

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
April 26, 1967

In the Matter of :
A. T. BROD & COMPANY : SUPPLEMENTAL
70 Wall Street : FINDINGS
New York, New York : AND OPINION
File No. 8-6503 :
Securities Exchange Act of 1934 - :
Sections 15(b), 15A and 19(a)(3) :

BROKER-DEALER PROCEEDINGS

Fraudulent Representations in Offer and
Sale of Securities

Where securities salesman made false and misleading representations and predictions in offer and sale of stock concerning, among other things, issuer's process for pork production, franchises sold by issuer and their profit potential, and future market price of stock, held, willful violations of anti-fraud provisions of Securities Act of 1933 and Securities Exchange Act of 1934.

APPEARANCES:

James W. Fredericks and William P. Sullivan, for the Division of Trading and Markets of the Commission.

Darwin Charles Brown, of Brown and Isakov, for John C. Pappas.

The remaining issues in these consolidated proceedings under the Securities Exchange Act of 1934 ("Exchange Act") are whether John C. Pappas, while employed by A. T. Brod & Company ("Brod"), a registered broker-dealer, willfully violated or aided and abetted Brod's violations of the Securities Act of 1933 and the Exchange Act in connection with the offer and sale of stock of Agricultural Research Development, Inc. ("AGR"). 1/

Following hearings, the hearing examiner found that Pappas had willfully violated certain anti-fraud provisions of the securities acts but determined that it was unnecessary to decide whether he had willfully violated other designated provisions of those acts. Exceptions and briefs were filed by Pappas and our Division of Trading and Markets, and we heard oral argument. Our findings are based upon an independent review of the record.

1/ On September 11, 1963, pursuant to an offer of settlement, we suspended Brod from membership in the National Association of Securities Dealers, Inc. for 40 days. 41 S.E.C. 643.

AGR was organized in 1959 and proposed to raise hogs and engage in related activities. In August 1960, it commenced a public offering of 120,000 shares of common stock at \$2.50 per share pursuant to Regulation A (17 CFR 230.251 et seq.) under the Securities Act. In February 1961, AGR filed a Form 2-A report stating that the offering had been terminated after the sale of 39,685 shares. 2/

Pappas, who had become employed by Brod as a salesman in October 1960, sold a total of 3,775 shares of AGR stock to 22 customers between March and May 1961. In the course of his sales efforts he made false and misleading representations and predictions. After another Brod salesman, who had no supervisory functions, told him on March 28, 1961 that AGR had signed a franchise agreement and gave him certain other information, Pappas promptly called all his customers and recommended that they purchase AGR stock. Although he had not seen any franchise agreement, or any current financial statements, he admittedly advised the customers that he had been told that AGR had sold its first franchise for \$500,000, that it was anticipated that the company would sign a few more franchises that year, that the company believed it could realize a net profit of \$100,000 from each franchise sold, and that he thought the price of the stock would appreciate greatly. According to four customer-witnesses, who purchased a total of 875 shares at prices ranging from 7 to 17, Pappas represented that AGR stock would be "moving", was a good investment of which the customer should buy all he could afford, that he thought the stock would appreciate 50, 80 or 100 per cent, and that AGR had a new and exclusive process for raising disease-free hogs and would have a profit of \$300,000 from five franchise contracts which had been signed.

All these extravagant statements and predictions about AGR and its stock had no basis in fact. 3/ AGR's offering circular, dated August 3, 1960, which Pappas had examined, showed that as of that date it had current assets of only \$9.15, as against current liabilities of \$16,389, and stated that unless substantially all the shares offered were sold, AGR could not engage in its proposed business and might lose its principal asset, a heavily mortgaged farm, through foreclosure. During the period following the purported termination of the offering in February 1961, AGR's financial condition became even more critical

2/ In fact, only 9,685 shares had been sold by the underwriter and the remaining 30,000 shares were placed in the names of nominees designated by a controlling person of AGR. On April 19, 1961, we temporarily suspended the Regulation A exemption with respect to the AGR offering. Securities Act Release No. 4357. Our order included charges that the offering circular was false and misleading in failing to disclose, among other things, the activities of a principal stockholder in connection with the distribution of AGR stock, that the Form 2-A report contained false statements, and that the offering was made in violation of the anti-fraud provisions of Section 17 of the Securities Act. No request for a hearing having been made, the suspension was made permanent.

3/ The predictions of substantial price increases for these speculative securities were inherently fraudulent. See, e.g., Harris Clare & Co., Inc., Securities Exchange Act Release No. 8004, p. 3 (December 9, 1966).

than before. As the examiner found, AGR could not pay its debts as they became due, and certain officers and directors signed a note to obtain funds to pay the interest on the first mortgage on AGR's farm. ^{4/} Further, AGR had in fact signed no franchise agreements by March 28, and while it did shortly thereafter enter into two franchise agreements for the use of its process of producing hogs, under those agreements each franchise holder was firmly committed to purchase only 330 pigs from AGR for a total price of \$38,250. ^{5/} Moreover, as stated in the offering circular, AGR's process for raising hogs was not unique.

Pappas contends that any violations by him were not willful. While conceding that he misinformed his customers, he asserts that his representations were made through "ignorance, fostered" by Brod, that he acted in good faith and reasonably relied on the information given to him, which he claims was confirmed by the officers of AGR, and that he was the gullible tool of a conspiracy whose members included practically every person to whom he could have turned for verification, and he points out that he himself purchased AGR stock on the basis of such information. Pappas also claims to have relied on the fact that AGR stock was increasing in price and that only a limited amount was available. He further asserts that three of the four customer-witnesses were more sophisticated than he, and that there is no proof that they relied on his statements.

These arguments are without merit. As noted, the offering circular examined by Pappas presented the picture of a business not yet in operation, in precarious financial condition and in danger of losing its principal asset, and wholly dependent upon a successful stock offering to permit even a commencement of operations. Pappas admittedly knew that only a short time prior to his initial sales the AGR offering had been terminated because less than 1/3 of it could be sold. Despite these "red flags" Pappas made no attempt to obtain more current data concerning the operations of AGR. When another Brod salesman had first mentioned to him that AGR was attempting to sell franchises for \$500,000, he had "dismissed the idea" as "kind of ridiculous" for "this little outfit." It is clear that under these circumstances, and in the absence of current financial information and of concrete information showing that AGR's fortunes had suddenly taken a dramatic turn for the better, Pappas was not justified in relying on the unsubstantiated generalities furnished to him, ^{6/} or on the rising price of the stock. "The protection from fraud to which investors are entitled cannot be dissipated by claims of naivete or gullibility on the part of those who hold themselves out as professionals with specialized knowledge and

^{4/} As of August 31, 1961, AGR had current assets of \$87,347, current liabilities of \$339,178, and an earned surplus deficit of over \$425,000.

^{5/} The franchise holders were each obligated to purchase an additional 700 pigs but only if their sales through AGR of pigs produced by the 330 pigs initially purchased reached a certain level.

^{6/} Cf. Lawrence Securities, Inc., 41 S.E.C. 652 (1963); Shearson, Hammill & Co., Securities Exchange Act Release No. 7743, p. 21 (November 12, 1965); Crow, Brouman & Chatkin, Inc., Securities Exchange Act Release No. 7839, pp. 8-9 (March 15, 1966).

skill and undertake to furnish guidance. . . ." 7/ It is clear therefore that Pappas' violations were willful within the meaning of the Exchange Act since he intentionally made optimistic predictions and representations without a reasonable basis. 8/ Moreover, the fact that some of Pappas' customers may have been sophisticated investors cannot excuse fraudulent representations made to them; 9/ and it is unnecessary to show reliance on such representations in order to establish violations of the anti-fraud provisions. 10/ Finally, that Pappas himself bought AGR stock does not aid him. "A salesman's willingness to speculate with his own funds without reliable information gives him no license to make false and misleading representations to induce his customers to speculate." 11/

Accordingly, we find that Pappas willfully violated and aided and abetted Brod's willful violations of the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder. 12/

Other Matters

Pappas contends that under various constitutional provisions he was entitled to be represented by counsel at all stages of these proceedings, and that since he assertedly was unable to afford counsel except as noted below, he should have been provided with appointed counsel. 13/ We cannot agree. The right to have counsel appointed to

7/ Alfred Miller, Securities Exchange Act Release No. 8012, p. 5 (December 28, 1966).

8/ See Tager v. S.E.C. 344 F.2d 5, 8 (C.A. 2, 1965); Dlugash v. S.E.C., ___ F.2d ___ (C.A. 2, February 21, 1967).

9/ Underhill Securities Corporation, Securities Exchange Act Release No. 7668, p. 6 (August 3, 1965); Hamilton Waters & Co., Inc., Securities Exchange Act Release No. 7725, p. 6 (October 18, 1965).

10/ See Hamilton Waters & Co., Inc., *supra*, and cases there cited.

11/ Shearson, Hammill & Co., Securities Exchange Act Release No. 7743, p. 22 (November 12, 1965).

12/ Pappas was also charged with willful violations of the registration provisions of Sections 5(a) and (c) of the Securities Act in the offer, sale and delivery of AGR stock and of the anti-manipulation provisions of Rule 17 CFR 240.10b-6 under Section 10(b) of the Exchange Act in bidding for and purchasing such stock while engaged in distributing it. On the record before us we are unable to make adverse findings with respect to these issues.

13/ Pappas initially appeared at the hearings without counsel. After the first customer-witness had testified against him, Pappas stated that he believed he could afford counsel for the purpose of cross-examining only that witness. He declined the hearing examiner's offer of a one-week postponement of the hearings and was granted permission to postpone his cross-examination of such witness for a reasonable time to enable him to obtain counsel. The three other customer-witnesses then testified, and Pappas cross-examined each of them. Thereafter, following a postponement of the hearings in order to enable Pappas to secure counsel, an attorney appeared in his behalf and cross-examined the first customer-witness, was present during

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represent impecunious respondents in our administrative proceedings was considered in Boruski v. S.E.C. 14/ where the respondent, who was without counsel throughout the proceedings, made a similar argument. The Court of Appeals, in rejecting the argument, stated, "We know of no requirement that counsel be appointed in these administrative proceedings. The orders, although serious in their effect, are not criminal judgments."

We also reject Pappas' argument that the examiner erred in permitting the introduction into the present proceedings of the record of proceedings previously instituted with respect to Brod, Pappas and others. Those proceedings had been terminated under the doctrine of Amos Treat & Co. v. S.E.C., 15/ because of a challenge to the qualifications of certain members of this Commission, without prejudice to the subsequent institution of new proceedings without the participation of the challenged Commissioners. In another proceeding involving precisely the same issue 16/ and in the instant proceedings, 17/ we held the prior record admissible, and we adhere to that position.

Public Interest

Pappas urges that the public interest does not require that he be precluded from working in the securities business. 18/ He asserts that he lost his position with Brod in 1961 as a result of our investigation into the sale of AGR stock and states that he has been unable to find employment in the securities business since that time. He further states that he has not previously been accused of any securities violations. Pappas also points to the fact that others found to have participated in unlawful activities in connection with the sale of AGR stock, including Brod and John Meslovich, a salesman, were permitted to continue in the securities business. 19/

13 contd./

Pappas' own testimony as a Division witness, and has since continuously represented him in these proceedings. Neither Pappas nor his counsel has challenged the accuracy of the pertinent testimony of the three customers whom counsel did not cross-examine.

14/ 340 F.2d 991, 992 (C.A. 2, 1965).

15/ 306 F.2d 260 (C.A.D.C., 1962).

16/ Siltronics, Inc., 41 S.E.C. 658 (1963).

17/ R. Baruch and Company, Securities Exchange Act Release No. 7932, p. 10 (August 9, 1966).

18/ Under Section 15(b)(5) of the Exchange Act, the willful violations by Pappas subject him to a disqualification with respect to his continuance or reentry in the securities business.

19/ As previously noted, Brod was suspended for 40 days from membership in the National Association of Securities Dealers, Inc. Findings of willful violations of Section 5 of the Securities Act and Rule 17 CFR 240.10b-6 under the Exchange Act made as to Meslovich were held not to bar his employment in the securities business in an appropriately supervised capacity (R. Baruch and Company, Securities Exchange Act Release No. 7932 (August 9, 1966)).

The remedial action which is appropriate in the public interest depends upon the facts and circumstances of each case and cannot be precisely determined by comparison with action taken in other cases. 20/ Suffice it to say that Meslovich was not found to have made any fraudulent representations to customers and that as to both Brod and Meslovich there were certain mitigating factors, including as to the latter the fact that he had only been in the securities business a short time when he committed his violations whereas Pappas had five years' experience in the securities business before he was employed by Brod. In our view, Pappas' conduct reflects at the least a gross indifference or insensitivity to his obligations as a securities salesman, and on the record before us makes it inappropriate in the public interest to authorize his continuance in the securities business. 21/

By the Commission (Commissioners OWENS, BUDGE and WHEAT), Chairman COHEN and Commissioner WOODSIDE not participating.

Orval L. DuBois
Secretary

20/ Martin A. Fleishman, Securities Exchange Act Release No. 8002, p. 5 (December 7, 1966).

21/ The exceptions to the recommended decision of the hearing examiner are overruled or sustained to the extent they are inconsistent or in accord with our decision.