to pay him \$20,000 per year for the first two years and \$25,000 per year for the last three years. The circular also pointed out that Mehalko's salary was \$5,200 per year. In this connection, the offering circular stated (p. 3) that:

"3. The Company will pay a total of \$25,200 during the next year to 2 officers, who are directors of the Company. The Company has not yet derived any profits from its operations. In the event that the Company's earnings during the year are insufficient to pay all or part of the \$25,200 to which it is committed in salaries, part of the proceeds of this offering may be used for that purpose. To that extent, irrespective of whether the business operations of the Company prove to be profitable, the two salaried directors and officers of the Company will be paid for their services and benefit from the proceeds of the offering." 3/

58. On this basis, the company was still under an obligation to pay its two salaried officers and directors over \$11,000 for services to be performed by them during the balance of the year but according to its Form 2-A Report it had, as at July 31, 1962, only a "Balance of cash proceeds on hand" of \$7,279.20, and despite statements which Transport made to the contrary, it had substantially no orders for its "double air chamber brakes."

59. In connection with the use to be made of the proceeds of the offering, Transport represented in its offering circular that if it disposed of the 75,000 shares which it was offering it would apply \$180,000

3/ A similar statement appears at p. 8 of the offering circular.

for the purchase of raw materials and supplies for the manufacture and assembly of the company's product; approximately \$25,000 for printing, selling literature, and promotion; and the balance of approximately \$45,000 for working capital and general corporate purposes. In addition, the prospectus stated:

"In the event less than all the shares offered hereby are sold, the Company will utilize the proceeds proportionately. If sufficient earnings are not realized by the Company, then some of the proceeds will be used to pay officers' salaries."

60. It was clear by July 31, 1962, the date of Transport's Form 2-A Report that insofar as the idea of raising approximately \$300,000 less the costs of the underwriting to be applied to the manufacture of brakes for automobiles was concerned, Transport's offering was a failure since it had sold only about twenty five percent of the securities it was offering and since approximately seventy five per cent of the small amount of money it had raised from its unsuccessful offering had been used to pay the cost of underwriting the securities and to pay the salaries of its two officers, leaving only about one quarter of the small amount remaining to be used for the manufacture and distribution of its double air chamber brakes.

61. The use of these funds "proportionately" as required by Transport's representations under "Application of Proceeds" in its offering circular, or otherwise, would hardly appear to be feasible since the amount remaining after expenses would not be adequate to fulfill any one of the purposes toward which Transport stated that the funds were to be applied.

62. It was in these circumstances that the registrant and Davis

made highly optimistic and wholly unreasonable representations concerning payment of dividends by Transport and concerning the company's business prospects. Registrant and Davis also made predictions of substantial price rises which had no reasonable basis.

63. These representations will be considered in the light of the anti-fraud provisions of the Securities Acts.^{4/} In addition, the effect of violating such anti-fraud provisions insofar as revocation of the registrant's broker-dealer registration^{5/} and the impact of Section 15A(b)(4) of the Exchange Act will also be considered.^{6/}

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- 4/ The anti-fraud provisions alleged to have been violated are Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 (17 CFR 240.10b-5 and 10c1-2) thereunder. The effect of these provisions as applicable in this case is to make unlawful the use of the mails or means of interstate commerce in connection with the sale of any security by the use 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 the use of any other manipulative, deceptive or fraudulent device.
- 5/ 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 person of such broker or dealer has wilfully violated any provision of that Act or of the Securities Act or any rule thereunder.
- 6/ 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 registered securities association if the broker or dealer or any partner, officer, director, or controlling or controlled person of such broker or dealer, whether prior to or subsequent to becoming such, was a cause of any order of revocation, suspension, or expulsion which is in effect.

64. In the summer of 1962, Marvin Joseph Hendrickson ("Hendrickson") of McKeesport, Pennsylvania, received Transport's offering circular in the mail from the registrant. Thereafter, Davis telephoned Hendrickson and asked him whether he had read the circular. Hendrickson said that he had but was not interested in buying over-the-counter stock because there were too many opportunities for manipulation and other undesirable practices. Davis telephoned Hendrickson thereafter on several occasions suggesting the desirability of purchasing Transport stock. Hendrickson looked at the offering circular again at Davis' request. Davis told Hendrickson he was the underwriter and that Transport looked like "a real good thing." Hendrickson relied on the financial information contained in the offering circular and Davis' oral representations and purchased 100 shares on August 8, 1962 from registrant at \$4 3/4 per share. The registrant mailed a confirmation to Hendrickson. This sale was made subsequent to June 21, 1962, the date that Transport had stated in its filing on Form 2-A that the company's offering had been discontinued after selling only approximately 25 per cent of the shares it had offered "because of the inability of the underwriter to market additional securities of the issuer."^{7/}

65. After Hendrickson made his initial purchase, the registrant mailed him Transport's 1962 annual report to its stockholders. Davis also told Hendrickson that Transport had signed or was about to sign a contract

^{7/} See Report of Transport Industries on Form 2-A, Item 9, p. 2.

which made the "stock look like an ironclad cinch." Davis also represented to Hendrickson that the stock looked like a "ten or twenty dollar share stock by year's end." Based upon these representations, Hendrickson purchased another 100 shares at \$6 3/8 per share on November 28, 1962. Davis also represented that Transport was about to sign a contract with Bostrum Corporation, a substantial Milwaukee seat company, which would provide an important outlet for the product. In fact, no such contract was ever entered into with Bostrum Corporation.

66. Shortly before August 1963, Hendrickson received another telephone call from Davis in which Davis stated that ". . . there had been some things happening at Transport, that it looked like the stock 'was going up by year's end,'" Hendrickson had also called a telephone answering service used by the registrant which gave out recorded statements of market prices. This recording service reported a sharp rise in the price of Transport from \$4 to better than \$6 a share in a relatively short time. Hendrickson then purchased 50 more shares of Transport at \$6 3/4 per share on August 1, 1963.

67. Hendrickson also noted that Transport Industries' 1962 Annual Report contained a certificate purporting to have been executed and signed by Michael Bepalko, a Certified Public accountant, when, in fact, such certificate had never been signed or executed or authorized to be used by Bepalko.

68. In May or June 1962, Mrs. Renny Selig ("Selig") of Pittsburgh, Pennsylvania called Alan Davis, whom she knew to be a

stockbroker, and advised him she wished to buy some IBM or some other good investment for her retirement. Davis advised Selig that she would do better in Transport Industries which was in the brake business and had a good future. Davis told Selig that the "price would go to ten dollars per share," and indicated to her that "the stock would pay a dividend."

69. Selig relied on the statements made to her by Davis and, as a result of the representations, she purchased 200 shares at \$4 1/2 per share on July 3, 1962. Selig received an offering circular and her confirmation from the registrant in the mail.

70. Bernard J. Schiller ("Schiller") of Pittsburgh, Pennsylvania, first heard of Transport Industries from Alan Davis in May or June 1962. Davis said that Transport Industries was a small firm headed by a Colonel Hoppenstand, who had invented a safety brake for trucks. Davis described Hoppenstand as a "genius." During these conversations, Davis informed Schiller that, in his opinion, the stock would rise in price. Based upon these representations, Schiller purchased 400 shares at \$4 per share on June 15, 1962. He received his confirmation, the offering circular and his stock certificates in the mail from the registrant.

71. Charles E. Shipley ("Shipley") of Beaver Falls, Pennsylvania, had a telephone conversation with Davis in late 1961. Shipley asked Davis to purchase some General Foods stock for him but Davis advised Shipley against such a purchase and he told Shipley that he had another security, Transport Industries, which was not yet on the market. Subsequently, Davis told Shipley that Transport stock was better; that it had a good product; that he, Davis,

thought very highly of Hoppenstand, the president of the company, and that "the stock would go to \$20-\$25 per share within two years." As a result of these representations and the information contained in the offering circular, which he received in the mail from the registrant, Shipley purchased 700 shares at \$4 per share on April 18, 1962. He received his confirmation for this purchase in the mail from the registrant.

72. Neither the registrant nor Davis ever advised any of the purchasers referred to hereinabove that Transport did not maintain adequate books and records; that the balance sheet in the offering circular and in the annual report to the stockholders was false and misleading in the numerous respects hereinabove recounted; that the "accountant's certificate" contained in the 1962 annual report to stockholders had never been executed by the accountant; that Transport had no orders for 544 brake units for future delivery as stated in the offering circular; that the company had not made any profits but had sustained operating losses; that the company was not in a position to pay dividends; or that the company had failed to file Federal and state income tax returns.

73. The Commission has repeatedly condemned activities of the character resorted to by the registrant and Davis. In connection with registrant's and Davis' conduct with their customers, the Commission in Heft, Kahn & Infante, Inc., Securities Exchange Act Release No. 7020, p.4

(1963) stated that:

". . . There is inherent in the dealer-customer relationship the implied relationship that the customer will be dealt with honestly and fairly and that representations respecting a stock which the dealer recommends are reasonably made on the basis of knowledge and careful consideration."

The Commission also observed in Alexander Reid & Co., Inc., 40 S.E.C. 986, 990 (1962), that:

"A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a stock which he had undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration. Without such basis the opinions and predictions are fraudulent, . . ." 8/

In Linder, Billotti & Co., Inc., Securities Exchange Act Release No. 7460 (p. 2), the Commission pointed out that:

"We have repeatedly noted that in our experience predictions of substantial price rises to named figures with respect to a promotional and speculative security of an unseasoned company have been a hallmark of fraud. 3/"

"3/ See e.g. Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962); MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846, p. 15 (July 11, 1962), aff'd sub nom. Berko v. S.E.C., 316 F.2d 137 (C.A. 2, 1963); Equity General Investment Corporation, Securities Exchange Act Release No. 7388, p. 4 (August 13, 1964)."

74. The hearing examiner finds that registrant and Davis in offering and selling Transport stock violated the terms and conditions of Rule 261 of Regulation A under the Securities Act.

8/ See also Barnett & Co., Inc., 40 S.E.C. 1 (1960); Leonard Burton Corporation, supra, p. 214.

75. The hearing examiner further finds that registrant and Davis used false and misleading literature and that they made use of fraudulent oral representations in the offer and sale of Transport Industries stock.

76. The hearing examiner concludes that by reason of the foregoing, the registrant and Davis, singly and in concert, wilfully violated and aided and abetted wilful violations of Sections 5(a) and (c) and Section 17(a) of the Securities Act.

77. The hearing examiner further concludes that registrant and Davis wilfully violated Sections 10(b) and 15(c)(1) and Rules 10b-5 and 15c1-2 of the Exchange Act.

78. In view of the serious nature and number of the wilful violations committed by registrant, the hearing examiner finds that it is in the public interest to revoke registrant's registration as a broker-dealer.

IV. RECOMMENDATIONS

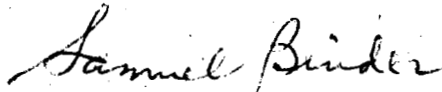
79. The hearing examiner recommends, on the basis of the foregoing, that the Commission enter an order finding that it is in the public interest to revoke registrant's registration as a broker-dealer.

80. It is further recommended that Davis be found to be a cause within the meaning of Section 15A(b)(4) of the Exchange Act of any

order of revocation entered herein against registrant.

81. It is further recommended that the Commission enter an order permanently suspending the exemption under Regulation A of the Securities Act, relating to the offering of Transport Industries, Inc.^{9/}

Respectfully submitted,



Samuel Binder
Hearing Examiner

Washington, D. C.
November 27, 1964

^{9/} To the extent that the proposed findings and conclusions submitted by the Division are in accord with the views set forth herein, they are sustained and to the extent that they are inconsistent therewith, they are expressly overruled.