

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
JOHN C. PAPPAS
R. BARUCH & COMPANY, et al
Files 8-8712, et al
(A. T. BROD & COMPANY, No. 8-6503)

RECOMMENDED DECISION

FILED
AUG 25 1966
SECURITIES & EXCHANGE COMMISSION

Washington, D. C.
August 25, 1966

Sidney L. Feiler
Hearing Examiner

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I. THE PROCEEDINGS

The Commission, by order dated February 19, 1962 instituted proceedings pursuant to Section 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act")^{1/} to determine whether to revoke the broker-dealer registrations of A. T. Brod & Company ("Brod"), R. Baruch & Company ("Baruch"), and Sutro Bros. & Co. ("Sutro") and whether certain named persons associated with those firms should be named causes of any order which might be entered by the Commission in those proceedings. On February 27, 1962, the Commission instituted broker-dealer revocation proceedings against Seraphim & Company, Inc. ("Seraphim"), Fairfax Investment Corporation ("Fairfax") and associated persons based upon their activities while employed by other broker-dealers. On the same date all the above proceedings were consolidated.

On April 10, 1962, hearings were commenced and continued until July 11, 1962 when the Commission stayed the proceedings pending a decision on a motion for dismissal made by counsel for certain of the respondents.

Pursuant to a motion by the Division, the Commission, on September 27, 1962, severed the proceedings with respect to Sutro,

^{1/} These proceedings were instituted prior to the adoption of the Securities Acts Amendments of 1964, 78 Stat. 565 (August 20, 1964). References to provisions of the Securities Act and the Exchange Act are to provisions as they existed prior to the adoption of the amendments, except as noted.

Irving Rudd, Stanley Bennett, and David Hersh.^{2/}

On September 27, 1962, the Commission also terminated the proceedings against Brod, Baruch, Seraphim and Fairfax and all persons named in the orders with respect to those broker-dealers. Proceedings were also terminated with respect to Sutro, insofar as the proceedings involved Claude V. Warren. The Commission's action was taken upon the consideration of motions seeking a determination whether two Commissioners should be disqualified, and whether the proceedings with respect to those respondents should be dismissed. In view of the decision in Amos Treat & Co. v. Securities and Exchange Commission, 306 F. 2d 260 (1962), the Commission, without conceding that any Commissioner was disqualified, terminated the proceedings but without prejudice to the subsequent institution of new proceedings.

On October 15, 1962, the Commission entered orders reinstating proceedings against the aforementioned respondents (excepting Sutro, Rudd, Bennett and Hersh), and consolidated the proceedings.

Hearings commenced again on May 20, 1963 at which time the Division moved to incorporate into the new proceedings the record of the past proceedings. The motion was granted by the Hearing Examiner and his ruling was certified to the Commission. On April 1, 1964 the

^{2/} The above firm and persons submitted an offer of settlement which was accepted by the Commission in its Findings and Opinion, In the Matter of Sutro Bros. & Co., Securities Exchange Act Release No. 7053 (April 10, 1963).

Commission affirmed the Hearing Examiner's ruling. On May 18, 1964 hearings were resumed which were concluded on July 23, 1964 at which time the record was closed. All post-hearing procedures have been completed, the Commission has heard oral argument, and the matter is presently awaiting a decision.

John C. Pappas, named in the Brod and Seraphim orders, was served with copies of the February 19 and February 27, 1962 orders. He did not appear or participate in any way in the original hearing. The Division was unable to serve Pappas with the October 15, 1962 orders prior to the conclusion of the hearings and for that reason did not proceed against him nor submit proposed findings as to him.

On October 29, 1965 the Division located John C. Pappas and on November 10, 1965 Pappas was served with copies of the October 15, 1962 orders for proceedings.

The Division then moved to reopen the hearing and introduce into the present proceedings the record of the prior original proceedings as to John C. Pappas. The motion to incorporate into the present proceedings the record of the past proceedings was granted by the Hearing Examiner on April 18, 1966 and on that date hearings again commenced for one day and were then concluded on April 26, 1966 at which time the record was closed. Pappas appeared in person at the April 18 session and was granted a postponement in order to obtain counsel. He was represented by counsel at the April 26 session and at all subsequent stages of these proceedings.

As a result of various consents, settlements and hearings,

the present posture of the proceeding reveals one remaining respondent, namely John C. Pappas.^{3/} The matters put in issue as to him are:

A. Whether he, during the period of his employment at Brod, a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, at relevant times, singly and in concert with other respondents in the proceedings, willfully violated Sections 5(a) and (c) of the Securities Act of 1933, as amended, ("Securities Act"), in that he, directly and indirectly, made use of the means and instruments of transportation and communication in interstate commerce and of the mails to offer to sell, to sell, and to deliver after sale securities, namely, the common stock of Agricultural Research Development, Inc. ("AGR") when no registration statement had been filed and when no registration statement was in

3/ R. Baruch and Company, Baruch Rabinowitz, Conrad Lippman and David Starr submitted offers of settlement which were accepted by the Commission in its Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7138 (September 11, 1963).

A. T. Brod & Company, Albert T. Brod and Martin Lesser submitted offers of settlement which were accepted by the Commission in its Findings and Opinion, In the Matter of A. T. Brod & Company, Securities Exchange Act Release No. 7139 (September 11, 1963).

Sidney Herwood submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7352 (June 22, 1964).

Sidney Spector submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7382 (August 5, 1964).

S. Thomas Guren submitted an offer of settlement which was accepted by the Commission in its Supplemental Findings and Opinion, In the Matter of R. Baruch and Company, Securities Exchange Act Release No. 7480 (December 7, 1964).

Claude V. Warren submitted an offer of settlement which was accepted by the Commission in its Order, In the Matter of Fairfax Investment Corporation, Securities Exchange Act Release No. 7475 (November 27, 1964).

Proceedings as to Seraphim, Fairfax, John Meslovich, Eugene Tucker and Bernard Hammett have been completed and that matter is presently before the Commission awaiting a decision.

effect as to such securities under the Securities Act.^{4/}

B. Whether Pappas, singly and in concert, willfully violated Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-6, promulgated by the Commission thereunder in that in connection with the purchase and sale of AGR stock, he employed manipulative and deceptive devices and contrivances by bidding for and purchasing AGR stocks for accounts in which respondents named in the proceedings had a beneficial interest while engaged in the distribution of the common stock of AGR.^{5/}

C. Whether Pappas, singly and in concert, willfully violated and aided and abetted willful violations of the anti-fraud provisions of the Securities Acts in the purchase and sale of AGR stock.^{6/}

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- ^{4/} Section 5 of the Securities Act provides in pertinent part that it shall be unlawful to make use of the instruments of transportation or communication in interstate commerce or of the mails to offer to sell or to sell a security unless a registration statement is in effect as to it.
- ^{5/} Rule 10b-6 defines as a "manipulative or deceptive device or contrivance" as used in Section 10(b) of the Act for any person who has agreed to participate or is participating in a distribution of securities to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution.
- ^{6/} 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 (17 CFR 240.10b-5 and 15c1-2) thereunder are sometimes referred to as the anti-fraud provisions of the Securities Acts. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

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

II. FINDINGS OF FACT AND LAW

A. The Respondent

1. Pappas was employed as a salesman for several brokerage firms from 1955 to 1960. In October 1960 he was employed as a registered representative at Brod and worked there for approximately one year. He was so employed during the period described in the order for proceedings, namely, January 1 to about July 1, 1961 and sold AGR stock.

B. Agricultural Research Development, Inc.

2. Agricultural Research Development, Inc. ("AGR") was incorporated under Colorado law on December 15, 1959. AGR proposed to engage in the hog raising business on farm property it had purchased from Eugene Petersen for common stock, the assumption of mortgage obligations and cash. In this transaction Petersen became a controlling person and the largest stockholder of AGR, holding 32,400 shares of common stock out of the 69,400 shares issued and outstanding before the Regulation A offering. The process by which AGR intended to raise hogs was neither unique nor patented.

3. In order to provide financing for the AGR hog raising venture, a registration statement was filed with the Commission on January 25, 1960. This registration contemplated the sale of 200,000 shares of common stock, par value 10 cents, to be offered to the

public at \$5 per share. The registration statement was withdrawn on March 24, 1960, after AGR was advised that if such action was not taken, the Division of Corporation Finance would recommend the institution of stop-order proceedings pursuant to Section 8 of the Securities Act of 1933.

C. Regulation A Offering

4. After changing the par value of its stock to 5 cents a share, AGR filed a notification pursuant to Regulation A of the Securities Act on May 23, 1960 in the Denver Office of the Commission. W. Edward Tague Company ("Tague") of Pittsburgh was designated as the underwriter on a best efforts basis and C. Henry Roath, an attorney in Denver, prepared the filing. The offering circular was processed by the regional office and AGR was informed that no objection would be raised if it were used, as then amended, on and after August 3, 1960. The offering, pursuant to the Offering Circular, of 120,000 shares of 5 cents par value common stock at \$2.50 per share for an aggregate of \$300,000 then commenced on August 7, 1960.

5. Prominently displayed on the first two pages of the Offering Circular, were 10 paragraphs under the heading "Speculative Aspects of the Proposed Business." Included therein were the following statements:

"The Company is not engaged in business at this time and if substantially all of the shares being offered are not sold, the Company will not be able to engage in its proposed business."

"There is no firm commitment for the sale of the securities being offered and no assurance that

sufficient funds will be raised to undertake to any degree the proposed program."

"As of the date of this Offering Circular the current assets of the Company amount to \$9.15, and current liabilities amount to \$16,389.27, and therefore a portion of the proceeds from this offering, if any, must be used to pay these liabilities. In the event that a substantial portion of the shares being offered are not sold, and there is no assurance that any of the shares being offered will be sold, then the principal assets of the Company, consisting of real estate, may be lost through foreclosure sales."

"The offering price of the stock has been arbitrarily established and has no relation to the value of the Company or its assets and there is no present market for the stock."

6. Through early January 1961 only 9,685 shares of the 120,000 offered had been sold.

D. The Closing of the Regulation A Offering and the Filing of the False 2A Report

7. On February 14, 1961 a meeting of the AGR stockholders was held in Denver for the purpose of closing the Regulation A offering. Among others present at the meeting were Petersen, Emil Jensen, an associate of Petersen, Roath and Herman Tripp, Vice-President and a director of AGR. Jensen was elected a director of the company. At the meeting, Petersen represented that 30,000 shares in addition to the prior 9,865 shares issued had been sold, and "flushed" checks in payment for 20,000 shares and in the total amount of \$40,000, signed by one of the respondents, Bernard Hammett and by Jensen. These purchases were stated to be on condition that

the Regulation A offering be closed. The 10,000 shares represented as sold for which Petersen did not display checks, had been issued on January 30, 1961 in the name of Tague and had been sight-drafted by Roath on Petersen's instructions to the Bank of Commerce, Washington, D. C., to be picked up by Petersen. These 10,000 shares were not paid for and were returned to Roath around February 15 or 16, 1961. Roath retained them in his office until late in March when he turned them over to Petersen. Roath testified that he turned these certificates for these shares over to Petersen on March 24, 1961, although he admits that the receipt which Petersen signed for them was falsely back-dated, February 16, 1961.

8. On February 17, 1961 AGR filed a Form 2A report pursuant to Regulation A dated February 16, 1961, stating that as of February 14, 1961, 39,685 shares had been sold and that the total amount received from the public was \$99,212, of which the issuer had received \$82,330.62, and that the remaining unsold portion of the issue was to be withdrawn because the offering had been discontinued due to lack of acceptance of the offering. The 2A report also stated in Item 11,

"There has been no change in the number of shares held by each promoter, director, officer or controlling person of the issuer, from that stated in the Offering Circular," despite the fact that Jensen had been elected a director and issued 10,000 shares.

9. Of the 39,685 shares reported as sold to the public on the 2A report, at most only 9,685 shares were sold by Tague. As of

February 14, 1961, 20,000 shares of the total shares reported sold (those issued on February 16, 1961 in the names of Hammett and Jensen) were not issued. As of February 16, 1961, all shares reported sold in the 2A report were issued. None of the proceeds from the sales or purported sales of AGR stock under the Regulation A offering were received by AGR. Jensen told Petersen that he did not have sufficient funds to cover his check for the 10,000 shares. Petersen explained that it was a matter of closing out an amount of stock prior to the conclusion of the offering. Jensen expected to pay for his 10,000 shares with the proceeds received from their sale by Sutro. As to the above 30,000 shares, Tague was supplied with the names of Emil Jensen, E. Neal Smith, Bernard Hammett, and prepared confirmations to these individuals which were not sent. W. Edward Tague's records reflect that on February 6, 1961, 10,000 shares were sold to Bernard Hammett and 10,000 shares were sold to E. Neal Smith and that 10,000 shares were sold to Emil Jensen on February 10, 1961. Jensen did not know of his purported purchase of AGR stock until February 13 or 14, 1961. E. Neal Smith denies that he purchased the stock or knew anything about his purported purchase of AGR stock. The shares earmarked for him were the 10,000 issued in the name of Tague and sight-drafted to be picked up by Petersen in Washington, D. C. Tague has invoked the Fifth Amendment and refused to answer questions relating to the sale to Hammett and payments from him.

10. On April 19, 1961 the Commission entered an order temporarily suspending the Regulation A exemption, Securities Act

Release No. 4357, and the order became final by passage of time on May 18, 1961.

E. The Financial Condition of AGR Immediately Prior to and during the Illegal Distribution

11. AGR was in even more straightened financial circumstances immediately prior to and during the stock distribution which began after the 2A report was filed than it had been when the Regulation A offering was commenced on August 3, 1960. During the period February 1, 1961 to May 31, 1961 AGR could not pay its debts as they became due. Roath's bills for legal services had not been paid in February 1961, and he threatened to take action. Officials and directors of AGR were forced to sign a note to obtain funds to pay first mortgage interest on AGR's farm in Wiggins, Colorado. The AGR bank account at the First National Bank of Denver had a total of \$64.29 on deposit on March 10, 1961.

12. The only two franchise agreements entered into by AGR were with Lombardy Farms in Leesburg, Virginia and McNair Farms in Laurinburg, North Carolina and were executed respectively on April 8, 1961 and April 6, 1961. The two franchise agreements are substantially identical and the only firm commitment thereunder by each franchiser was to purchase 330 pigs for \$38,250. No pigs had been sold prior to August 31, 1961 even though the two franchise agreements called for delivery in June 1961.

13. AGR was obligated under a construction contract involving the building of certain facilities for Lombardy farms in

consideration of a payment of \$159,000. As of August 31, 1961, this construction had not been completed and according to the financial statement prepared as of that date by Arthur Andersen & Co., \$37,148 had already been expended on the construction work and it was estimated that an additional expenditure of \$150,460 would be required to complete the project. Accordingly, in addition to its other difficulties AGR was committed to a construction project which would eventually entail a net loss of approximately \$28,608.

14. On September 29, 1961, Arthur Andersen and Company prepared a balance sheet for AGR as of August 31, 1961 showing current assets of \$87,347 and current liabilities of \$339,178. AGR had at that time a deficit in earned surplus of \$425,115.

F. Activities of John C. Pappas in the Sale of AGR Stock

15. During the period of time that Pappas was employed by Brod he bought a total of 3,875 shares of AGR for his customers and sold a total of 1,250 shares for them. Four customers testified as to their transactions with him.^{7/}

16. A.H.E. an attorney, had done business with Pappas while the latter was employed by another brokerage firm. He continued to do business with Pappas when Pappas joined Brod. He first heard of the AGR stock in late February or early March 1961 when

^{7/} The testimony of these witnesses was not challenged, but was adopted by the respondent as summarized in the Division's proposed findings. Exception was taken to the inferences the Division sought to draw therefrom.

Pappas told him that the stock was selling for about \$5 a share, basic work had been done in developing special feeds and techniques of breeding disease-free pigs of low fat content, that no contracts had yet been signed and that it was a speculative situation. E. did not make any investment at that time. On March 29, 1961 Pappas told E. that five franchise contracts had been signed which would yield AGR \$60,000 per contract for a total of \$300,000 and that the Department of Agriculture's staff at Beltsville was interested in the males which would be developed. Pappas further stated that the stock would start moving because it was a good deal and that it had already gone up from \$5 to \$7.50 per share. E. placed an order with Pappas for 50 shares and purchased the stock at \$7.50 per share.

17. Pappas telephoned E. several times on March 29, 1961 and said that the stock was moving up, that it was a good investment, and he should buy all he could afford. E. purchased an additional 150 shares of AGR through Pappas. Several weeks after his purchases, he was told by Pappas that because of a thin market there was consideration of a stock split. He later told E. in a telephone conversation that there was no definite promise of this but that active consideration would be given to it since there were only 39,000 shares outstanding. E. never was given nor did he see any offering circular or financial statement of AGR.

18. At the end of April or in early May 1961, E. went to the offices of the Commission in connection with an investigation being conducted into transactions in AGR stock and after that visit he told Pappas that he had seen contracts to which AGR had been a party and that he had concluded that he had not been given accurate information by Pappas and that he thought it would be appropriate for Brod to repurchase the stock at the price he had paid for it. On May 15 E. received such a refund and signed a letter of release addressed to Pappas.

19. W. B., a store employee, purchased AGR stock from Brod with Pappas acting as a representative. He purchased 100 shares on March 29, 1961 at \$7; 100 additional shares on the same date at \$7.50; and 100 shares on May 3, 1961. B. first became interested in the stock when he received a telephone call from Pappas recommending a purchase. Pappas told him AGR was in a good situation, it looked good for the future, its process was new, and it would meet with a great demand. Pappas further explained that AGR was going to develop disease-free hogs and that therefore the processed meat would be in great demand and the company would be very successful. Pappas further told B. that he thought the stock would rise much higher and would split later, that the stock was active, the company was doing well, and that B. could expect to sell the stock for a higher price. Pappas never showed B. an offering circular on the AGR stock or any financial statements of AGR.

20. B.'s last purchase through Pappas occurred after the Commission had entered an order temporarily suspending the AGR Regulation A exemption. B. did not think that Pappas mentioned anything to him about the suspension at the time of the purchase.

21. Pappas sold Mrs. V. A. 75 shares of AGR on March 29, 1961 at \$11-1/2 per share. Mrs. A., who then worked with the same store at which W. B. was employed, spoke to Pappas during one of his conversations with B. Pappas described the process the company supposedly had developed, told her that it was an exclusive process, and said that the stock was going to be good and go up in price. Pappas never showed her any offering circular or financial statement dealing with AGR. When she tried to sell her stock later on, Pappas persuaded her not to sell, telling her the stock would go very much higher.

22. R. B. purchased 300 shares of AGR stock from Brod on April 6, 1961 at the price of \$14 per share. Pappas acted as his representative. Prior to his purchase, Pappas told B. that the AGR stock was very good, it would appreciate, and was going to move, and that it would appreciate, 50, 80 or 100 percent. Pappas further stated that because of the thin market in the stock they could look for a split at 75. Pappas never informed B. that the original issue had been withdrawn because it could not be sold nor did Pappas discuss the financial condition with AGR, with B. or exhibit to him any offering circular pertaining to AGR.

23. Pappas testified at the hearing and also during an investigation conducted by the Commission into the transactions involving sales of AGR stock. The transcript of Pappas's investigation testimony is in evidence (Division Exhibit 8-B). According to Pappas, his desk at Brod was next to that of John Meslovich, another registered representative. Meslovich gave him an offering circular during the original distribution of the Regulation A offering. Pappas looked through it and returned it but was not interested in selling the stock to his customers at that time.

24. Pappas testified that Meslovich was active in the sale of AGR stock and was his chief source of information on it. He also spoke from time to time with officers of AGR and others associated with it and they, according to him, corroborated Meslovich. On March 28, 1961 Meslovich told Pappas that AGR had signed its first franchise contract. Pappas then proceeded to call his clients suggesting that they purchase AGR stock. He made calls to 20 to 30 clients. Pappas told his clients that AGR had sold its first franchise for \$1/2 million, that it was anticipated that the company could not handle more than 5 that year, that the company could net \$100,000 profit from each franchise and that the company was selling pigs to the Department of Agriculture.

25. Pappas had not seen any franchise contract at that time and did not see one until his appearance at the aforementioned investigation. As previously noted, franchise contracts were not

signed until April 6 and 8 and the amounts involved and the profit potential were substantially different from the information Pappas gave his customers. Pappas also told his customers, according to his version, that the issue had been closed out at 39,600⁷ shares and that the stock was in short supply. However, he also knew that AGR had closed out the Regulation A offering before all the stock offered had been sold because there had been a lack of demand for the stock. Pappas also sold some of the AGR stock to customers after the Commission had entered its order temporarily suspending the Regulation A exemption. In his testimony at the hearing, Pappas stated that he could not recall if he mentioned this circumstance to his customers. He himself bought and sold 100 shares of AGR after the order of suspension.

26. It is concluded that in his dealings with customers Pappas made false and misleading statements of material facts and omissions of material facts concerning among other things:

- (a) the existence, terms and potential value of certain franchises of AGR;
- (b) the profit potential of AGR;
- (c) the earnings of AGR;
- (d) the financial condition of AGR;
- (e) a price increase in AGR stock;
- (f) a split of AGR stock;
- (g) AGR's process for pork production;

G. Violations by Pappas of the Anti-Fraud Provisions of the Securities Acts

27. It is contended on behalf of Pappas that even if it is assumed that Pappas made the statements attributed to him, the Division has not proven that he willfully violated the Securities Acts. It is urged in his behalf that he made no representation; he acted in good faith relying on information which he believed and purchased AGR stock himself; his customers were sophisticated investors and there is no proof they relied on his statements; and any violations which were committed were not willful.

28. It is argued that Pappas did not represent; but merely discussed, speculated and calculated and thus was exercising his right of free speech under the First Amendment. Actually, Pappas did much more than this. He gave his customers detailed information on the operations of AGR which he impliedly represented as factually correct. He also spoke of price increases in the stock and levels at which there would be a stock split. The Commission has held that predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are inherently fraudulent and cannot be justified. It is also well

8/ R. Baruch And Company, et al; Sec. Exch. Act Rel. No. 7932 (August 9, 1966). In this case which was concerned with other respondents to this proceeding defenses, similar to those urged here, were advanced by a salesman respondent and were considered by the Commission and rejected (See pp. 5-8). See also Crow, Brourman & Chatkin, Inc., Sec. Exch. Act Rel. No. 7839, p. 6; (Nov. 15, 1966), Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962); Hamilton Waters & Co., Inc., Sec. Exch. Act Rel. No. 7725 p. 4 (October 18, 1965).

established that the making of representations to prospective purchasers without a reasonable basis, couched in terms of opinion or fact and designed to induce purchases, is contrary to the basic obligation of fair dealing of those who sell securities to the ^{9/} public.

29. Pappas embarked on a selling campaign urging his customers to make immediate purchases of AGR without having seen any current financial statement of AGR or the franchise agreements he misrepresented to customers, but relying solely on office gossip supported by unverified statements of those with a financial stake in AGR. He had seen a copy of the offering circular, but had not been impressed by it. This was the only written material he ever saw dealing with AGR's financial condition. He had not seen a current balance sheet nor did he make any effort to obtain one. Despite this lack of information he proceeded to paint a glowing picture of AGR and its prospects. He told investors that franchises had been sold and gave them figures on profit per franchise that would be obtained. He made no attempt to verify the actual number of franchises which had been sold, the terms of each franchise, AGR's

^{9/} See e.g., MacRobbins & Co., Inc., Sec. Exch. Act. Rel. No. 6846, p. 4 (July 11, 1962), aff'd sub. nom. Berko v. S.E.C., 316 F. 2d 137 (C.A. 2, 1963); Shearson, Hammill & Co., Sec. Exch. Act Rel. No. 7743, p. 20 (Nov. 12, 1965); Linder, Bilotti & Co., Inc., Sec. Exch. Act Rel. No. 7460, p. 3 (November 13, 1964).

ability to perform its obligations under the contracts, what performance, if any, had taken place and other pertinent information. In actual fact, Pappas made misstatements as to the number of franchises sold, the extent of the obligations under each franchise, and the reasonable profit potential under the actual agreements signed. At the time Pappas was selling AGR stock, AGR was in poor financial condition. Pappas did no checking on it nor did he give his customers that information or any of the details contained in the offering circular.

30. Basic to the relationship between a broker or dealer and his customers is the representation that the latter will be dealt with fairly in accordance with the standards of the profession.^{10/} This obligation is applicable to securities salesmen.^{11/}

31. As has been pointed out, misrepresentations to prospective purchasers must have a reasonable basis. Easily ascertainable facts bearing upon the justification for the representations must be disclosed.^{12/} Pappas made no effort to check any of the information he had received. He knew or should have known that his sources of informa-

10/ MacRobbins & Co., Inc., *supra*; Duker v. Duker, 6 S.E.C. 386, 388-89 (1939). Cohen & Rabin, "Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication In Their Development", in "Law and Contemporary Problems", Summer 1964, pp. 703-708.

11/ A. J. Caradean & Co., Sec. Exch. Act Rel. 6903, p. 2 (Oct. 1, 1962).

12/ Best Securities, Inc., 39 S.E.C. 931; Barnett & Co., Inc., 40 S.E.C. 1, 521 (1960, 1961); D F. Bernheimer & Co., Inc., Sec. Exch. Act Rel. 7000 (Jan. 23, 1963).

tion were questionable. Meslovich, on whom he stated he relied most, was another representative with no supervisory authority. Actually, Pappas was more experienced than Meslovich. His other sources were AGR officials who had an economic interest in seeing that a demand was created for the stock. The sharp advance in AGR stock, under all the circumstances, should have alerted Pappas that the rise might well have been attributable to an aggressive sales campaign rather than to any intrinsic merit in AGR stock.^{13/} However Pappas continued to sell the stock even after a suspension order had been issued by the Commission charging fraud in the AGR offering. Again, he made no inquiry as to surrounding circumstances.

32. It is further asserted on behalf of Pappas that of the four investor witnesses there is no proof they relied on the representations by Pappas. While the evidence does establish such reliance it is well settled that it is unnecessary to show reliance on such representations or that the customer was in fact misled in order to establish violations of the anti-fraud provisions. The fact that a customer is a sophisticated investor or usually deals in speculative securities cannot excuse fraudulent representations made to him.^{14/} The fact that Pappas bought some AGR stock himself does not

13/ Crow, Brouman & Chatkin, Inc., supra, p. 6.

14/ R. Baruch And Company, supra, p. 7, and cases cited therein.

constitute a valid defense. The Commission has held that ". . . 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."^{15/}

33. It is concluded that Pappas grossly violated his obligations to his customers, that he thereby violated the anti-fraud provisions of the Securities Acts, and that the violations were willful.^{16/}

H. Other Matters

34. The Division alleges that Pappas willfully violated the registration provisions of the Securities Act and violated the rule against engaging in open market activities while participating in a distribution of securities (Exchange Act, Section 10(b) and Rule 10b-6). In view of the findings previously made concerning the sales activities of Pappas it is unnecessary to adjudicate these issues.

35. It is contended on behalf of Pappas that the proceedings brought against him violated his constitutional rights since he was impecunious and unable to obtain counsel for his defense and no counsel was appointed to defend him.

^{15/} Shearson, Hammill & Co., supra, pp. 21-22.

^{16/} Tager v. S.E.C., 344 F. 2d 518 (2nd Cir. 1965); 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).

36. The Commission is not required to appoint counsel for a respondent in an administrative proceeding.^{17/} It is sufficient that a party had the opportunity to appear at the hearing, present evidence, cross-examine witnesses,^{18/} and except to any adverse findings.

37. In the instant proceeding, the respondent had all the aforementioned rights and, in addition, a postponement was granted him to obtain counsel, the cross-examination of a witness was deferred at his request, and he was represented by counsel of his own choosing at all subsequent stages.

III. RECOMMENDATIONS

It has been found that John C. Pappas willfully violated the anti-fraud provisions of the Securities Acts. It has been urged on his behalf that he was not a willful violator but acted in good faith and, therefore, should not be found a cause of the order of revocation entered against Brod. However, it has been found that his violations were willful and that he made false and misleading representations to his customers in contravention of his duties and responsibilities to them. Under these circumstances, his contentions^{19/} are rejected. It is, therefore, recommended that John C. Pappas

17/ Boruski v. S.E.C., 340 F. 2d 991, 992 (C.A. 2nd Cir. 1965).

18/ Crow, Brouman & Chatkin, Inc., Sec. Exch. Act Rel. No. 7876 (April 29, 1966).

19/ Sutro Bros. & Co., Sec. Exch. Rel. No. 7053, April 10, 1963, (Hersh, p. 13); Ross Securities, Inc., Sec. Exch. Act Rel. No. 7069, April 30, 1963, (pp. 7-8).

be found a cause of the order issued against A. T. Brod & Company. ^{20/}

^{21/}
Respectfully submitted,

Sidney L. Feiler
Sidney L. Feiler
Hearing Examiner

Washington, D. C.

August 25, 1966

20/ It is urged that since there is no record of any previous violation by Pappas he should not be barred from the securities business. For the effect of a "cause" finding, see Ross Securities, Inc., supra, footnote 10.

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