

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
COMMONWEALTH SECURITIES CORPORATION
File No. 8-6739)

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INITIAL DECISION

FILED

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SECURITIES & EXCHANGE COMMISSION

Sidney L. Feiler
Hearing Examiner

Washington, D. C.
August 14, 1967

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COMMONWEALTH SECURITIES CORPORATION	:	INITIAL DECISION
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File No. 8-6739	:	

APPEARANCES: Messrs. John W. Vogel, Hyman Braham,
David A. Tenwick, and Charles E. Cook,
for the Division of Trading and Markets

David J. Young, Esq. of Dunbar, Kienzle &
Murphey, 50 W. Gay Street, Columbus, Ohio 43215,
for Herbert Beck

Lyman Brownfield, Esq., 88 East Broad Street,
Columbus, Ohio 43215, for Certified Credit
Corporation (Clarence A. Graham, Trustee in
Bankruptcy), Commonwealth Securities Corporation
and Houston Financial Corporation.

BEFORE: Sidney L. Feiler, Hearing Examiner

I. THE PROCEEDINGS

These are proceedings instituted by order of the Commission pursuant to Section 15(b) and 15A of the Securities Exchange Act of 1934, as amended ("Exchange Act") to determine whether it is in the public interest to revoke the registration as a broker and dealer of Commonwealth Securities Corporation ("registrant") and whether the Commission should find that certain individuals named in the order are causes of any order of revocation or suspension which might be issued.^{1/}

The matters put in issue by the allegations in the order are:

A. Whether during the period from April 17, 1958 to the date of the order herein, registrant and certain named respondents

^{1/} The order originally raised the issue whether Commonwealth should be suspended or expelled from membership in the National Association of Securities Dealers, Inc. ("NASD"), a national securities association. This issue became moot when the registrant was later expelled from the NASD on findings of violations by failure to comply with prompt payment and frozen account provisions of Regulation T; failure to maintain and keep current proper books and records; failure to preserve information relative to financial condition; and failure to properly supervise transactions of registered representatives. In view of the fact that the registrant is not actively carrying on a securities business and there are no plans for it to resume operations it is unnecessary to deal with a further question raised in the order; namely, whether to suspend the registration of registrant pending final determination of the question of revocation.

violated the provisions of Section 15(b) of the Exchange Act and Rule 17 CFR 240.15b3-1 thereunder (formerly Rule 15b-2, renumbered) by failing and causing registrant to fail to promptly file amendments on Form BD to registrant's application for registration to report changes in registrant's officers and directors which rendered inaccurate the information contained in registrant's application for registration and amendments thereto;

B. Whether Houston Financial Corporation, a Texas corporation ("Houston Financial"), and Certified Investment Corporation ("Certified Investment"), an Ohio corporation, at all times material to the allegations have been in control of, controlled by, and under joint and common control with registrant, Certified Credit Corporation ("Certified"), Certified Credit and Thrift Corporation ("Certified Thrift"), Certified Mortgage Corporation, an Ohio corporation ("Certified Mortgage"), Certified Life Corporation, an Ohio corporation ("Certified Life") and two named individuals.

C. Whether during the period from on or about January 1, 1957 to on or about June 30, 1959 Certified, Houston Financial, and certain named individuals, singly and in concert, willfully violated Sections 5(a) and (c) of the Securities Act of 1933 ("Securities Act") in that these respondents offered to sell and sold and delivered securities, namely, the Class A and B common stock of Certified when no registration statement had been filed or was in effect as to said securities under the Securities Act.

D. Whether, during the period from about June 17, 1960 to about December 31, 1961, registrant, Certified, Certified Investment, Houston Financial, and certain named respondents including Herbert Beck, in connection with the offer and sale of shares of the Class A common stock (par value \$10) and the Class B common stock (par value 20¢) of Certified Credit and Thrift Corporation, singly and in concert, willfully violated and willfully aided, abetted and caused violations of the anti-fraud provisions of the Securities Acts ^{2/} by certain described activities.

E. Violations of the aforementioned anti-fraud provisions are also alleged as against registrant, Certified and three named individuals in the offer and sale of the Class A common stock and Class B common stock of Certified Mortgage Corporation and Certified Life Corporation.

F. Other issues raised in the order are whether registrant willfully violated the record-keeping requirements of the Exchange Act (Section 17(a) of the Exchange Act and Rule 240.17a-3 thereunder) and whether it violated net capital requirements

^{2/} 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 are sometimes referred to as the anti-fraud provisions of the Securities Acts. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

(Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder).

The order for these proceedings originally named 18 individuals, of whom 17 are no longer in these proceedings, ten respondents submitted Stipulations and Consents, and orders have been entered barring them from being associated with a broker-dealer for a period of six months from the effective date of the order, with future return to the securities business being subject to an appropriate showing of adequate supervision. One respondent died during the pendency of the proceedings. With respect to another respondent, the Division moved to discontinue as to him and said motion was granted by a Commission order. Four respondents submitted Stipulations and Consents and orders have been entered barring them from being associated with a broker or dealer. Counsel for respondent, Daniel Armel, at the outset of the hearing moved that the proceedings with respect to him be severed. This motion, which was not opposed, was granted and the proceedings were indefinitely postponed as to him, subject to further order.

The respondents remaining in the case are registrant, Certified, Certified Investment, Houston Financial and Herbert Beck. Registrant and the remaining respondents except Certified Investment appeared by counsel and participated in the proceedings. Herbert Beck who was employed by the registrant as a salesman is involved solely in the allegations relating to the offer and sale of Certified Thrift stock.

At the conclusion of the presentation of evidence, opportunity was afforded the parties for filing proposed findings of fact and conclusions of law, together with briefs in support thereof. Proposed findings, together with supporting briefs, were submitted on behalf of the Division and Herbert Beck.

II. FINDINGS OF FACT AND LAW

A. The Respondents

1. The Registrant

On August 20, 1958 the registrant was effectively registered with the Commission as a broker and dealer in securities pursuant to provisions of Section 15(b) of the Exchange Act. Its principal office was in Columbus, Ohio. Registrant also was licensed by the Division of Securities, Department of Commerce, State of Ohio but its license was revoked on September 10, 1962. It also was a member of the National Association of Securities Dealers, Inc. but as previously noted it was expelled from the NASD on September 6, 1963.

During the period of its active operations, it was under common control in a group of companies jointly referred to as the Certified Companies. The parent company of the Certified Companies was Certified. The capital funds for the formation of registrant were supplied by Robert E. S. Young, a member of the Board of Directors of Certified and a member of its executive committee. He held other offices among the Certified Companies. He was elected

a director of registrant on February 20, 1959 and continued as such up to the time of the institution of these proceedings.

The key link between registrant and the Certified Companies was Daniel E. Armel, president of Certified. He was one of the promoters of registrant, became one of its directors, owned a substantial block of its equity stock, conceived the various underwritings engaged in by registrant, and took an active part in its operation. As a member of the Certified group, registrant acted as underwriter for various offerings of companies in that group, as more particularly set forth later. These offerings included primarily those of Certified Mortgage, Certified Life, and Certified Thrift.

The underwriting for Certified Thrift was pursuant to a registration statement filed with the Commission on January 26, 1960, which registration became effective June 17, 1960 and was continuously in full force and effect from that date. The Certified Life and Certified Mortgage underwritings were not filed with the Commission but were registered in Ohio under a claimed intrastate exemption under the Securities Act.

2. Certified Credit Corporation

Certified, the parent corporation of the Certified Companies, was organized in 1950 for the purpose of engaging in the consumer small-loan business. From a small beginning of three loan offices, the next decade was marked by a very substantial expansion of its activities in this and other fields, ostensibly very successful.

The first phase of Certified's growth was reflected in the increase of branch offices and by the formation of wholly-owned subsidiaries which in turn opened offices. Another phase of the Certified growth picture was the merger route whereby corporations in other states were merged into the Certified system. During the years 1954 through 1961, net assets valued at \$10,574,952 were added to Certified's total assets by the merger route.

In 1957 Certified branched out into life insurance investment operations. Through holding and operating companies Certified obtained control of a number of life insurance companies so that for the year ending December 31, 1961 its books reflected accumulated book value of investments in and advances to insurance and insurance holding subsidiaries in the amount of \$3,549,872. According to Certified's Annual Report to shareholders for the year ending December 31, 1961 the Combined Statement of Condition of Underlying Owner or Controlled Insurance Companies Reflected Total Assets of \$4,136,395.

Certified, starting in 1957, engaged in real estate operations. It organized a Real Estate Division and in 1957 its books reflected real estate valued at \$228,881. This figure rose to \$1,150,551 in 1959 and \$5,403,494 in 1961. Another Division was composed of motel subsidiaries whose assets were carried on the books of Certified at approximately \$1,500,000 for the years 1960 and 1961.

The Annual Report of Certified for the year 1959 entitled "The Certified Companies - The First Ten Years" is an impressive document of 52 pages containing within it a history of Certified, a description of its growth, diversification into the fields of life insurance, real estate investment, general investment, and real estate mortgage financing; plans for the future, and financial statements. The Consolidated Comparative Condensed Balance Sheet for the 10-year period shows an increase of total assets from \$185,897 in 1950 to \$9,187,486 in 1959. Net profit of Certified alone was reported at \$158,754 in the Certified Financial Statement and a total system net profit of \$239,948.

The true picture of Certified's financial condition was substantially different from that depicted in the aforementioned financial statement and other statements issued by the company. In the years 1959 and 1960 when operations purportedly were most successful the Certified Companies consisted of Certified and 25 subsidiary companies. An involved system of financial juggling was in operation whereby Certified carried as substantial income on its books or as assets various charges made to subsidiaries for alleged services rendered. Most of the subsidiaries were operating at a loss, but a true consolidated financial statement was not prepared. Such a statement would have reflected net losses for all the years from 1952 through 1961, and a loss of \$104,849 in 1959.

Another method used to raise funds and to give the appearance of growth was the use of public offerings through controlled subsidiaries of Certified. In each instance the proceeds were channelled into the treasury of Certified. There were five such offerings. Total funds received by Certified from the sale of securities by its subsidiaries during the years 1956 through and including 1961 totalled \$4,122,760. These funds were made available to the Certified management whether there was a later merger into Certified or whether the subsidiary maintained its nominal separate identity.

An additional source of funds for Certified was the employment of the device of the offer and sale of debentures, known as "Thrift Certificates." These securities were sold pursuant to registration with the Ohio Division of Securities. Their sale commenced in 1950 when they totalled \$4,100 and sales continued until the end of 1961 when they had accumulated to a total of \$5,954,894.

3. Other Respondents

Certified Investment was an Ohio corporation with offices at the same address as Certified in Columbus, Ohio. During the years 1954 through and including 1961 it had a controlling interest in the voting stock of Certified.

Houston Financial, during the years 1957 through 1961, owned over 10% of the voting shares of Certified of all classes. It was also a subsidiary of that company. Its income during that

period was derived from dividends arising out of its stock holdings in Certified and profit on the sale of Certified stock. It was used by Certified to bolster Certified's income by charges for management services. It was also used as a vehicle for the offer and sale of securities of Texas subsidiaries, which funds were channelled back to Certified. Houston Financial and Certified Investment were at all times material to the allegations herein under joint and common control with the registrant, Certified, and the other Certified Companies.

As previously noted, Herbert Beck is the sole individual remaining in these proceedings. He was employed as a salesman by the registrant and the allegations in the order for these proceedings, so far as he is concerned, deal solely with his activities in the offer and sale of Class A and Class B common stock of Certified Thrift.

B. Failure to Correct Inaccuracies in Registrant's Application for Registration

Every broker-dealer, pursuant to the provisions of Section 15(b) of the Exchange Act and Rule 17 CFR 240.15b3-1 thereunder, is required to promptly file an amendment on Form BD if the information contained in its application for registration as a broker or dealer, or any supplement or amendment thereto is or becomes inaccurate or incomplete for any reason.

In its original application, filed on July 21, 1958, the registrant furnished a list of its officers, as required. Prior

to the filing date and until October 11, 1961 there were 11 changes in the offices of Assistant Treasurer, Assistant Secretary, and Treasurer. None of these changes was reported to the Commission by registrant in accordance with existing requirements.

Registrants are required to list on Form BD the full name of each person who, directly or indirectly, is the beneficial owner of 10% or more of any class of any equity securities of such registrant, if a corporation. The original filing by registrant listed William E. Swantner and S. Brooks Johnston as each owning 50% of the capital stock of registrant. Actually, the true ownership at that time, pursuant to an oral arrangement, was that Swantner, then president of the registrant, and Johnston, then its vice president, received a 25% interest each for their work in running the registrant while Daniel Armel, and Robert Young, principals in the Certified Companies and who had invested the capital funds but did not want their connections revealed, each had a 25% beneficial interest in the registrant. This ownership interest was revealed months later in amendments filed on March 12, 1959.

Registrant's original capitalization was 250 shares of common stock at \$100 per share. On February 20, 1959 the stock was split 10 for one and all of these shares were issued to Olentangy Investment, Inc., a corporation owned in equal amounts by Armel, Young, Swantner and an Albert Schrader. On October 30, 1961 registrant's authorized but unissued 7500 shares of common stock were

exchanged for a block of stock of Western Republic Life Insurance Co., which shares were then acquired by Certified. Details of these various stock transfers set forth above were either not reported at all or not noted promptly in appropriate amendments, or were reported in a fragmentary and incomplete form. It is concluded by its failure to maintain the information contained in its application for registration in an accurate and complete form by the prompt filing of appropriate amendments the registrant willfully violated Section 15(b) of the Exchange Act and Rule 17 CFR 240.15b3-1 thereunder.

C. Violation of Record-Keeping
and Net Capital Rules

Every broker and dealer, pursuant to the provisions of Section 17(a) of the Exchange Act and Rule 240.17a-3 thereunder, is required to make and keep current certain specified books and records relating to his business.

On February 6, 1962 and for two days thereafter an investigator for the Commission tried to conduct a broker-dealer examination of the registrant's records. The investigator tried to make a trial balance, but was not able to because the books and records had not been properly closed for a period of six months. Subsidiary records could not be balanced to the general ledger. There was no record of a trial balance having been taken for the registrant in the preceding six months; the broker's ledger could

not be balanced to the general ledger; reconciliation could not be made between the securities accounts as against appropriate accounts in the general ledger. This condition of the books was brought to the attention of registrant's then president and treasurer. Registrant was conducting a brokerage business at that time despite the condition of its records.

On March 28, 1962, the investigator returned to the offices of the registrant and found that it was still impossible to make a trial balance despite some work which had been done on them by accountants. Registrant's president was informed that registrant's continuance of a brokerage business under these conditions might be considered a violation of the Exchange Act. These conditions had not been remedied as of the time of the next inspection on May 7, 1962.

A computation of registrant's net capital position in accordance with the net capital rule (Section 15(c)(3) of the Exchange Act and Rule 240.15c3-1 thereunder) as of April 30, 1962 reflected a net capital deficit in the amount of \$32,272.13.

The undersigned concludes that by the aforementioned activities the registrant willfully violated the record-keeping and net capital requirements of the Exchange Act and applicable rules thereunder. Certified, Certified Investment, and Houston Financial, which had substantial interests in registrant at the time of these violations, aided and abetted such violations.

**D. Unregistered Sale of the Class A
and Class B Common Stock of
Certified Credit Corporation**

Houston Financial was both a subsidiary of and held a controlling interest in Certified. As part of the Certified group it conducted offerings of the stock of two subsidiaries in 1956 and 1957. Substantial sums were channelled to Certified as a result of these underwritings.

In 1958 and 1959 Houston Financial sold 17,743 units and 839 units respectively of Certified common stock and transferred the proceeds to Certified. The sales were made in Texas and the funds were transmitted to Certified's main office in Columbus, Ohio. Since the stock of Certified was never registered for sale either with this Commission or the State of Texas, these sales, which involved the use of the facilities of interstate commerce, were made, singly and in concert by Houston Financial and Certified, in willful violation of Section 5(a) and (c) of the Securities Act of 1933.^{3/}

**E. Fraud and Misrepresentation in the
Sale of Certified Mortgage Corporation
Class A and B Common Stock**

Certified Mortgage was the first of the Certified controlled subsidiaries in which Commonwealth was the underwriter. In the first of two underwritings with Certified Mortgage, Commonwealth

^{3/} This Section in substance makes it unlawful for any persons, directly or indirectly, to make use of the facilities of interstate commerce or of the mails, to sell or offer to sell any security unless a registration statement has been filed as to such security.

was the underwriter for an issue marketed under a claimed intrastate exemption under the terms of which Certified Mortgage offered 200,000 units of Class A and B common stock for a total offering price of \$2,020,000. This underwriting commenced April 30, 1958. A second offering was made commencing May 8, 1959, at which time Commonwealth offered for Certified Mortgage 100,000 units for a total price of \$1,010,000.

The management of Certified Mortgage was essentially the same as Certified and the stated use of the proceeds was to furnish additional equity capital for Certified Mortgage to operate its mortgage and mortgage brokerage business in Ohio and perform other authorized functions of that corporation in the real estate mortgage, home improvement loan and mortgage servicing business. Control of Certified Mortgage was disclosed to reside in Certified.

Investors were given a highly optimistic picture of the plans and prospects of Certified Mortgage. Among other things they were told that a rapid growth could be expected, that the stock could always be disposed of through registrant, that Certified Mortgage would be merged into Certified within one year and there would probably be an immediate stock split, that investors would make a lot of money and that the stock would probably double itself within three years, that Certified would be listed on a stock exchange and there would be no problem in selling the stock, that there was only a limited supply of stock for sale, that there would

be a guaranteed dividend of at least 7% from the stock, and that the stock would be a very safe investment. In the presentation to investors emphasis was placed on the asserted accomplishments of Certified so that investors were confused as to whether they were buying stock in Certified or Certified Mortgage.

The above representations were not justified by the background and operating history of Certified Mortgage. Actually, both offerings resulted in cash realized to Certified Mortgage in the sum of \$2,200,000 in cash. It remitted \$1,700,000 of that sum to Certified, some of it directly and the remainder as deposits in its own bank account. These sums were used to purchase the debentures of Certified which Certified was then currently selling. These debentures were cancelled when the company was merged into Certified on December 31, 1959. The balance of assets which Certified Mortgage had in the net amount of approximately \$380,000 passed to Certified at the time of the merger. This self-dealing was not disclosed to prospective purchasers of the second offering of Certified Mortgage common stock. Instead, the balance sheet attached to its 1959 prospectus carried an item "Investments-At-Cost" at \$1,044,932.72 which actually represented holdings in Certified thrift certificates. Although control by Certified was disclosed in the prospectuses, indirect control by Houston Financial and Certified Investment was never disclosed.

During the entire period of its existence, Certified Mortgage invested \$68,000 in mortgages and home improvement loans.

Its only other significant transactions were a \$300,000 construction loan to a race track company and some loans to corporations controlled by a Certified director.

It is therefore concluded that in connection with the two offerings of Certified Mortgage by the registrant, these respondents, being under common control, singly and in concert, willfully violated the anti-fraud provisions of the Securities Acts in that they directly and through authorized agents made false and misleading statements of material facts and omitted to state material facts concerning the business and financial history and experience of Certified Mortgage, the business and financial history and experience of Certified; the business and financial history and experience of the management of both companies; the interrelationship and extent of control existing among Certified, Certified Investment, Houston Financial, and Certified Mortgage; the application and use of the proceeds of the offering; the eventual merger of Certified Mortgage with and into Certified; the safety of investment in Certified Mortgage stock; the market for and the potential appreciation in the market price of Certified Mortgage common stock; assurance as to dividends on Certified Mortgage Class A common stock; listing of securities on a national securities exchange; and the identity of Certified Mortgage as the issuer of the securities being offered.^{4/}

^{4/} The facilities of interstate commerce and of the mails were regularly used by the registrant in the offer and sale of the Certified Mortgage and other securities mentioned in this decision.

**F. Fraud and Misrepresentation in the
Sale of Certified Life Corporation
Class A and B Common Stock**

Registrant was the underwriter of an issue of 200,000 units of Class A and B common stock of Certified Life offered at a total price of \$2,020,000. The stock was offered under a claimed intrastate exemption and was not registered with the Commission. The effective date of the offering was November 17, 1958.

Like other companies whose stock offerings have been considered here, Certified Life was a controlled subsidiary of Certified having substantially the same chief officers and the specific point was made in the prospectus that Certified Life was under the same management as other Certified Companies. The stated purpose for the use of the proceeds was "to furnish the equity capital necessary to enable the Corporation to acquire controlling and working control interests in life insurance companies, and to invest in and take positions of investment in life insurance companies, and to perform any other authorized functions of the Corporation." In actual practice, Certified Life was used as other subsidiaries were as a vehicle for the raising of funds to support Certified. Certified Life realized \$181,000 from its stock issue. Of this sum \$177,000 was supplied to Certified through the purchase of debentures. A \$7,000 loan was also made to Certified Mortgage. Outside of these transactions no other business was carried on and no effort was made to apply the proceeds of the stock sale to the

stated purposes set out in the prospectus. The sole income reported was that of interest due from Certified which was not paid but accrued. A very small profit was shown on the books of Certified Life for the years 1959, 1960, and 1961.

The prospectus used in the offering of the Certified Life stock did not reveal the intended use of the proceeds of the offering. These sums obviously were used as part of a planned pattern of fund-raising for Certified. The true financial picture of Certified, which was known to the principals of Certified, the registrant, and Certified Life was also not revealed. The interrelation and extent of control existing among Certified, Certified Investment, Houston Financial, Certified Life, and the registrant, with all its ramifications, was also kept secret from investors.

Under these circumstances the undersigned concludes that registrant and Certified willfully violated the anti-fraud provisions of the Securities Acts in connection with the offer and sale of the Class A and B common stock of Certified Life.

G. Fraud and Misrepresentation in the
Sale of Certified Credit and Thrift
Corporation Class A and B Common Stock

Certified Thrift, a controlled corporation of Certified, was organized in 1959 for the stated purpose of engaging in the consumer finance and small loan business and the business of investing in special situations. A registration statement was filed with the Commission in January 1960 for an offering of

250,000 shares of Class A and B common stock to be offered in units of one share of each class at \$20.20 for a total offering price of \$5,050,000 with maximum proceeds to the issuer of \$4,292,500. The registration statement became effective on June 17, 1960 and sales were then commenced by the registrant acting as underwriter.

The proceeds of the offering were to be used as follows: the first \$1,610,500 were to be used to permit the exercise of an option to purchase the Beggs Building (an office building in Columbus, Ohio) and the balance, estimated at \$2,682,000 was to be used to pay the initial expenses of opening loan offices and to supply working capital for their business (Div. Ex. 61, p. 7). The prospectus used in the sale of the issue disclosed that Certified was the controlling parent of Certified Thrift and that each of the officers and directors of Certified Thrift was also an officer or director of Certified.

The sales kit used by the salesmen of the registrant included the 1959 Annual Report of Certified (Div. Ex. 53). As previously pointed out, this was an elaborate brochure extolling the asserted very successful operations of Certified and its affiliated companies in a decade of operations and the ability and astuteness of those controlling its operations. The salesmen also had available for their use an 11-page pamphlet dealing specifically with Certified Thrift and its program (Div. Ex. 69). It noted the company plans to open offices in seven Ohio and five Indiana cities. It pictured its senior officers

under the caption "Management is a Corporation's Most Important Asset" (p. 3). It asserted that with the purchase of a finance company Certified's assets were in excess of \$16,900,000 and its capital and surplus was in excess of \$6,900,000 (p. 4). Stress was placed on consumer credit as the fastest growing business in the United States ("it earns up to 24% per year on volume"), that there was safety of principal, traditional steady and heavy growth, with consistent and liberal dividends (p.5-6). It listed the cash dividends paid by a South Bend finance company which had been in business since 1919 and concluded with a statement that \$1000 invested in that company was now worth \$309,460. A table comparing operational results of certain finance companies and those in other industries was also included (pp.7-8). The pamphlet also included a Consolidated Comparative Condensed Balance Sheet of Certified showing growth of assets from \$185,897 in 1950 to \$9,187,486 in 1959, a chart showing continuous increase in net profits for the period, and another chart illustrating the asserted substantial growth of assets and capital funds of Certified over those years. The third written document that salesmen had available for their use was the prospectus itself for this issue by Certified Thrift.

Sales of Certified Thrift securities were \$339,000 in 1960 and \$1,538,000 in 1961. However, purchases totalling \$787,000 were subsequently cancelled, leaving approximately \$1,100,000 in net sales. The issuer received \$925,000 and "invested" \$910,000 in

the debentures of its parent, Certified. Thus, Certified Thrift carried on no actual business operations. It acted as a conduit funnelling money to its parent leaving its treasury barren of any assets other than debentures of its parent, which was in financial distress.

One of the methods used by the registrant to sell the Certified Thrift stock was to send a group of salesmen, under the control of a supervisor or manager, to cities and towns away from its main office to attempt to make sales by house calls on prospects. Beck, who had been employed by Commonwealth as one of its salesmen, participated in this activity. The testimony of six investors establishes that Beck painted a glowing future for Certified Thrift in his talks with prospective investors and made no effort to also give them an outline of problems and other circumstances which affected any investment they might make in Certified Thrift stock.^{5/}

Mrs. M.M.C. testified that Beck visited her home and talked to her husband and then herself about Certified Thrift. Among other things that Beck told Mrs. C. was that the stock had a good potential growth and compared it to a stock which had sold for \$10.00 a share and in ten years had jumped to \$60.00, that it was a new company and that it was best for her to get in on the ground floor. When

^{5/} The testimony of these investors is credited unless otherwise indicated.

Mrs. C. said that she was enrolled in a payroll savings plan for United States Savings Bonds whereby she bought a bond with each pay check every two weeks, Beck said that with a small additional amount she could buy a share of stock and that it would be as good as United States Savings Bonds. He further stated that she could always cash in the stock if she needed money, but made no mention of the price that could be obtained. Mrs. C. bought sixty-eight units on the installment plan.

W.R.L. bought 500 shares of Certified Thrift through Beck at a unit price of \$20.20 for a total cost of \$1,100.00. Beck came to L.'s home after first sending him a postcard and said that he was selling Certified Thrift, that L. and his wife could get in on the ground floor and could buy the stock cheaper now than later, that the stock paid 6% interest, payable every six months. When L. said they were not interested in buying Beck emphasized they would receive 6% on their investment and they could get their money back with six months' notice. Other points that Beck made to L. in his presentation was that the stock would be listed on the American Exchange soon, that it would rise in value, that the company would be making substantial profits on money it would be able to borrow. Beck, according to L., stated that he could get his money back on six months' notice, that the stock was first being offered to those who had invested in certificates of a Certified subsidiary, and that only 250 shares could be issued in one name. L. bought his 500 shares in 250 share lots, each in the name of himself and his wife.

On cross-examination he admitted that he knew when he bought the stock that he could only get dividends to the extent that the company had earnings.

Mrs. J.L., the wife of L., was present at her husband's discussions with Beck and participated in them. In addition to the purchases set forth above, she made an additional investment in Certified Thrift for her sister. She corroborated her husband's testimony that Beck urged them to buy the stock, stating it was very good, that they were being given the first chance to invest, that it was only available to those who had certificates in Certified Financial Company, one of the Certified companies. She also recalled his emphasizing that they would get 6% on their money payable every six months, and that they could get their investment back after six months if they wanted to. She further testified Beck said that Certified Thrift had a limit on how much money it would ~~lend~~ ^{lend} to any ~~borrower~~ ^{borrower}, that there would not be any risk, and that there was no danger in losing any money, and that's why he recommended it highly.

Another witness, V.H.H. corroborated prior testimony set forth above that the stock was being sold only to present holders of certificates of Certified Credit Finance Corporation who were getting preference in buying the stock. H. further stated that Beck told him that he could get his money out on substantially the same basis as he could with the certificates he was holding. After a second interview with Beck H. agreed to buy \$5,000 worth of

stock, which was the limit which Beck said he could buy. H. had savings certificates in Certified Credit Finance Corporation which paid interest. He turned in \$4,000 worth of these plus an additional amount in cash for his purchase.

U.S. was also visited by Beck at his home and he bought \$3,030 worth of Certified Thrift stock after discussions with Beck. Beck told him of the purchase of Citizens Discount by Certified Credit (actually Citizens Discount was a subsidiary of Certified Credit, with which it merged), and he was selling Certified Thrift stock to certificate holders of Citizens Discount only. Beck stated to S., who was a certificate holder of Citizens Discount, that Certified Thrift was a newly organized corporation and that its function would be to act as a small loan division to make loans to service stations to finance sales of oil and accessories. S. said that he had a brother who might be interested in some of the stock. Two weeks later, after S. had purchased his stock, Beck telephoned him and told him it would be all right for his brother to buy some at that time. Beck, according to S., said that in approximately one year Certified Thrift would be merged into its parent company, that not much growth could be expected other than a 6% dividend on the stock, but "when they reached the Board of Trade we could benefit greatly by this investment after it was merged into the company" (Tr. p. 309). He identified the Board of Trade as the New York Stock Exchange and stated that this would take place in

approximately one year. Beck emphasized to S. the broad scope of the operations of Certified Credit and gave him a copy of the 1959 Annual Report.

S. testified that he understood that the stock was speculative but, he further testified, that he understood that there would not be any growth and the stock would be speculative until the point when there would be a merger into the parent company and listing on an exchange, after which it would experience a great deal of growth and he would profit from his investment.

M.A.R. bought some Certified Thrift units after receiving a visit from Beck at his farm and discussing the stock with him. Beck told R. that Certified Thrift was a finance business principally, that that business was a good business, that in the past year the Certified finance business had made 36%, that in approximately a year Certified Thrift would be merged into Certified Credit and those who purchased Certified Thrift would get in on the ground floor of Certified Credit, that offices of Citizens Discount would be turned over to Certified Thrift, and that in about a year after the merger the stock would be on the American Exchange.

Other statements Beck made to R. ^{were} ~~that~~ that the main business of Certified Thrift would be to set up small loan offices throughout Ohio and that it was supposed to enter into an agreement with Sun Oil Company for the financing of sales of batteries and tires. Beck further stated that there was a limit of \$5,000 of stock that any individual could buy because "they" wanted to place the stock over a large area.

Contentions of the Parties; Conclusions

It is urged, on behalf of Beck, that the Division has adopted a "guilt by association" approach as against Beck and has charged him with improprieties initiated and implemented by Certified and the registrant while ignoring the crucial question as to what was known or knowable by Beck when he was selling Certified Thrift. It is contended that Beck was fooled by these companies and their key officers just as a substantial portion of the local business community and others were misled and that the true facts as to the financial condition of Certified and its relationship with its subsidiaries were only brought to light after Beck had left the employ of the registrant and after extensive investigation by the Department of Justice. However, regardless of what Beck might have found out by a careful scrutiny of information available on Certified, it is evident that in his presentations to investors he made representations which were contradicted by the very prospectus of the stock he was selling and that he omitted important information contained therein which an investor would need to know in order to be able to make an informed judgment as to the value of these securities. Some of the important items contained in the prospectus are as follows:

It was stated that the Class A common stock was entitled to receive a noncumulative dividend of \$1.20 per share per

year before the payment of any dividends on the Class B common stock, but that payment of any dividend would depend upon earnings and that there was no assurance that dividends would be paid. There was no provision for the payment of omitted dividends at a later date. Dividends could be paid on the Class B common out of surplus provided by the purchasers of the Class A common.

As of the date of the offering there was no established market for the Class A or Class B common stock and the offering price for the shares had been arbitrarily determined. If all the shares being offered were sold to the public the public would have contributed 98% of the capital of the corporation. If Certified would exercise an option it then had to purchase Class B common stock it would contribute 2% of the total capital and would thereby have voting control of the company.

As to the finance business to be carried on by Certified Thrift it was pointed out

"The finance business in which the Corporation will engage is a competitive one involving competition not only within the small loan and discount financing industry, but involving as well competition from banks, credit unions and other institutions which engage in similar activity. Success in the lending field is largely the result of management ability and experience, particularly in the matter of the effect of competition of various kinds upon the volume and quality of lending to be expected for the Corporation. Since the Corporation will be newly entering the finance business, it may

be at a competitive disadvantage with various well established lending institutions, including those with substantially greater assets.

"Certified Credit Corporation presently has 10 small loan offices. It is believed that the projected operations of the Corporation may approximately double this number. Since new small loan offices will generally operate at a loss for a period of time, it is believed that the speculative nature of a new operation of this magnitude and the accompanying risk of loss should be borne entirely by new capital. Accordingly, Certified Credit Corporation would not consider such an expansion, in view of its existing matured operations, even if financed through a public offering of its own shares"(p.4).

It was also stated:

"It is understood that expenses of placing loans in the small loan industry have, in recent years increased, through necessity of greater advertising and other soliciting devices; that inferior credit risks are being accepted, in some instances, as a means of maintaining employment of capital; that bank competition has been a major competitive factor in the business of consumer financing and that this competition has required some finance companies to reduce profit margins; that the proportion of consumer financing handled by companies such as the Corporation has declined substantially in relation to total consumer financing; and, that delinquency in payments on consumer installment loans in connection with the purchase of automobiles and home appliances have recently been increasing.

"As is common with many other companies of this nature, the Corporation may make investments in other companies of similar nature or otherwise, or may make investments in other income-producing properties where in the opinion of the Board of Directors, such investment will work to the advantage of the Corporation. No specific such investment is under consideration at this time, except the proposed acquisition of the Beggs Building. As a future policy, the Corporation intends to employ at least half of its funds in the discount financing and small loan business and not more than half in such investments. Such other investments, when and if made, may be of any nature, size, or duration.

USE OF PROCEEDS

"Of the net proceeds of the offering made hereby, estimated at \$4,292,500., \$1,610,500 will be applied to pay the unpaid balance of the cash purchase price of the Beggs Building and the balance, estimated at \$2,682,000, will be used to pay the initial expenses of opening loan offices and to supply working capital for their business.

"As described under 'The Beggs Building', the option for the purchase of the Building provides that 80% of the net proceeds to the Corporation of the stock offered hereby shall be reserved for payment to the Beggs Building Company until the cash price of \$750,000 and the second mortgage in the amount of \$860,500, or a total of \$1,610,500, shall have been paid. Accordingly, until that payment is completed, funds will be available for the establishment of loan offices only out of the remaining 20% of the net proceeds.

"The Management estimates that capital in a minimum amount of \$100,000 per lending office established and in a probable maximum of \$400,000 per lending office will be required for the proper operation of each such office. The amount of capital required for each office will vary considerably, depending upon the proportionate amount of each class of business contemplated to be transacted in any year by each such office, upon such factors as the area served, location of the office, qualified dealers available in the area, competition, and upon general business conditions at the time of establishment of each such office.

"It is contemplated that branch offices will be opened at such times and in such numbers as capital may be available for their operation, in all probability in the cities named elsewhere herein. Inasmuch as lending offices can be opened on a schedule mainly to be determined by the receipt of net proceeds available for such use from the Underwriter, the rate of establishment of these lending offices by the Corporation will be directly dependent upon the success of the offering as to amounts and timing of the receipt of such net proceeds to be allocated to the lending operations" (p.6),

The prospectus thus clearly indicated that the Certified Thrift stock did not have the safety of a U. S. Savings Bond, as Beck told Mrs. M.M.C. Nor, when Beck told her that she could always cash in her stock if she needed money, did he tell her, as stated in the prospectus, that the price of the stock had been arbitrarily determined and therefore there was no certainty as to what if any price she would receive if she attempted to sell her shares some time in the future.

Beck stressed to investors that they would receive 6% on their investment without telling them that this return was not guaranteed and would depend on the successful operations of the company. He also told some of his customers that they could get their investment back after six months if they wanted to. There was no such representation made in the prospectus. While Beck stressed to investors the substantial profits that Certified Thrift would make in the finance business he did not advise them of the caveats contained in the prospectus. Nor did he point out that basically the offering was an effort to raise money to enter into a real estate venture and that except for a small percentage only the balance over and above that needed for this venture would be used in the finance business.

Beck also represented to investors that Certified Thrift would be merged into Certified whose stock would be listed on a stock exchange which he had at times identified as the New York

Stock Exchange and at others as the American Stock Exchange. While such a possibility had been rumored in the offices of the registrant, according to a one-time sales manager, no steps at all had been taken to initiate such a merger and exchange listing and Beck made no effort to outline the problems entailed in obtaining such an exchange listing, that Certified might or might not secure approval, and that such a listing did not insure a sharp rise in the price of the stock as he asserted.

All the above representations and omissions were accompanied by highly optimistic predictions by Beck of the future earnings of the company without indicating the problems it faced as outlined in the prospectus. Sales of Certified Thrift commenced in June 1960. As late as July 1961 Beck was still painting a rosy picture of Certified Thrift, but if he had made any effort to check on its operating history he would have found that it had not yet been able to engage in any of the activities stated in the prospectus and did not have one finance office in operation. He also made comparisons with other companies that had had substantial increases in earnings and price rises per share without indicating their differences from Certified Thrift.

In his dealings Beck used high-pressure selling tactics by telling investors they had to act quickly to get in on the ground floor, that the stock was cheaper now than it would be later on, and that the stock was being offered only in limited

amounts to holders of securities of certain Certified subsidiaries. The fact, according to the undisputed testimony of a former sales manager, was that the stock was being offered to anyone who would buy. There was no announced limitation on the amount of investment each purchaser could obtain.

Basic to the relationship between a broker or dealer and its customers is the representation that the latter will be dealt with fairly in accordance with the standards of the profession.^{6/}

The Commission has stated:

"At the expense of restating the obvious, we emphasize that compliance with these requirements for delivery of a prospectus or offering circular does not, however, license broker-dealers or their salesmen to indulge in false or fanciful oral representations to their customers. The anti-fraud provisions of the Securities Act and the Securities Exchange Act apply to all representations whether made orally or in writing, during or after the distribution. We have repeatedly held that the making of representations in the sale of securities unsupported by a reasonable basis is contrary to the obligation of fair dealing imposed on broker-dealers and their salesmen by the securities laws. This obligation is not diminished because a prospectus or offering circular containing information specified by the Act and our rules has been or is to be delivered. Such information furnishes the background against which the salesman's representations may be tested. Those who sell securities by means of representations inconsistent with it do so at their peril." ^{7/}

^{6/} Duker & Duker, 6 S.E.C. 386, 388-89 (1939).

^{7/} Ross Securities, Inc., 41 S.E.C. 509, 510 (1963). See, to the same effect, J. P. Howell & Co., Inc., Sec. Exch. Act Rel. No. 8087, p. 4 (June 1, 1967); Underhill Securities Corporation, Sec. Exch. Act Rel. No. 7668, p. 6 (August 3, 1965).

The Commission has also held that it is an abdication of responsibility to deal fairly with customers when there is a substantial departure from representations made in a prospectus by the use of,

" . . . Predictions of substantial short-term price increases or increases in the price of the security, optimistic representations as to the company's future prospects and the quality of an investment in the stock, wholly unsupported and unwarranted in the light of the information available in these documents, appear with monotonous regularity in the context of high-pressure sales practices, a procedure which makes confusing, if not impossible, an intelligent and considered evaluation by the investor of the security being offered."
Ross Securities, Inc., supra, p. 511. 8/

A broker-dealer and his salesmen have a fiduciary relationship to their customers and owe them the duty of acting with care making recommendations to them. The Commission has stated:

"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, and where as here they are highly optimistic, enthusiastic and unrestrained, their deceptive quality is intensified since the investor is entitled to assume that there is a particularly strong foundation for them. And it is not a sufficient excuse that a dealer personally believes the representation for which he has no adequate basis." (Footnote omitted.) 9/

8/ See, to the same effect, Mac Robbins & Co., Inc., 41 S.E.C. 116, 120 (1962), aff'd sub nom Berko v. S.E.C., 316 F. 2d 173 (1963); Underhill Securities Corporation, supra; J. P. Howell & Co., Inc.; supra; Century Securities Company, Sec. Exch. Act Rel. No. 8123, p. 4 (July 14, 1967).

9/ Alexander Reid & Co., Inc., 40 S.E.C. 986, 990 (1962).

It is concluded that Beck made representations to his customers in the offer and sale of Certified Thrift stock which were incomplete, false, and misleading concerning, among other things, the business and financial history and experience of Certified Thrift; comparison of the growth potential of Certified Thrift with established, successful companies;^{10/} the application and use of the proceeds of the offering; the merger of Certified Thrift into Certified and the results thereof; the safety of investment in the Class A common stock; the market for and the potential appreciation in the market price of the Class A common stock; listing on a national securities exchange, and the results thereof; and the availability of the stock being offered to members of the investing public.

It is further concluded that Beck by the aforementioned activities in his sale of Certified Thrift stock and the methods he used violated the anti-fraud provisions of the Securities Acts.^{11/} It is also found that these violations were willful.

^{10/} Such comparisons without indicating facts necessary to make the comparisons fair have been condemned by the Commission as misleading and improper. Aircraft Dynamic International Corporation, 41 S.E.C. 566, 569 (1963); American Republic Investors, Inc., 37 S.E.C. 287, 290-91 (1956); The Whitehall Corporation, 38 S.E.C. 259, 266-67 (1958).

^{11/} Tager v. S.E.C., 344 F. 2d 518 (2nd Cir. 1965); Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E. W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959).

Registrant, Certified, Certified Investment, and Houston Financial were all participants in a scheme to defraud investors and were staffed by persons with full knowledge of the background facts which were concealed from investors and which rendered the Certified Thrift offering a fraud on those persons. It is concluded that each of them willfully violated the anti-fraud provisions of the Securities Acts by their participation in this fraudulent scheme.

III. CONCLUDING FINDINGS, PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b) of the Exchange Act, so far as it is material herein, is required to revoke the registration of any broker or dealer if it finds that such action is in the public interest, and such broker or dealer, subsequent to becoming such, has willfully violated any provision of the Exchange Act, the Securities Act, or any rule or regulation thereunder.

It has been found that the registrant willfully failed to comply with record-keeping and net capital rules and failed to promptly correct inaccuracies in its broker-dealer application for registration. It has further been found that registrant willfully violated the anti-fraud provisions of the Securities Acts in the offer and sale of stock in Certified Mortgage, Certified Life, and Certified Thrift. It played a key role in an extensive fraud practiced upon the investing public whereby funds collected

from investors were not used for their stated purpose but diverted to prop a crumbling financial empire. In view of the extensive violations found it is concluded that it is in the public interest to revoke the broker-dealer registration of the registrant.

It is urged on behalf of Beck that he should not be found a cause, within the meaning of Section 15A(b)(4) of the Exchange Act, of the order of revocation. It is pointed out that he had no position with registrant other than salesman and had no voice in the management of the registrant or Certified. However, this argument disregards the fact that the stock-selling schemes by which registrant marketed substantial amounts of securities of certain Certified companies would not have succeeded without the enthusiastic cooperation of salesmen, such as Beck, who in disregard of their obligations to investors persuaded them to buy stock by making exaggerated claims and using methods inconsistent with their responsibilities to customers. In view of the activities of Beck in the sale of Certified Thrift stock, it is concluded that he is a cause of the order of revocation found to be appropriate.

It is further argued that it is not necessary in the public interest to impose any sanction upon Beck. It is pointed out that he had no prior securities experience before his work with the registrant and he had had little if any training with it. Furthermore, it is pointed out that he had purchased \$2,500 in Certified Mortgage stock in 1959 and sold \$2,000 worth of that

stock to his brother. He also sold Certified Mortgage and Certified Thrift stock to many of his personal friends, thus, it is argued, evidencing his faith in the Certified issues. The Commission has rejected such arguments in cases of serious violations of the type encountered here.^{12/}

Beck became associated with another broker-dealer firm in August 1962 and has been employed by it as a salesman since then. The president of this firm, who has served as a member of the District Conduct Committee of the NASD, testified that when Beck was hired he was treated as a new salesman, given the training course for new salesmen, and since then has built up an exceptionally good clientele and there have been no complaints from anyone about his work or selling activities. It is urged that in view of these factors Beck should be considered "retrained" and that the imposition of a sanction is not necessary in the public interest. This argument glosses over the very serious damage Beck caused investors and is rejected as a complete defense^{13/} although it has been given some weight in view of other factors present here.

^{12/} Ross Securities, Inc., *supra*, p. 516; Shearson, Hammill & Co., Sec. Exch. Act Rel. No. 7743, p. 22 (November 12, 1965); Alfred Miller, Sec. Exch. Act Rel. No. 8012, p. 5 (December 28, 1966); A. T. Brod & Company, Sec. Exch. Act Rel. No. 8060, p. 3-4 (April 26, 1967).

^{13/} Robert Edelstein Co., Inc., Sec. Exch. Act Rel. No. 7400, p. 9 (August 20, 1964).

It was stipulated that Beck cooperated with the Government and the Division during the Government's investigation of criminal charges against Daniel Armel and others in connection with activities of the Certified Companies; that he testified as a witness during the Grand Jury hearing, and as a witness for the Government during the resulting criminal trial (Tr 511-512). This is urged as a mitigating factor and the undersigned finds merit in the contention. In view of the strong public policy supporting full disclosure of pertinent evidence in criminal trials growing out of alleged stock frauds and Beck's apparent ability to adhere to the standards of the profession under conditions of adequate supervision it is concluded that it is not contrary to the public interest to permit Beck to return to the securities business after a period of time despite the cause finding against him.

Accordingly, IT IS ORDERED that the registration as a broker and dealer of Commonwealth Securities Corporation is revoked.

IT IS FOUND that Herbert Beck is a cause of the order of revocation. This finding shall not operate as a bar to his continuance in the securities business after a period of four months from the date of the Commission's decision herein upon a proper showing of his employment under proper supervision.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him.

This initial decision, pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.^{14/}

Sidney L. Feiler
Hearing Examiner

Washington, D. C.
August 14, 1967

^{14/} All contentions and proposed findings have been carefully considered. This initial decision incorporates those which have been found necessary for incorporation therein.