UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of

FRANCIS J. BRENEK AND CO., INC.
1904 - 3rd Avenue
Securities Building
Seattle 1, Washington

File No. 8-8211

RECOMMENDED DECISION

IRVING SCHILLER
Hearing Examiner

Washington, D.C.
August 28, 1961

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BEFORE: IRVING SCHILLER, HEARING EXAMINER

APPEARANCES: Donald J. Stocking, Lane B. Emory and Grant B. Mumpower, Seattle, Washington Regional Office for the Division of Trading and Exchanges.

G. Robert Brain of Merges, Brain and Hilyer for Francis J. Brenek and Co., Inc., Patrick L. Calligan and Clinton F. Crow.

These proceedings were instituted pursuant to Section 15(b) and 15A(1)(2) 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 Francis J. Brenek and Co., Inc. ("registrant"), whether to suspend or expel registrant from membership in the National Association of Securities Dealers, Inc. ("NASD"), a registered securities association, and whether under Section 15A(b)(4) of the Exchange Act Francis J. Brenek (Brenek), Patrick L. Calligan (Calligan) and Clinton F. Crow (Crow), or any of them, are each a cause of any order of revocation which may be issued. 1/

1/ Section 15(b) of the Exchange Act, as here applicable, 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 of any rule thereunder. It further provides that pending final determination of the question of revocation, the Commission shall suspend such registration if it finds that it is necessary or appropriate in the public interest or for the protection of investors.

Section 15A(1)(2) of the Exchange Act provides for the suspension for a maximum of twelve months or the expulsion from a registered securities association of any member thereof who has violated any provision of that Act or any rule thereunder or has willfully violated any provision of the Securities Act of 1933 or any rule thereunder, if the Commission finds such action to be necessary or appropriate in the public interest or for the protection of investors.

Under Section 15A(b)(4) of the Exchange Act, in the absence of our 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 or revocation, suspension or expulsion which is in effect.

The order for proceedings alleges that during the period between February 4, 1960 and the date of the order, May 11, 1961, registrant, together with, or aided and abetted by, Brenek, Calligan and Crow, improperly made false and misleading statements of material fact in connection with the offer and sale of registrant's stock in willful violation of the anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act; [2/] that Brenek caused registrant to issue its checks payable to customers and Brenek, without knowledge and consent of such customers, affixed, or caused to be affixed, the indorsement of such customers on such checks which Brenek deposited to his own bank account, and that Crow aided and abetted Brenek in certain of such activities in willful violation of the Exchange Act; that registrant, aided and abetted by Brenek, Calligan and Crow, willfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 by failing to make and keep current certain books and records of registrant as required under said rule; [3/] and that registrant, aided and abetted by

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2/ 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 15c1-2) thereunder. The effect of these provisions, as applicable here, is to make unlawful the use of the mails or means of interstate commerce in connection with the purchase or sale of any security by the use of a device to defraud, an untrue or misleading statement of 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.

3/ Section 17(a) of the Exchange Act requires registered brokers or dealers to make and keep current such books and records as we may prescribe as necessary and appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records which must be maintained and kept current.

Brenek, Calligan and Crow, effected securities transactions in willful violation of the net capital requirements of Section 15(c)(3) of the Exchange Act and Rule 17 CFR 240.15c3-1 thereunder.[4/] The order was amended at the hearing to allege that registrant, Brenek and Crow are temporarily enjoined by an order of the United States District Court for the District of Western Washington, Northern Division, from engaging in and continuing certain conduct and practices in connection with the purchase and sale of securities.

After appropriate notice, hearings were held before the undersigned Hearing Examiner. Proposed findings, conclusions and argument were filed with the Hearing Examiner by the Division of Trading and Exchanges.[5/]

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:

4/ Section 15(c)(3) of the Exchange Act prohibits the use of the mails or interstate facilities by a broker or dealer in securities transactions otherwise than on a national securities exchange, in contravention of our rules prescribed thereunder providing safeguards with respect to the financial responsibility of brokers and dealers. Rule 15c3-1 provides, subject to certain exemptions not applicable here, that no broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per cent of his net capital computed as specified in the rule.

5/ The record indicates that counsel for registrant advised the Seattle Regional Office that he does not intend to file proposed findings or brief with the Hearing Examiner but reserved his right to file a brief before the Commission.

1. Registrant, a Washington State corporation, has been registered with this Commission as a broker and dealer since February 4, 1960. Brenek has been and is President, a Director and beneficial owner of 10% or more of the capital stock of registrant. Calligan was a Vice President, Director, and a salesman of registrant from its inception until his resignation in about August 1960. In September 1960 Calligan returned to registrant as a salesman, in which capacity he was employed until March 1961. Crow was and is one of registrant's salesmen and became Vice President and Director on or about September 10, 1960.

Violations of the Anti-Fraud Provisions

2. The record discloses that Brenek, Calligan and Crow engaged in the sale of registrant's securities during December 1959 and January 1960, and again during the period from September 1960 through January 1961. According to Brenek, these latter sales were undertaken when registrant needed additional funds, particularly in order to meet the net capital requirements of the Exchange Act and the Commission's rules thereunder.

3. The record discloses that during the period December 1959 and January 1960 Brenek and Calligan sold registrant's stock and made false and misleading representations of material facts and omitted to state material facts necessary in order to make the statements made not misleading. Four witnesses who testified concerning their purchase of registrant's stock in December 1959 and January 1960 stated that they were told that the stock was a safe investment, that holders of the stock could expect to receive dividends ranging from six per cent to twenty per cent

depending on how well the company did, that the stock would pay off, that money could always be made in a brokerage business regardless of the direction of the general market, that registrant's stock was one of the best securities available, that in a few years a $1,000 investment might be worth $20,000, that funds from sale of stock would be used for expansion purposes, and that Brenek would buy back the stock at any time.[6/]

4. The record shows that registrant was incorporated in November 1959 to take over the broker-dealer business that was conducted by Brenek as the sole proprietor. A statement of registrant's financial condition as of January 15, 1960, accompanying its application for registration with this Commission as a broker and dealer, disclosed that registrant had a net operating loss of approximately $300 as of such date. It is clear from the record that starting in December 1959 Brenek requested Calligan to sell registrant's stock, informing him that the company was doing well, that he expected it to grow and hoped to make it a success. Calligan, though an officer and director, without knowledge of registrant's financial condition, or attempt to examine any of registrant's books, undertook the sale of its stock without commission therefor. There was no basis for any of the representations which were made to the customers. Obviously, the corporation had just

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6/ Though not all of the representations were made to each witness they were all told of the safety of the investment, of the dividends which would be expected and of Brenek's promise to repurchase the stock.

started functioning, had no record or history of earnings, no assurance of financial success and certainly such operations as were previously conducted did not warrant a prediction that the stock would be a safe investment or worth twenty times its investment in a few years.[7/] In addition, one of the witnesses testified he had not been told and had no knowledge he had in fact purchased Brenek's personally owned stock in registrant. The record contains no evidence that any funds received from customers were used for expanding registrant's business. Accordingly, the Hearing Examiner finds that the representations made to investors between December 1959 and January 1960 were unwarranted, had no reasonable basis in fact and were therefore false and misleading[8/] and that registrant willfully violated Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder.

5. The record further discloses that during the period between September 1960 and January 1961 registrant again undertook to sell its securities. Four witnesses who testified with respect to sales made during this period stated that Calligan, Crow and Brenek represented to them that the stock would be a good growth investment, that registrant had plans

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7/ The evidence indicates that Brenek, operating as a sole proprietor during 1959, made a gross profit between 30 and 40 thousand dollars primarily from the sales of one security, and Brenek testified that when sales were made in December 1959 and January 1960 he had no knowledge of whether he had net profit or loss for 1959.

8/ See e.g., Biltmore Securities Corp., Securities Exchange Act Release No. 6394 (October 17, 1960).

for joining a national stock exchange, which one of the witnesses identified as the Pacific Coast Stock Exchange, that registrant's stock would be a very profitable investment, that the stock was being sold to finance registrant's expansion, that the stock would pay six per cent dividend, that such earnings could be expected to be received every three months, that the stock would be repurchased at par value at any time, and that the company was making money. The record discloses that these representations were also unwarranted. For the period ended June 30, 1960 registrant had an operating deficit in excess of $12,000,[9/] and by the end of December 1960 its operating loss totaled in excess of $32,000. Registrant had a net loss for the year 1960 in excess of $34,000. Though registrant's gross income for the year ended December 31, 1960 was approximately $30,000, it paid in salaries and commissions approximately $40,000 and its total operating expenses, including such salaries and commissions, was approximately $62,500. In addition, it is clear from the record that for the months of June, August, September, November and for the month ended December 27, 1960, and March and April, 1961, registrant's aggregate indebtedness exceeded 2,000 per cent of its net capital in violation of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.[10/] Commencing about August 15, 1960, registrant

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9/ Such information was reflected in a financial statement filed with the Commission in August 1960.

10/ See infra, paragraph 10.

was informed of such net capital deficiency within 30 days after the end of each of the foregoing months.

6. None of the investors who testified were given any information concerning the financial condition of registrant, its operating losses, or the fact that during 1960 registrant's salaries and commissions exceeded its gross income. Nor were any investors informed of the fact in s i x of the last seven months of 1960, registrant's net capital position failed to meet the requirements of the Exchange Act and rules thereunder. The statements that registrant's stock would be a profitable investment and would pay dividends should have at least been accompanied by the disclosure of registrant's financial condition since such disclosure would have indicated that registrant had no source of funds for dividend payments in the foreseeable future and that it was operating at a loss.

7. The record contains no evidence that registrant qualified for membership on any securities exchange or that it made any overt efforts to become a member of any such exchange. Nor was there any evidence that any of the funds raised by the sale of stock had in fact been used for expansion purposes. On the contrary it is evident that money was being sought to meet net capital requirements of the Exchange Act, which material information was not disclosed to investors. Though Brenek knew of registrant's adverse financial condition, he never informed Calligan or Crow, the other officers and directors of registrant's losses. Calligan and Crow never received a financial statement of registrant's operations and when they inquired of Brenek regarding such matter, were informed that registrant was doing well. The Commission has condemned

the technique of salesmen engaging in the sale of stock without any knowledge of the financial condition of the issuer or any effort to obtain such information, and without disclosure to customers of an issuer's adverse financial situation and where there was, as in the instant case, an absence of any reasonable basis for the optimistic statements and predictions made.[11/]

8. The evidence further shows that two of the investors purchased non-voting stock issued by registrant but no disclosure was made to them of such fact. One of such witnesses, and a third witness, further testified they were never told that the stock they were purchasing was Brenek's personally owned stock. In light of the fact that investors were told that funds were to be used for expansion purposes, there was at least an implied representation, which was materially false, that customers were purchasing stock being issued to them by registrant.[12/] The record further discloses that in November 1959 Brenek acquired 295 shares of registrant's capital stock of the par value of $100 per share in consideration for turning over to the corporation office fixtures, furniture, furnishings, an automobile, together with an active list of about 600 customers, and a mailing list of potential customers of approximately 2,000 names, some of which names had been purchased for cash. Such lists were arbitrarily assigned a value of about $19,900 by registrant's accountant

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11/ Barnett & Co., Inc., Securities Exchange Act Release No. 6310 (July 5, 1960).

12/ Cf. Indiana State Securities Corporation, 38 S.E.C. 118 (1957).

and carried on registrant's balance sheet as "goodwill". None of the information relating to Brenek's manner of acquiring stock was disclosed to prospective investors. There is ample evidence in the record that in connection with the foregoing sales the mails and means and instrumentalities of interstate were used.

9. The Hearing Examiner finds that with respect to the sale of its stock between September 1960 and January 1961 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 Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder.

Record Keeping and Net Capital Violations

10. Registrant engaged in business over an extended period of time while its aggregate indebtedness exceeded 2,000 per cent of its net capital computed as specified in Rule 15c3-1. On various occasions during this period, registrant was informed by the staff in the Commission's Seattle Regional Office of the net capital deficiencies. Such deficiencies, computed from registrant's books and records, were as follows:

Date	Net Capital Deficiency
June 30, 1960	$7,303.01
August 31, 1960	8,707.69
September 30, 1960	10,959.42
October 31, 1960	No deficiencies
November 30, 1960	5,193.15
December 27, 1960	9,832.98
March 31, 1961	2,219.28
April 30, 1961	28.25

11. The record is clear that during the period its net capital was deficient registrant used the mails to engage in the securities business otherwise than on a national securities exchange.

12. The Hearing Examiner finds that in these respects registrant willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder.

13. In addition, the record shows that for several of the periods indicated above registrant's net capital deficiency was actually larger than the amounts reflected in its books and records. The evidence shows that the August 31, 1960 trial balance referred to in the above schedule included as an asset a check in the amount of $6,000 issued by Brenek on his personal bank account on that date. Registrant admitted that pursuant to Brenek's instructions this check was kept in its physical possession until September 30, 1960 when it was deposited and apparently paid early in October 1960. The reason was quite apparent since the evidence shows that at September 1, 1960 Brenek's personal bank account had a balance of $20.00, that the highest amount in Brenek's personal bank account during the month of September was $1,456.90 and that the balance at the end of September was $43.91.

14. Under the circumstances, registrant's records improperly included $6,000 as an asset for the months of August and September 1960. By eliminating the fictitious amount, registrant's net capital deficiency would have been shown to be $14,707.69 and $16,959.42, respectively, for the months in question rather than the amounts set forth above. The Hearing Examiner finds that the inclusion of a check in the amount of $6,000 as an asset on August 31, 1960, when in fact registrant knew or should

have known that there were insufficient funds on deposit to pay such check, was improper and that the registrant willfully violated the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

15. Perhaps a more striking example of the effect of a practice of including in cash receipts a check issued by the president of a registered broker-dealer on the date a trial balance is prepared when such individual had insufficient funds in his account is demonstrated with respect to the computation of registrant's net capital position for October 31, 1960. Registrant's books and records reflected no deficiency but rather the sum of $1,254 in excess of the requirements of Rule 15c3-1. However, the evidence discloses that on October 12, 1960 registrant received Brenek's personal check for $6,000, and on October 18 received another personal check from Brenek for $5,000, both of which were credited to the capital stock account. Brenek's personal bank account reflects that on October 12, 1960 his balance was approximately $237.00, that the highest balance during the remainder of the month was $654.90, and on November 1, 1960 there was an overdraft of $54.40. Obviously, Brenek has no funds on deposit with which to honor the checks he gave to registrant to be included in its assets. 13/

13/ In fact Brenek's personal bank statements reflect no checks were paid in amounts of $5,000 or $6,000 from October 12 through the remainder of the month. His November bank statement reflects a deposit of $5,333.24 on November 22, of $6,000 on November 23, 1960, and payment of a check of $5,000 on November 22 and of $6,000 on November 30, 1960.

Hence, if the $11,000 were eliminated from registrant's assets for October 31, 1960, it would have resulted in a net capital deficiency of approximately $9,161.35, and the amount needed to comply with the aforesaid Rule would have been $9,746 as contrasted with the fact that no net capital deficiency was apparent from an examination of registrant's records for October 31, 1960. The Hearing Examiner finds that the inclusion of Brenek's personal checks in the amount of $11,000 in October 1960 in registrant's assets, when registrant knew or should have known there were insufficient funds on deposit to pay such checks, was improper and that registrant willfully violated the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

16. A similar practice was followed with respect to registrant's trial balance for May 31, 1961, which was obtained from registrant by the staff of the Seattle Regional Office several days before these hearings commenced. Registrant's assets as reflected in its books included in cash receipts a personal check of Brenek dated May 31, 1961 in the amount of $3,250, given in repayment of an advance made by registrant to Brenek during that month. The evidence shows that Brenek's personal bank account on May 29, 1961 reflects an overdraft of $66.73, a deposit of $840.00 on June 1, 1961, a balance of $481.24 on June 3, 1961, a further deposit on June 5, 1961 of $2,418.31, and the balance on that day was an overdraft of $357.35. The conclusion is inescapable that on May 31, 1961 Brenek had no funds on deposit with which to honor the check

issued to registrant on that date. Nor does it appear that payment could have been made until at least June 5, 1961. Registrant urges that since the check in question was in fact honored by the bank at a subsequent date the check must be considered as an asset on May 31, 1961. The Hearing Examiner rejects such contention. Whether a broker and dealer is in compliance with the net capital requirements of the Exchange Act and Rules thereunder as on a given date is determined by the facts extant on such date. With respect to cash items or cash receipts, the question is whether such items carried on a broker's books are in fact what they purport to be. Where, as in the instant case, registrant's president issues his personal check to registrant on the day a trial balance is prepared when he knows, or should know, he has insufficient funds in his account, and there is no evidence of any source of funds to honor such check or that arrangements have been made for such purpose, it is improper to include such check in the computation of assets for purposes of determining net capital requirements under the above-mentioned Rule. It is clear from the record that had the check been presented for payment on May 31, 1961, or even the next business day, Brenek's personal bank account was insufficient to honor such check. That such a check was in fact paid at a subsequent date cannot, under the circumstances, determine whether registrant was in compliance with the net capital rule on May 31, 1961. Accordingly, if the cash receipt item of $3,250 were eliminated, registrant's net capital deficiency on May 31, 1961 would have been shown to be $3,325.55. The Hearing Examiner finds that the inclusion of Brenek's personal check in the amount of $3,250, as a part of registrant's cash

receipts on May 31, 1961, when registrant knew, or should have known, there were insufficient funds on deposit to honor such check, was improper [14/] and that registrant willfully violated the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

17. The vital significance of the net capital requirements of the Exchange Act and the Rules thereunder as a means of protecting investors is amply demonstrated in the instant case by events which occurred during the months of August, September and October of 1960 when, as discussed above, registrant's net capital position was deficient under Rule 15c3-1. On six separate occasions during this period registrant issued its checks to another broker and dealer in payment for securities it had purchased for its customers, but payment was refused by registrant's bank because of insufficient funds. The amounts of these checks ranged from approximately $1,000 to $6,250. Registrant maintained one bank account which included not only its cash assets but customers' free credit balances. All of the checks in question were paid by registrant's bank from 7 to 10 days after their issuance date. The Commission has held that where a registrant engages in the securities business it represents to customers that it is solvent and able to discharge its liabilities. [15/] The Hearing Examiner finds that

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14/ Cf. Auld & Co., Inc., Securities Exchange Act Release No. _____ (August 18, 1961).

15/ See Thompson & Sloan, Inc., Securities Exchange Act Release No. 6443 (January 31, 1961); R. G. Williams & Co., Inc., Securities Exchange Act Release No. 6276 (May 27, 1960).

in issuing checks in connection with securities transactions which were dishonored by registrant's bank because of insufficient funds, registrant willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder.

18. It is uncontroverted in the record that no blotter entries were made of sales of registrant's stock, nor do the customers' ledger accounts reflect acquisition of registrant's stock. It is also undisputed that no memorandum was made and no confirmation of sales of registrant's stock by registrant or by Brenek of his personal stock in registrant were prepared or sent to customers. Brenek testified in this connection that he was unaware that sales of registrant's own stock were required to be entered on the blotters, that he left all bookkeeping matters to his accountants and legal matters to his attorneys, and that no one ever informed him that such transactions had to be reflected in the blotters as well as customers' ledger accounts. None of these assertions are sufficient to relieve registrant of its responsibility for compliance with the record-keeping requirements.[16/] In light of Brenek's testimony that he has been a broker about four years and has had twenty years' experience in selling securities, the Hearing Examiner finds no merit in Brenek's explanation. The Hearing Examiner finds that in the respects set forth above registrant willfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

16/ Cf. Peoples Securities Company, Securities Exchange Act Release No. 6176 (February 10, 1960).

Injunction

19. On May 23, 1961, on the basis of a complaint filed by the Commission, and with the consent of the defendants, the United States District Court for the District of Western Washington, Northern Division, entered an order of preliminary injunction enjoining registrant, Brenek and Crow from violating the anti-fraud provisions by making any further offers or sales of registrant's securities by means of false and misleading statements; misusing customers' funds entrusted to or made payable to registrant, failing to give or send written confirmations of securities transactions to customers and endorsing checks payable to customers without a disclosed authority from such customers; and from purchase and selling securities while in contravention of the net capital requirements and from violating the record-keeping requirements of the Exchange Act and the Rules thereunder.[17/]

Findings as to Brenek, Calligan and Crow

20. As previously noted, Brenek was President, a director and owner of 10% or more of registrant's capital stock, Calligan was Vice President, director and a salesman of registrant from its inception until August 1960, and from September 1960 until March 1961 was again employed as a salesman, and Crow was and is one of registrant's salesman and became Vice President and a director about September 10, 1960.

21. Brenek was in complete charge of registrant's operations, supervised the salesmen and clerical help and, in general, determined

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17/ Civil Action File No. 5264.

the policies of registrant. Brenek admitted that he requested Calligan and Crow to sell registrant's stock to raise capital for the registrant and indicated to them during both periods in which sale took place that registrant was doing well. Brenek was aware certainly as of the end of June 1960 that registrant had operating losses and by the fall of 1960 should have made an effort to ascertain registrant's financial condition before undertaking to sell and request Calligan and Crow to aid in selling additional shares of registrant's stock. Brenek himself never informed customers of registrant's operating losses or of its poor financial condition. The record shows that Brenek instructed the bookkeeper to prepare checks at times when Brenek knew or should have known that registrant had insufficient funds on deposit. Finally, Brenek admitted that he knew no entries were made on registrant's blotters with respect to sales of registrant's stock, that no memoranda were prepared and no confirmations were sent to customers, and that customers' ledger accounts did not reflect purchases of registrant's stock. The Hearing Examiner finds that Brenek participated in or aided and abetted in all of registrant's willful violations and is a cause of any order that may be entered revoking registrant's broker-dealer registration. In addition, the record further shows that Brenek on two occasions endorsed, or caused to be endorsed, the names of two of his customers on checks issued by registrant which Brenek thereafter deposited to his own account. In August 1960 registrant prepared a check for $2,000 payable to one of its customers. Brenek's former bookkeeper testified that at

Brenek's request she endorsed the customer's name on the back of the check which Brenek admitted he deposited to his own account. In December 1960 registrant prepared a check for $2,000 payable to another of registrant's customers. The evidence shows the check was never delivered to the customer but was deposited in Brenek's personal account. Though Brenek testified he probably endorsed the customer's name he stated he was not positive he did so. However, the evidence shows Brenek had possession of the check from the time it was prepared until he personally deposited it to his account on the day it was issued or the following day. Brenek's explanation in both instances was that he had already paid the customers, that the money really belonged to him, and he believed he did nothing wrong. This explanation does not absolve Brenek's wrongful conduct. It is clear from Brenek's own testimony that though registrant had some discretion in handling the accounts of both customers, he had no direct or implied authority to endorse their names to checks.[18/] Viewing Brenek's acts only in light of the provision of the Securities Act and the Exchange Act, the Hearing Examiner finds that Brenek, in endorsing customers' names to checks made payable to them without their authority, willfully violated the anti-fraud provisions, and registrant aided and abetted by Brenek willfully violated Section 17(a) of the Exchange Act and the Rules thereunder.

18/ Moreover, no satisfactory explanation was offered in light of Brenek's purported justification of his conduct as to the reason why the checks in question could not have been voided and new checks issued payable to Brenek.

22. Calligan and Crow made a number of the representations to prospective customers which the Hearing Examiner found to be false and misleading, including how well registrant was doing, the dividends it would pay, its future listing on an Exchange, that the investment would be a profitable one, and that the moneys raised would be used to expand registrant. Calligan and Crow both testified that during their entire association with registrant they knew nothing of registrant's financial condition, never saw any of its books and records or financial statements and never knew whether the stock they were selling was stock to be issued by the registrant or was Brenek's personally owned stock. During the Fall of 1960 in particular, when both of them were engaged in selling registrant's stock, neither of them disclosed registrant's operating losses to customers or made any effort to inform customers of registrant's financial condition. Both Calligan and Crow testified that in this respect they relied primarily on Brenek's assurance to them that registrant was doing well, and they fortified this assurance by their own observation of registrant's operations from which they concluded that since the number of customers and securities transactions were increasing registrant must have been making money. What registrant's expenses were or what was paid to Brenek by way of salary and advances in relation to its increased volume they never knew nor made any effort to ascertain. Calligan and Crow, certainly in the fall of 1960, either knew that there was no adequate basis for the optimistic statements made and that their other statements were false and misleading, or they were

grossly careless or indifferent as to the existence of an adequate basis for their statements or as to the truth or adequacy of the material facts they represented.[19/] Moreover, Calligan and Crow, at various times, each occupied positions as officers and directors of registrant, and having accepted such responsibilities cannot escape them by pleading ignorance, particularly of registrant's financial condition. The Hearing Examiner finds that Calligan and Crow participated in or aided and abetted registrant's willful violation of the aforementioned anti-fraud provisions, and aided and abetted registrant's willful violations of Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder.

Public Interest

23. In view of the willful violations found, the sole remaining question is whether it is in the public interest to revoke registrant's registration as a broker and dealer. During the course of the instant hearings, registrant made an effort to demonstrate there was no deliberate plan or scheme to violate the Acts, and urged that none of the violations were willful or intentional, that it sought to set up proper records by hiring competent certified public accountants and relied on them to maintain its books and records in proper fashion, and that all the customer witnesses who testified were "satisfied" with the manner in which their accounts were handled.

19/ See A. G. Bellin Securities Corp., Securities Exchange Act Release No. 5966 (May 18, 1959); Barnett & Co., Inc., Securities Exchange Act Release No. 6310 (July 31, 1960).

24. The Hearing Examiner considered these factors but, in his opinion, they do not outweigh the serious nature of the violations he has found not only involving fraudulent representation in connection with sales of registrant's securities, but also persistent violations of the net capital requirements. It is well settled that in intention to violate the law is not necessary to findings of willfulness within the meaning of Section 15(b) of the Exchange Act; it is sufficient that "the person charged with the duty know what he is doing." 20/ The net capital rule promulgated by the Commission enunciates a basic concept that a broker-dealer subject to the Exchange Act would be solvent and provide investors with a margin of protection against financial strain of the securities business. It is no answer to say that customers are "satisfied" or that customers had no losses. The impact of the Commission's net capital rule on investors was most forcefully pointed out by an appellate court in Blaise D'Antoni & Associates v. Securities and Exchange Commission (C.A. 5, April 20, 1961), where the Court stated:

> "The net capital rule is one of the most important weapons in the Commission's arsenal to protect investors. By limiting the ratio of a broker's indebtedness to his capital, the rule operates to assure confidence and safety to the investing public. The question is not whether actual injuries or losses were suffered by anyone. [The broker] . . . improperly -- and wilfully -- subjected its customers to undue financial risks by conducting its business in violation of this rule."

20/ 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).

Moreover, Brenek's acts and practices, such as his endorsement of checks to customers without authority, demonstrate registrant's lack of knowledge or disregard of standards of fair and honest dealing with the public which are basic to the securities industry. Moreover, registrant must assume responsibility for its failure to record transactions in its own securities and send confirmations of such transactions to customers. Such responsibilities are under the Exchange Act placed on the registered broker-dealer, not its accountant. Finally, the Hearing Examiner has taken into consideration that the Commission has held that proof of entry of an injunction by a court of competent jurisdiction enjoining a broker-dealer from engaging in and conducting certain acts and practices in connection with the offer and sale of securities, whether based on defendant's consent or otherwise, may, in itself, form a sufficient basis for a finding that revocation is in the public interest.[21/] In view of the foregoing willful violations and the injunction entered against registrant, the Hearing Examiner finds that public interest requires revocation of registrant's registration as a broker and dealer and its expulsion from membership in the NASD.

RECOMMENDATIONS

In light 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 to expel it from membership in the NASD. It is further

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21/ Kimball Securities, Inc., Securities Exchange Act Release No. 6274 (May 27, 1960).

recommended that the Commission also find that Brenek, Calligan and Crow willfully participated in or aided and abetted in registrant's willful violations 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/]

The Commission's order for proceedings includes as one of the issues to be determined whether pursuant to Section 15(b) of the Exchange Act, pending final determination of the question of revocation, it is necessary or appropriate in the public interest or for the protection of investors to suspend the registration of registrant.

The Hearing Examiner has given careful consideration to this matter and has concluded that in the public interest and for the protection of investors, registrant's registration should be suspended pending final determination of the question of revocation.[23/] In fact, and a crucial factor in weighing whether to recommend suspension in the instant case, the record shows that in six of the last seven months of 1960 registrant has consistently been in violation of the net capital requirements, and in the last three of the first five months of 1961 this violation

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

23/ Since the issue was presented in the Commission's order, the requirements of notice and opportunity for hearing specified in Section 15(b) have been met.

has continued. Notwithstanding that the Commission obtained an injunction on May 23, 1961, which, among other things, enjoins registrant from engaging in securities transactions when its net capital position fails to meet the requirements of Rule 15c3-1, registrant had a net capital deficiency of $3,325 at May 31, 1961, which was five days before the instant proceedings commenced. Clearly, registrant is subjecting its customers to undue financial risks in being permitted to continue in business. In addition, and for the protection of investors, consideration was given to the general manner in which registrant's business was being conducted, and the record shows a practice of issuing checks when there are insufficient funds in registrant's bank account during periods when it had a net capital deficiency, a practice of including in cash receipts checks of registrant's president when he knew he had insufficient funds on deposit, obviously in a bald attempt to demonstrate compliance with net capital requirements, a practice of violating the record-keeping requirements, and finally, there were two occasions when registrant's president, without authority of customers, improperly endorsed their names to checks. Such conduct by a registered broker-dealer evidences a complete lack of concern regarding not only compliance with the Act and rules but with the basic standards of fair and honest dealing with the public. Such a record of persistent violations should not be tolerated, nor should the public be subjected to the hazards of a broker and dealer responsible therefor.

The Commission has held that in considering if the public interest requires suspension, the question is whether the record contains sufficient showing of misconduct to indicate the likelihood that registrant will be found to have committed willful violations or any of the other grounds prescribed with respect to revocation in Section 15(b) will be established and that revocation will be required in the public interest.[24/] That the record contains a sufficient showing of misconduct is amply demonstrated and that revocation will be required in the public interest is clear.

The Hearing Examiner recommends that the Commission issue an order forthwith under Section 15(b) of the Exchange Act finding it is necessary or appropriate in the public interest and for the protection of investors to suspend the registration as a broker and dealer of the registrant pending final determination of whether such registration shall be revoked.

Respectfully submitted,

IRVING SCHILLER
HEARING EXAMINER

Washington, D. C.
August 28, 1961

24/ A. G. Bellin Securities Corp., supra.