

FILE COPY

ADMINISTRATIVE PROCEEDING
FILE NO. 3-3826

Filed-6-27-74

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

ANDREW A. PILATO
8-13487
ANDREW A. PILATO & COMPANY, INC.
8-17122
ANDREW A. PILATO, Individually
MELVIN LLOYD RICHARDS
JAMES S. ROSS

INITIAL DECISION

APPEARANCES: Michael Bertz, Attorney of the Los Angeles Regional
Office for the Division of Enforcement

Thomas J. McKay and John H. Wolf for respondents
Andrew A. Pilato (registrant), Andrew A. Pilato &
Company, Inc. (applicant) and Andrew A. Pilato,
Individually

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission order ("Order") of July 18, 1972, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether an application for broker-dealer registration filed by Andrew A. Pilato & Company, Inc., ("applicant") should be denied and whether the other above-named respondents committed certain charged violations of the Securities Act of 1933 ("Securities Act") and the Exchange Act and regulations thereunder, as alleged by the Division of Enforcement ("Division"), and the remedial action, if any, that might be appropriate in the public interest.

The order for proceeding alleges, in substance, that about April 17, 1972, registrant succeeded under applicant's name to the business of another securities firm, which in other broker-dealer proceedings had consented to revocation of its registration, and opened a branch office in that firm's premises in Las Vegas, Nevada; that between January 1969 and July 1972 registrant willfully violated or aided and abetted violations of the net capital, broker-dealer filing, antifraud, registration, and recordkeeping provisions of the securities laws; and that between May and July 1972 applicant, willfully aided and abetted by registrant, willfully violated the broker-dealer filing provisions. Also, registrant and Pilato are charged with failing to supervise with a view to preventing the alleged violations.

1/ Enterprise Securities Corporation, Securities Exchange Act Release No. 9617, May 31, 1972.

The Commission's order provided that there first be determined the question whether suspension of Andrew A. Pilato ("registrant") on an interim basis, pending final determination of the issues presented by the order, is necessary or appropriate in the public interest or for the protection of investors. This has been determined by Commission order withdrawing the application for broker-dealer registration of applicant, discontinuing the suspension proceeding of registrant upon certain terms and conditions and accepting applicant's offer of settlement with respect to all other charges against it.^{2/} In addition, the proceeding has been determined as to James S. Ross ("Ross") and Melvin Lloyd Richard ("Richards").^{3/} Accordingly, the findings herein are applicable only to registrant and Andrew A. Pilato ("Pilato"), individually. However, in view of the nature of the charges and the factual circumstances, it will be necessary to make findings concerning other respondents named in the order.

Registrant and Pilato were represented by counsel throughout the proceeding and proposed findings of fact and conclusions of law and briefs in support were filed by the parties.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

^{2/} Securities Exchange Act Release No. 9833, October 30, 1972.

^{3/} Offers of settlement from the respective respondents were accepted by the Commission in Securities Exchange Act Releases as follows: James S. Ross, 9965, January 30, 1973; Melvin Lloyd Richards, 10183, May 30, 1973.

FINDINGS OF FACT AND LAW

Respondents

Andrew A. Pilato ("registrant"), a sole proprietorship, was registered with the Commission pursuant to Section 15(b) of the Exchange Act on February 21, 1968, and is a member of the National Association of Securities Dealers ("NASD"). From its inception registrant has operated a small, one man office at 258 Wyckoff Avenue, Ridgewood, New York, with Pilato being the trader, salesman and recordkeeper at various times. Occasionally his wife helps out or he hires a part time clerk.

On April 17, 1972, registrant commenced business in Las Vegas, Nevada, in the same offices occupied by Enterprise Securities Corporation ("Enterprise"), which, on the same day had submitted an offer of settlement to the Commission. On March 14, 1972, the Commission had ordered public proceedings against Enterprise, a registered broker-dealer, Charter Financial Corporation ("Charter"), an applicant for registration as a broker-dealer, Melvin Lloyd Richards ("Richards") and seven other individuals pursuant to Sections 15(b) and 15A of the Exchange Act charging violations of Section 5(a), 5(c), and 17(a) of the Securities Act and Sections 7(c), 10(b), 15(b), 15(b)(5)(E), 15(c), and 17(a) of the Exchange Act and Rules 10b-5, 10b-6, 15b1-1, 15b3-1, 15c2-11, 15c3-1, and 17a-3 thereunder and Regulation T.

Upon learning of the possibility that the broker-dealer registration of Enterprise would be revoked, the principals of Enterprise, primarily Richards, began looking for ways to continue operating. To accomplish this, Charter was formed and a Form BD application filed under that name. For

the most part, the principals of the new Charter were the same as the principals of the old Enterprise. This maneuver was halted by the Commission which named Charter as well as Enterprise in the proceedings brought on March 14, 1972.

Having failed in their attempt to establish a front for the continuance of their activities the principals of Enterprise considered the possibility of merger but discussions with the first firm selected ended when Richards learned that he would not be able to continue trading low cost penny stocks or other over-the-counter securities free from supervision by the other firm. At that point, it became apparent that attempts to pursue either a merger or to set up a new company would be fruitless. Thereupon, through the efforts, primarily of Richards, they sought a new entity to provide a home for the customers of Enterprise and to employ the registered representatives and others who qualified and desired employment. This is where Pilato enters the picture. Richards, who was the trader for Enterprise, had become acquainted with Pilato who did his own trading, through the execution of occasional over-the-counter trades on the telephone. Apparently, on a visit to Las Vegas, Pilato was approached by Richards and informed of the opportunity to rent the offices of Enterprise and open a Branch office. The inducement to Pilato was a ready made sales force of registered representatives and the customers which they would bring with them which would expand his business manyfold overnight.

Section 15(b) Violations

The order for proceedings charges that during the period from on or about April 17, 1972 until July 18, 1972. Pilato willfully violated and Richards willfully aided and abetted violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder in failing to promptly file an amendment to registrant's Form BD^{4/}.

On April 21, 1972, Pilato wrote to the Commission on the letter-head of registrant, 258 Wyckoff Avenue, Ridgewood, N.Y. stating that he had established a branch office at 608 South 6th Street, Las Vegas, Nevada. On April 17, 1972, the day he succeeded to the business of Enterprise, Pilato prepared a Form BD for Andrew A. Pilato & Company, Inc., which was received at the Commission on May 4, 1972, and recorded as filed on May 31, 1972. This Form BD states applicant was incorporated in the State of New York on March 31, 1969 and that its principal place of business is 258 Wyckoff Avenue, Ridgewood, N.Y. Schedule E to Form BD states that Pilato is "conducting a securities business as a sole proprietor and presently registered with your department." Schedule A lists Pilato as the only officer and director of applicant. None of the correspondence or broker-dealer forms filed by Pilato on behalf of registrant and applicant indicate in any way that any one other than Pilato exercised control, directly or indirectly, over the management or policies of registrant or applicant. This is contrary to the evidence adduced in the proceeding.

The record indicates that once the broker-dealer registration for applicant became effective registrant would be phased out of the securities business and replaced by applicant. Pending that development registrant

^{4/} Rule 15b3-1(b) provides that if the information contained in any application for registration as a broker or dealer, or in any amendment thereto, becomes inaccurate for any reason, the broker or dealer shall promptly file an amendment on Form BD correcting such information.

was to operate the Las Vegas branch while continuing its New York office. As a matter of fact the reference to registrant's Las Vegas office as a "branch" is a misnomer. While Pilato had been the only trader-salesman in the New York office the Las Vegas office had a ready made complement of employees from Enterprise which included 12 securities salesmen and 2 traders. With registrant's name on the door the Enterprise people continued the practices which the Commission had endeavored to stop. Richards, formerly a principal of Enterprise remained in control of the office and continued as the chief trader. In effect the only thing registrant contributed to the Las Vegas operations of Enterprise was its name and its recordkeeping, to the extent that confirmations were handled in New York.

Respondents, while admitting that Richards had been a principal and the chief trader at Enterprise and that Pilato had hired him as chief trader for registrant's Las Vegas office, deny that he had a controlling influence over the management and policies of registrant which would require registrant to amend its form BD to disclose such influence.

Registrant in its April 12, 1972 notification to the Commission listed its Las Vegas address as 609 South 6th Street. As a matter of fact registrant commenced operations at 310 South Third Street the premises then occupied by Enterprise. The 609 South 6th Street address were premises owned by Richards' father and into which Enterprise was planning to move. At the end of June 1972 registrant moved to 609 South 6th Street just as Enterprise had planned to do.

Registrant's employees in its new Las Vegas office were all former Enterprise personnel. Richards continued as chief trader and Ross

as assistant trader. Mrs. Bernadine Schneider ("Schneider"), the president of Enterprise also held the title of manager from September 1971 until April 1972 and continued as manager of registrant until approximately May 11, 1972, when she was succeeded by John Engl. That change occurred following a Commission staff interview with Pilato concerning his hiring of persons charged with securities violations in the Enterprise proceedings and the steps he was taking to see that such violations did not continue under registrant.

John Engl ("Engl") a retired Army Colonel with approximately two years experience as a registered representative, testified that he had no training in the brokerage business, that he never took the NASD principal's examination, that he transferred from Enterprise to registrant on April 17, 1972, that he and all other Enterprise personnel had been informed by Richards at a meeting on April 14, 1972, that registrant was taking over Enterprise, that this was the first any one knew about it and that he had never previously talked to Pilato about working for him. Engl stated that on May 13, 1972 Pilato called him from New York and asked him to take care of the Las Vegas office in a limited capacity. He was not to interfere with the cashiering or order taking. An SEC staff investigator testified that when he interviewed Engl on May 17, 1972, he discussed with him his responsibilities as manager and asked him what his duties were. Engl stated that he was very unclear as to what his duties were except to open the office in the morning, that they were limited at that time but that he was going to speak to Pilato the following week.

On April 17, 1972, Richards conducted a meeting of Enterprise personnel and informed those present that they would be able to trade and proceed with their business as a branch of registrant. Pilato was not present at this meeting and not in Las Vegas when registrant's new office commenced operations. Richards spoke with the salesmen of Enterprise about transferring their licenses to registrant and, in effect, hired them for registrant. He also advised them as to the handling of registrant's paperwork and trading policies, including which securities would be traded.

Pilato testified that he intended to operate the Las Vegas business by means of his corporation ("applicant") but had to use registrant until such time as applicant would become registered with the Commission. As a matter of fact he issued business cards for the registered representatives in the name of A. A. Pilato & Co., Inc. but then had the & Co., Inc. deleted by crossing out in ink. Pilato estimated that he needed \$50,000 to \$100,000 to finance the planned expansion of his broker-dealer operations through applicant and intended to raise that money through subordinated loans. Inasmuch as registrant had been in violation of the Commission's net capital requirements for much of the time during the period from February 1969 through May 1972 (see Net Capital Violations hereunder, infra, page 15) and was incapable of financing the expanded operations Pilato had to seek other sources of capital. Accordingly, Richards arranged a subordinated loan from one of his Enterprise customers in the amount of \$20,000. The agreement was prepared by Pilato with the borrower to be applicant. It was executed on June 2, 1972 and on June 6, 1972 repayment was guaranteed by Richards.

Applicant's BD application filed with this Commission on May 31, 1974, was signed by Pilato and did not disclose that others besides Pilato were helping to finance applicant. The order alleges that from on or about May 31, 1972 until July 18, 1972, applicant, willfully violated and Pilato and Richards willfully aided and abetted violations of Section 15(b) of the Exchange Act and Rule 15b1-1 thereunder in that applicant's Form BD application among other things, contained inaccurate statements concerning financial arrangements such as the one described above. Although this allegation concerning applicant has been determined (supra), for purposes of this proceeding it is found that applicant, aided and abetted by Pilato and Richards committed the violations as alleged in the order. This activity of Richards in arranging financing for Pilato is further evidence of his behind the scene influence in the entwined affairs of registrant, applicant and Enterprise.

Upon consideration of all the circumstances as outlined above there is no doubt that Richards exercised directly or indirectly a controlling influence over the management and policies of registrant after April 17, 1972. Accordingly, it is found that by failing to promptly file an amendment to disclose such influence registrant willfully violated and Pilato willfully aided and abetted violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

Section 5 of the Securities Act

The order alleges that during the period from on or about April 17, 1972, until July 18, 1972, all of the respondents, except applicant, willfully violated and willfully aided and abetted violations of Section 5(a) and 5(c)

of the Securities Act in that they offered to sell, sold and delivered after sale shares of numerous issuers, including but not limited to Basic Empire, Multinational Industries, and Continental Dynamics, when no registration statement was in effect as to those securities pursuant to the Securities Act.

When registrant took over the operations of Enterprise it continued selling many of the same stocks offered by Enterprise. It also utilized a blackboard in the office on which stocks were listed daily. These stocks were selected by Richards and written on the board with chalk so that erasures and changes could be made from time to time in the prices as well as the stocks offered. Although there were usually about 15 or 20 stocks listed the record shows some 43 stocks offered at prices ranging from 20 cents to \$5.00. Of these 43 stocks only 41 had the semblance of ever being registered. These were Globe Hill, Inc. ("Globe Hill") and Multinational Industries Corporation ("Multinational"). Globe Hill filed under Regulation A on April 9, 1956, and Rio Grand Mortgage & Investment Co., Inc. of which Multinational was the successor, filed under Regulation A on October 16, 1957. There was no showing made by registrant that the shares of these companies, which were sold during the period here pertinent, were in any way subject to the claimed exemptions.

In the case of Globe Hill over 50,000 shares sold by registrant came from one seller. In addition, Globe Hill was the subject of a permanent injunction brought by the Commission on June 196, 1970.

In the case of Multinational this was a dormant shell corporation which Richards' father Melvin E. Richards had gotten control of in 1957. In 1971 registrant had participated in a distribution of Multinational shares for which it received a gift of 2,000 shares from Melvin E. Richards.

As to Continental Dynamics, Inc., no registration statement has been filed and trading in its shares was suspended by the Commission on December 9, 1969 and August 3, 1971 (SEC Releases 9275 and 9297). Also, Continental Dynamics Inc., and Continental Dynamics, Ltd., were the subjects of Commission Litigation Release No. 5340 issued on March 6, 1972.

There is no record in the Commission's files of any registration statements or Regulation A exemption applications ever having been filed for any of the other companies whose shares were being offered by registrant. This includes Basic Empire, Inc.

Respondents' contention is that stocks were sold under an exemption from registration pursuant to Regulation A or that the sale of Basic Empire, Globe Hill, Continental Dynamics and Multinational were exempt sales under the dealer's exemption provided by Section 4(3) of the Securities Act.

The burden of proof regarding the availability of an exemption is upon the one claiming it.^{5/} The respondents have not discharged that burden. Accordingly, it is found registrant and Pilato willfully violated Sections 5(a) and 5(c) of the Securities Act.

Anti-Fraud Provisions

The order charges that from on or about April 17, 1972 until July 18, 1972, all of the respondents, except applicant, willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

^{5/} SEC v. Ralston Purina Co., 346 U.S. 119 (1953); U.S. v. Custer Channel-Wing Corp., 376 F. 2d 675 (CA 2d, 1959).

As stated above under Section 5 of the Securities Act, 41 of 43 stocks traded by Enterprise and its successor registrant had never been registered. Also, 5 of the issuers had been the subject of either suspension, injunction or other litigation by the Commission. These are: Continental Dynamics, Industrial Manufacturing Corp., Barr Financial, Ltd., Globe Hill, and Colorado Energy Corp.

In addition, registrant continuously quoted the stock of Brathendle Original Soup Kettle, Inc., Genie Oil & Gas Corp., Luna Mining Co., Monarch Minerals, Inc., Nutrition Centers, Inc., and Television Corporation of America in the National Quotation Bureau (NQB) pink and white sheets. These were shells with little or no assets, some of them insolvent, about which little information was to be had.

Respondents make no serious attempt to dispute the characterization of many of the stocks dealt in as being those of shell corporations. Rather, they argue that these companies were quoted by registrant at the request of customers who wished to buy and sell them, that these were "penny stocks", and that persons buying them realized that they were speculative.

Respondents cannot evade responsibility by depending upon either the attitude or sophistication of its customers. As this Commission has stated:^{6/}

"Where sale of securities of a shell corporation is involved, it is incumbent on a broker-dealer to exercise special care so as to be reasonably assured that no violation of the securities laws is involved."

6/ Bohn-Williams Securities Corporation, Securities Exchange Act Release No. 9237, p. 4 (9-8-71) See, also Hanley v. SEC, 415 F. 2d 589, 595 (CA 2d. 1969.

By placing quotations for these shell corporations in NQB sheets and on its quote board registrant was inviting negotiations for transactions in those securities at the prices quoted. Therefore, registrant was required to make sufficient investigation to form a reasonable basis for its recommendations regarding those shell corporations. Moreover, registrant's "due diligence" files contained little or no information concerning those companies and Pilato displayed little or no knowledge of their operations, facilities, principals and transfer agents. His only activity was to review the NQB sheets on the theory that if four or five market makers were quoting the stock then it would be a reputable stock for trading.

On the basis of the record herein it is found that registrant and Pilato willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Net Capital Violations

The order for proceeding charges that at various times during the period from on or about January 1, 1969 until July 18, 1972, registrant willfully violated the net capital provisions of Section 15(c) of the Exchange Act and Rule 15c-3^{7/} thereunder.

The record clearly establishes that during the relevant period registrant was in violation of the Commission's net capital requirements

^{7/} Section 15(c)(3) of the Exchange Act, insofar as here pertinent, prohibits securities transactions by a broker-dealer in contravention of the Commission's rules prescribed thereunder providing safeguards with respect to the financial responsibility of brokers and dealers. Rule 15c3-1 provides, subject to certain exemptions not applicable here, that no broker or dealer shall permit his aggregate indebtedness to all persons to exceed 2,000% of his net capital computed as specified in the rule or have a net capital of less than \$5,000.

and that the additional capital required in order to bring it into compliance on the dates indicated was as follows:

<u>Computation Date</u>	<u>Adjusted Net Capital</u>	<u>Additional Capital Required</u>
April 30, 1971	(\$1,280.77)	\$ 6,280.77
May 28, 1971	(8,391.80)	13,391.80
June 30, 1971	(3,427.42)	8,427.42
July 30, 1971	(7,852.51)	12,852.51
August 6, 1971	(3,237.90)	8,237.90
August 20, 1971	(3,146.67)	1,853.33
September 30, 1971	4,653.87	346.13
October 15, 1971	(7,129.70)	12,129.70
October 22, 1971	556.65	4,443.35

The Registrant's net capital position was computed pursuant to Rule 15c-3 and based on an examination of registrant's books and records by an NASD examiner. It is argued on behalf of registrant that the NASD examiner improperly discounted a subordinated loan made by Pilato's wife to registrant and disallowed certain inventory stocks in which registrant was the only market maker. Pilato testified that if these items had been allowed registrant would have been within the net capital rule.

Aside from Pilato's testimony there is no evidence to support registrant's position that it was not in violation of the net capital requirements during the periods specified in the order. Moreover, in addition the deficiencies set forth above, the NASD found deficiencies during an earlier period as follows:

<u>Computation Date</u>	<u>Adjusted Net Capital</u>	<u>Additional Capital Required</u>
February 28, 1969	\$3,179.44	1,820.56
June 30, 1969	4,544.54	455.46
July 31, 1969	4,482.57	417.43

The above cited net capital deficiencies were included in an NASD complaint against Pilato which resulted in his being censured by the NASD on May 19, 1970, and fined \$750.00. The complaint, also, found that registrant had not prepared and maintained its general ledger in accordance with SEC Rule 240.17a-3.

Registrant's arguments are rejected and it is concluded that the evidence supports a finding that registrant willfully violated the net capital provisions of Section 15(c)(3) of the Exchange Act and Rule 15c-3 thereunder.

Failure to Supervise

The order charges Pilato and applicant with failing to reasonably supervise, with a view to preventing the violations alleged therein, persons who were and are subject to their supervision and who committed such violations, for the period from on or about April 17, 1972 until July 18, 1972.

Pilato, as principal of registrant, maintained his office in New York and visited Las Vegas as the occasion required. He was not present to see that the office was properly managed and had to depend on his appointed office manager and Richards who had been charged with violations of the federal securities laws in the Enterprise proceedings. Pilato did not establish any supervisory procedures for the Las Vegas office and had no procedures manual. He testified that he kept in touch with Las Vegas by telephone but this was obviously not enough to prevent the violations which have been found herein. Pilato was under a duty to use reasonable care to see to it that the everyday

operations of registrant's business at its Las Vegas office were properly performed.^{8/} The record demonstrates that Pilato failed in the performance of such duty. Accordingly, it is concluded that Pilato failed reasonably to supervise persons subject to his supervision with a view to preventing the violations committed by them.

Other Matters

The order alleges that from on or about April 17, 1972 until July 18, 1972, Pilato willfully violated and Richards and Ross willfully aided and abetted the violation of the record keeping provisions of the Exchange Act. However, this allegation was not pressed by the Division at the hearing and not alluded to in the recommended findings. Inasmuch as it was not briefed it is regarded as waived for purposes of this proceeding and, accordingly, no finding will be made.

Public Interest

The Division urges that it is in the public interest, on the basis of the willfull^{9/} violations committed by registrant and Pilato, that the registration of registrant with the Commission as a broker-dealer be revoked and that Pilato be barred from being associated with any broker or dealer.

The violations found to have incurred herein are numerous, serious and varied. Each violation has been previously discussed in detail but the

^{8/} Madison Management Corp., 42 SEC 390, 392 (1964); General Investing Corporation, 41 SEC 952, 958 (1964).

^{9/} It is well established that a finding of willfullness does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing. Billings Associates, Inc.,⁴³ SEC 641, 649 (1967); see e.g. Biesel, Way & Company, 40 SEC 532, 536 (1961).

cumulative effect must be taken into account in considering the appropriate sanctions to be applied for the protection of investors. This is particularly true as to Pilato who allowed himself to be used as a cover-up for the continuation of violations already sanctioned by the Commission. Respondents, in denying such cover-up, depend almost entirely on the testimony of Pilato which, for the most part, was vague, hesitant, contradictory and generally not creditable.

The record of the registrant and Pilato, as evidenced by the violations found in this proceeding, reflects either an unwillingness or a lack of capacity to operate as a broker-dealer in conformity with applicable laws and regulations. The impression imparted by Pilato through his actions as reflected by the record and his appearance as a witness is that of an individual who has no comprehension as to what is required to properly manage a securities business. This is illustrated by his willingness to act as a front for Richards and his failure to properly supervise the staffing, registering and operations of the Las Vegas branch office.

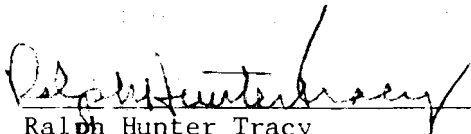
In view of the nature and extent of the violations and the lack of any genuinely mitigating factors, it is concluded that the public interest requires that the registration of the registrant be revoked, and that Pilato be barred from association with a broker or dealer.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer of Andrew A. Pilato (registrant) is revoked and the firm expelled from membership in the National Association of Securities Dealers, Inc., and that Andrew A. Pilato is barred from association with a broker-dealer.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(f), unless 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 for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.^{10/}


Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.
June 26, 1974

^{10/} To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected.