ADMINISTRATIVE PROCEEDING
FILE NO. 3-250

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
M.G. DAVIS & CO., INC. (8-9237) LAWRENCE LEVINE WALTER WAX MORRIS KOPEL HAROLD R. ROSENBERG	:
CRERIE & CO., INC. (8-9152) FRANK CRERIE	:
MARIO TROMBONE ASSOCIATES, INC. (801-2872) MARIO TROMBONE	:

INITIAL DECISION

March 21, 1969
Washington, D.C.

Samuel Binder
Hearing Examiner

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APPEARANCES: Charles Snow, Mortimer Gerber, Morris Rosenzweig, Dennis J. Block and Lawrence Jaffee, Attorneys for the Division of Trading and Markets, Securities and Exchange Commission.

Stanley Kreutzer, Esq. of Kreutzer, Heller, Selman & Galt and ~~Stanley~~ Kleinman, Esq. of Goldenbock & Barell, Attorneys for Respondents M.G. Davis & Co., Inc., Lawrence Levine, Walter Wax and Morris Kopel.

BEFORE: Samuel Binder, Hearing Examiner

These public proceedings were instituted by the Commission on August 4, 1965 pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(d) of the Investment Advisers Act of 1940 ("Investment Advisers Act") to determine (1) whether allegations made by the Division of Trading and Markets ("Division") charging the respondents herein with violations of the anti-fraud provisions of the Securities Acts 1/ in offering, selling and effecting transactions in the common stock of The Cosnat Corporation ("Cosnat") during the period beginning in July 1963 and continuing for several months thereafter are true; (2) what, if any, remedial action is appropriate in the public interest; and (3) whether the withdrawal of M.G. Davis & Co., Inc. ("Davis") as a broker-dealer should be allowed to become effective and, if so, under what, if any terms and conditions.

M.G. Davis & Co., Inc. ("Davis"), a New York corporation, was effectively registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act on March 18, 1961. 2/ At the

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1/ The anti-fraud provisions alleged to have been violated by the respondents are Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. The composite effect of these provisions as applicable to this case is to make unlawful the use of the mails or means of interstate commerce in the purchase or sale of any security by the use of a device to defraud, and untrue or misleading statements of a material fact, or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer or by the use of any other manipulative, deceptive or fraudulent device.

2/ M.G. Davis & Co., Inc., Lawrence Levine, Walter Wax, and Morris Kopel, among other things, brought suit against the Commission and its members to enjoin these administrative proceedings in the United States District Court for the Southern District of New York claiming that a notice of withdrawal from registration filed (continued on following page)

time the Commission instituted this proceeding Davis was a member of the National Association of Securities Dealers, Inc. ("NASD"). 3/

Lawrence Levine ("Levine") since June, 1963 has been an officer, director, principal stockholder and a controlling person of Davis. Walter Wax ("Wax") since June 1963 has been an officer, director, principal stockholder and a controlling person of Davis. Morris Kopel ("Kopel")

2/ (continued from preceding page)
by M.G. Davis & Co., Inc., a registered broker-dealer with the Commission had become effective prior to the institution of these proceedings, and that therefore the Commission should be enjoined from any further administrative action against them. The District Court denied plaintiff's application for a preliminary injunction, dismissed the complaint, and granted summary judgment in favor of defendant Securities and Exchange Commission. M.G. Davis & Co., Inc. v. Cohen, et al., 256 F. Supp. 128 (1966), and the District Court's order was affirmed by the Court of Appeals for the Second Circuit 369 F.2d 360 (1966). During the course of the litigation and pending disposition of the matter by the courts, the administrative proceedings were adjourned from time to time. Thereafter, hearings were held in this administrative proceeding until December 5, 1967 when, after the taking of more than 3800 pages of testimony and after numerous exhibits had been received in evidence, the direct case of the Division was completed. At that time the then presiding hearing examiner reached the age of 70. The respondents remaining in these proceedings refused to waive objections to such hearing examiner presiding beyond the age of 70 and advised the Commission that rather than continue this proceeding with the then hearing examiner they chose to discard the entire record then made and start the taking of evidence, ab initio, with a new hearing examiner. On March 7, 1968 the undersigned was substituted as the hearing examiner and was directed by the Commission to preside in this matter and file an initial decision to be based solely upon evidence thereafter adduced, unless waived by the parties, and without consideration of any of the evidence theretofore received in the record, except such portions thereof as might be agreed upon by the parties. Thereafter, on the resumption of the hearing before the undersigned hearing examiner, counsel for respondents then remaining in the proceeding and counsel for the Division of Trading and Markets stipulated that the complete record and the transcript of proceedings including all the exhibits theretofore received be considered by the undersigned with the same force and effect as if originally heard and received by him, in the same manner as originally testified to, and that the exhibits marked in evidence be deemed exhibits for all purposes in this proceeding, unless otherwise indicated.

3/ The Division did not seek an order expelling Davis from the NASD and the hearing examiner infers from the Division's proposed findings that Davis at this time is not now a member of the NASD.

was a registered representative of Davis from approximately July 1963 to sometime in November 1963. Harold R. Rosenberg ("Rosenberg") was a registered representative of Davis from approximately July 1963 to sometime in September 1963.

Crerie & Co., Inc. a New York corporation ("Crerie & Co.") became effectively registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act on January 6, 1961, and was a member of the NASD when the Commission's order was issued.

Frank Crerie ("Crerie") has been the sole officer, director and the owner of 10 per cent or more of the equity securities of Crerie, Inc. since January 10, 1964 and since January 6, 1961 has been an officer, director and owner of 10 per cent or more of the equity securities of Crerie, Inc.

Mario Trombone Associates, Inc., a New York corporation ("Trombone") became effectively registered with the Commission as an investment adviser pursuant to Section 203(c) of the Investment Advisers Act on April 11, 1962. Mario Trombone ("Trombone") has been an officer, director and owner of 10 per cent or more of the equity securities of Associates from the date of its application for registration. 4/

4/ On April 2, 1968 and June 6, 1968 the Commission accepted proposals of settlement submitted on behalf of respondents Crerie & Co., Inc., Frank H. Crerie, Mario Trombone Associates, Inc., and Mario Trombone (in which they neither admitted or denied the allegations made in the Commission's order), and the Commission issued orders by which the broker-dealer registration of Crerie & Co., Inc. and the investment adviser registration of Mario Trombone Associates were withdrawn; Frank H. Crerie was barred from engaging in the securities business or from becoming associated with a broker-dealer without prior approval of the Commission, and Mario Trombone was barred from engaging in the business of a broker-dealer or investment adviser for ninety days after the Commission's order approving the offer of settlement, or until the final disposition of an indictment pending against Trombone in the United States District Court for the Southern District of New (continued on following page)

The Division alleged that beginning in July 1963 and continuing for several months thereafter the respondents Davis, Crerie, Inc., Levine, Wax, Kopel, Rosenberg and Crerie, singly and in concert with others, wilfully violated and with Associates and Trombone wilfully 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 and employed devices, schemes and artifices to defraud in offering, selling and effecting transactions in the common stock of The Cosnat Corporation ("Cosnat"), and that in connection with these activities Davis and Crerie, Inc. singly and in concert wilfully violated and Levine, Wax, Kopel, Rosenberg, Crerie, Associates and Trombone wilfully aided and abetted violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder.

The respondents filed answers denying generally the Division's charges and with the exception of Crerie, Inc., and Crerie, Associates, and Trombone, all the respondents admitted that they had "disseminated a market report prepared by Mario Trombone Associates, Inc. describing the present business and earnings of "THE COSNAT CORPORATION AND ITS FUTURE PROSPECTS". Crerie, Inc. and Crerie denied generally all the

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4/ (continued from preceding page)
York, whichever is longer. The Commission's order instituting these proceedings also alleged that Crerie, Inc. and Crerie violated and aided and abetted violations of Section 17(b) of the Securities Act. The hearing examiner considers that the Commission made a disposition of this allegation when it issued its order accepting the settlement proposal made by Crerie, Inc. and Crerie and that this issue is no longer before him for purposes of this initial decision.

allegations of the order charging it with violations of the anti-fraud provisions. Associates and Trombone also denied that it had violated the anti-fraud provisions and asserted that it had prepared from information both written and oral submitted to it by The Cosnat Corporation, its officers, directors, employees and representatives, a report and magazine article, relating to the business and affairs of The Cosnat Corporation and that it prepared reports, articles and press releases which were disseminated only after obtaining the prior approval of Cosnat's management. The report referred to was referred to in the proceedings as the Crerie Report and the magazine article was one which appeared in the November 1963 issue of Stock Market Magazine and the releases were referred to as Tromson Financial Reports.

Following the conclusion of the hearings held in this matter the Division filed its proposed findings of fact, conclusions of law and a supporting brief, the respondents Davis, Levine, Wax, Kopel and Rosenberg filed their proposed findings of fact and conclusions of law and a supporting brief, the Division filed a reply brief, and the matter was certified to the undersigned on January 22, 1969 on the record as of the latter date to prepare his initial decision. Thereafter, counsel for the respondents addressed a letter to the hearing examiner dated February 4, 1969, discussing the reply brief and various issues raised in these proceedings. In substance, counsel's letter of February 4, 1969 is a brief replying to the Division's reply brief. The Division responded by a letter dated February 13, 1969, which, in pertinent part

contended that the sending of respondents' letter was inappropriate. The Division "strongly urges" that the record be considered closed as of the date of its reply brief and that counsel's letter "be excluded from any consideration in this proceeding."

As the Division correctly pointed out in its letter of February 13, 1969, "In order to properly be considered as part of the record in this matter, it [i.e., respondents' letter of February 4, 1969] should have been preceded by an application to reopen the case. If granted, the Division would normally be given an opportunity to reply. Such responses could go on indefinitely."

Rule 16(e) of the Commission's Rules of Practice makes no provision for briefs to be filed subsequent to the filing of a reply brief.

In respondents' letter of February 4, 1969 counsel states that the respondents do not agree with the views expressed in the Division's reply brief to the effect that respondents "have not controverted any of Division's Proposed Findings of Fact and that absent specific counter-proposed findings of fact to offset Division's findings, it is fair to assume all of Division's proposed findings are adequately and properly supported by the record."

The record in this proceeding reflects that respondents have rarely, if ever, agreed with the Division on any material aspect of this proceeding and accordingly, the hearing examiner would not have assumed and does not assume that respondents agreed with the contentions or assumptions advanced by the Division in its reply brief. The

assumption made by the Division regarding the respondents' proposed findings and brief is essentially argument and as such it has been considered with all the other arguments made by all the parties to this proceeding. In any event what has to be determined here is whether or not the evidence in this record standing on its own feet supports the charges made by the Division. Such a determination can be made only on the basis of the record made in this proceeding and could not properly rest simply upon an assumption made by the Division on the basis of the failure or the alleged failure of the respondents to respond more directly or specifically than they have to the Division's proposed findings and conclusions.

It should also be observed that the greater part of the comments made in the respondent's letter of February 4, 1969 deal with issues on which the respondents have stated their position repeatedly and at great length during the hearings held herein and on which they have further expressed themselves in lengthy oral argument, and in their proposed findings of fact and conclusions of law and supporting brief. To a substantial degree counsel's letter is a restatement of positions previously expressed by the respondents during oral argument and at other times during the hearing.

Under these circumstances and in view of the provisions of Rule 16(e) of the Commission's Rules of Practice it is not appropriate, necessary or desirable to include the respondents' letter of February 4, 1969 as a part of the formal record of these proceedings.

The Division contends that the evidence presented in this proceeding establishes that the respondents in selling Cosnat stock engaged in a scheme to defraud investors by means of a persistent high-pressure selling campaign which, among other things, included the use of materially false and misleading selling literature implemented by telephone solicitations engaged in by Davis' salesmen and Crerie who misrepresented the material facts concerning Cosnat. In this connection the Division charged that the respondents mailed and delivered a market letter called the Crerie Report which contained materially false and misleading statements about Cosnat, a reprint of an article prepared by Associates which appeared in "Stock Market Magazine" for November 1963 which contained misrepresentations substantially similar to those in the Crerie Report and that respondents employed certain documents, principally press releases prepared by Associates and Trombone, called Tromson Financial Reports which were also false and misleading. In addition, the Division contends that Davis furnished salesmen including Kopel and Rosenberg with a draft of the Crerie Report bearing the legend "FOR OFFICE USE ONLY - NOT FOR DISTRIBUTION" to be used by them in repeating misrepresentations contained therein to customers concerning Cosnat stock and that in at least one instance despite the legend this report was delivered to an investor by Kopel.

The Division contended that the Crerie Report contained false and misleading representations concerning, among other things, Cosnat's

net income for the fiscal year ending September 30, 1962 and for the six months ending March 31, 1963, Cosnat's future earnings, the manufacturing capacity of its principal subsidiaries, referred to during the proceedings as the Monarch Record Group, the dollar increase in sales of phonograph records to be made to the General Services Administration ("GSA") under a contract to supply military and civilian installations, Cosnat's plans for additional centers for distribution of phonograph records, Cosnat's activities in the production of motion pictures, and Cosnat's negotiations, alleged to be in progress, for the merger or the acquisition of three companies in the record or related fields. The Division also charges that concommitantly with such fraudulent merger or acquisition representations, the respondents represented that these negotiations would enable Cosnat to refinance some of the company's exceedingly large debt owed to factors on which the company was paying very high interest rates with an institutional loan which would substantially reduce its interest expenses to about one-half of its then current costs.

Furthermore, the Division contends that there was no reasonable ground for statements in the Crerie Report that, if the negotiations alleged to be in progress proved successful the result would be an improvement in the merged company's earnings to $1 per share during 1964. In addition, the Division contended that Crerie as well as Kopel and Rosenberg, Davis' registered representatives, embellished and further enlarged and exaggerated the false and misleading statements distributed

by Davis in the Crerie Report concerning Cosnat stock in a high-pressure telephone selling campaign in which such representatives not only placed telephone calls in New York City, but made telephone calls to investors in Indiana, Connecticut, Pennsylvania and New Jersey as well. In these telephone calls the Division claimed that the evidence established that Davis' registered representatives made additional false and misleading statements in which they told investors that Cosnat stock would shortly be listed on a national securities exchange, that an acquisition or merger of Cosnat with three other companies was being negotiated which would result in substantially increased earnings for Cosnat, that the company would pay dividends, and predicted without reasonable basis a dramatic rise in the market price of Cosnat stock in a short time, and asserted that Cosnat was about to acquire a motion picture production company, that Cosnat had signed a contract with GSA which would add $2,000,000 to its sales per year, misrepresented the facts relating to Cosnat's past and future earnings and omitted to furnish members of the public adequate information about Cosnat's very large indebtedness to factors and the extremely high rates of interest being paid to such factors by Cosnat.

The findings and conclusions made herein are based upon the preponderance of the evidence as determined from the record and upon consideration of all the proposed findings of fact, conclusions of law and the supporting briefs submitted herein as well as on the oral arguments made in the course of these proceedings.

Cosnat filed a registration statement on Form S-1 with the Commission on May 26, 1961 covering an offering of $1,250,000 of its 6% convertible debentures due 1977. 5/

The registration statement disclosed, among other things, that Cosnat was incorporated in Delaware on January 8, 1960 to acquire a phonograph record distributing business which originated in 1946 and the company was engaged at that time solely in the business of distributing records throughout the United States until early 1961 when it acquired Monarch Record Mfg., Etan Products, and Monarch Enterprise ("Monarch Record Group") which had manufactured records since 1945. With this acquisition Cosnat entered the business of manufacturing records. Late in 1961 the company acquired an affiliate Jay-Gee Record Company, Inc. ("Jay-Gee") which had produced records since 1947 and thus the company entered the field of producing records.

The registration statement disclosed, among other things, that

> "The operations of the distributing enterprise have resulted in a low profit margin in 1959 and 1960 and a substantial loss in 1961. In this connection the registration statement discloses that the operation of Cosnat resulted in net profits after taxes equal to 1.5% of sales in fiscal 1959 and .5% of sales in fiscal 1960 and a net loss equal to 3.0% of sales in fiscal 1961."

Cosnat also stated that

> "The sales of the producing enterprise, [i.e. Jay-Gee] whose operations may be subject to unpredictable public taste, have fluctuated volatilely. Its operations resulted in inconsequential profits in 1957, 1958 and 1960 and a substantial loss in 1959. The company believes that the profit

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5/ This registration statement never became effective and was withdrawn on March 22, 1963. Quotations and other references to the registration statement are derived from Amendment No. 5 to such statement filed September 27, 1962.

of the producing enterprise after taxes for 1961 is largely attributable to the popular success of recordings by Rusty Warren (an artist under exclusive contract) and to an available tax loss carried forward."

With regard to its branches employed in the distribution of its records, Cosnat reported in its registration statement that:

"Cosnat has endeavored to counteract reduced profit margins by increasing its sales. Thus, while some existing branches have shown a decline, new branches have been opened in other areas. During the period of initial growth, it is expected that a new branch will show losses since a new branch results in the first instance in increased selling and administrative costs out of proportion to net sales. Although volume of sales is actually on the increase, the opening of these branches has contributed to the reduction of income of Cosnat which during the fiscal 1960 amounted to approximately $36,000 and during fiscal 1961 to approximately $156,000, thereby resulting in a loss for fiscal 1961. Cosnat's 1961 earnings were also adversely affected by non-recurring expenses occasioned by the acquisition of the Monarch Record Group. Management believes that the decline in the ratio of its sales to inventory is attributable to the shift in emphasis to LPs (which move more slowly than singles), the increased initial inventory required to stock new branches and the increase from year to year in the number of labels handed. The operation of Cosnat resulted in net profits after taxes equal to 1.5% of sales in fiscal 1959 and .5% of sales in fiscal 1960, and a net loss equal to 3.0% of sales in fiscal 1961."

Cosnat's registration statement also sets forth that:

"During the fiscal years 1957 through 1961, the combined earnings of Cosnat and Jay-Gee have varied from a loss of approximately 1.5% of sales to a profit of approximately 1.5% of sales. Combined with the manufacturing portion of the business under the Monarch Record Group for the same period, the profit rate would vary from about .7% to 3.5% of sales. Generally speaking, all phases of this industry would probably be adversely affected during the periods of regional and/or nationwide depression or under a wartime economy, since its products are not classifiable as necessities."

Stripped down to its essentials the material facts regarding the Monarch acquisition may be summarized as follows:

Cosnat acquired the stock of Monarch Record Group from DuRoff and Rothstein, its controlling stockholders on March 20, 1961 by the expenditure of cash in the amount of $1,025,000 which it borrowed from factors and the issuance of shares of its Class A stock 10¢ par value. As additional consideration for the acquisition, Cosnat gave DuRoff and Rothstein and various other persons 47,314 shares of its Class A 10¢ par value stock having a stated value of $120,000. The cash and stock thus amounted to $1,145,000. Further, Cosnat paid professional persons associated with the Monarch acquisition for their services an additional 25,000 shares of Cosnat's Class A Stock 10¢ par value having a stated value of $42,500. Thus the total price paid for the acquisition of the Monarch Record Group by Cosnat was $1,187,500.

In addition, the purchase agreement provided that two of Monarch's stockholders, namely, DuRoff and Rothstein would be employed for five years for $57,500 each per year and further, that DuRoff and Rothstein would be given insurance policies on their lives aggregating $150,000 each in which the Monarch Record Group was to be named beneficiary.

Cosnat did not have the financial means to buy the stock of Monarch Record Group. Accordingly, to finance the acquisition of Monarch Record Group Cosnat borrowed money from factors at very high rates of interest, namely, interest ranging from 10% to 15% per annum. It

borrowed $550,000 from Alben Affiliates, $350,000 from Jones & Co., and $375,000 from Mobile Discount Corporation, a nominee of Alben Affiliates. The total amount borrowed from such factors was $1,275,000.

In this connection it should be noted that the loan from Alben Affiliates in the amount of $550,000 bore interest at 10% per annum until April 1, 1962 at which time the interest rate was increased to 12%. These notes were evidenced by a series of fifty-five $10,000 notes, two maturing every Monday and two every Thursday commencing March 27, 1961 and concluding June 19, 1961. These notes were renewed for four successive periods of 120 days. As these notes became due and payable commencing July 20, 1962, they were further extended for 120 days. These loans are secured by a pledge of the stock of Monarch Record Group and Jay-Gee, a lien on the assets of Monarch Record Group and a pledge of the company's accounts receivable.

Cosnat also borrowed $298,500 and Jay-Gee borrowed $51,500 which it immediately loaned to the company (i.e. a total of $350,000) from Jones and Company against a pledge of accounts receivables in accordance with standard factoring arrangements. The loan balances vary from day to day and accounts are collected or additional sums are borrowed for general corporate purposes. These loans bear interest at the rate of 1/24% per day on a daily basis, i.e., approximately 15% per annum.

Jones and Company advanced 65% of the amount of the pledged accounts and upon their collection remits the other 35% to the company. These

loans are also secured by pledges of the stock of the Monarch Record Group and of Jay-Gee. Of the $350,000 initially borrowed from Jones and Company, $200,000 was used to complete the $600,000 for the Monarch closing and $150,000 was used to repay a loan payable to a bank. As of June 30, 1962 the Jones and Company loan balance was $561,346. In this connection, accounts receivable totaling $813,488 were pledged as at June 30, 1962.

On September 27, 1962, the company also borrowed $375,000 from Mobile Discount Group, a nominee of Alben Affiliates. The $375,000 loan from Mobile Discount is evidenced by thirty-eight six-month notes bearing 12% interest and is secured by a lien on all of the assets of the Monarch Record Group, a lien on the capital stock of the Monarch Record Group and Jay-Gee, a pledge of the company's accounts receivable, the personal guarantees of Messrs. Jerry Blaine and Elliott Blaine, and a pledge of 100,000 shares of Class B Stock of the company owned by Jerry Blaine. In this connection Messrs. Broznan and Holman were issued 5,000 shares of Class A Stock and Arthur Meyer was issued 5,000 shares of Class A Stock on account of services rendered in arranging the loans from Alben Affiliates and Jones and Company and negotiating the Monarch Record Group acquisition.

Cosnat's attempt to offer debentures to raise $1,250,000 from the public stemmed from its tight capital position and lack of working capital brought about by its purchase of the Monarch Record Group in March 1961 with monies borrowed from factors.

The Monarch Record Group consisted of three companies called Monarch Record Mfg., Monarch Enterprises and Etan Products, Inc. With the exception of a very small amount of sales in novelty items, its business consisted solely of the manufacture of records for label owners. In this connection Cosnat under the heading "PROCEEDS" in the registration statement sets forth the uses which it would make of the proceeds it hoped to obtained from the public as follows:

> "The net proceeds to the Company from the sale of the debentures offered hereby are estimated at $1,070,000. These proceeds will be used in the following order: (1) $375,000 will be used to repay the loan from Mobile Discount Corp; (2) $45,000 will be used to pay a note given by the Company to Mortimer B. Burnside & Co., Inc. in partial payment for the repurchase of 12,000 shares of Class A Stock . . .; (3) $500,000 will be used to repay the loan from Alben Affiliates; and (4) the balance of the proceeds will be applied to reduce the indebtedness to Jones & Co., which as of June 30, 1962 was $561,346 . . . By refinancing part of its debt, the Company believes it will be able to acquire open lines of credit or obtain loans on terms more favorable than those presently available to it. Funds thus borrowed . . . together with those arising from the operations of its business, will be applied to payment of the balance of the Jones & Co. loans. There is no assurance that such loans can be obtained or, if obtained, that the terms thereof will be more favorable than those obtained in the past, nor can any assurance be given as to the amount, if any, of funds arising from the operations of the Company's business that will be available for payment of the Alben Affiliates' loans. The proceeds from the sale of 15,000 shares of Class A stock to Van Alstyne, Noel & Co., [the underwriter] if it should exercise the options granted by the Company, will be added to the general funds of the Company."

It will be observed that the company owed over $1,400,000 to factors. The major purpose of seeking this public financing was to repay the factors and get rid of the extremely high interest rates

Cosnat was paying to the factors.

Following the acquisition of Monarch Record Group, Cosnat owed factors approximately $1,250,000 and despite the high interest cost it was paying to such factors it was not in a position to repay such loans.

Prior to borrowing money from factors to acquire Monarch Record Group, Blaine the president and principal stockholder of Cosnat, had visited Amos Treat & Co. and Van Alstyne Noel & Co., underwriters with Levine and Crerie in an effort to get financing to acquire Monarch. However, these efforts were unsuccessful and accordingly Cosnat obtained money from the factors to buy the Monarch Record Group.

Levine assisted Cosnat and Blaine in acquiring Monarch and was paid substantially for his services in such acquisition. Levine was a friend of Jerry Blaine and conferred with him frequently regarding Cosnat's business and financial condition and was fully familiar with its business and financial problems during all periods pertinent to this proceeding.

The respondents requested the hearing examiner, inter alia, to make and adopt the following:

> "During the course of the long-standing and still-continuing relationship between Levine and Cosnat, 'virtually every aspect of the company's operations were discussed' and Levine attended and participated in many conferences of Cosnat officials, including its general counsel, auditors and other executive officers."

The hearing examiner makes the finding requested.

Prior to the large borrowing from factors Blaine had hoped and expected to get financing by an offering to the public through underwriters. As he explained,

> " . . . the company needed financing, we had hocked our receivables in order to purchase the business plant, based on the financing publicly, and that didn't come through. So we had to use other ways and means of trying to get outside financing."

In amplifying what he meant by "hocking" Cosnat's receivables, Blaine testified that

> " . . . it was supposed to have been for a short period of time with a factor. It was supposed to be presumably about three months, until the issue would come out with Amos Treat, but Cosnat was never able to get financing through underwriters to discontinue its factoring arrangements."

Blaine continued his efforts to get financing for Cosnat so that the company as he put it could get out of "hock" to the factors.

It was in this connection that Blaine approached the managements of three companies, namely, Atlantic Record Corp. ("Atlantic") Globe Albums, and Sun Plastics, Inc. ("Sun") in about May 1963 for the purpose of exploring the possibility of merging such companies with Cosnat and during the same general period he also approached McDonnell & Co. seeking its assistance in raising capital in connection with his attempts to merge with Atlantic, Globe and Sun.

It was during this period of time that Davis and Crerie started in July 1963 to distribute to the public a market letter called the Crerie Report. Levine, Crerie and Trombone cooperated in the preparation of the Crerie Report and 5,000 copies were printed. Levine conceded

that Davis distributed between 300 and 500 copies of the report.

Prior to the time that the Crerie Report was printed Jerry Blaine told Levine that "Crerie was doing a study on the Cosnat Corporation and that this study was being done in a broad sense for the purposes of seeking financing." Levine also testified that he met with Crerie "to pick his brain" . . . and give him any assistance of what I might have known". Between on or about June 27, 1963 and on or about October 25, 1963 Davis through the efforts of Wax, Levine, Rosenberg and Kopel sold approximately 37,000 shares of Cosnat to approximately 150 public investors by use of the Crerie Report, the reprint of the Stock Market Magazine, the Tromson Financial Reports which contained materially false and misleading statements as well as by materially false and misleading representations made orally by Davis' registered representatives.

While Davis and its registered representatives were extolling the virtues of Cosnat as an investment to members of the public, insiders of Cosnat namely the secretary of the company, Elliott Blaine, sold approximately 4,600 shares in July, 1963, Michael Lipton, then sales manager of Cosnat sold approximately 2,200 shares in July, 1963, Irwin Lisabeth, an executive of Cosnat and Blaine's son-in-law sold approximately 5,000 shares in July 1963, and Charles Gray, principal in charge of Cosnat's Detroit subsidiary sold approximately 10,000 shares in July and August, 1963. Levine was personally fully aware of these sales. However, there was no inkling that while Davis was engaged in its selling campaign, that any of its salesmen told any

members of the public of such sales by insiders.

The Crerie Report stated on its frontspiece that

> "Upon occasion, a situation arises which offers unusual investment opportunities. Such a situation often prevails when a corporation is entering a period of remarkable expansion stemming from a series of developments, all of which appear to be converging simultaneously. The Cosnat Corporation, the nation's largest independent distributor of phonograph records, finds itself in just such circumstances at this time."

Page 4 of the Crerie Report states, in pertinent part, that

> "Negotiations are in progress for the acquisition of three companies in the record or related fields. If the negotiations are successful these acquisitions would enable Cosnat to increase its sales to $16 million plus . . . . Negotiations are also underway to refund some of the present debt with an institutional loan which could substantially reduce expenses, perhaps to as much as half the current cost. The company believes that should the negotiations now in progress prove successful, it could earn at the rate of $1 a share during the ensuing year."

At page 3 of the Crerie Report there appears a table labeled "INCOME STATISTICS" which, among other things, purports to show Cosnat's "earnings per share" for the fiscal years ended September 30, 1959 through September 30, 1964, the latter figure being referred to as "prospects" and the period labeled "Year To 9-30-63" labeled as "Estimates".

The figure for fiscal year 1964 showed earnings of $1.00 plus per share on the basis of 460,000 shares.

These representations distributed to public investors were buttressed by representations, among others, made principally over the telephone to members of the public by Crerie and Davis' salesmen, particularly Kopel and Rosenberg, that this merger would be of great financial benefit to Cosnat and they predicted earnings for Cosnat of over $1.00 per share for fiscal year 1964.

The Division charges that these representations as well as numerous other representations contained in the Crerie Report were materially false and misleading. The facts upon this particular issue are as follows:

A meeting initiated by Jerry Blaine was held in mid-May 1963 in the offices of Atlantic Records. Present at such meetings were Jerry Blaine and the principal officers of Atlantic Recording Corporation ("Atlantic") Globe Albums, Inc. ("Globe") and Sun Plastics, Inc. ("Sun").

The largest of these corporations was Atlantic. Atlantic is engaged in the manufacture, distribution and sale of phonograph records as was Cosnat. Sun is engaged solely in the manufacture of phonograph records for others. Globe Albums is engaged solely in the manufacture of covers for phonograph records.

Cosnat had done business with the companies represented at the conference. It had distributed some records for Atlantic, had some records "pressed" by Sun and had bought some covers from Globe Albums.

Wexler, executive vice-president and general manager of Atlantic testified without contradiction that he had known Blaine for about 15 years before this meeting and that Blaine for a period of approximately 5 years theretofore and at any time Atlantic was flourishing referred to Cosnat and Atlantic "getting together". All of these conversations were initiated by Blaine.

Wexler was suspicious of Blaine's motives in proposing such merger and in this connection insisted that Blaine show him some economic advantage to Atlantic before he would recommend that his company consider such proposed merger. No such advantage was ever shown him by Blaine. Wexler also knew that Cosnat was strapped for cash

and "suffered" some "under financing". Cosnat's straitened cash position and its obligations to creditors were always the nub of these conversations between Wexler and Blaine.

Wexler told Blaine that the latter's "debt situation was a matter of concern of [Atlantic] and that under no circumstances would [Atlantic] affect a merger with [Cosnat] under which [Blaine] could use [Atlantic's] assets and [its] cash to liquidate [Cosnat's] debt problem because that would be very self-serving for [Cosnat] and [Wexler] couldn't see advantages for us."

Blaine asked Wexler if Atlantic would be interested if Cosnat could clear up its debt problems and Wexler told Blaine that if Cosnat could do that "we would entertain evaluating a fresh proposal" from Cosnat.

Blaine never indicated to Wexler that he had ever cleared up his debt situation. According to Wexler, Blaine's idea was that if Cosnat Atlantic, Sun, and Globe could merge and become one company, there would be a great advantage to all in that the company would own its sources of supply and distribution, and that if they could get together they could create a "conglomerate made up of these ingredients" and that the parties "would receive shares in the merged corporation in proportions relative to their contributions to the new entity."

No agreement of any kind was ever reached at this meeting and nothing was committed to writing. Wexler said at the meeting that "We should immediately evaluate the worth of each company and that could best be

done, I suggested by examining the figures before it would be relevant to continue any further". The meeting with Blaine according to Wexler was only exploratory in character. Nothing of substance in regard to a merger was agreed upon by any of the parties. Thereafter, the conferees submitted financial statements to Fred Landau & Co. Cosnat's accountants for the purpose of formulating a pro forma financial statement which would give some idea of what a merged company would look like financially. Except for the one meeting in May, 1963, at which nothing was decided of a substantive character regarding the merger, there were never any further meetings with Cosnat by Atlantic with regard to this matter.[5a/] Occasionally Blaine initiated discussions with Wexler regarding this matter during the summer of 1963 but no proposal was ever agreed to by Wexler. On July 19, 1963, Wexler received from Blaine a letter which he requested by telephone that Wexler sign. This letter which Blaine requested Wexler to sign on behalf of Atlantic was addressed to the Cosnat Corporation and stated:

> "We have an understanding whereby at a meeting held on June 19th, between The Cosnat Corporation and the Atlantic Recording Corporation that Atlantic will sell all of their assets to The Cosnat Corporation for the amount of 440,000 shares of common stock of The Cosnat Corporation, providing, that The Cosnat Corporation will secure a firm commitment for $1,500,000 in long term debt to eliminate the factors.
>
> Very truly yours,
>
> ATLANTIC RECORDING CORPORATION"

After Wexler received this document he telephoned Blaine and told him he would not sign it. Blaine expressed disappointment and said that if Wexler would sign the document it would help him to accomplish

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5a/ Merrill Halpern went to Atlantic with Blaine but no definitive discussions related to a merger took place.

the refinancing of Cosnat. Wexler told Blaine that it was "nonsense" and that he would not sign it nor would he put such a document in Blaine's hands. Wexler told Blaine he would not sign any such document before he got financing and that Blaine never showed Wexler any documents which would show such financing. Wexler testified that during periods pertinent thereto no negotiations were in progress for either the acquisition or a merger between Cosnat and Atlantic in any form. Later in the summer or early fall of 1963 Wexler told Blaine that he was distrubed about rumors in the industry that Atlantic and Cosnat were to merge, that such rumors did not emanate from Atlantic and that they were damaging to Atlantic. Finally, Wexler caused a story to be published on October 26, 1963, in Billboard, a trade magazine, in which he vehemently denied rumors that Atlantic and Atco would merge with or sell its assets to Cosnat Distribution Corporation.

The principals in Atlantic after analyzing Blaine's last financial figures available to them and disclosed in the pro forma statements prepared by Cosnat's accountants notified Blaine that any proposed further discussions involving a merger could not be held.

Wexler denied that any transaction to sell Atlantic had taken place and added that "their only relationship with Cosnat is that they distribute for us in some areas but I never mind taking Blaine's money on the golf course."

Atlantic never authorized any person during the spring, summer or fall of 1963 to state publicly or privately that negotiations were

were in progress with regard to a proposed merger between Cosnat, Atlantic, Sun and Globe. In fact, Wexler testified that he had a distinct understanding to the contrary. It was Wexler's opinion as a participant in the discussions that no negotiations of this character were ever feasible and as he pointed out on numerous occasions to Blaine, Cosnat's financial conditions precluded the effectuation of any merger.

After Wexler saw the consolidated pro forma report in early October 1963, Atlantic refused to continue any further discussion with Cosnat concerning any proposed merger.

Moe Silvers the former president of Sun Plastics testified that his corporation had done business with Jay-Gee, a subsidiary of Cosnat and that they had pressed records for such company under different labels controlled by Cosnat; that he had been familiar with Jay-Gee from about 1959 or 1960; that his company had done between $15,000 and $20,000 a year in business with Cosnat. Silvers said that Cosnat had approached his firm several times about buying Sun's business and that in May 1963 there was a meeting at the offices of Atlantic records which he attended on behalf of Sun.

Blaine at such meeting proposed a merger of all of the companies and they met for about an hour. That during such meeting it was agreed that each of the companies would submit a financial statement to Blaine's accountants Fred Landau & Co.; that his firm had done so; that there was no discussion as to the terms of any merger and no discussion of the "prices" to be paid in connection with such merger;

no papers were signed and no letter of intent was prepared at such meeting. Following the meeting Silver instructed his accountant to prepare a financial statement for submission to Fred Landau & Co.

Nothing ever happened in connection with the merger thereafter, and there were no further communications and no further conversations.

At Mr. Blaine's request on August 15, 1963 he addressed the following letter to Cosnat:

"Jerry Blaine:

We have an understanding, whereby at a meeting between Cosnat Corporation, Sun Plastics Co., Inc. and Dynamic Hi Stereo Record Pressing Co., held on June 19, 1963 that Sun Plastics Co., Inc. and Dynamic Hi Stereo Co. will sell all of their assets to Cosnat Corporation, providing that Cosnat Corporation will secure a firm commitment for $1,500,000 long term debt to eliminate their indebtedness to Factors.

Very truly yours,

Sun Plastics Co., Inc."

Dynamic Hi Stereo Record Pressing Company is a subsidiary of Sun.

The letter was dictated by Blaine to a secretary in Silvers' office. So far as Silvers was concerned he was always willing to sell his business providing Blaine had the money to buy Sun Plastics, but nothing ever came of the discussions and the letter dictated by Blaine and signed by Silvers contained no provision reflecting the terms of any merger with Sun nor did the letter reflect the consideration to be paid by Cosnat for the acquisition, and made no reference to Atlantic. Silver had never had any discussion with Blaine prior to the meeting in May 1963 and the only discussion that he had thereafter

was in August 1963 when at Blaine's request he signed the letter which Blaine had dictated.

Silvers testified that nobody either favored or was opposed to the merger but at the suggestion of Atlantic's executives they decided to have accounting statements prepared so that they would have some idea of what the merged company would look like, but nothing had ever come of such discussion. He also testified that the letter quoted above related only to a possible deal between Sun Plastics and Cosnat and had nothing to do with any merger.

Globe Albums had done business with Cosnat for 8 or 9 years. Lee Halpern, the president of Globe was called as a witness. His memory of the May meeting at Atlantic's offices appeared to be somewhat dim He testified that he could not recall what was concluded at the meeting held with Atlantic concerning the formation of one corporation out of all four corporations represented at the meeting. Thereafter he recalled that Globe supplied financial statements to Fred Landau & Co. Thereafter some time elapsed and he heard subsequently that the deal or merger was "off" but he has no recollection of when he obtained such information. On August 15, 1963 Halpern signed a letter reading as follows:

"Gentlemen:

> We have an understanding whereby at a meeting held on June 19th, 1963, between The Cosnat Corporation and Globe Albums, Inc. that Globe Alubms, Inc. will sell all of their assets to The Cosnat Corporation providing, that The Cosnat Corporation will secure a firm commitment for $1,500,000.00 in long term debt to eliminate the factors.
>
> Very truly yours,
>
> Globe Albums, Inc.
>
> LEE HALPERN
> President"

The testimony of Wexler, Silvers, and Lee Halpern is credited. It will be observed that in all the conversations between Blaine and the managements of Atlantic, Globe and Sun it was clearly understood that there would be no acquisition and no merger unless Cosnat secured a firm commitment for a long-term debt of $1,500,000 to eliminate Cosnat's indebtedness to factors. Further there was no definitive discussion at anytime as to the consideration to be exchanged in the event that the parties were to agree on a merger or consolidation.

It will be noted that the figure of $1.00 plus for prospective earnings for fiscal year 1964 was based upon a merger having become effective, but the Crerie Report was based upon having 460,000 shares outstanding. 6/ However, as the letters quoted above, particularly the letter which Atlantic was requested to sign by Blaine point out the number of shares outstanding in the merged company would far exceed 460,000 shares. In fact, Atlantic's shares in the merged company above would be at least 440,000 shares. There was no reasonable basis for projecting earnings of $1.00 plus per share and it is clear that in making such statements the effect was to mislead Davis' customers.

In early 1963 Blaine had a meeting with Merrill Halpern, an Assistant Vice-President in the Corporate Financing Underwriting Department of McDonnell & Co., a member of the New York Stock Exchange.

6/ Of course, absent a merger there would be no basis whatever for the earnings figure of $1.00 plus.

Halpern was a certified public accountant and financial analyst with substantial experience in merger transactions. Blaine had come to McDonnell's offices to see Halpern to explore possible financing private placement for the Cosnat Corporation. Blaine was seeking for private financing of approximately a million and one-half dollars principally for the purpose of refunding Cosnat's obligations to factors. He told Merrill Halpern that Cosnat had agreed in principle with Atlantic, Globe and Sun, that they would make a merger with Cosnat provided that Cosnat could secure a loan to pay off the factors. i.e., a long-term loan to reduce the interest which he felt was exhorbitant.

Shortly, thereafter, i.e. on July 12, 1963 Blaine on behalf of Cosnat signed a letter authorizing McDonnell & Co. to obtain a loan for his company and to pay McDonnell & Co. a commission if they were successful in getting a loan. Merrill Halpern requested Blaine to furnish McDonnell & Co. with financial data covering the financial condition and operations of Cosnat, Atlantic, Globe and Sun. Pursuant to Blaine's direction Merrill Halpern was furnished with a substantial number of financial statements prepared by Fred Landau & Co., certified public accountants and the regular auditors of the company. Merrill Halpern told Blaine that no financing such as Cosnat was seeking would be feasible in the light of Cosnat's financial condition unless a merger were effected. In addition Merrill Halpern told Blaine that before McDonnell & Co. would present any proposed financing to any of its institutional clients, it would have to be satisfied that such merger

would actually take place. In this connection he asked Blaine to supply him with additional financial statements and he also asked Blaine to give him some written proof that there actually was a merger deal before McDonnell would even attempt to obtain the proposed financing. Specifically, he asked for copies of agreements between the parties or letters of intent.

Merrill Halpern told Blaine that he would have to make an analysis of the financial condition of the companies which Blaine wanted to have merged with Cosnat as a prerequisite to any action which might be taken by McDonnell & Co. to seek financing. He pointed out that of all the companies concerned the most important was Atlantic.

Pursuant to Merrill Halpern's request Blaine directed the company's auditors, Fred Landau & Co., certified public accountants, to prepare a pro forma combined balance sheet to reflect what such a merged company would look like financially.

Blaine never supplied McDonnell with a copy of any merger agreement or letters of intent to participate in a merger. However, pursuant to Blaine's request Fred Landau & Co. prepared a pro forma combined balance sheet and combined income figures assuming a proposed merger of the Cosnat, Atlantic, Globe and Sun Groups.

In pertinent part, the pro forma combined balance sheets prepared by Cosnat's accountants gave effect to the following proposed transactions:

(a) a merger or other combination of the Cosnat Group, (including Monarch and Jay-Gee), the Atlantic Group, the Globe Group, and the Sun Group of companies.

(b) Receipt of a loan in the amount of $1,500,000 by the merged companies proposed to be obtained from an insurance company with proceeds of the loan being used to pay off existing high interest factoring loans and other notes.

In addition these statements also included a statement of income for such groups of companies as follows:

(a) Cosnat, Monarch, and Jay-Gee for the fiscal years ended September 30, 1960, 1961 and 1962. (October 31, 1961 applicable to Jay-Gee).

(b) Atlantic Group for the fiscal years ended December 31, 1960, 1961 and 1962.

(c) Globe Group various fiscal years ended 1960, 1961, 1962 and 1963.

(d) Sun Group eleven months ended September 30, 1962 and fiscal years ended September 30, 1960 and 1961.

(e) In addition Fred Landau & Co. presented a pro forma statement presenting income for these three companies on a combined basis.

The statements of the Atlantic Group, the Sun Group and the Globe Group were presented by the accountants without audit and without verification.

The purpose of this presentation was to help Merrill Halpern to analyze what these companies would look like financially if the merger sought by Jerry Blaine, president of Cosnat, were actually to take place.

After Halpern received the financial presentations prepared by Cosnat's accountants he expressed his disappointment and was "disenchanted with the prospect of going forward with the loan inquiry," to any institutional investor and in fact McDonnell & Co. made no such inquiry of any insurance company or any other institutional client and so informed Blaine.

The pro forma combined balance sheets reflect that for the combined corporate groups the total current assets were $5,835,000 and that the total current liabilities were $4,664,000, reflecting a very low current ratio of 1.25 to 1, and indicating a marginal ability to meet current liabilities as they fell due.

The pro forma combined balance sheet reflects that if the merger were achieved and the combined company actually obtained an institutional loan of $1,500,000 the company intended to employ practically the entire amount obtained from the institution to pay off factoring loans and other notes on which Cosnat was paying extremely high interest amounting to between 12% and 15%.

If such loan were obtained the pro forma statements reflected that the cash position of the combined companies would be very slightly affected amounting to an increase in cash of only $7,000. The current ratio would also be only slightly affected, namely, it would go from 1.25 to 1 to 1.44 to 1. 7/

7/ The change in the current ratio reflects merely that $618,000 in factoring loans payable which were included in current liabilities would be paid off with funds received from the institutional financing and would be converted thereby from a current liability to a long-term liability.

The principal benefits to be derived from obtaining an institutional loan of $1,500,000 would be the reduction in the interest expense as compared to the interest expense paid to factors and that accounts receivable would be released from the lien placed upon them by reason of the making of the loan by factors. The institutional loan sought would also enable the company to be relieved of making current payments to factors and would stretch the loans over a longer period of time.

The combined income figures presented to McDonnell & Co. sets forth under the heading "Cosnat Group" that for the year ended September 30, 1960 Cosnat alone had net income of $19,157; that for the year ended September 30, 1961 it had a loss of $137,367 and that for the year ended September 30, 1962 it had a loss of $333,486, all in the face of substantially rising sales.

The Monarch group included under the same heading, however, reflected net income of $142,074 for the fiscal year ended September 30, 1960, $242,080 for the fiscal year ended September 30, 1961, and $322,352 for the year ended September 30, 1962.

Jay-Gee also included under this heading presented net income of $22,412 at the year ending October 31, 1960, $211,169 for the year ending October 31, 1961 and $212,701 for the year ending September 30, 1962.

The sales of Jay-Gee had increased substantially during the three-year period but the earnings for 1961 and 1962 remained about the same even though sales had almost doubled for Jay-Gee as between fiscal year 1961 and fiscal year 1962.

The combined income figures for the Cosnat Group Consolidated which included all the above named companies for the year ended September 30, 1960 reflected on a consolidated basis net income of $183,643; for the year ended September 30, 1961, net income of $280,882 and for the year ended September 30, 1962 net income of $120,808, an erratic earnings picture. In this connection interest costs appear to be a significant factor. The interest charges for the year ended September 30, 1960 for Cosnat alone amounted to $6,103 and for the year ended September 30, 1962 they had amounted to $183,968.

For the year ended September 30, 1962 for the Cosnat Group Consolidated the interest charges were shown as $190,093. In addition depreciation amounted to almost $150,000 for this period and alleged SEC expenses amounted to almost $42,000.

When considered with the erratic pattern of earnings which were outlined in the financial statements the existence of these two items would not appear large enough to provide substantial cash flow in the future or to provide adequately for interest and payments of principal to a lender of $1,500,000 to the Cosnat group alone. The final column in the combined income figures reflected net income for the combined companies of almost $375,000 on almost $15,000,000 of sales or a net return on sales of only approximately 2½%, which as Merrill Halpern pointed out was an extremely low rate for a "highly volatile industry", 8/ such as a record distributing and record manufacturing enterprise.

8/ The final column reflecting income figures for the proposed merger also reflects the very erratic earnings pattern for the three years.

After Merrill Halpern ascertained the financial facts he had no further interest in having McDonnell & Co. approach any of its clients. As Merrill Halpern put it, "There was a formal termination which occurred after I received very disappointing financial statements" and according to Merrill Halpern's recollection this occured in October 1963.

The statements in the Crerie Report concerning Cosnat's negotiations in progress for the merger or acquisition of three companies in the record field and the references to $16,000,000 in sales made in the table of "INCOME STATISTICS" and in the text of the Crerie Report were a gross exaggeration of the facts pertaining to the acquisition or merger sought by Cosnat and were intended to deceive prospective purchasers in reaching a judgment whether to buy or not to buy Cosnat stock.

The Crerie Report at page 3 thereof, includes a table labeled "INCOME STATISTICS". Among other things, this table reflects that for fiscal year ended September 30, 1962 the net income before taxes of Cosnat was $359,000, its net income after taxes was $162,000 and that its earnings per share for the fiscal year was 39 cents. The 39 cents figure per share compared with a 45 cents per share earnings figure for the prior fiscal year.

The text of the Crerie Report states in pertinent part, that

> "In the fiscal year which ended September 30, 1962 Cosnat earned 39 cents per share on the 419,314 shares then outstanding. These earnings were achieved despite an increase in interest charges from $36,000 the year before to $190,000 and despite the heavy cost (estimated as $150,000) of an abortive effort due to adverse market conditions, to offer a public issue of convertible debentures."

The 39 cents figure depicted as Cosnat's earnings for fiscal year 1962 was a figure reached on the basis of the company's earnings before deducting non-recurring expenses including expenses related to the abortive underwriting. These expenses as reflected in Cosnat's auditors report were approximately $42,000 in fiscal year 1962, and not $150,000 as set forth in the Crerie Report. When the underwriting expenses are considered the earnings for fiscal year ended September 30, 1962 were 29 cents per share.

The representation in the Crerie Report is that the abortive underwriting cost Cosnat $150,000 during fiscal year 1962 and that it thereby reduced its earnings to $162,000 for the period or 39 cents per share. The clear implication is that had it not been for these alleged abortive underwriting costs Cosnat's earnings would have been $312,000 for fiscal 1962 or 74 cents a share.

The 39 cents earnings figure did not include the costs of the underwriting. Had this alleged $150,000 been reflected, net earnings would have amounted to only about $12,000 or about 3 cents per share. In fact, however, the abortive underwriting expenses were only about $42,000 for the fiscal period and should have been reflected in the earnings figure. The appropriate earnings figure then would be 29 cents per share or 10 cents less than represented in the Crerie Report.

In this connection it should be noted that testimony given by the partners of Fred Landau & Co. and an employee of the accounting firm who was directly involved in preparing Cosnat's

financial statements was in agreement that the presentation of Cosnat's earnings in the Crerie Report particularly for fiscal year ended September 30, 1962 and for the six months ended March 31, 1963 was inaccurate. The partners who testified and their employee all testified that the use of the 39 cents per share earnings figure was improper and misleading because it did not reflect that the company had sustained a non-recurring loss of 10 cents in the period and that absent such information the 39 cents figure was incorrect, the correct figure being 29 cents. They also testified similarly that the 31 cents figure for earnings for the 6 months period ended March 31, 1963 also was incorrect. As one of the partners of Fred Landau & Co. testified the latter figure "should have read 31 cents net income per share, 23 cents negative special items giving an accurate earnings per share figure of 8 cents." 9/ In referring to a statement in

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9/ During the hearing, reference was made to Accounting Research Bulletin No. 49 issued in 1958 by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants ("Institute"). This bulletin reflected that it was appropriate for accountants to present a combined statement of income and earned surplus in such manner as to reflect current income and charges or credits to earned surplus. The normal presentation would show income from operations added to earned surplus at the beginning of the year followed by adding or subtracting of extraordinary items, with the final figure showing earned surplus at the end of the accounting period. Under this bulletin disclosure of the extraordinary items was required so that the reader would know exactly what the earnings for the period were. The reader of an accounting statement prepared in accordance with Bulletin No. 49 would be fully informed and no material facts would be omitted or hidden from him.

However, the presentation made in the Crerie Report in fact omitted material facts from the reader and would mislead him.

In Opinion No. 9 of the Accounting Principles Board ("APB") of the Institute in December 1966, the Board concluded that net income should reflect all items of profits and loss recognized during the period (with the sole exception of [certain] prior period adjustments not applicable here). Extraordinary items should, however, be segregated from (continued)

Jerry Blaine's letter as president to Cosnat's stockholders in the company's annual report for fiscal 1962 that earnings were 39 cents per share, William Landau, a partner in the auditing firm pointed out that such letter was signed by Jerry Blaine and sent out after the auditing firm had submitted its financial statements. He testified that the representation in the annual report which was substantially the same as the representation in the Crerie Report was incorrect. He further testified that

> "Had I been aware of [the letter] at the time I would have been extremely concerned, yes sir. But really at that time there was nothing I could have done about it other than resign from the engagement. There is no legal responsibility I had to, what Mr. Blaine says so long as my report is correct."

The representations contained in the Crerie Report regarding Cosnat's past earnings were materially false and misleading and the representations regarding future earnings were made without reasonable basis.

Under page 2 the caption "MANUFACTURING" the Crerie Report stated that

> "Monarch owned two plants in California with a combined capacity for pressing 6 million records per month."

Jerry Blaine testified that in July 1963 the capacity of Monarch was "anywhere from 3 to 4 million units per month". In its Amendment No. 5 to its registration on Form S-1, Cosnat reported that

> ". . . the company . . . has a capacity of over 2 million records per month."

9/ (continued)
the results of the ordinary operations and be shown separately in the summary arriving at net income.

It should be observed that both under the former method of presentation described in the earlier research bulletin and under the latest accounting practice there is no basis for not disclosing extraordinary items or for reporting net income as it appeared in the Crerie Report.

In any event it is clear that the representations in the Crerie Report grossly overstated the productive capacity of the company and such representations were materially false and misleading. The Crerie Report under the caption "FUTURE" at page 4 states, among other things, that

> "Recently the company was awarded an exclusive one-year government contract to supply records bought by the General Services Administration for all GSA installations, both military and civilian in continental U.S., such as officer's clubs, libraries, hospitals, recreation rooms, etc. It is estimated that this contract will add at least $2 million in sales during the term of the agreement."

The fact was that General Services Administration had informed Jerry Blaine that the dollar volume in sales to be expected under its contract was approximately $200,000. The representations concerning Cosnat's GSA contract in the Crerie Report were materially false and misleading.

Under the same caption, "FUTURE" the Crerie Report stated that Cosnat had entered into the field of low profit film production and that its first film, "Rage Within" was completed and ready for distribution and that a second movie starring Mickey Rooney was going into production November 10, at Republic Pictures Studios, and that Republic Pictures would distribute the company's first two movies.

In fact, Mickey Rooney was never under any commitment to Cosnat to make any pictures, nor was there any arrangement or commitment for the production of any movie by Cosnat at the Republic Picture Studios nor were any arrangements ever made or commitments entered into with Republic to distribute Cosnat's first two movies.

Davis distributed reprints of an article on Cosnat appearing in the November 1963 issue of "Stock Market Magazine". This article was substantially similar to the Crerie Report and was separately produced in a quantity of several thousands, and distributed to customers and potential customers of Cosnat's stock. Some of the reprints of the stock market article had a rubber stamp correction endorsed upon it indicating that Allied Artists was the prospective distributor of Cosnat's first two movies instead of Republic Picture Studios but such endorsement was also false and misleading in that Allied Artists had no contract to distribute any of Cosnat's pictures.

Under the heading "DISTRIBUTION" the Crerie Report stated, among other things, that Cosnat had record distribution centers located in various cities which were designated as key markets and that "additional distribution centers are in the planning stage."

These representations were intended to convey the impression that the distribution centers were an asset of Cosnat where as in fact the distribution centers had been losing money for a period prior to July 1963 and thereafter the company closed out and eliminated its distribution centers in Newark, Pittsburgh and Cincinnati.

The Crerie Report, read as a whole, was materially false and misleading.

The record also reflects that Crerie and Davis' registered representatives, particularly Kopel and Rosenberg, embellished and enlarged upon the exaggerated and false and misleading statements in the Crerie Report in oral representations made to members of the investing public, concerning Cosnat stock. Kopel and Rosenberg engaged

in a high-pressure telephone campaign in which they made telephone calls not only in the New York area but to Indiana, Connecticut, Pennsylvania, and New Jersey as well. Three investor witnesses testified concerning their transactions and conversations about Cosnat stock with Crerie; three investor witnesses testified concerning false and misleading statements made to them concerning Cosnat by Kopel; and three investor witnesses testified concerning the false and misleading statements made to them by Rosenberg. There was no direct contradiction of their testimony.

Wax and other employees of Davis testified that they never heard Kopel and Rosenberg make the representations which the investor witnesses testified were made to them. Two of the three investor witnesses who testified concerning their transactions with Crerie stated that he had represented that Cosnat stock would soon be listed on the American Stock Exchange. In addition, Rosenberg mailed to an investor who had first been contacted by Crerie a second copy of the Crerie Report and a copy of the Tromson Financial Report dated September 28, 1963 stating that Jerry Blaine "would shortly be initiating steps to apply for listing on one of the major stock exchanges". Crerie told another customer that the stock would go from its then price of $7 per share to $12 per share and told another customer when the stock was selling at about $4¼ per share it would go to $8 or $9 per share. This customer bought Cosnat at $3½ per share. Crerie's customers were mailed copies of the Crerie Report

and the Tromson Financial Report. The six investor witnesses who testified concerning their transactions with Davis' registered representatives testified that Kopel and Rosenberg had represented in every case that Cosnat would soon be listed on the national securities exchange. In some cases Rosenberg and Kopel stated to investors that the stock would be listed on a national securities exchange, in others that it would be listed on the New York Stock Exchange and others were told that it would be listed on the American Stock Exchange. In any event they made it clear that Cosnat would be listed on a national securities exchange. The representations had no basis in fact and were materially false and misleading.

Crerie sent a copy of the Crerie Report bearing the legend "Compliments of M.G. Davis & Co., Inc." to one investor witness and on behalf of Cosnat discussed the contents of the Crerie Report with another.

Rosenberg also sent a copy of the Crerie Report to another investor witness together with a reprint of the Stock Market Magazine article on Cosnat.

Kopel sent one of the investor witnesses a copy of the Crerie Report, a copy of the Tromson Financial Report, a copy of the so-called preliminary draft of the Crerie Report bearing the handwritten legend "FOR OFFICE USE ONLY - NOT FOR DISTRIBUTION" and a reprint of the article in "Stock Market Magazine". He sent another investor

witness a copy of the Crerie Report to which Kopel attached his business card.

All the investor witnesses testified that Crerie, Rosenberg, and Kopel had represented that the price of Cosnat would rise rapidly. The misrepresentations made by Rosenberg, Kopel and Crerie concerning the rapid rise in Cosnat stock ran from double in price to three or four times in price.

The registered representatives also repeated to their customers the misrepresentations contained in the Crerie Report.

In addition to the misrepresentations contained in the selling literature relating to mergers (discussed hereinabove) Crerie, Kopel and Rosenberg represented orally to at least five investor witnesses that Cosnat would shortly merge with or acquire new companies that would enhance the value of the Cosnat stock dramatically and would increase its earnings substantially.

Crerie, Kopel and Rosenberg also failed to tell customers anything about the company's tight cash position, or the large loans it had made from factors, or the high interest it was paying factors.

Crerie, Kopel and Rosenberg also falsely represented to customers that Cosnat would have increased earnings when the Cosnat Corporation merged with other companies in the record business and would pay dividends.

The testimony of the investor witnesses concerning the false and misleading statements made to them is credited.

The record establishes that the respondents engaged in a scheme to defraud investors by means of a persistent high-pressure sales campaign involving the use of false and misleading sales literature which they mailed to members of the investing public as well as telephone calls made by the registered representatives, particularly Kopel and Rosenberg to sell the speculative stock of Cosnat which also involved the use of fraudulent representations and predictions.

The representations and predictions made by the respondents were without reasonable basis. The Commission has repeatedly held that predictions of substantial price increases within relatively short periods of time with respect to a speculative security are inherently fraudulent whether expressed in terms of opinion or fact. 10/

The respondents claimed initially that all the representations made in the Crerie Report were correct and in any event they now claim that they relied upon statements and representations made to them by Jerry Blaine and the management of Cosnat.

Any reasonable investigation of the representations made in the Crerie Report would have disclosed that the representations contained therein were materially false and misleading. The Commission in commenting on a similar claim, pointed out in In N. Linsker & Co., 40 SEC 285 (1960), that

> "Registrant's asserted self-reliance on self-serving statements by [the issuer] when even the most superficial investigation would have disclosed the nature of [the issuer's] operations,

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10/ See, e.g. Hamilton Waters & Co., Securities Exchange Act Release No. 7725, p. 4 (October 18, 1965).

> its financial condition and lack of funds and prospects, was at the least reckless and misplaced and not consistent with the existence of a responsible relationship between securities dealer and customer." 11/

In this case Levine has testified that he was fully familiar with the financial facts including Cosnat's factoring arrangements, the large debt and the high interest rates being paid by Cosnat and its efforts to obtain financing. Furthermore, Levine and Wax were particularly responsible for their employees' misrepresentations since they supplied the salesmen with the Crerie Report which was materially false in fact. Wax supplied each of the registered representatives with a draft copy of the Crerie Report which contained the same false and misleading misrepresentations as the Crerie Report. Insofar as Kopel and Rosenberg are concerned they also cannot be excused for their false and misleading representations. The representations concerning price rises went substantially beyond the statements made in the Crerie Report and were highly deceptive.

The Commission in MacRobbins & Co., Securities Exchange Act Release No. 6846 (July 11, 1962) stated:

> "Whatever may be a salesman's obligation of inquiry, or his right to rely on information provided by his employer, where securities of an established issuer are being recommended to customers by a broker-dealer who is not engaged in misleading and deceptive high pressure selling tactics, that situation is not present here. Certainly, there can be little, if any justification for a claim of reliance on literature furnished by an employer who is engaged in a fraudulent sales campaign. In our view, a black letter rule providing exculpation of a salesman in such circumstances, because of reliance to his employer, would place a premium on indifference and responsibility at the point most directly and intimately affecting the investor." 12/

11/ Citing Leonard Burton Corporation, 39 SEC 211 (1959) and Barnett & Co., Inc., 40 SEC 1 (1960).

12/ Ross Securities, S.E.A. Rel. No. 7069 (April 30, 1963). See also S.E.C. v. Broadwall Securities, 64 Civ. 3995 (U.S.D.C., S.D.N.Y., March 3, 1965).

The use of misleading brochures known as market letters to facilitate a telephone sales campaign has been found to constitute a violation of the anti-fraud statutes sufficient to support revocation. 13/

The picture represented to customers by Kopel and Rosenberg was that Cosnat was a growing successful company engaged in negotiations to acquire other companies; that Cosnat was going to be listed on a national securities exchange shortly and that they predicted the purchase of the stock would return very high profits in capital gains to purchasers in a short period of time. They omitted to tell customers about the large debt of Cosnat to factors and the high interest rate being paid and their representations regarding the negotiations alleged to be in progress were essentially a hoax. No application for listing on a national securities exchange was ever filed on behalf of Cosnat. 14/

The conduct of the respondents did not meet the standards of fairness required of them under the Securities Acts.

In MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962) the Commission stated

> "Early in the administration of the federal securities laws, we held that basic to the relationship between a broker or dealer and his customers is the representation that the latter will be dealt with fairly in accordance with the standards of the profession. The failure of a brcker or dealer to disclose that his conduct does not meet such standards operates

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13/ Heft, Kahn & Infante, Inc., Securities Exchange Act Release No. 7020 (February 11, 1963).

14/ Counsel for Cosnat in this proceeding indicated that he had written letters to Cosnat explaining what the requirements for listing were, but this was far away from any justification for any representation that the stock would be listed on a national securities exchange. M.G. Davis, Levine and Wax must be held accountable for the dissemination of false and misleading market letters to the public investors by their registered representatives.

as a fraud on customers. The Court in a landmark case Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (1943), cert. denied, 321 U.S. 786 (1944) 15/ recognized this so-called 'shingle' theory . . . ."

The respondents as broker-dealers and the salesmen as representatives of the broker-dealer hold themselves out as having special knowledge and they cultivated the customer's confidence in their possession of such special knowledge.

The dissemination by the respondents of the sales literature employed here and the misrepresentations made orally were a betrayal of the confidence they had engendered in their customers.

It was the obligation of the respondents to have made a reasonable investigation of the facts regarding Cosnat before they made their false and misleading statements in their sales literature and orally. The evidence reflects that the false and misleading representations were made knowingly or at best were made as a result of respondents' failure to make an investigation of the facts before making their false and misleading statements.

The position of the respondents on the substantive issues in this proceeding appears to be that the Crerie Report, the reprint of the Stock Market Magazine article, and the Tromson Financial Reports, which they mailed to customers, were not materially false and misleading but if they were, the respondents should not be held

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15/ United States Corp., 15 SEC 719, 727 (1944); E.H. Rollins & Sons, Inc., 18 SEC 347, 362 (1945); William Harrison Keller, Jr. SEA Rel. No. 5909 (March 18, 1959).

responsible for their distribution and use in recommending sales of Cosnat's stock because the respondents knew the management of Cosnat well and favorably, they had received their information from the management and believed that the representations, as contained in the selling literature was correct.

Respondents make no argument in their brief that violations of the anti-fraud provisions of the Securities Acts had not occurred, if, in fact Crerie, and Davis' registered representatives had made the false and misleading statements attributed to them by the nine investor witnesses called by the Division as part of its affirmative case.

The Hearing Examiner has fully credited the testimony of such witnesses. In the opinion of the Hearing Examiner, cross-examination did not serve to impair their credibility and the record contains no contradiction of their testimony.

The emphasis in respondents' brief was not placed on the evidence and the substantive issues discussed by the Division in its initial brief but largely on respondents' claims that they were denied due process of law in this proceeding. Respondents' arguments rested on two bases.

One was that the Attorney General of the State of New York ("Attorney General"), had suppressed evidence obtained from respondents by subpoena during the course of an investigation he had conducted into the business activities of Davis and others pursuant to the provisions of Section 352 of the General Business Law of the State of New York ("Martin Act") and as a

corollary to this contention, respondents claimed that any evidence which the Division introduced in this proceeding which they obtained by examining the Attorney General's files, was "tainted" because the Division had produced no proof that the Attorney General had personally authorized the Division to disclose the information contained in the Attorney General's files.

The second contention bearing on respondents "due process" claims was that they were deprived of the opportunity to present the evidence of a large number of Davis' customers whom they claimed had been sold Cosnat stock without false and misleading statements. Respondents made an offer of proof that if they called 47 former customers of Davis, that such customers would testify "that during the period beginning sometime in the early part of July through a period that probably ended sometime in September 1963, they purchased securities of the Cosnat Corporation on the recommendation of securities salesmen and registered representatives of M. G. Davis & Co." . . . and it was counsel's "impression that if they were here to testify, they would testify that they received the Crerie report; and that in connection with any recommendations made to them by representatives of M. G. Davis, they did not receive any misleading information, excessive claims, predictions of price rise and the like."

The Hearing Examiner has found that the Crerie Report was materially false and misleading. Accordingly, its employment by Davis and its registered representatives to sell Cosnat securities violated

the anti-fraud provisions of the Securities Acts. Accordingly, the testimony offered by respondents would be cumulative to the extent that it established that the registered representatives used false and misleading literature to sell Cosnat stock. In addition, such testimony would not constitute a refutation of the testimony of the investor witnesses called by the Division concerning false and misleading statements made to them by Crerie, Kopel and Rosenberg.

The following comments are made with regard to the respondents' Martin Act claims.

Section 352 of the General Business Law of the State of New York, among other things, authorizes the Attorney General to conduct certain types of investigations including investigations relating to fraudulent sales of securities. In this connection sub-section 5 of Section 352 provides in pertinent part that: "Any officer participating in such inquiry and any person examined as a witness upon such inquiry who shall disclose to any person other than the attorney-general the name of any witness examined or any other information obtained upon such inquiry except as directed by the attorney-general shall be guilty of a misdemeanor."

Throughout the course of this hearing, the respondents objected to any reference by any witness to any material which the respondents thought had any relation to information received by the Attorney General during his investigation or any information which respondents thought emanated from the documents obtained by the Attorney General during his Martin Act investigation.

The respondents brought in a well-known New York lawyer versed in legislative draftsmanship to advise the hearing examiner that, in his opinion, witnesses who had appeared in the Attorney General's Martin Act inquiry could not lawfully disclose to any person the name of any witness who was examined in such inquiry or disclose any information obtained from such inquiry except as directed by the Attorney General.

Shortly thereafter, an Assistant Attorney General of the State of New York appeared at the hearing and advised the Hearing Examiner that the Attorney General personally had approved orally a request by the Commission to examine the books and records of Davis and others which had been obtained by the Attorney General. He added that when the Attorney General's office decided to permit an agency to examine its records, the Attorney General usually did so orally. There was no question raised about the integrity of the Assistant Attorney General who so advised the Hearing Examiner.

Apparently neither Davis nor Levine had asked the Attorney General for a receipt for the books and records which they had turned over to him pursuant to subpoena. Further, none of the respondents claimed that they had a record showing what documents they had delivered to the Attorney General. Levine claimed that he had turned over a Davis file which he referred to as a "due diligence" file which he said contained a great deal of information concerning Cosnat and its operations. Counsel for the respondents claimed that the Attorney General had taken the files delivered by Davis including the alleged "due diligence" file pursuant to subpoena and rearranged them to suit his convenience without designation as to source, at least insofar as respondent's records were concerned, and the respondents

were unable specifically to advise the Attorney General what documents were contained in the "due diligence" file that they wanted to examine.

The Attorney General's position as explained to the respondents, was that they could look at any document which they had furnished the Attorney General but could not examine documents furnished to the Attorney General by other persons. In this connection, the record shows that the Attorney General returned several of Davis' books to the respondents and offered to let respondents examine such books and records as they could identify as belonging to them. There is no evidence that the Attorney General ever refused to permit counsel's respondent or respondents to examine any books and records which they could establish they had delivered to him.

During the course of the hearing a representative of the New York Attorney General appeared in the hearing room with certain records which had been furnished the Attorney General by Davis. The Division had subpoenaed the respondent Davis to produce the "blotter" of Davis for 1963 and 1964. This document, as well as others, was in the possession of the Attorney General. When counsel for the respondent was requested to look at the books and papers brought in to the hearing room by the Attorney General's representative and advised that the latter had brought certain documents to the hearing room belonging to Davis, counsel refused to examine such documents. One of the documents brought into the hearing room by the Attorney General's representative was one which was then used by the Division in the examination of a witness who had been a cashier and bookkeeper for Davis in 1963. In this connection, counsel for the

respondents said that he thought that ". . . the introduction of the records is highly prejudicial to the interest of our client and in my judgment is completely improper."

Davis" cashier testified that his best recollection was that with the exception of the blotters he got some or all of Davis' books back from the Attorney General.

There is no evidence whatever that the respondent took any measures to require the Attorney General to return any of the papers and records delivered under subpoena which it was seeking including its "due diligence" file. There is no evidence or claim that the respondents took any action addressed to the Commission or the federal or state courts to require the New York Attorney General to permit them to look at any documents which they claim belonged to them and which they considered were being wrongfully withheld by the Attorney General.

There is no reasonable basis for concluding that any of the papers turned over to the Attorney General by the respondent would establish that respondent used reasonable efforts to investigate whether the representations they made to customers in the selling literature were correct. The most that respondents claim is that the "due diligence" file alleged to have been maintained by Davis could establish the extent of Davis' investigation in support of its recommendations to customers to buy Cosnat stock. Based on this conjecture the respondents claim that they were deprived of due process.

Essentially what they assert is that evidentiary material, which they could not describe with any specificity, was suppressed by the New York Attorney General and that therefore they were deprived of due process in this administrative proceeding conducted by the Commission. In the opinion of the hearing examiner, there would not appear to be any suppression of evidence.

One of the important elements in this proceeding is the evidence in the record concerning the financial condition of Cosnat at the time that respondents were conducting its sales campaign.

The financial facts were available to and known by the respondents at all times pertinent to this proceeding. There was no claim that evidence bearing on the financial condition of Cosnat as testified to by Cosnat's auditors and by Blaine and Levine was not available to respondents, nor did the respondents claim that the evidence relating to alleged negotiations was not as readily available to the respondents as it was to the Division. The claim that Davis' "due diligence" file somehow or other contained information which could have assisted the respondents to defend themselves is nebulous and highly conjectural. On the other hand, Levine was a very close friend of Jerry Blaine's, was fully familiar with the Monarch transaction, knew very well that the company was in "hock" to factors but nevertheless Davis chose to distribute sales literature which omitted to point out these material facts to investors. There is no requirement under the anti-fraud provisions of the Securities Act that salesmen cannot be found to have committed a fraud in the sale

of securities to certain customers unless they committed a fraud in the sale of such securities to the majority of their customers. 16/

There was no claim that the Division had not complied with the Jencks rule or that the Commission or its employees had any relationship to this alleged "suppression of evidence."

The respondents claimed that their "due process" questions should have been certified to the Commission for interlocutory review prior to any initial decision by a Hearing Examiner and they renewed their claim in their answering brief.

In the Hearing Examiner's opinion such certification would not be appropriate under Rule 12 of the Commission's Rules of Practice concerning certification. The validity of respondents' claims in this regard can be passed upon adequately by the Commission should respondents seek review of the Hearing Examiner's initial decision.

The record establishes that M. G. Davis, Levine, Wax, Kopel, and Rosenberg from approximately July, 1963 to approximately November, 1963 wilfully violated and aided and abetted violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder in offering and selling Cosnat common stock; that while engaged in such violations M. G. Davis, Levine, Wax, Kopel and Rosenberg, directly and indirectly, made use of the mails and means and instruments of transportation and communication in interstate

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16/ Hughes v. Securities and Exchange Commission, 174 F. 2d 1969 (D.C. Cir. 1949); Miller, Sotell & Freedmark, Securities Exchange Act Release No. 8012 (December 28, 1966).

commerce, and of the means and instrumentalities of interstate commerce, and effected transactions in Cosnat common stock, otherwise than on a national securities exchange.

The application for withdrawal of Davis' broker-dealer registration should be and is denied.

It is in the public interest to revoke the broker-dealer registration of M. G. Davis pursuant to Section 15(b) of the Securities Exchange Act of 1934.

It is in the public interest to bar Levine, Wax, Kopel and Rosenberg from being associated with a broker-dealer within the meaning of Section 15(b)(7) of the Securities Exchange Act of 1934.

Public Interest

All the respondents participated in a concerted high-pressure sales campaign to defraud the investing public. The investing public should not be exposed to further risk of fraudulent conduct by those who have demonstrated their gross indifference to the basic duty of fair dealing required of persons in the securities business.[17/] The conduct of these respondents requires a remedy which will protect the investing public from further exposure to activities such as the respondents have practiced in the past.

17/ In Walker v. S.E.C., (C.A. 2, No. 30,628, October 3, 1967) the Court of Appeals held that "The Commission is justified in holding a securities salesman chargeable with knowledge of the contents of sales literature. He cannot avoid his duty to the public by blindly relying on his employer's brochures."

Accordingly, IT IS ORDERED that the registration of M. G. Davis & Co., Inc. is revoked; and that Lawrence Levine, Walter Wax, Morris Kopel and Harold R. Rosenberg are barred from association with a broker-dealer.

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 Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision 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.[18/]

Samuel Binder
Hearing Examiner

Washington, D.C.
March 21, 1969

18/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.