IN THE MATTER OF

DUNHILL SECURITIES CORPORATION

PATRICK R. REYNAUD

PATRICK RENE REYNAUD DE ST. OYANT, LTD.

PATRICK RENE REYNAUD
DE ST. OYANT, (a/k/a
PATRICK R. REYNAUD)

File Nos. 3-1961 and 3-2018. Promulgated January 26, 1971

Securities Exchange Act of 1934—Sections 15(b) and 15A

BROKER-DEALER PROCEEDINGS

Revocation and Denial of Registration

Bar from Association with Broker-Dealer

Offer, Sale and Delivery of Unregistered Stock
Fraud in Offer and Sale of Securities
Failure of Supervision
Noncompliance with Record-Keeping and Net Capital Requirements
Injunctions

Where registered broker-dealer and its president and controlling stockholder participated in unlawful distribution of unregistered stock; president and salesman recommended such stock to customers without disclosing adverse and speculative factors; broker-dealer and president failed reasonably to supervise salesman; broker-dealer failed to comply with record-keeping and net capital requirements, notwithstanding prior injunction against violations of those requirements; and broker-dealer and president were also subject to injunctions against violations of securities registration provisions and broker-dealer against violations of fraud provisions, *held*, in public interest to revoke broker-dealer's registration, bar president from association with any broker-dealer, and deny registration application of broker-dealer also controlled by president.

APPEARANCES:

William Nortman and *Thomas R. Beirne*, of the New York Regional Office of the Commission, for the Division of Trading and Markets.

Morris Rosenzweig, for respondents.

FINDINGS, OPINION AND ORDER

Following hearings in these consolidated proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act

of 1934 ("Exchange Act"), the hearing examiner filed an initial decision concluding that the registration as a broker and dealer of Dunhill Securities Corporation ("registrant") should be revoked and that it should be expelled from the National Association of Securities Dealers, Inc. ("NASD"), that an application for broker-dealer registration filed by Patrick R. Reynaud de Saint Oyant, Ltd. ("applicant") should be denied, and that Patrick R. Reynaud, president and sole stockholder of both registrant and applicant, should be barred from association with any broker-dealer.[1] In reaching this conclusion he found that, as alleged in the orders for proceedings, registrant and/or Reynaud were the subjects of a total of four injunctions and that these respondents had willfully violated, or willfully aided and abetted violations of, certain provisions of the Exchange Act and the Securities Act of 1933 and had failed reasonably to supervise an employee of registrant. We granted a petition for review filed by respondents, and briefs were filed by respondents and by our Division of Trading and Markets.[2] On the basis of an independent review of the record, and for the reasons set forth herein and in the initial decision, we make the following finding.

Reynaud became president and controlling stockholder of registrant in March 1967; one Guido Volante, who had previously been registrant's principal officer and controlling stockholder, retained the remaining stock interest and became vice-president. Volante terminated his association with registrant in about June 1968, and Reynaud remained as its sole principal. Applicant was incorporated in February 1969 and filed its registration application in May 1969.

VIOLATIONS OF REGISTRATION AND ANTIFRAUD PROVISIONS; INJUNCTIONS AGAINST VIOLATIONS OF THOSE PROVISIONS

As found by the examiner, during the period from about February 1, 1968 through May 1968, in connection with the offer, sale, and delivery of common stock of Lynbar Mining Corporation, Ltd., a Canadian corporation, registrant willfully violated, and Reynaud willfully aided and abetted violations of, the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933 and the antifraud provisions of Section

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[1] We previously suspended registrant's registration pending final determination of whether such registration should be revoked and postponed the effective date of applicant's registration until final determination of whether such application should be denied, 44 S.E.C. 1 1969 and 43 S.E.C. 1143 (1969).

[2] Oral argument before us had been scheduled at respondents' request, but was cancelled upon their subsequent request that we reach our decision without such argument.

17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder.

As part of a large-scale distribution in the United States of Lynbar stock emanating in part from control persons in Canada, registrant sold 133,000 shares of such stock to 315 retail customers and other broker-dealers through its own trading account, two accounts maintained in the names of relatives of Edward Flinn, a trader and salesman for registrant, and an account in the name of Panamerican Bank & Trust Co., a Panamanian company of which Reynaud was president and for which he made investment decisions. In addition, registrant purchased approximately 16,000 shares of Lynbar stock as agent for some 18 customers. No registration statement had been filed with us with respect to Lynbar stock, and respondents concede that no exemption from the registration requirements was available for registrant's transactions in such stock and that registrant violated Sections 5(a) and 5(c).

Respondents also do not contest the examiner's finding that in connection with the offer and sale of Lynbar stock Flinn made certain misrepresentations and failed to disclose material facts necessary to make statements made not misleading.[3] Lynbar, which was organized to engage in mining activities, had never had any income from operations, and such funds as it had were derived solely from the sale of its stock While it had acquired exclusive rights to a process for the extraction and processing of potash the economic feasibility of that process had not yet been established. Nevertheless, Flinn represented to one customer that Lynbar had one of the largest known potash reserves in the world and had developed a new technique for extracting the potash which would make its stock valuable, and that the stock was or would be a "high flier" which would within 60 days go up to 10 from its then price of 4⅛. He made no disclosure concerning the stage of development of the new process, the amount of capital that would be required to make the mining of potash by means of that process economically feasible, or the capability of Lynbar to finance the process. In recommending the stock to other customers, he made no disclosure regarding Lynbar's lack of earnings or financial condition.

In February 1969, registrant and Flinn, upon their consent, but without admitting or denying the allegations of the com-

[3] On the basis of Flinn's consent, in which he neither admitted nor denied the charges as to him, an order was issued on May 9, 1969, barring him from association with any broker or dealer. Securities Exchange Act Release No. 8604.

plaint, were permanently enjoined from violating the registration and antifraud provisions in connection with transactions in Lynbar stock.[4]

Respondents' principal contention with respect to the Lynbar transactions is that they were carried out essentially by Volante and Flinn, who have not been associated with registrant since about June 1968, that Reynaud's position with the firm at the time of those transactions was mainly ministerial, and that his participation in them was peripheral, stemmed from ignorance rather than wrongful intent, and resulted in no harm or loss to public investors. Reynaud testified, in this connection, that he did not become registered with the NASD as a principal until the end of February 1968 and prior thereto did not take, and in his view was precluded from taking, an active part in registrant's business. He further testified that even after February 1968, Volante was primarily in charge of registrant's operations until he terminated his association with registrant. Respondents also point out that the three customer-witnesses who testified were all customers of Flinn and that Reynaud was not named as a defendant in the injunctive proceedings.

The record shows, however, that Reynaud in fact played a substantial role in connection with the Lynbar transactions. He was personally responsible for the purchase and sale of a substantial number of Lynbar shares through the Panamerican account. Moreover, he acknowledged that in connection with the offer and sale by him of Lynbar stock to customers of registrant he did not discuss Lynbar's lack of earnings or other specific details with them. He asserted that his customers generally relied on his judgment and were not interested in the specifics concerning particular securities, but further testified that to the extent he discussed Lynbar, he stated merely that this was a Canadian stock which he was buying, that he felt Lynbar could be "a good company later on" "if everything is all right" and that it was a "gambling operation." In our view these representations, which were tantamount to a recommendation to purchase, were misleading in the absence of specific disclosure of the speculative and adverse factors referred to above.[5] It is not necessary to a finding of violation or

[4] *S.E.C. v. Lynbar Mining Corporation, Ltd.*, S.D.N.Y., 68 Civ. Action No. 4493.

[5] See *Richard J. Buck & Co.*, 43 S.E.C. 998 (1968), *aff'd sub nom. Hanly v. S.E.C.*, 415 F.2d 589 (C.A. 2, 1969).

willful violation that there be an intention to violate the law[6] or that harm or loss to investors be shown.[7] Nor is it of importance to the decision of the issues in these proceedings that no customers of Reynaud were called to testify or that he was not named in the injunctive action.

We also agree with the examiner's finding that registrant and Reynaud failed reasonably to supervise Flinn with a view to preventing his violations of the registration and antifraud provisions in connection with the offer and sale of Lynbar stock. By virtue of his position as registrant's president and controlling shareholder, and in light of his awareness of the substantial activity of registrant in Lynbar stock, Reynaud was under an obligation to exercise appropriate supervision of Flinn's conduct.[8] That he failed to do so is demonstrated by his own testimony that he did not know or inquire as to what Flinn was telling his customers concerning Lynbar. The fact that Reynaud was not registered as a principal with the NASD when such activity commenced could not in our view relieve him of his obligation, and in any event the Lynbar transaction extended well beyond the date when he became registered.

In addition, prior to or during the period in which registrant was selling Lynbar stock, Reynaud and registrant were enjoined, in connection with other securities, against violations of the registration provisions, and violations of those and the antifraud provisions, respectively. Thus, Reynaud, together with Panamerican, was permanently enjoined in May 1967 from violating Section 5 of the Securities Act in connection with the offer, sale and delivery of Panamerican stock,[9] and in February 1968, registrants, with others, was preliminarily enjoined from violating the registration and antifraud provisions in connection with the offer and sale of stock of North American Research and Development Corporation.[10]

VIOLATIONS OF RECORD-KEEPING AND CAPITAL REQUIREMENTS AND RELATED INJUNCTION

In June 1968 registrant, Reynaud, and Volante were preliminarily enjoined from violating the net capital and record-keeping provisions of the Exchange Act and rules thereun-

[6] It is only necessary that there be an intent to perform the act that is violative of the law. See, *e.g.*, *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965); *Gilligan, Will & Co.*, 38 S.E.C. 388, 395 (1958), *aff'd* 267 F.2d 461, 468 (C.A. 2, 1959), *cert. denied* 361 U.S. 896 (1959).

[7] See *May-Phinney Company*, 27 S.E.C. 814, 831, n. 21 (1948).

[8] *Cf. Albion Securities Company, Inc.*, 42 S.E.C. 544, 547 (1965); *Aldrich, Scott & Company, Inc.*, 40 S.E.C. 775 (1961).

[9] *S.E.C.* v. *Panamerican Bank & Trust Co.*, S.D.N.Y., 67 Civ. Action No. 1825.

[10] *S.E.C.* v. *North American Research and Development Corporation*, S.D.N.Y., 67 Civ. Action No. 3724.

der.[11] In entering the injunction the Court found that as of May 31, 1968, registrant had a net capital deficiency of over $22,000, and that as of May 24, 1968, entries on 7 different records of registrant had not been currently posted, the last dates of posting ranging from March 29 to May 16, 1968. The Court further found that the record-keeping situation had been substantially improved by May 31, although there were still shortcomings. However, as detailed below, early in 1969, when Reynaud was in complete charge of registrant's operations, its books and records were again seriously non-current and it was operating with a large net capital deficiency. We find, as did the examiner, that during the period from about January 31, to April 21, 1969 (the date on which the proceedings with respect to registrant were instituted), registrant willfully violated, and Reynaud willfully aided and abetted violations of, the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder, and that at and about March 31, 1969, registrant, willfully aided and abetted by Reynaud, willfully violated the net capital requirements of Section 15(c)(3) of the Exchange Act and Rule 15c3–1 thereunder.

An inspection of registrant's books and records on March 10, 1969, disclosed that its general ledger and its failed to deliver ledger were posted only to January 31, the firm's trading account to the end of February, the securities record or ledger to December 13, 1968, and the failed to receive ledger to February 3, 1969. Moreover, although paragraph (11) of Rule 17a–3 requires that a trial balance and a computation of aggregate indebtedness and net capital be prepared currently at least once a month, the latest available trial balance was that of January 31, 1969 and no computation of aggregate indebtedness and net capital as of that date had been prepared. Subsequent inspections of registrant's books and records on April 1 and April 11, while indicating some improvement, disclosed that certain of the records were still deficient.

While not disputing these deficiencies, respondents point out that the extent of noncompliance had been substantially reduced by the time proceedings were instituted and assert that efforts were continued after that date to make the records current. They argue that since registrant's blotter, the original record of its transactions, was current, it was just a matter of manpower to transpose the figures to various "secondary"

[11] *S.E.C.* v. *Dunhill Securities Corporation*, S.D.N.Y., 68 Civ. Action No. 2152. A permanent injunction was entered against registrant and Reynaud in June 1969.

records, and that the delay in doing so was attributable, among other things, to unavoidable personnel problems and absences in January and February 1969 and to the seizure of certain records by the Attorney General of New York.[12]

The fact that registrant's blotter was current cannot excuse its failure to maintain other required books and records on a current basis.[13] Unless records are maintained on a current basis, neither the broker-dealer nor those charged with its regulation are in a position to know whether it is meeting the net capital requirements.[14] And we agree with the examiner that the various allegedly extenuating circumstances cited by respondents cannot excuse the shortcomings in registrant's records and indeed provide no explanation for the deficient state of those records at the time of the March 1969 inspection. We also concur with his observation that Reynaud aggravated the situation resulting from the inexperience of back-office personnel, by pursuing an aggressive program for expanding registrant's business when he should have restricted its activities to a pace consistent with the capacity of its personnel properly to maintain required books and records.

With respect to net capital, the examiner found that registrant had a deficiency of $140,967 as of March 31, 1969. While respondents argue that this finding is not fully supported by the record and that any "apparent deficiency" stems from a novel and unwarranted method of calculation, there is nothing in the record casting any doubt on the validity of the net capital calculation which was made by our staff investigator, or indicating that he departed in any way from accepted standards.[15] Respondents further claim that, largely as a result of a subordinated loan by Reynaud to registrant, any deficiency was more than overcome "in time to avoid serious consequences." In support of this argument they introduced a capital analysis as of April 30, 1969 prepared by an independent accountant who had audited registrant's books for some years. However, as the examiner found, the record does not establish whether or to what extent certain of the assets

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[12] Respondents misconstrue the statement in our opinion on the issue of interim suspension to the effect that no willful violations of the record-keeping provisions were being found (Securities Exchange Act Release No. 8653, p. 5) as representing a finding that willful violations had not been established by the record. What we stated was merely that on the issue of interim suspension, it was not necessary to find that such willful violations had been established and that therefore we were making no such finding.

[13] See *Eugene N. Owens*, 42 S.E.C. 149 (1964); *Whitney & Company*, 41 S.E.C. 699, 703 (1963).

[14] *Palombi Securities Co., Inc.*, 41 S.E.C. 266, 276 (1962).

[15] It would appear that respondents' contentions in fact relate only to a net capital computation as of May 29, 1969, whose validity the examiner found it unnecessary to determine since it was as of a date not within the period encompassed by the orders for proceedings.

included by the accountant were properly includible in the computation of net capital so as to be curative of the deficiency. And in any event, a later rectification could not cure the prior substantial deficiency.

PUBLIC INTEREST

Respondents contend that it is not in the public interest, nor required for the protection of investors, to impose any further sanctions on them. They urge that lesser sanctions were imposed in other cases involving assertedly similar circumstances. Respondents state that registrant and Reynaud have been out of the securities business since registrant's registration was suspended in July 1969, and they point to Reynaud's testimony that, if afforded the opportunity to engage again in the securities business, he intends to institute specified procedures to avoid future violations. With reference to applicant, they argue that it is a new entity without a history of its own which should not be subjected to "guilt by association."

We have repeatedly held that the remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other cases.[16] In reaching our conclusion here, we have considered all the factors adverted to by respondents, together with the fact that the violation in which Reynaud participated or for which he must bear responsibility were serious and occurred despite the prior injunctions against the same or similar types of conduct. Indeed, subsequent to the filing of the initial decision, registrant and Reynaud were charged with and pleaded guilty to criminal contempt of the June 1968 record-keeping and net capital injunction and the permanent injunction entered against them in that case in June 1969; registrant was fined $10,000 and Reynaud was sentenced to four months imprisonment.[17] And it should be noted that frantic efforts to bring records up to date and to remedy capital deficiencies after violations have been uncovered cannot be equated with a conscientious and constant program of compliance.

Respondents' attempt to have us treat applicant as distinct from Reynaud is without merit in light of the fact that the firm is clearly his *alter ego*.

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[16] See *Melvyn Hiller*, 43 S.E.C. 969, 971 (1968), *aff'd* 429 F.2d 856 (C.A. 2, 1970).

[17] An appeal by registrant and Reynaud from an order denying their motion to withdraw their pleas of guilty and from the sentences imposed on them is pending (C.A. 2, No. 34940).

Finally, we note that applicant's registration application grossly mistated the amount on deposit in its bank account and the amount of its capital, and that the examiner considered Reynaud's explanation regarding the discrepancies not credible. This latest instance of misconduct indicates that despite the various enforcement action, Reynaud is still not impressed with the necessity for diligent compliance with applicable requirements.

Under all the circumstances, we adopt the examiner's conclusion that the public interest requires imposition of the maximum sanctions against respondents.[18]

Accordingly, IT IS ORDERED that the registration as a broker and dealer of Dunhill Securities Corporation be, and it hereby is, revoked; that it be, and it hereby is, expelled from membership in the National Association of Securities Dealers, Inc.; that the application for registration as a broker-dealer of Patrick R. Reynaud de Saint Oyant, Ltd. be, and it hereby is, denied; and that Patrick R. Reynaud be, and he hereby is, barred from association with any broker or dealer.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG).

[18] The exceptions to the initial decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.