

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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: In the Matter of :  
: RICHARD W. LORD :  
: GERALD P. TOMAS :  
: (8-12588) :  
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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

(Private Proceedings)

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Irving Schiller  
Hearing Examiner

Washington, D. C.  
November 23, 1970

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Appearances: William D. Goldsberry, Joan Fleming and  
Donald Dreyfus of the Chicago Regional  
Office of the Commission for the Division  
of Trading and Markets

Philip R. Davis, for Richard W. Lord and  
Gerald P. Tomas

Before: Irving Schiller, Hearing Examiner

These are private proceedings instituted pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Harris Upham & Co., Inc. ("registrant") and Gerald P. Tomas ("Tomas") willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; whether Richard L. Kennedy, Jr. ("Kennedy") and Richard W. Lord ("Lord") failed reasonably to supervise Tomas with a view to preventing the violations alleged in the order for proceedings and whether any remedial action is appropriate in the public interest pursuant to the above-mentioned sections of the Exchange Act.

The order for proceedings alleges, in substance, that during the period from on or about March 1, 1968 to March 1, 1969, registrant and Tomas, singly and in concert, willfully violated and willfully aided and abetted violations of the above-mentioned sections of the Securities Act and the Exchange Act and that they, in connection with the offer, sale and purchase of securities, employed devices, schemes, and artifices to defraud, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading and engaged in acts, practices and a course of business which would and did operate as a fraud and deceit upon certain persons. The conduct and activities which form the basis

for the foregoing allegations are set forth in the order for proceedings.

The Commission accepted offers of settlement from registrant and Kennedy and in its Findings and Order dated April 29, 1970 stated it was not passing upon the responsibility or culpability of Tomas and Lord the remaining two respondents. <sup>1/</sup> This decision will consider the allegations relating solely to Tomas and Lord.

After appropriate notice, hearings were held before the undersigned hearing examiner. Proposed findings of fact and conclusions of law and briefs were filed by the parties. The following findings and conclusions are based upon the preponderance of the evidence as determined by record, the documents and exhibits therein and the hearing examiner's observation of the various witnesses.

#### Background

The issues in these proceedings involving charges against Tomas for willful violation of the anti-fraud provisions of the securities acts relate to the manner in which Tomas, a registered representative employed by registrant, treated the account of his customers Mrs. Pauline Houdek and her daughter and the nature and propriety of the transactions effected by Tomas on behalf of such customers. The issues concerning Lord involve the charge against

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<sup>1/</sup> Securities Exchange Act Release No. 8872 (April 29, 1970).

him for failing reasonably to supervise Tomas with a view to preventing the violations allegedly committed by Tomas.

Registrant has been and is registered with this Commission as a broker-dealer since October 29, 1965. It is a successor to Harris, Upham and Company, a partnership, which registered as a broker-dealer with the Commission on April 28, 1943.<sup>2/</sup> Tomas was employed as a registered representative by registrant from November 10, 1960 to May 20, 1969. About January 1961 Lord was employed as manager of the branch office of registrant at North Michigan Avenue, Chicago, Illinois and became an assistant vice president of registrant in September 1967. As manager of registrant's branch office Lord exercised supervisory functions for the operations of that office and over all of its employees including Tomas. His compensation, in part, was based on the net profits of the branch office.

Tomas' Relationship with the Houdeks

Prior to detailing the securities transactions effected in the Houdek account and to facilitate an understanding and appreciation of the manner in which Tomas handled the account it is essential

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<sup>2/</sup> Registrant is a member of the New York Stock Exchange, American Stock Exchange, Midwest Stock Exchange, Boston Stock Exchange, Pacific Coast Stock Exchange, Salt Lake City Stock Exchange, Colorado Springs Stock Exchange and the Chicago Board of Trade, and is an associate member of the Philadelphia-Baltimore-Washington Stock Exchange.

to detail not only the origin of the relationship established between Tomas and Mrs. Houdek but the events occurring after the opening of the account as they bear upon such relationship. Some time in the latter part of February or early March 1968 a friend of Tomas' informed him he would receive a phone call from Mrs. Houdek. Tomas testified that when Mrs. Houdek called him they talked about stocks in general and that several days later she phoned again and wanted to open an account. Without obtaining any information concerning Mrs. Houdek, Tomas sent her a blank account card on or about March 5, 1968 which was returned to registrant with only the signatures of Mrs. Houdek and her daughter Miss Bernice Houdek. Tomas further testified he phoned Mrs. Houdek and obtained information from her which he wrote on the account card in his own handwriting. One of the items in the card requests information concerning the business of the client and Tomas wrote that Mrs. Houdek was a "real estate saleswomen." Another item calling for the business address was not completed. Tomas concedes he never obtained the information notwithstanding her purported statement about her business. In response to the item calling for information as to the length of time the client was personally known by someone in the office Tomas wrote "2 years." Tomas admitted that the two-year statement was erroneously written on the card by him. In fact the information concerning Mrs. Houdek's business was also incorrect. The record discloses that Mrs. Houdek is an elderly widow who completed her education at age fourteen and whose only employment was to operate a

sewing machine at various factories. It is also evident from the record that at the time Tomas sought information from Mrs. Houdek for the account card he made no effort to learn the age of his new customer or true financial condition or whether she carried insurance or her investment aims or objectives. He testified all he knew of her financial condition was that she was in "good financial condition" and there was "nothing wrong."

On the other hand Mrs. Houdek testified she called Tomas early in March having been told he dealt in real estate and the stock market and told him she was "looking for building." In her words she was told by Tomas that ". . .he handling the real estate or that he knows about it." At Tomas' suggestion she went to see him and ". . .he done lot of talking and what all he is going to look for it and help me to obtain." She further testified she told him she had sold property left to her by her late husband and wanted to invest the money in another small apartment building. After promising to assist Mrs. Houdek in finding a suitable building Tomas induced her to open an account and the record shows that on March 11, 1968 he sold 50 shares of a stock she owned. On the same day he purchased 100 shares of a mining stock Mrs. Houdek never heard of and 60 shares of Montgomery Ward. Tomas sold the mining stock within two weeks.

The next event which vividly illustrates the manner in which Tomas handled the account occurred in the latter part of March. The testimony of Tomas and Mrs. Houdek are in substantial agreement

concerning both the transaction and payment and differs in one area noted below. On March 22, 1968 without prior authorization from Mrs. Houdek Tomas purchased 1500 shares of Montgomery Ward stock in four transactions at prices ranging from 27-1/8 to 27-5/8 for a total cost of \$41,753.69. In the evening of March 26, 1968 Tomas admits he went to Mrs. Houdek's home to get the money to pay for the stock purchased because as he testified whenever a large amount of money is involved he should go out and pay the customer a visit because of the policy of the New York Stock Exchange "to know your customer." Tomas spent several hours at Mrs. Houdek's home in an effort to convince her to pay for the stock which at first she refused to do. Tomas testified that during that evening Mrs. Houdek showed him several listings of properties she was considering buying and solicited his advice. She made it quite clear to Tomas that her primary objective was to buy an apartment house of some 15 to 20 units and was not interested in the stock market until after she has purchased her property. Tomas apparently paid little attention to her desires but told her he had bought stock in the amount of some \$41,000 and that unless she paid him he would be in "bad with his boss." To induce her to pay for the stock Tomas promised her a profit of \$15,000 overnight on the securities he had purchased stating he would sell the securities the following day. Tomas testified he told Mrs. Houdek she could expect a fifteen point profit. On the strength of his promise she agreed to give him a check. Mrs. Houdek's testimony concerning this part of their



meeting is so illustrative of not only her naiveté but of her faith in and her trust which she placed on Tomas' promises that it is quoted in the margin.<sup>3/</sup> Apparently all Mrs. Houdek was able to do was sign her name to the check. Tomas in his own handwriting completed the check. Tomas' testimony in this regard is most revealing particularly in light of his later testimony that Mrs. Houdek was a trader in securities. He testified "She asked me to fill out the check because she couldn't - - she didn't know how to write a check that big or add all that to it. So, I just wrote the check."

The record discloses that on April 1, 1968 a joint margin account was opened by the registrant for Mrs. Houdek and her daughter. However, the manner in which registrant opened such margin account is not quite clear in the record. Though registrant's records disclose the establishment of a margin account for the Houdek joint account there is no evidence that a margin agreement was ever signed by Mrs. Houdek or her daughter. Moreover, the record shows that on four occasions registrant sent margin calls to Mrs. Houdek who testified

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<sup>3/</sup> "He put them [confirmations] on a table and - - - which I refused to give him the money. He said if I don't give him the money, he can go back to his office to the boss and tell him that why he bought so many and he didn't get the money for it. So, in good faith - - as he was there quite a few hours talking to me that he had to have that money and with the promise that he is going to sell it and return money to me next day. So, I let him have the money."

In response to further questioning Mrs. Houdek testified "Well he told me - - - promised next morning he said when he - - - that he is going to sell it, which - - - only which he got the money that he is going to sell them the next day and he said he is going to make 15,000."

that upon receiving them she immediately called Tomas and was told to disregard them since they were intended for another customer with the same name, that the office had put the wrong address on the notices and that he would take care of it. Mrs. Houdek never forwarded any funds in response to the margin calls but the record shows and Tomas testified that upon instructions from Mrs. Houdek he sold securities to cover the calls. Mrs. Houdek on the other hand testified and the hearing examiner credits her testimony that she does not know what a margin account means and that she never gave any instructions to sell securities for the margin calls because Tomas told her to disregard the notices.<sup>4/</sup>

In April 1968 Mrs. Houdek and her daughter went to see Tomas. During lunch the daughter told Tomas her mother still was interested in buying a building and was assured by Tomas not to worry about it, that there was a large sum of money in the account and if needed for a down payment on a building it would be there. During the same conversation Mrs. Houdek's daughter told Tomas that she and her mother each had \$15,000 in a savings and loan account. Tomas informed them that money in savings and loan was not in a safe place, that the money they had in the account was doing so well they should

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4/ When asked if she knew what the margin calls were Mrs. Houdek testified

"No I don't know what they were. I asked him...I called Tomas and I told---he told me I could disregard it, they don't bwrong(sic) to me. I said, how come they have my name and address. He said I have customers with same name and address... No,...not...same name and they just put wrong address on it and mailed it out."

invest more in securities. Following this conversation Tomas phoned Miss Houdek toward the latter part of April and repeated that money in a savings and loan was not too safe and that by investing in securities she could make more money than keeping it where it was. Several days later Miss Houdek withdrew her funds and forwarded it to registrant. The funds were deposited in the joint account. However, Mrs. Houdek refused to give Tomas her \$15,000 to deposit in the account.

Mrs. Houdek further testified that during the period March 1968, particularly after the unauthorized purchase of the Montgomery Ward stock, until July when Tomas went on vacation she spoke with Tomas almost daily and on some days two or three times in efforts to determine what was happening with her money. Since she was receiving confirmations of transactions and monthly statements she was trying to understand what Tomas was doing. She constantly told Tomas she wanted to have money to buy an apartment building and he consistently told her he had the money but the stocks "were going to go up" and then he would sell. Mrs. Houdek further testified that Tomas told her to "leave it up to him because he knew what he was doing."

In August Mrs. Houdek consulted an accountant for help in understanding the monthly statements and thereafter retained an attorney who on August 27 wrote Tomas instructing him at Mrs. Houdek's request not to make any further purchases or sales without obtaining her express authorization. Tomas upon receipt of the letter phoned

Mrs. Houdek first then her attorney and lastly Miss Houdek. Tomas testified Mrs. Houdek told him she was sorry the letter was sent and to forget the whole thing. Tomas' testimony in this regard is not credited for admittedly instead of forgetting the matter he called Mrs. Houdek's attorney for reasons which he was unable to explain on the stand. Tomas admitted the attorney did not cancel the instructions to refrain from trading and testified he could not even recall telling the attorney that Mrs. Houdek said to forget the matter. Mrs. Houdek's attorney testified he told Tomas that Mrs. Houdek did not understand the trading or what the account contained. Tomas also phoned Miss Houdek telling her the attorney's letter upset him and told her that her mother was confused and did not understand what was going on. She told Tomas she did not understand what was happening in the account but her mother wanted the money which previously was in the account deposited in a bank so she could buy a building and would then be satisfied that the account was in fact making money. Tomas told her "it wasn't done that way," that the money "was just as good as being in the bank when it was with him and it didn't have to be deposited." Viewing all of the foregoing leads the hearing examiner to conclude that Mrs. Houdek, from the very beginning of the account, placed her faith and confidence on Tomas and relied on his oft repeated assurances that he knew what he was doing and that she would be able to carry out her primary objective of purchasing a suitable piece of property. The manner in which Tomas responded to the confidence placed in him is illustrated below.

The Transactions in the Houdek Account

As noted earlier the joint account established by registrant for the Houdeks in early March 1968 was both a cash account and a margin account. The margin account appears to have been established about April 1, 1968 although registrant never received a signed margin agreement from either of the Houdeks. Since the documentary evidence in the record, consisting of monthly statements, copies of which were sent to the Houdeks, indicates that only one joint account was maintained with some transactions charged as cash and others as margin, the discussion below makes no distinction between transactions listed as either cash or margin. An analysis of the Houdek account from March 5, 1968 through December 31, 1968 establishes that there were 121 purchases and 118 sales of securities for a total of 239 transactions. During the same period the total cost of securities (including commissions) was \$873,426.75. After deducting the tax and SEC charges the proceeds from sales of securities was \$817,113.96. During the same period the account sustained a trading loss of \$16,359.54. Adding to such loss the interest and miscellaneous charges of \$1,259.37 and deducting the sum of \$239 received in dividends the account suffered a realized loss of \$17,379.91. Realized losses occurred in six of the ten months the account existed.

A further analysis of the account during the 10-month period in question reveals a rate of turnover of 16.8 times based upon the total cost of purchases noted above of \$873,426.75 and an average

monthly investment of \$51,906.31. Additionally the account shows that 41 items were held in the account from a period of zero to nine days, 37 items were held from 10 to 19 days, 17 items were held from 20 to 29 days, 8 items were held 30 to 39 days, 7 items were held 50 to 59 days and 16 items were held for 60 days or more.

The documentary evidence further shows that in the 10-month period the Houdek account generated commissions totalling \$19,474.51 of which \$9,408.24 represented commissions on purchases of securities subsequently sold prior to December 31, 1968, the sum \$9,369.01 in commissions on sales of securities and \$697.26 in commissions generated on purchases of securities which were retained in the account on December 31, 1968. The evidence also shows that the Houdeks deposited \$59,717.57 in the joint account and withdrew a total of \$2,000. The equity in the account as of December 31, 1968 was \$42,652.90. In connection with the commissions generated in the account there is no dispute that Tomas' compensation from registrant was based upon the commissions generated by him. During the year 1968 Tomas' commissions totalled \$97,000 of which \$19,474.51 or 20% was generated by the Houdek account.

On the basis of uncontroverted documentary evidence relating to the amount of money invested in the account, the number of transactions effected in the ten-month period in question, the length of time items were held in the account, the rate of turnover, the amount of commissions generated in the account and giving consideration to age and background of Mrs. Houdek, her financial situation,

the nature of the account established including the aims, needs and objectives of Mrs. Houdek and the relationship established between Tomas and his customer the hearing examiner finds that Tomas willfully violated the anti-fraud provisions of the Securities Acts in that he induced his customers to engage in securities transactions which were excessive in size and frequency in light of the character of the customer's account, established a margin account without the customer's authorization and effected transactions which were not authorized by the customer and contrary to the customer's express orders.

The Commission has consistently held that basic to the relationship between a broker and dealer and his customers in the representation that the latter will be dealt with fairly in accordance with the standards of the profession and that the failure of a broker to disclose that his conduct does not meet such standards operates as a fraud on customers. Mac Robbins & Co., Inc., 41 SEC 116, 118 (1962). In a recent case the Commission further held that a broker who uses his relationship of trust and confidence to a customer to cause an excessive number of transactions in the customer's account commits a fraud upon the customer. Richard N. Cea, Securities Exchange Act Release No. 8662, p. 10 (August 6, 1969). In the instant case the evidence clearly establishes that Tomas not only failed to deal fairly with the Houdeks but deceived and exploited them for his personal gain. In addition to the hearing examiner's conclusion that Mrs. Houdek placed her trust and

confidence in Tomas and relied upon his judgment in connection with the transactions he effected for her account, the hearing examiner further finds that substantially all of the transactions were consummated by Tomas without first obtaining Mrs. Houdek's approval. The record shows he contacted her by phone after the purchase or sale of a particular security and that Mrs. Houdek was, except on two or three occasions at most, never informed of the type of investment being made, the nature of the company's business or its operations or earnings nor did he advise her as to the reasons for any particular sale. The record further reflects that Tomas knew very little of his customer's financial condition other than she had money from the sale of a house left her by her late husband.

As to the aims and objectives of the Houdek's it is clear from the record that Tomas knew, at least from March 26, 1968, when he received the aforementioned \$41,000 check, that her sole concern was the purchase of an apartment house. Indeed, Tomas testified he discussed that matter with her on that occasion assuring her he would help her find a suitable building. On the many occasion Tomas talked with Mrs. Houdek and on the several occasions he talked with her daughter he always assured them there was sufficient funds in the account to purchase the type of house she wanted and that the money would be available to her. However, despite her requests for cash so she could deposit it in her bank account he continued to trade convincing her he knew what he was doing and telling her daughter that Mrs. Houdek was confused and unable to understand what



was going on. Under the circumstances the hearing examiner finds that Tomas failed to act in the best interests of his customers. Instead, he utterly ignored the fiduciary duties owed his customers. It is abundantly clear that Tomas was motivated by the desire to derive the greatest possible income for himself while disregarding the interests of his customers. R. H. Johnson & Company, et al., 36 SEC 467 (1955), aff'd 231 F. 2d 253 (C.A.D.C. 1956), J. Logan & Co., 41 SEC 88 (1962).

The record further shows that at times and certainly after August 27, 1968, when he was advised by Mrs. Houdek's attorney not to effect purchases and sales without first obtaining her express authorization, he effected transactions in the Houdek account which were contrary to Mrs. Houdek's express orders in willful violation of the anti-fraud provisions of the Acts mentioned earlier. With respect to at least one purchase, the acquisition of the Montgomery Ward stock, concerning which Tomas admitted he represented could rise fifteen points, the hearing examiner finds that Tomas made false and misleading statements in the nature of a prediction of a specific and substantial price rise without any facts indicating a reasonable basis for the highly optimistic opinion nor is there evidence he made adequate inquiry of the issuer's securities prior to his prediction. Such conduct was in willful violation of the anti-fraud provisions of the Securities Acts. Alexander Reid & Co., Inc., 41 SEC 372 (1963). The asserted reliance by Tomas on the fact that registrant and others were recommending the stock to customers is

wholly insufficient to justify his predictions. B. Fennekohl & Co., et al., 41 SEC 210 (1962).

Respondent Tomas urges that his conduct comported with the wishes of his customers, that he always obtained the approval of Mrs. Houdek prior to effecting any transactions and that he is not chargeable with the use of the mails or interstate facilities in connection with any of the transactions. The record fails to support any of these contentions and they are rejected. The sole basis for the contention that Mrs. Houdek's approval was obtained prior to any transactions is Tomas' testimony. The hearing examiner does not credit such testimony. After observing both Tomas and Mrs. Houdek on the witness stand the hearing examiner is of the opinion that Tomas rarely, if ever, obtained prior consent. Tomas' testimony that Mrs. Houdek called to establish a margin account because she wanted leverage strains the credulity of the hearing examiner particularly in light of Mrs. Houdek's education, her employment as a seamstress in a factory, her lack of sophistication as an investor <sup>5/</sup> and her inability to comprehend such terms as fixed or current assets, or liabilities or earnings ratio. When asked what earned surplus means responded simply "Well I know when somebody earns the money in the company that earns the money, that is

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5/ The record shows that the Houdek's maintained a joint account at another brokerage concern from November 1957 and that through February 1969 had effected a total of eight transactions. During eight of the twelve years there were no transactions and during any one year there were, at most, three transactions.

all I would understand." There is no substance to the contention that Tomas is not chargeable with use of mails or interstate facilities. The Courts have held that where one commits an act with knowledge that the mails would be used in the ordinary course of business he "causes" the mails to be used. Pereira v. U. S., 347 U. S. 1 (1954); Danser v. U. S., 281 F. 2d 492 (C.A. 1, 1960). Certainly Tomas knew confirmations of his security transactions would be and were being sent by mail to Mrs. Houdek. The numerous phone calls initiated by Tomas to Mrs. Houdek concerning security transactions he effected for her account also constituted use of the means of interstate communication facilities. Lennerth v. Mendenhall, 234 F. Supp. 59 (N. D. Ohio E.D. 1964). See also Myzel v. Fields, 386 F. 2d 718 (C.A. 8, 1967), cert. denied 88 S. Ct. 1043 (1968).

#### Alleged Failure to Supervise

As noted earlier Lord is charged with failure reasonably to supervise Tomas with a view to preventing the violations asserted against Tomas. Lord first became affiliated with registrant in 1960. In approximately September 1967 he became assistant vice president of registrant. There is no dispute that during the ten-month period the Houdek account existed Lord had complete supervision of all the employees at registrant's North Michigan branch office including Tomas, one of the registered representatives. Lord's compensation, in part, came from the net profits generated in the office he supervised. The source of such profits consisted of commissions from transactions effected by registered representatives and interest income.

Lord's first contact with the Houdek account was initialling the new account card for the opening of the account which he admitted was one of his duties. Other than initialling the form he made no inquiry concerning the age, occupation (which was incorrectly stated as real estate saleswoman in Tomas' handwriting), the net worth or investment objectives of the customer. Notwithstanding that a margin account was opened for the joint Houdek account in April Lord admitted he never ascertained whether the required margin agreement had been signed. As a part of his duties Lord was required to examine the monthly statements sent to customers. He testified that he examined approximately one-third or one-fourth of such statements each month and examined the commission runs of each salesman sometime during each month. The latter documents reflected the account number of each customer, the name of the salesman and the total commissions earned by each salesman during the month. Lord further testified that some months after the account was opened he observed that the Houdek account "was a very active account." When pressed as to when he first considered the account active he testified that the May statement reflected the account was very active. He thereupon made inquiry of Tomas concerning the account. The sole question he asked of Tomas was whether Tomas was sure that the customer knew what she was doing and upon receiving a "yes" answer did nothing further and was satisfied.

The record reflects that in June 1968 registrant prescribed various procedures to be followed by those in supervisory positions.

Such procedures were contained in a written office memorandum to "All supervising Officers, Officers and Managers in Charge of Offices" entitled "Supervision" in which among other things the following appeared: "Whenever a supervising officer or officer or manager in charge of an office believes that the activity in an account is subject to question he should see that the attached letter be sent to the client." The memorandum specifically stated that "In reviewing the activity in an account consideration be given to the following general questions - -" including, among others, whether the transactions are effected on the client's own volition whether the transaction resulted from the recommendations of the registered representative, the relationship of the results of the transactions to the commissions charged, the sophistication of the investor, whether the manager has met and talked with the client and if not that he do so. The letter recommended to be sent to the customer pointed out, among other things, that "in and out trading usually produces profits low in relation to our commission charges and often actually results in a net loss to the customer." Lord testified he was familiar with the memorandum but never sent any letter to either of the Houdeks nor did he ever meet or talk to either of them. There is no evidence in the record that Lord ever ascertained that substantially all of the Houdek transactions were upon Tomas' recommendation or initiated, in the first instance, by him. Lord's explanation for the failure to follow registrant's instructions was that he was completely satisfied with Tomas' statement that the customer knew what she was doing. The hearing

examiner finds that Tomas' statement is wholly unsupported by the record.

Early in September 1968 Kennedy, who was registrant's first vice president, informed Lord that he was concerned with the activity in the Houdek account and had requested Tomas to write him a history of the account. On September 10, 1968 Lord received a copy of a letter written by Tomas to Kennedy in which Tomas purports to explain the activity in the account stating that 60% of all activity in the account was initiated by Mrs. Houdek or her daughter and the balance of trades came about due to discussions between Mrs. Houdek and Tomas. Immediately following Tomas' letter Kennedy dispatched a memorandum to Lord advising him that he was accepting Lord's suggestion that no order be accepted from Tomas for the Houdek account without it first being shown to Lord who would talk to Tomas to be certain "it is all right" and suggesting in addition that Lord initial such order. Lord testified he did not see the memorandum until May 1969. The hearing examiner does not credit such testimony in light of the statement in Kennedy's memorandum indicating that Lord had previously suggested to Kennedy that he, Lord, be shown the orders and Kennedy's testimony, that the memorandum was sent to Lord in the regular course of the registrant's operations and if it had not been delivered to Lord he would have been so advised. Kennedy was never informed that Lord had not received the memorandum. The record is clear that Lord never initialled any of Tomas' orders for the Houdek account.

In light of all of the foregoing the hearing examiner finds that Lord was responsible for supervising Tomas and that he failed reasonably to supervise with a view to preventing Tomas' violations of the Securities Acts as found above.

### Public Interest

The sole remaining question is whether remedial action is appropriate in the public interest pursuant to Section 15(b) of the Exchange Act. Considering first the findings relating to Tomas' violations it is abundantly clear that such violations were willful. It is well established that a finding of willfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing.<sup>6/</sup> Tomas' violations were of such a nature that they demonstrate a complete lack of understanding of the relationship which is expected of a salesman in the circumstances here existing. Mrs. Houdek, an elderly widow, whose only occupation was that of seamstress in a factory and concerned with seeking to invest in a small apartment house made that fact clear to Tomas, at the very latest, on March 26 when Tomas came to pick up the sizeable check for a transaction he had effected for her account. Tomas testified he spent quite some time at her home, that she showed him some listings of property she was considering purchasing and solicited his advice concerning the advisability of making a purchase. There is little doubt that this meeting and other conversations Tomas admitted he had with Mrs. Houdek created the type of relationship where his

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<sup>6/</sup> Tager v. SEC, 344 F. 2d 5, 8 (C.A. 2, 1965).

advice, knowledge and experience was both sought and relied upon and that Mrs. Houdek placed her trust and confidence in Tomas. Similarly Mrs. Houdek's daughter was convinced by Tomas that her savings and loan account was unsafe and the money on deposit could be put to better use if transferred to the brokerage account which was making money. Tomas admitted that throughout their relationship he never told Mrs. Houdek that he had sustained losses on any transactions, his explanation being that she was receiving confirmations and monthly statements. The hearing examiner finds Mrs. Houdek was unable to understand the monthly statements which reflected not only purchases and sales but transfers of securities and funds from the cash account to the margin account, transfer funds to the cash account, debits and credits and balances in the account. The monthly statements reflected matters which were, for Mrs. Houdek, complicated and beyond her comprehension. In fact the record reflects that Tomas was aware that Mrs. Houdek was unable to understand the nature of the activities in the account and told her daughter several times that her mother was confused, and that she did not understand what was going on. Mrs. Houdek's trust and confidence in Tomas and the reliance she placed on his representations is best exemplified by the fact that after considerable discussion one evening she was persuaded to turn over approximately \$41,000 to Tomas on the strength of his promise to sell the following morning the stock he had purchased, without her authorization. He did not sell such securities as promised.



The foregoing factors, indicative of the relationship of trust and confidence which existed between Mrs. Houdek and Tomas, when considered along with the excessive trading and rate of turnover, as detailed above, and the fact that substantially all of the transactions were either initiated or recommended by Tomas resulting in substantial losses makes it abundantly clear that Tomas thoroughly disregarded his fiduciary duties and obligations and was motivated solely by a desire to produce the greatest possible commissions for himself. Not only did Tomas not deal fairly and honestly with his customers but lulled them into believing that Mrs. Houdek had more than ample money in her account at all times to purchase her much desired property yet failing to disclose the transactions in which there were losses. Tomas' contention in his brief that Mrs. Houdek's account was treated "with due regard for her financial and social status and well-being" is frivolous in light of the manner in which handled the account. The evidence is overwhelming that Tomas placed himself in a position of trust and confidence and realizing that Mrs. Houdek was confused and unable to understand what he was doing, it is evident that Tomas' conduct manifests a lack of understanding of the fiduciary obligations which in this case were imposed upon him. A salesman in the circumstances here presented, particularly where he knows that the customer is concerned with having enough money to purchase real estate which was here the customer's primary objective, has a basic obligation to deal fairly with the customer and make only such recommendations as

he has reasonable grounds to believe met the customer's express needs and objectives. A mere glance at the highly speculative type of securities which Tomas recommended and indeed purchased clearly indicates he did not meet his responsibilities under that obligation.<sup>7/</sup> The public interest requires that Tomas be barred from association with any broker-dealer registered with the Commission.

With respect to Lord, the findings that he failed reasonably to supervise is amply supported by the record. Lord was in complete charge of the office in which Tomas was employed and received monthly commission runs which reflected total commissions earned by Tomas. Of utmost significance is that Lord knew that registrants' office procedures in 1968 required him, as a supervising officer, to take certain action and initiate certain procedures if an account is subject to question. Lord admitted that the May 1968 transactions were indicative of an actively traded account which would have prompted him to talk to Tomas. Apparently his sole concern when an account is active is to determine solely whether the customer knew what he was doing and Lord's sole explanation for not following required procedure was that after talking to Tomas he was satisfied the account was not "subject to question."

Lord testified that in determining whether an account was excessively traded he applied certain standards or guides

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<sup>7/</sup> See Richard N. Cea, supra, Exchange Act Release No. 8662 (1969).

which included, in addition to the amount of commissions generated, the aims and desires of the customers and his financial condition. It is clear from the record that other than knowing the amount of commissions earned by Tomas Lord never ascertained from the Houdek's their financial condition or their aims and desires. Again Lord's explanation was simply that he was satisfied by Tomas that the customer knew what he was doing. Such explanation and the similar one for not following required procedures are insufficient for one who is charged with supervisory responsibilities and his conduct evinces a failure of proper supervision to prevent violations by Tomas of the anti-fraud provisions of the Securities Acts. In addition, a preponderance of the evidence supports the finding that in September Lord was told by Kennedy to carefully supervise the Houdek account and initial all orders and that he failed to carry out such instructions. At the hearing and in his brief Lord urged that consideration be given to the fact that no complaint was ever made by Mrs. Houdek with respect to any particular transaction. Such an argument was considered by the Commission in The Matter of Reynolds & Co., et al., 39 SEC 902, 917 (1960) where Commission stated:

"Supervisory personnel cannot rely solely upon complaints from customers to bring misconduct of employees to their attention, particularly where customers may be inexperienced and may fail to realize that they have been mistreated, . . ."

In the instant case careful supervision by Lord of Tomas' activities could have prevented the excessive trading as well as the

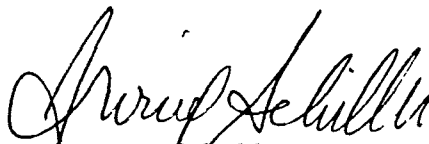
breach of fiduciary obligations of Tomas to his customers. Under all of the circumstances the public interest required that Lord be suspended from association with a broker-dealer for a period of sixty days. Accordingly,

IT IS ORDERED that Gerald P. Tomas be, and he hereby is, barred from being associated with any broker or dealer.

IT IS FURTHER ORDERED that Richard W. Lord be, and he hereby is, suspended from association with any broker or dealer for sixty days.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for review of this initial decision by the Commission within 15 days after service of such decision on him. In accordance with the provisions of Rule 17(f) this initial decision shall become the final decision of the Commission as to each of the parties unless such parties file a petition for review pursuant to Rule 17(b) or the Commission pursuant to Rule 17(c) determines on its own initiative to order review as to each such party. If a party timely files a petition to review or the Commission takes action to review as to a party, this decision shall not become final as to that party.

  
Irving Schiller  
Hearing Examiner

Washington, D. C.  
November 23, 1970