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ADMINISTRATIVE PROCEEDING
FILE NO. 3-145

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

F. R. BURNS & COMPANY (8-4205)
FLOYD R. BURNS

INITIAL DECISION

Sidney L. Feiler
Hearing Examiner

Washington, D. C.
March 21, 1966

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APPEARANCES: E. Byron Crosier and Leo Fred Wyrick, Esqs.
for the Division of Trading and Markets

Paul C. Duncan, Esq.
2401 First National Building
Oklahoma City, Oklahoma 73104,
for F. R. Burns & Company and Floyd R. Burns

BEFORE: Sidney L. Feiler, Hearing Examiner

I. THE PROCEEDING

The Commission, by order, instituted this proceeding pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, as amended, ("Exchange Act") to determine whether the respondent, F. R. Burns & Company ("the registrant"), willfully aided and abetted by the respondent Floyd R. Burns, its president, willfully violated the Exchange Act as alleged by the Division of Trading and Markets ("Division"); what, if any, remedial action is appropriate in the public interest; and whether to permit a notice of withdrawal of the registrant from registration to become effective, and, if so, whether it is necessary in the public interest and for the protection of investors to impose terms and conditions under which the said notice of withdrawal may be permitted to become effective.

The Division alleged in substance that the registrant, aided and abetted by Burns, violated applicable provisions relating to the net capital to be maintained by brokers and dealers; that it violated anti-fraud provisions in the Exchange Act by buying and selling securities from customers at prices having no reasonable relationship to the prevailing market price; that it failed to make and keep current books and records relating to its business; that it extended credit to customers in violation of applicable regulations; and that it filed a report of financial condition which was false and misleading. The respondents filed answers denying any willful violations by them of the Exchange Act.

Pursuant to notice, a hearing was held in Oklahoma City, Oklahoma. All parties to the proceeding were represented by counsel. Full opportunity to be heard and to examine and cross examine witnesses was afforded

the parties. At the completion of the presentation of evidence, opportunity was afforded the parties to state their position orally on the record. Oral argument was waived. Opportunity was then afforded the parties for filing proposed findings of fact and conclusions of law, or both, together with briefs in support thereof. Proposed findings, together with supporting briefs, were submitted on behalf of all parties to the proceeding.

Upon the entire record and from his observation of the witnesses, the undersigned makes the following:

II. FINDINGS OF FACT AND LAW

A. The Registrant

The registrant, an Oklahoma corporation, has been registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act since April 15, 1955. At all times here relevant, Floyd R. Burns has been the president, a director, and beneficial owner of ten per cent or more of the capital stock of the registrant. Registrant is a member of the National Association of Securities Dealers, Inc., a national securities association, registered pursuant to Section 15A of the Exchange Act ("NASD").

Registrant and Floyd R. Burns are permanently enjoined by decree of the United States District Court for the Western District of Oklahoma entered on April 15, 1965, on consent, from engaging in violations of net capital and record-keeping regulations, and credit restrictions, as set forth in the Exchange Act and applicable rules (Div. Ex. 1).

By letter received April 26, 1965, the registrant notified the Commission that after March 27, 1965, it had engaged in the securities business only to the extent necessary to wind up its affairs and that it desired to withdraw as a registered broker-dealer.

B. Violations of the Net Capital Rule

It is alleged in the order for this proceeding that during the period from about October 31, 1964 to about April 16, 1965, the registrant willfully violated, and Burns willfully aided and abetted violations of the net capital rule.[1/]

M. D. Leach, a Securities Investigator for the Commission, visited the premises of the registrant from February 23 through February 26, 1965, and March 23 through March 26, 1965, during which times he made a comprehensive examination of the books and records of the registrant. He found net capital deficiencies[2/] in the registrant's finances during the months of October, November, and December, 1964 and January and February, 1965. These amounts were as follows:

		[3/]
October 31, 1964	-	$ 3,422.10
November 30, 1964	-	61,755.84
December 31, 1964	-	14,591.21
January 31, 1965	-	32,820.32
February 28, 1965	-	17,406.21

1/ The net capital rule, Rule 17 CFR 240.15c3-1, promulgated by the Commission pursuant to Section 15(c)(3) of the Exchange Act, provides that "No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 2,000 per centum of his net capital." It further provides that the net capital of a broker or dealer is to be computed by deducting from his net worth "fixed assets and assets which cannot be readily converted into cash."

2/ Additional assets needed in registrant's accounts to be in compliance with the net capital rule.

3/ This deficiency does not include any deduction for a $50,000 item carried by the registrant as an asset whose inclusion the Division has challenged.

The respondents do not challenge the computations made by Leach but they do take issue with his valuation of certain over-the-counter stocks in registrant's portfolio. Leach testified that as to these securities he checked for quotations in the Wall Street Journal and in the National Daily Quotation Bureau (known as the "sheets"). If he did not find any quotations in these sources he ascribed no value to the particular over-the-counter issue. The registrant's accountant, on the other hand, testified that in preparing financial material, such as a financial statement of the registrant as of October 31, 1964, he asked a girl employed in the trading room of the registrant for quotations on over-the-counter securities and was guided by quotations she supplied and some quotations from a local newspaper. The registrant did a substantial business in local securities traded over-the-counter and the disallowance of value to many securities carried in its portfolio was a substantial factor in its being found in violation of the net capital rule.[4/]

The Commission has pointed out that Congress, in enacting provisions with respect to financial responsibility of brokers and dealers, intended that brokers should not be permitted to continue operations unless they had on hand cash or liquid assets in the required ratio to aggregate indebtedness.[5/] In keeping with the statutory purposes the

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4/ For example, securities valued by the registrant at $53,119.29 in its October 31, 1964 financial statement were not included in computations made by staff members on examination of the material submitted. (Resps. Ex. 2)

5/ John W. Yeaman, Inc., Sec. Ex. Act Rel. 7527, p. 4 (Feb. 10, 1965).

Commission has excluded from assets in computing net capital securities for which there was no ready exchange or over-the-counter market.[6/]

The sheets published by the National Daily Quotation Bureau are recognized as the primary medium for the dissemination of wholesale or "inside" quotations among professionals.[7/] The National Association of Securities Dealers has established a retail quotation system for over-the-counter securities, under which various lists are prepared including a national, four regional and supplementary local lists. The Wall Street Journal is recognized as a prime source for these quotations.[8/]

The above sources were consulted as source material for quotations on the over-the-counter securities carried in the registrant's portfolio. Securities were excluded from asset computation when quotations for them could not be found. This approach has received judicial approval. In the case of Securities and Exchange Commission v. C. H. Abraham & Co., 186 F. Supp. 19 (1960), the court approved the approach of ascribing no value to securities for which no published market quotations were contained in the sheets terming them "assets which cannot be readily converted into cash" within the meaning of the net capital rule. This was

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6/ Pioneer Enterprises, Inc., 36 S.E.C. 199, 207 (1955); Whitney-Phoenix Co., Inc., 39 S.E.C. 245, 249 (1959).

7/ Report of Special Study of Securities Markets of the Securities and Exchange Commission, House Document No. 95, 85th Cong., 1st Sess., Pt. 2, pp. 595 et seq.

8/ Report of Special Study, supra, Pt. 2, pp. 630-634.

done even though the registrant showed some purchases of the securities from brokers during the period involved. These were termed self-serving purchases and not fulfilling the requirement of demonstrating an independent market. 9/

It is recognized that the above publications carry quotations in securities which are of interest to securities dealers and investors. When the contention is made that securities not listed in these publications are readily tradeable, it is incumbent on the party making this contention to demonstrate that such an independent market exists. This has not been done here. The accountant for the registrant testified that he obtained his stock valuations from quotations given him by an employee in the registrant's trading room. Registrant at that time maintained an active interest in local securities, according to its contention. There is no proof that there was a market for the securities involved which would have permitted their quick disposal at the values given to them. Further doubt as to the liquidity of the over-the-counter portfolio of the registrant excluded from the computation is raised by the fact that at least in one month, October, 1964 there was a concentration in two issues. Of the $53,119.29 of securities excluded from registrant's statement of that month over $41,000 was concentrated in two issues. In one issue registrant owned 25,268 shares valued at $22,984.50. In another issue it held 18,754 shares valued at $1.00 a share. It is recognized that in a thin market of over-the-counter securities a small amount of shares may be

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9/ Supra, at p. 21.

liquidated with much more ease than a substantial block. Under all the circumstances the undersigned concludes that a prima facie case has been established demonstrating that the over-the-counter securities of registrant should have been excluded from the net capital computation and that the respondents have not come forward with any evidence justifying a contrary conclusion.

The respondents urge that in any event any violations which may have occurred were not willful. It is pointed out that the computations of value of the over-the-counter securities in question were made by the registrant's accountant and it is asserted that the respondents relied upon him. However, it is clear that the registrant's accountant relied on the registrant as his source for valuation of these securities. This was a matter within the expertise of the respondents and they could not shirk their duty to comply with the net capital rule by failing to make sure that the securities were properly valued.

The registrant's accountant further testified that some of the securities excluded from computations made in this proceeding were included in earlier filings which were not challenged. While no specific evidence was submitted on this point, the fact that this may have occurred furnishes no justification for the respondents disregarding their obligations under the Exchange Act and applicable rules.[10/] Respondents also assert

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10/ See Robert H. Davis, 40 S.E.C. 994 (1962); Midland Securities, Inc., 40 S.E.C. 333, 340 (1960); Ernest F. Boruski, Jr., 40 S.E.C. 258, 261 (1960).

that the value of these securities is demonstrated by the ability of the registrant to liquidate its business and pay off creditors. The fact that the securities may have had an intrinsic value which ultimately enabled the registrant to liquidate successfully also does not excuse the violation. The Commission has pointed out in the Yeaman case, supra, that the essential object is to assure sufficient liquidity to meet obligations to customers on reasonable demand. The undersigned concludes that the registrant violated the net capital rule in the months specified above, and was aided and abetted by Floyd R. Burns in this violation and that the violations were willful within the meaning of the Exchange Act. 11/

C. Violations of the Anti-fraud Provisions of the Exchange Act

It is further alleged in the order for this proceeding that during the period from October 31, 1964 to about April 14, 1965 registrant willfully violated Section 15(c)(1) of the Exchange Act and Rule 17 CFR 240.15c1-2 thereunder and Burns willfully aided and abetted such violations in that they sold securities to and purchased securities from customers at

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11/ Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E. W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959).

prices having no reasonable relationship to the prevailing market price of such securities or to registrant's contemporaneous cost for or prices at which registrant contemporaneously sold such securities. 12/ Leach testified that in the course of his examination of the books and records of the registrant he checked registrant's dealings with customers for the two-month period of November-December, 1964 and found that of the 111 dealer-customer transactions during that period there were 55 in which

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12/ The aforementioned Section and Rule are sometimes referred to as the anti-fraud provisions of the Exchange Act. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or the instrumentalities of interstate commerce in connection with the purchase or sale of any security by any untrue statement of a material fact and to any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or any act, practice, which operates or would operate as a fraud or deceit upon any person.

The Commission has stated,

> "The relationship of a securities dealer to his clients is not that of an ordinary mercahnt to his customers. Inherent in the dealer-customer relationship is the implied representation that the customer will be dealt with honestly and fairly and in accordance with the established standards of the profession. We have consistently held this vital representation is rendered false and works a fraud or deceit upon customers when the dealer charges prices not reasonably related to the prevailing market prices, without disclosing that fact, and this principle has been sustained upon judicial review."

(W. H. Keller, Jr., 38 S.E.C. 900, 905 (footnotes omitted) (1959)); See to the same effect Murrayhill Investment Company, 40 S.E.C. 612, 615 (1961); Lawrence Rappee, 40 S.E.C. 607, 610 (1961).

The NASD has enunciated a similar principle as part of its "Rules of Fair Practice" (Art. III, Sec. 1). It has instructed its District Business Conduct Committees to keep in mind the results of a survey showing a substantial majority of the transactions involved being made at mark-ups of five percent or less. The philosophy expressed has been referred to as the "5% Policy" (NASD Manual, p. G-1-2).

there was a mark-up or mark-down[13/] by the registrant in excess of 5%. The Division contends that these charges were excessive and that these transactions were made without reasonable relationship to the prevailing market price of the securities involved or to registrant's contemporaneous cost for or prices at which registrant contemporaneously sold such securities. A chart prepared by Leach summarizing his findings is in evidence (Div. Ex. 16). In making his calculation of percentage of mark-up or mark-down Leach used the registrant's cost of purchase or sale in a same-day transaction. (Tr. 257). He found such data available in 52 transactions. In three instances where same-day transactions did not occur Leach used quotations from the National Quotation Bureau sheets or the Wall Street Journal. According to Leach his calculations revealed the following percentages of mark-ups or mark-downs:

Range of 5.1 to 7.5%	-	18
Range of 7.6 to 10%	-	9
Over 10% up to 60%	-	28
Total		55

The Division contends that the aforementioned markups and markdowns were violative of the Exchange Act.

The respondents argue that the Division has misconstrued the law

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13/ The term "mark-up" is generally defined as a charge added on to the cost of the security sold a customer. The term "mark-down" is defined as a differential from the market price paid a customer on a sale made by him to the broker.

misplaced emphasis on dealer's cost. It has summarized its position in the following language,

> "The registrant contends that the current market price is a question of fact to be determined after consideration of all the surrounding facts and circumstances, and that contemporaneous cost is not the sole factor to be considered, but that the Hearing Examiner may, and should consider other market quotations in the daily sheets and local newspapers; and may, and should, make allowances to adjust the prices paid to dealers in order to properly reflect the price to a retail customer; and may, and should, consider the testimony of the registrant as to the prevailing market price." (Resps. Br. p. 27).

To support their contention, the respondents submitted a detailed analysis of the transactions attacked by the Division (Resps. Ex. 25). Accordingly to this analysis, 38 of the 55 transactions relied on by the Division involved securities listed in the National Quotation Bureau sheets -- in some instances by a substantial number of brokers. A local newspaper carried same-day quotations for securities involved in 29 of the 55 transactions listed by the Division. As to the transactions not listed in either the sheets or the local newspaper, the registrant it is contended, in all but one instance, maintained firm, consistent markets.

According to the respondents analysis of the "Dealers Market" (Quotations in the sheets and the registrant's quotations), and after consolidating ten transactions which it claimed were part of other transactions, the respondents concluded that there were 11 mark-ups in excess of 5%, with 9 ranging from 5.1 to 7.5 percent and two mark-ups ranging from 7.6 to 10.0 percent. According to respondents analysis of the "Retail Market" (mark-ups from wholesale quotations and newspaper

quotations) there was only one transaction involving a mark-up in excess of 5 percent. The Division does not challenge the computations, but does differ from the respondents as to the legal standard applicable in ascertaining the fairness of the mark-ups and mark-downs.

The validity of mark-ups and mark-downs both under the Rules of the NASD and under the anti-fraud provisions of the Exchange Act has been considered by the Commission in numerous decisions. In the Naftalin & Co., Inc.,[14/] the Commission stated,

> "We note that the NASD mark-up policy expressly states that '[i]n the absence of other bona fide evidence of the prevailing market, a member's own contemporaneous cost is the best indication of the prevailing market price.' The use of contemporaneous cost as an appropriate base upon which to compute mark-ups in retail transactions, 'absent countervailing evidence,' has frequently been recognized in our decisions and has been affirmed by the courts. This rule merely reflects a recognition of the fact that the prices paid for a security by a dealer in actual transactions closely related in time to his sales are normally a highly reliable indication of the prevailing market price." (Supra, p. 4, footnotes omitted.)

The evidence of prevailing market price frequently offered to outweigh the fact of a dealer's actual cost are "bid" and "ask" quotations obtained from the National Quotation Bureau sheets or through an inter-dealer network. As to this, the Commission pointed out that these quotations, particularly for low-priced speculative issues, do not necessarily represent prices at which transactions are actually

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14/ Sec. Exch. Act Rel. 7220 (Jan. 10, 1964).

consummated. Further negotiations between buyer and seller usually precede an actual transaction. The Commission reaffirmed its position of refusing to accept published quotations, in lieu of contemporaneous costs, as the best evidence of prevailing market price, although permitting their use as the base for computing mark-ups or mark-downs in the absence of evidence of same-day costs.

The use of same-day costs as a proper basis on which to compute mark-ups and mark-downs and the use of quotations in the sheets when no contemporaneous cost price is available has been reaffirmed in decisions after Naftalin.[15/]

In substance, the respondents argue that data submitted by them (Resps. Ex. 25) constitute "countervailing evidence" of the type warranting the use of a measure other than contemporaneous cost as a bas upon which to compute the registrant's mark-ups and mark-downs. They have submitted an analysis of a "Dealers Market" listing, for the transactions involved here, registrant's ask and the high ask quotation in the sheets and mark-ups

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15/ Merritt, Vickers, Inc., Sec. Exch. Act.Rel. 7409, Sept. 2, 1964, aff'd 353 F.2d 293 (1965); Samuel B. Franklin & Company, Sec. Exch. Act Rel. No. 7407, Sept. 3, 1964 (rejection of an individual firm's stated professional offer as the best evidence of the prevailing market); Costello, Russotto & Co., Sec. Exch. Act Rel. No. 7729, October 22, 1965 (rejection of use of applicant's ask prices); Arnold Securities Corp., Sec. Exch. Act Rel. 7813, Feb. 7, 1966 (rejection of sales at figures slightly higher than offering prices in the sheets); Kenneth B. Stucker, Sec. Exch. Act Rel. 7823, February 15, 1966 (retail newspaper quotations held insufficient to overcome force of applicant's contemporaneous costs in determining fairness of his mark-ups).

from those figures. They have used similar bid figures in computing mark-downs. However, they have not submitted proof that those figures, with reasonable mark-ups or mark-downs are better indicators of prevailing market price than contemporaneous cost. The quotations are no certain indicator that trading activity was occurring in the over-the-counter market on that date or at the prices indicated.

Conclusions

The respondents have not presented any evidence warranting a departure from the use of the standard of same-day costs in evaluating the fairness of mark-ups or mark-downs in this proceeding. The countervailing evidence submitted is of a nature which the Commission has consistently held should only be resorted to when current cost figures are not available.

The respondents contend that in fact there are 45 mark-up or mark-down transactions involved here instead of the 55 set forth by the Division in its analysis. The respondents do not challenge the fact that the transactions listed by the Division were actually entered on the registrant's books as set forth but maintain that certain transactions occurring on the same day were unit transactions to the same customer rather than the several transactions listed. Accepting the respondents' contention, the revised list of the mark-ups and mark-downs is as follows:

Range of 5.1% to 7.5%	-	15
Range of 7.6 to 10%	-	8
Range over 10%	-	22
Total		45

Some of the mark-ups in the over 10% range were substantially above that figure and ranged up to 50% and 60%. The Commission has held that mark-ups of more than 10% are unfair in the sale of low priced securities.[14/] It is concluded that the registrant willfully violated the anti-fraud provisions of the Exchange Act and Rule 17 CFR 240.15c1-2 thereunder by selling securities to and purchasing securities from customers at prices having no reasonable relationship to the prevailing market price of such securities or to registrant's contemporaneous cost for or prices registrant contemporaneously sold such securities. It is further concluded that said violations were willful.

Burns was the registrant chief officer. It was his obligation to supervise the registrant's business so as to satisfy all applicable legal requirements.[15/] Burns had the responsibility to exercise adequate

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14/ Costello, Russotto & Co., Sec. Exch. Act Rel. 7729 (Oct. 22, 1965); Ross Securities, Inc., 40 S.E.C. 1064, 1066 (1962).

15/ Merritt, Vickers, Inc., Sec. Exch. Act Rel. 7409, p. 8 (1964). Aff'd 353 F.2d 293 (1965); Sutro Bros. & Co., Sec. Exch. Act Rel. 7053, p. 11 (Apr. 10, 1963); Sutro Bros. & Co., Sec. Exch. Act Rel. 7052, p. 19 (Apr. 10, 1963); Reynolds & Co., 39 S.E.C. 902, 917 (1960); Shearson, Hammill & Co., Sec. Exch. Act Rel. 7743 (Nov. 12, 1965).

supervision over the registrant's employees to make sure that transactions they accomplished were made with due regard to applicable standards.[16/] He did not fulfill these obligations. It is concluded that Burns willfully aided and abetted the aforementioned violations by the registrant.

D. Violations of Reporting and Record-Keeping Requirements

It is further alleged in the order for this proceeding that the registrant violated reporting requirements under the Exchange Act and Burns willfully aided and abetted such violation in that registrant and Burns filed a report of financial condition of the registrant which was false and misleading by overstating assets and understating liabilities. It is further alleged that in connection with the above violation, and in other respects, the registrant willfully violated and Burns willfully aided and abetted violations of the record-keeping requirements under the Exchange Act.[17/]

16/ Aldrich, Scott & Co., Inc., 40 S.E.C. 775 (1961); Lucyle Hollander Feigin, 40 S.E.C. 594 (1961); Floyd A. Allen & Co., Inc., 35 S.E.C. 176 (1953); Charles E. Bailey & Co., 35 S.E.C. 33 (1953); W. M. Bell & Co., Inc., 29 S.E.C. 790 (1949).

17/ Section 17(a) of the Exchange Act requires every registered broker or dealer to keep such books and records and make such reports as the Commission by appropriate rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 17 CFR 240.17a-3 specifies the books and records which must be kept, while Rule 17 CFR 240.17a-5 requires every registered broker and dealer to file during each calendar year a report of his financial condition.

The requirement that records be kept and reports be filed by registered broker-dealers embodies the requirement that such records and reports be true and correct. Lowell Niebuhr & Co., 18 S.E.C. 471 (1945); Pilgrim Securities, Inc., 39 S.E.C. 172 (1959); Herman Bud Rothbard, 39 S.E.C. 253 (1959); Talmage Wilcher, Inc., 39 S.E.C. 936 (1960); Joseph Ernest Murray, 38 S.E.C. 460 (1958); Donald L. Tiffany, Inc., 37 S.E.C. 841 (1957).

The Division alleges that the registrant filed with the Commission on December 15, 1964, a Statement of Financial Condition, as of October 31, 1964, which was false and misleading. In this connection, it is further alleged that the registrant aided and abetted by Burns improperly treated a $50,000 item as an asset. The background of this item is as follows:

Edward B. Kennedy, President of Kennedy Investments, Inc., a registered broker-dealer at Tulsa, Oklahoma, had had many dealings with the registrant, through Burns, involving very substantial sums. According to Kennedy, in July, 1964 he had received $60,000 in cash from an investor-client to be used to purchase certain Oklahoma City bonds. Kennedy asserted that he turned over $50,000 of this money to Burns with instructions to buy the bonds when they became available and that he later turned over an additional sum in excess of $8,000 for the same purpose. A receipt is in evidence dated July 24, 1964, signed by Burns, in which he acknowledged receipt of $50,000 from Kennedy.

On September 23, 1964, Kennedy wrote Burns and the registrant, stating that the bonds were now being issued and called upon the registrant and Burns to make delivery. Despite this, Kennedy testified, he did not receive any bonds from the registrant and was unable to see Burns when he attempted to meet him at his offices. He engaged an attorney to protect his interests. On October 19, 1964, Burns wrote him complaining of some of the tactics used by Kennedy, asserting that the $50,000 was money owed him arising out of a joint account in the stock of Investors Counsel, Inc., suggesting that there be an accounting between them, and that the matter be taken to court if necessary (Div. Ex. 8). Eventually the matter was

settled by the respondents herein paying Kennedy $30,000 and also delivering 20,000 shares of stock in a company, which shares had only a nominal value (Div. Ex. 9, 10).

As previously indicated, Burns took the position in his dealings with Kennedy that he had had a joint account with him in the stock of Investors Counsel, Inc. He so testified in this proceeding. Kennedy denied that he had ever had a joint account of any kind with registrant or Burns or any other arrangement providing that he and either registrant or Burns were to share in the profits and losses of any enterprise. Burns admitted that he could not produce any proof of the existence of a joint account.

Marjorie Work, who had served as registrant's bookkeeper for five or six years until her resignation on February 1, 1965, corroborated Kennedy's testimony by stating there had never been any joint account of Kennedy with the registrant or Burns. She further testified that in the summer of 1964 Burns gave her two packages to take home and that when he came for them he showed her that they contained large sums of money and told her that he had received $50,000 from Kennedy and that the latter could not prove it.

The $50,000 item was originally entered on the books of the registrant on July 28, 1964 and credited to the personal account of Floyd R. Burns. As of October 30, 1964, one day prior to the close of business, for the period the statement here in question was prepared, an entry was made charging the personal account of Burns with $50,000 and crediting

firm income in that amount. (Tr. 146). The statement of October 31, 1964, had the following entry under the heading of "CONTINGENT ITEMS":

> "During the year the company reported as income a fee of $50,000.00, which was received in dispute. During the course of this audit, this dispute was settled by payment of $30,000.00 and 20,000 shares of Standard Installment Finance Company common stock."

As previously mentioned, there was a settlement of the dispute between Kennedy and Burns on November 10, 1964. On December 31, 1964 the $50,000 item was taken out of income. (Tr. 147).

Conclusions

It is contended on behalf of the respondents that Kennedy's receipt for the $50,000 did not disclose the purpose of the payment and that the version of Burns that there was a joint account should be credited. It is further argued that the $50,000 was entered on the books of the registrant and was not concealed and the footnote to the Financial Statement called attention to the way this item was handled. Finally, it is pointed out that Kennedy was willing to settle his claim at a substantial discount rather than press his claim in court.

However, no records of an alleged joint account with Kennedy were in existence, and while respondents contend that this was a customary method of operation between Burns and other brokers, it is significant that Mrs. Work knew of no arrangement between Burns and Kennedy of a joint account in all the five or six years she was employed by the registrant. Kennedy's testimony that he had difficulty in meeting with Burns is corroborated by Mrs. Work. Registrant's record entries on the $50,000 were changed one day before the close of the period for which the Statement of Financial Condition was submitted. Furthermore, the registrant and Burns settled Kennedy's claim for a substantial sum-something that they would probably not have done if there had been no substance to Kennedy's

charges. While the note to the Statement of Financial Condition does call attention to the existence of the dispute over the $50,000 item and the eventual settlement, it does not clearly indicate that the $50,000 was actually carried as income in that particular statement, nor does it set forth the true facts as to the course of dealings between Kennedy and Burns.

Under all the circumstances the undersigned concludes that the Division has established by a preponderance of the evidence that the transaction between Kennedy and Burns was as testified to by Kennedy, as corroborated by Mrs. Work and other evidence, and that the failure to list the $50,000 on the books of the registrant as a liability rather than income rendered those records false and misleading during the period in which those entries appeared; namely, from July 28 until the correction of the books and that the Statement of Financial Condition as of October 31, 1964, as filed with the Commission in December, 1964, was false and misleading in that it overstated assets and understated liabilities.

It is urged that the violations, if they existed, were not willful and that the matter of appropriate entries was left to the registrant's accountant who prepared the footnote after consultation with registrant's attorney. However, Burns was in full knowledge of the facts and it was his obligation to see that they were clearly set forth in the Statement of Financial Condition. This was an obligation which he could not shrug off to others with less intimate knowledge of the facts, particularly since he swore to the statement as true and correct. It is concluded that the registrant's violations were willful and Burns willfully aided and abetted such violations. The failure to list the obligation to

Kennedy properly on the books of the registrant as a liability rather than as an asset of course compounded the net capital violations previously found.

* * * * *

The false entries on the Kennedy item were violations of the record-keeping requirements of the Exchange Act. Other violations of these provisions have also been alleged by the Division. Two incorrect entries have been pointed out by Leach in his testimony. However, the Division relies primarily on testimony by Leach that on his inspection visits to the registrant in February and March 1965 he found that no postings had been made to registrant's records during the period from January 31 to February 23, 1965, that the registrant did not prepare a trial balance as of February 28, 1965, and the general ledger of the registrant could not be reconciled with its subsidiary ledger. (Tr. 153-155).

It is undisputed that these deficiencies did exist. However, the respondents point out that a special posting machine was used by them which required a skilled operator. Mrs. Work was the only one in the office able to operate the machine. She quit without notice on February 1, 1965. Thereafter, efforts were made to secure a replacement but difficulty was encountered and a replacement was not obtained until mid-February. Postings were then made promptly and with some overtime work the books and records were brought up to date by the middle or end of March. The Division urges that Mrs. Work quit because of the activities of Burns and since the latter caused his bookkeeper to resign he is responsible for the failure to maintain proper records and that, in any event, when Burns determined that he could not obtain competent help he should have ceased to do business until help could be obtained.

Mrs. Work did testify that she did not like some of the things that were going on at the registrant's offices, including a lock being placed on the front door and Burns making himself scarce when Kennedy appeared at the registrant's offices, and that she was advised by her physician to change jobs.

So far as the evidence shows there had been no trouble with registrant's records prior to the resignation of Mrs. Work. A substitute for her was obtained on or about February 12, 1965, and according to the testimony of registrant's accountant the books and records of the registrant were brought up to date by the end of March. During all that time the hand posting of records was current.

The registrant was faced with a very special situation in the resignation of Mrs. Work without notice. The evidence indicates that due diligence was exerted to find a replacement as soon as possible, and the records of the registrant were brought up to date without too long a delay. While there may have been a technical violation of the record-keeping requirements, the undersigned concludes that the respondents acted reasonably under the circumstances and any violation which occurred was not willful. The undersigned rejects the contention that under the circumstances Burns should be held responsible for bringing about a situation resulting in the record-keeping violations.

E. Violations of Credit Regulations

It is further alleged in the order instituting this proceeding that during the period from January 23, 1963 to about April 14, 1965 the registrant, aided and abetted by Burns, extended credit on securities in contravention of Regulation T promulgated by the Board of Governors of the Federal Reserve System pursuant to Section 7(c) of the Exchange Act.[18/]

Section 4(c)(2) of Regulation T (12 CFR 220.4c-2), as here applicable, provides that a broker or dealer shall promptly cancel or otherwise liquidate the transaction where a customer purchases a security in a special cash account and does not make full cash payment within seven business days. The Division submitted a schedule which, with additional evidence, purports to establish twenty-nine violations of Section 4(c)(2). (Div. Exs. 17 and 18). The respondents asserted that many of the transactions listed took place in "Payment on Delivery" accounts and were not violative of Regulation T.[19/]

18/ Sections 7(c)(1) and (2) of the Act, as applicable here, in general make it unlawful for any broker or dealer who transacts a business in securities through the medium of any member of a national securities exchange to extend credit to a customer in contravention of regulations prescribed by the Federal Reserve Board under Section 7 of the Act.

19/ Section 4(c)(5) provides in pertinent part:

> "If the creditor, acting in good faith . . . purchases a security for a customer, or sells a security to a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment to be made promptly by the customer is to be made against such delivery, the creditor may at his option treat the transaction as one to which the period applicable . . . is not the 7 days . . . but 35 days after the date of such purchase or sale."

While not every "Payment on Delivery" transaction automatically falls within the protection of Section 4(c)(5),[20] the Division does not contest the Regulation T aspects of these transactions (Items 11, 12, 19-28) but it maintains that these transactions were not properly recorded on the registrant's books and records and thus were made in violation of the record-keeping requirements of the Exchange Act.[21]

The undersigned concludes that at the very least the order memoranda relating to these transactions should have fully disclosed that these were "Payment on Delivery" transactions and the failure to do so constitutes willful violations of the record-keeping requirements by the respondents.

As to the remaining seventeen transactions, the number of days of violations ranged from one day to eighty-five plus, with twelve being ten days or less. The respondents have conceded Regulation T violations in 7 transactions. They further point out that in the case of the transaction involving the largest days of violation payment was not received, but due to an asserted error in the registrant's cage, the stock was sent to transfer and there has been a resultant lawsuit. (Item 2)

20/ Coburn and Middlebrook, Incorporated, 37 S.E.C. 583, 587 (1957); John W. Yeaman, Inc., Sec. Exch. Act Rel. No. 7527, p. 3 (Feb. 10, 1965); Effros, "A Note on Regulation T", 82 The Banking Law Journal, 471, 475-477 (1965).

21/ Rule 17a-3(6) of the General Rules and Regulations under the Exchange Act provides in pertinent part that every broker or dealer shall make and keep current, a memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order or instructions.

It is further alleged that several of the alleged Regulation T violations were due to posting errors. (Items 3, 5, 6 and 7). The undersigned concludes from an examination of the evidence that not only were violations of Regulation T established in the instances where the respondents conceded violations (Items 1, 2, 4, 8, 10, 13 and 14), but also additional violations were proved in at least five more instances (Items 9, 15 thru 18) even if violations due to posting errors are not included in the computation. It is, therefore, concluded that the registrant, aided and abetted by Burns, violated Regulation T of the Exchange Act as alleged and that these violations were willful. It is contended on behalf of Burns that he only participated in one of these transactions personally, but this does not excuse his failure, as chief officer of the registrant, to see to it that violations of such regulations, as Regulation T, did not occur.

III. CONCLUDING FINDINGS; PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b) of the Exchange Act, so far as it is material herein, is required to censure, suspend or revoke the registration of any broker or dealer if it finds that such action is in the public interest, and such broker or dealer, subsequent to becoming such or any person associated with such broker or dealer, has willfully violated any provision of the Exchange Act or any rule or regulation thereunder or is permanently or temporarily enjoined by any court from continuing any conduct or practice in connection with activity as a broker or dealer, or in connection with the purchase or sale of any security. It has been found that the registrant, and the individual respondent, Floyd R. Burns, a person in control of the registrant's operations, willfully violated the Exchange Act and applicable

rules in the conduct of registrant's brokerage business. The registrant and Burns also have been permanently enjoined from continuing certain practices in connection with activity as a broker and dealer and in connection with the purchase and sale of securities.

It is urged on behalf of the respondents that no sanctions should be imposed. It is argued that when registrant was informed that it was operating in violation of applicable statutory provisions and rules it ceased doing business, liquidated, and paid off its creditors. As to the transaction with Kennedy, it is asserted that the registrant had had many transactions with Kennedy and other brokers involving large sums without any trouble. With reference to the violations of the mark-up and mark-down rules and Regulation T, it is maintained that these were few in number in view of the large number of transactions by the registrant in the period involved (19,500). The respondents also presented the testimony of representatives of several large brokerage firms in Oklahoma City who testified that their firms had had satisfactory dealings with the registrant and that the registrant had performed a valuable service in maintaining trading markets in local securities.

The respondents violated statutory provisions and rules which are at the very heart of the regulatory pattern established for the protection of investors.[22/] It is concluded that it is in the public

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22/ Blaise D. Antoni & Associates, Inc. v. S.E.C., 289 F. 2d 276 (C.A. 5, 1961); S.E.C. v. General Securities Co., 216 F. Supp. 350 (S.D.N.Y., 1963); Sutro Bros. & Co., Sec. Exch. Act Rel. 7052 (April 1963).

interest to impose sanctions for the violations found.

However, the undersigned finds that these are mitigating circumstances present warranting consideration in determining the sanction to be imposed. Registrant ceased operations when Commission personnel informed it of preliminary findings that it had committed violations of the Exchange Act. It proceeded to satisfy its creditors. The Division points out that even though creditors may have been satisfied, Kennedy and the customers who were charged excessive mark-ups or mark-downs sustained losses by the registrant's activities. The evidence establishes that the $50,000 Kennedy bond item was treated by both participants in an almost casual manner. There was no definitive evidence in writing clearly setting forth the obligations of each party to the transaction. In view of that fact and the further evidence that the same parties had had many transactions involving large sums without any difficulty, the undersigned does not feel that this violation warrants the very heavy sanction that would ordinarily be recommended. The Regulation T violations were few in number and do not evidence a deliberate attempt by the registrant to avoid its responsibilities under Regulation T.

The undersigned concludes that it is in the public interest to deny registrant's request for immediate withdrawal of its registration as a broker-dealer. It is appropriate in the public interest to suspend the registration of registrant as a broker-dealer and its membership in the National Association of Securities Dealers, Inc., for ninety days, after which the request for withdrawal may be permitted to become effective.

Floyd R. Burns was in control of the registrant at all times here relevant and the violations found are all due to his activities directly or were caused by his failure to supervise and direct its operations. The violations found adversely reflect on his ability to engage in the securities business with due observance of applicable statutes and rules. It is concluded that it is in the public interest to bar the respondent, Floyd R. Burns, from association with a broker or dealer, provided however, that such bar shall not preclude an application by Floyd R. Burns, after ninety days, for approval of his association with a broker or dealer, upon appropriate showing that such association would include safeguards to protect the public interest.

Accordingly, effective as of the date that the Commission issues 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,

IT IS ORDERED that the registration as a broker and dealer of F.R. Burns & Company and its membership in the National Association of Securities Dealers, Inc., are suspended for ninety days, after which the request for withdrawal of the broker-dealer registration of F.R. Burns & Company shall be permitted to become effective.

FURTHER ORDERED, that Floyd R. Burns is barred from being associated with a broker or dealer, without prejudice to his application, after ninety days, for approval of his association with a broker or

dealer, upon appropriate showing that such association would include safeguards to protect the public interest.[23/]

Sidney L. Feiler
Hearing Examiner

Washington, D.C.
March 21, 1966

23/ All contentions and proposed findings submitted by the parties have been carefully considered. This Initial Decision incorporates those which have been accepted and found necessary for incorporation therein.