ADMINISTRATIVE PROCEEDING
FILE NO. 3-364

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

WALDMAN & CO. (8-11460)

SEYMOUR WALDMAN
ELLIOT ROSE
BERNARD PORTNOY
FRANK ENGELMAN
JULIUS GLADSTEIN
SAMUEL LEWIS
STUART DAVIS
LOUIS PILNICK
REUBIN EHRLICH
MARTIN A. FLEISHMAN
NORMAN B. BABAT
NORMAN POLLISKY
AARON J. GABRIEL
ALLAN HARRIS

INITIAL DECISION

Warren E. Blair
Hearing Examiner

Washington, D. C.
January 3, 1966

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Before: Warren E. Blair, Hearing Examiner

Appearances: David Marcus, Robert G. Willner, Michael P. Stern and Michael Gettelman of the New York Regional Office of the Commission, for the Division of Trading and Markets

Martin M. Frank, of Feldshuh & Frank, for Waldman & Co.

Proceedings in this matter were instituted by the Commission on November 3, 1965 under an Order for Public Proceedings ("Order") pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether allegations of the Division of Trading and Markets ("Division") that the respondents, Waldman & Co. ("registrant"), Seymour Waldman ("Waldman"), Elliot Rose, Bernard Portnoy, Frank Engelman, Julius Gladstein, Samuel Lewis, Stuart Davis, Louis Pilnick, Reubin Ehrlich, Martin A. Fleishman, Norman B. Babat, Norman Pollisky, Aaron J. Gabriel, and Allan Harris wilfully violated and wilfully aided and abetted violations of the Securities Act of 1933 ("Securities Act") and the Exchange Act are true, whether remedial action pursuant to Sections 15(b) and 15A of the Exchange Act is necessary, and whether, pending final determination of those issues, it is necessary or appropriate in the public interest or for the protection of investors to suspend the registration of registrant.

The Division alleged in substance that the respondents, during the period from January 1, 1964 to November 31, 1965, wilfully violated Section 17(a) of the Securities Act, and Sections 10(b) and 15(c)(1) of the Exchange Act, and Rules 10b-5 and 15c1-2 thereunder, by offering and selling the common stocks of Development Corporation of America ("DCA") and of United Utilities Corp. of Florida ("UUF") by means of an intensive "boiler-room" type sales campaign which included use of various misrepresentations and omissions of material

facts concerning the present operations and future activities of DCA and UUF and the prospects of financial reward from investments in the stocks of those companies. The Division also charged that registrant, Waldman, and Rose, wilfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1 ("Net Capital Rule") thereunder by engaging in business at times when registrant's aggregate indebtedness exceeded 2,000 per centum of its net capital. The Order further sets forth that the Commission's public files disclose that the United States District Court for the Southern District of New York entered an order on May 13, 1965 preliminarily enjoining registrant, Waldman, Rose, Fortnoy, Gladstein, Pilnick, Ehrlich, and Fleishman from violations of the anti-fraud provisions of the Securities Act and the Exchange Act in the offer and sale of common stocks of DCA and UUF. Additionally, reference is made to a permanent injunction entered on June 1, 1965 by the United States District Court for the Southern District of Florida which enjoined Babat from violations of the anti-fraud and registration provisions of the Securities Act and the anti-fraud provisions of the Exchange Act in the offer and sale of the securities of two other companies not here involved.

Answers which included general denials of the Division's allegations were filed by all respondents except Babat, Davis, Engelman, and Pilnick.

A preliminary hearing limited to the question of whether a suspension of registrant's registration was necessary or appropriate pending final determination of the other issues in this matter was held pursuant to the Order. Timely filings of proposed findings, conclusions and briefs were made by counsel for registrant and counsel for the Division.

The following findings and conclusions are based upon the record and upon observation of the witnesses appearing at the hearing.

Background of Registrant

Registrant, under its present name and previous style of Waldman, Rose & Co., has been registered under the Exchange Act as a broker-dealer since May 11, 1963. It is presently a member of the National Association of Securities Dealers, Inc. ("NASD"). Waldman and Rose were general partners of registrant until March 12, 1965, at which time the registrant became a partnership of Waldman and Lucille Waldman. Respondents Babat, Davis, Engelman, Fleishman, Lewis, and Portnoy were salesmen employed by registrant during the period in question. On the dates that registrant employed Babat, Engelman, Fleishman and Portnoy, or during the course of that employment, each of them was or became a respondent in proceedings instituted by the Commission under the Exchange Act.[1/] In addition, Babat's securities

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1/ Thomas F. Quinn, et al., File No. 8-8997, January 11, 1965 (Babat, Fleishman); William Glanzman & Co., Inc., File No. 8-10312, May 27, 1963 (Engelman); Costello, Russoto & Co., File No. 8-9178, May 24, 1965 (Fleishman); Fabrikant Securities Corporation, File No. 8-9565, July 17, 1964 (Portnoy).

activities prior to his employment by the registrant resulted in the United States District Court for the Southern District of Florida permanently enjoining him from violations of the registration provisions of the Securities Act and the anti-fraud provisions of the Securities Act and Exchange Act.[2/] The injunction was entered against Babat on June 1, 1965 when he was still in registrant's employ. An amendment to the registrant's application for registration disclosing that injunction was filed June 16, 1965.

On April 20, 1965 the Commission instituted action in the United States District Court for the Southern District of New York seeking to enjoin registrant, Waldman, Rose, Ehrlich, Fleishman, Gladstein, Pilnick, and Portnoy from violating the anti-fraud provisions of the Securities Act and Exchange Act in the offer and sale of stock of DCA and of UUF.[3/] Pending final determination, a preliminary injunction was entered on May 13, 1965 against those defendants enjoining them from making untrue statements of or omitting to state material facts in the offer and sale of DCA and UUF stocks concerning, among other things, the earnings or dividend policies of DCA or an increase in the market price of DCA stock. Subsequent to the entry of the preliminary injunction, registrant continued to use the mails and means or instruments of communication in interstate commerce to offer and sell DCA stock.

2/ S.E.C. v. Bankers Intercontinental Investment Co., Limited, et al., No. 65-24 - Civ. - CF (D.C.S.D. Fla. - 1965).

3/ S.E.C. v. Waldman, Rose & Company, et al., 65 Civ. Action 1198 (D.C.S.D.N.Y. - 1965).

DCA and UUF

DCA was incorporated in 1960 for the purpose of constructing homes or operating in fields affiliated with home construction in Florida; Alvin Sherman has been DCA president since its formation. In 1961, 200,000 shares of DCA stock were offered and sold to the public; thereafter, DCA stock has been traded over-the-counter.

For the year 1960, DCA net income after taxes was $201,603; its net income declined in the years following. Earnings for 1963 were about $75,000, or 11¢ per share, and declined in 1964 to $20,312, or less than 3¢ per share.

In October, 1963, a contract was entered into by DCA with one of its organizers and promoters, Alan Fink, under which DCA agreed to reacquire and retain in its treasury the 297,582 shares of DCA stock owned by Fink. DCA gave Fink its $297,000 note in this transaction, payable over a twenty year period ending December 31, 1983, in annual installments of $10,000, plus an amount equal to 50% of DCA's net profits in excess of $10,000. DCA further agreed that while any portion of the note's principal remained unpaid, it would not "declare and pay a dividend in any year in which its then current obligation under the Promissory Note is not fully satisfied."

UUF, of which Sherman is also president, was a wholly-owned subsidiary of DCA until latter 1962 when DCA spun-off the UUF shares it held to DCA shareholders on a basis of 3 shares of UUF for every 10 shares of DCA. UUF is a utility company primarily engaged in installing systems and supplying gas to residential areas.

Earnings of UUF in 1962 and 1963 were less than in 1960 and 1961, and for the year 1963 the company's net income was $1441, less than 1/2¢ per share. In 1964, earnings fell to $778, or about 1/4¢ per share. Stockholders' equity was increased, however, by 32¢ per share in 1963 and 6¢ per share in 1964, because UUF benefited from contributions to it in aid of construction. These contributions, almost entirely received from DCA, were received pursuant to a practice in Florida by which real estate developers, in effect, pay for the installation of utilities as a cost of developing their lots. Such contributions are not treated on the books of UUF as earnings, and appear on UUF's statements of income and expense as a separate item apart from net income and retained earnings.

During the course of personal meetings and through information given by telephone or sent by mail during 1963 and 1964, Sherman kept Waldman and Rose acquainted with the results of operations and prospects of DCA and UUF. In particular, DCA income statements for the years 1961 and 1962 were made available, as were the 1963 annual reports of DCA and UUF. Waldman and Rose also knew of the Fink contract and its terms, and were told that 1964 would not be a good year for DCA.

Sales of DCA and UUF Stock by Registrant

Registrant's interest in the common stocks of DCA and UUF was a matter of deliberate choice made in 1963, and that interest remained constant thereafter. The concentration of registrant on those stocks is well illustrated by the fact that transactions in DCA and UUF stocks

constituted 80% to 90% of its business during the period from July, 1964 to May, 1965.

Testimony of six of registrant's customers indicates that four of registrant's salesmen used high-pressure sales techniques in offering and selling DCA and UUF stock to unsophisticated investors, and in doing so, resorted to misrepresentations and omissions of material facts concerning the companies and their prospects. Adequate inquiry was not made about the financial position of these customers, some of whom could ill afford to risk their money on speculative stocks, nor were their investment needs or objectives determined.

Davis induced Mrs. Harriet Larson, a secretary, to make two purchases of DCA stock through representations made during the course of numerous telephone calls to her that investors would receive stock of a hardware company to be formed by DCA; that an investment was practically without risk, practically guaranteed to make money, and would provide enough money for a vacation and the needed repairs to her car. It appears that Rose also called this customer for the purpose of implying that Davis was offering DCA stock only to friends.

Lewis sold DCA stock to Seebert Gregory, a junior high-school science teacher, in November, 1964 by telling him that the price of the stock would double by January 1, 1965; that DCA would pay a substantial dividend on January 2, 1965.

A series of telephone calls from Pilnick caused Adolph Abbondanza, a mechanic, to purchase DCA stock on November 6, 1964 and a second time two weeks later. Pilnick represented that DCA had earned 12-1/2¢ in

1963; that DCA's forthcoming annual report for 1964 would reflect earnings of 80¢ per share and would make DCA stock worth $8 or $9 per share; that DCA stock had a book value of $6 or $7 and was well worth more than its market price; and that DCA would soon spin-off stock of a subsidiary which was expected to be worth $5 per share.

By dint of multiple telephone solicitations near the end of 1964 and during the first half of 1965, Fleishman made two sales of DCA stock to Mrs. Lenore Alper, a housewife, and one to Joseph Mulvey, a government worker, as well as two sales of DCA and one of UUF stock to Edward Bauer, a purchasing clerk. In his sales talks Fleishman estimated DCA's earnings for 1964 to be 40¢ to 50¢ and ranging between 64¢ and $1 per share for the year 1965. Other representations made about November, 1964 when DCA stock was being sold at about $3, were that the price "would double shortly to about $6" and "would go to about $6 at least." In May, 1965 Fleishman represented that the DCA stock then selling around $5 per share "would be selling for $10 before the end of the year." Representations were also made by Fleishman that DCA stock would be listed on the American Stock Exchange and that dividends would be paid in 1965. Fleishman also sold UUF stock to Bauer by telling him that UUF earnings were good in 1963 and 1964 and would be better in 1965.

Time and again the Commission has condemned sales practices that rely upon predictions of substantial price rises within relatively short periods of time in order to persuade investors to purchase specu-

lative securities in an unseasoned company.[4/] Equally offensive are representations and opinions of optimistic nature which have no basis in fact.[5/]

Nor is the obligation of a broker-dealer to deal fairly with its customers met by a registrant which holds out a lure of quick profits through investment in highly speculative securities, even when such possibility exists, unless at the same time the substantial risks of loss are made known in a clear and unequivocal manner.[6/] This, registrant did not do. It is evident that at least some of registrant's customers bought DCA stock in the mistaken belief brought about by registrant's salesmen that the risk of loss was negligible or nil.

The testimony of Sherman, and Waldman's testimony on behalf of the registrant, establish that registrant was well aware before making the sales in question that DCA's earnings probably would be less in 1964 than in 1963. In the light of that knowledge and of the fact that DCA's earnings were only 12¢ per share in 1963, there was no reasonable basis for predictions that earnings would reach 40¢ in 1964, much less 64¢ or $1 in 1965; similarly, predictions concerning a prospective doubling in the price of DCA's stock within any foreseeable time could not be justified. With respect to the representation that

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4/ Hamilton Waters & Co., Inc., Securities Exchange Act Release No.7725, p. 4 (October 18, 1965); Albion Securities Company, Inc., Securities Exchange Act Release No. 7561, p. 3 (March 24, 1965); Alexander Reid & Co., Inc., 40 S.E.C. 986, 990 (1962).

5/ Alexander Reid & Co., Inc., supra.

6/ Leonard Burton Corporation, 39 S.E.C. 211, 214 (1959).

DCA's book value was $6 or $7 per share, it suffices to note that the DCA financial statements for 1963 in registrant's possession indicated such book value to be no more than $2, and that Sherman never informed anyone that in the years 1963 through 1965 the book value exceeded $3. No basis existed for the representations concerning dividends, and even if a conclusion that dividends were in the offing were warranted, a representation respecting such payment would be misleading under the circumstances here unless investors were advised of the restriction on payment of dividends imposed by the Fink contract. Neither was there a valid basis for predictions of a spin-off of DCA's hardware subsidiary. The most that Sherman ever indicated was that the DCA directors informally favored the spin-off, and that indication is a far cry from sufficient reason to represent that a spin-off would soon take place. That the stock of DCA was soon to be listed on the American Stock Exchange was likewise a palpable misrepresentation without the slightest foundation. The fact is that in 1962 Sherman considered listing DCA on the American Stock Exchange but dropped the idea when the Exchange refused to waive one of its listing qualifications that DCA could not meet.

The record is equally clear that the representations relating to UUF earnings were misleading. Earnings of 1/2¢ per share on stock selling at a price of more than $5 cannot reasonably be considered "good." Even assuming some justification for such characterization, the representation would still be misleading under the circumstances here unless at the same time the investors were told the specific amount of the earnings.

Registrant contends, for various reasons which are not persuasive, that the testimony of its customers is not to be credited.

Abbondanzo did not impress the Examiner as having such bias against either registrant or Pilnick as to make his testimony unbelievable, whereas Pilnick's testimony was self-serving and untrustworthy. Pilnick's categorical denials that he made the representations attributed to him by his customer are in sharp contrast to his inability to recall the substance of those conversations in any detail. Moreover, Pilnick admitted that he told this customer that DCA stock would appreciate in price.

Fleishman's self-serving denials are equally unimpressive in the light of the forthright and disinterested testimony of Mulvey, who canceled his purchase of DCA stock before making payment. The pattern of Fleishman's sales practices which emerges from the testimony of three of his customers also indicates those denials are unworthy of credence.

The customers of Davis and Lewis are also convincing in their testimony and no reason appears for not accepting their versions of the means employed to induce them to buy DCA stock.

A preliminary showing has been made indicating serious misconduct by registrant's salesmen in offering and selling DCA stock and UUF stock by means of false and misleading statements. This misconduct becomes that of the registrant because of the responsibility imposed upon the registrant upon entering the securities business. 7/

7/ Reynolds & Co., 39 S.E.C. 902, 917 (1960).

Registrant's position that it did everything possible under the circumstances to supervise its salesmen is not well taken. Registrant knew or should have known that four of its salesmen were or had become subjects of proceedings under the Exchange Act and that the backgrounds of three of those salesmen, one being Fleishman, included past employment with securities firms whose registrations as broker-dealers had been revoked by the Commission. Although it is true, as registrant argues, that these salesmen at the time of their employment were not subject to statutory impediment, and were registered with the NASD, it is equally true that the registrant was put on notice of the need for closer supervision of these salesmen than would ordinarily be required. Not only did registrant neglect to take the additional precautions dictated by its decision to employ and to continue the employ of Babat, Engelman, Fleishman and Portnoy, it failed to maintain such supervision as would be required in ordinary circumstances to detect overreaching of its customers. Occasional monitoring of telephone conversations of salesmen with customers and nothing more is not adequate supervision of a sales force engaged in selling highly speculative securities, and such monitoring is all that appears to have been done by registrant.

Public Interest

In view of the preliminary showing of registrant's misconduct of a nature indicating a likelihood that wilful violations of the antifraud provisions of the Securities Act and Exchange Act have been committed and that revocation of registrant's registration may well

result therefrom, it is necessary to determine whether the public interest or protection of investors requires suspension of registrant's registration as a broker-dealer pending final determination of whether such registration should be revoked.[8/] It is concluded that suspension is necessary in the public interest and to preclude a continuance of the offending sales practices pending final resolution of the revocation question.

In reaching this conclusion, the Examiner was not unmindful of the fact that registrant would suffer most serious consequences and that a suspension might well, as pointed out by registrant, be the end of registrant's business life. However, the need to enlist the aid of a Federal court to enjoin registrant from violations of the Securities Act and Exchange Act in the offer and sale of DCA and UUF stock, and the apparent pertinacity of Fleishman's sales practices in the face of that injunction, indicate a strong probability that registrant is unable or unwilling to change its methods of doing business pending the final outcome of these proceedings. In weighing the burden imposed upon the registrant by a suspension of its registration against that placed upon an investing public by an exposure to registrant's continued solicitations, it is clear that the latter outweighs the former.

8/ Section 15(b)(6) provides with respect to such suspension:

> "Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors."

Accordingly, effective as of the date the Commission enters an order pursuant to this initial decision as provided by Rule 17 of the Rules of Practice (17 CFR 203.17), and subject to the provisions for review afforded by that rule as modified by Rule 19 of the Rules of Practice (17 CFR 203.19),

IT IS ORDERED that the registration of Waldman & Co. as a broker-dealer be suspended pending final determination whether such registration shall be revoked. 9/

Warren E. Blair
Hearing Examiner

Washington, D. C.
January 3, 1966

9/ All proposed findings and conclusions of the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this Initial Decision, they are accepted.