UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
CENTURY SECURITIES COMPANY (8-8623) FRED COLTON DAVID T. FLEISCHMAN WILLIAM REIGEL ROBERT W. NEES PIERRE LAMBRUN JAY B. COOK DONALD R. BROPHY JOHN DESBROW	

INITIAL DECISION

Sidney Gross
Hearing Examiner

Washington, D. C.
August 26, 1966

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DONALD R. BROPHY		
JOHN DESBROW		

Before: Sidney Gross, Hearing Examiner

Appearances: Arthur W. Fred, Richard D. Capparella, and E. Gary Smith for the Division of Trading and Markets.

Century Securities Company, Fred Colton and David T. Fleischman, pro se.

Robert A. Eisenberg and Paul A. Schumann of Schumann & Zeiring for Robert W. Nees.

Bernard I. Segal for William Reigel, Pierre Pambrun and Jay B. Cook.

This proceeding is brought pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"). It was instituted by the order for public proceedings issued by the Securities and Exchange Commission ("Commission") dated October 20, 1964, against Century Securities Company ("registrant"), a partnership consisting of Fred Colton ("Colton") and David J. Fleischman ("Fleischman"), general partners, and William Reigel ("Reigel"), Robert W. Nees ("Nees"), Pierre Pambrun ("Pambrun"), Jay B. Cook ("Cook"), Donald R. Brophy ("Brophy") and John Desbrow ("Desbrow"), who were salesmen employed by registrant. Registrant has been registered as a broker-dealer with the Commission since June 16, 1960, and is a member of the National Association of Securities Dealers, Inc. ("NASD").

The order alleges, in substance, that during the period January 1, 1963 to October 20, 1964 ("the relevant period"), registrant and the other respondents, singly and in concert, wilfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act")[1/] in the offer, sale and delivery of unregistered securities and wilfully violated the anti-fraud provisions of the Securities Act and the Exchange Act and the rules promulgated thereunder in the offer and sale of securities.[2/]

1/ Sections 5(a) and 5(c) of the Securities Act, as applicable here, make it unlawful to use the mails or interstate facilities to sell or deliver a security unless a registration statement is in effect as to such security.

2/ The anti-fraud provisions alleged to have been violated are Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 10b-6, 15c1-2 and 15c1-8 thereunder. The composite effect of these provisions as applicable to this case is to make unlawful the use of the mails or means of interstate commerce in connection with the purchase or sale of any security by use of a device to defraud, an untrue or misleading statement of a material fact or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by the use of any other manipulative, deceptive or fraudulent device.

On the basis of a stipulation and offer of settlement by Desbrow, the Commission suspended him from being associated with any broker or dealer for 45 days.[3/]

Hearings were held and the record was closed on August 27, 1965. Brophy and Nees did not appear. All remaining respondents appeared pro se. After service of the Division's requests that a default be entered as to both Brophy and Nees pursuant to Rule 6(c) of the Commission's Rules of Practice, Brophy was barred from being associated with a broker or dealer.[4/] Nees, however, objected and moved to reopen the record. The Hearing Examiner's order of December 3, 1965 granted Nees' application and reopened the record to afford him "an opportunity to interpose a defense to the allegations of the order for proceedings and to respond to such evidence as has been or may be introduced against him".

The reopened hearing was held on February 14, 1966. Nees, Reigel, Pambrun and Cook appeared by counsel. Registrant, Colton and Fleischman appeared pro se. The record was closed on that day.

Proposed findings of fact, conclusions of law and briefs have been filed by the Division of Trading and Markets ("Division"), by counsel on behalf of Nees, Reigel, Cook and Pambrun, and pro se by registrant, Colton and Fleischman.

3/ Securities Exchange Act Release No. 7670 (August 3, 1965).

4/ Securities Exchange Act Release No. 7745 (November 15, 1965).

Sale of Unregistered Securities

(a) Jayark

Jayark Films Corporation ("Jayark") is engaged in the business of the distribution for television presentation of programs and motion pictures. At all pertinent times Reuben R. Kaufman was its President and a director and Jane Kaufman, his wife, was Secretary and a director.

It is stipulated that:

> "On September 4, 1964 (sic), 5/ the Registrant purchased as principal 3,750 shares of Jayark stock at 5-1/4. The record indicates here that Kaufman refers to both Jane and Reuben Kaufman. On September 13, 1964 (sic), 6/ Registrant received certificates for 3,750 shares of Jayark, of which 3,000 shares were registered in the name of Jane Kaufman, and 750 shares in the name of Reuben Kaufman. These certificates were issued to the Kaufmans by transfer from larger certificates, which were originally issued to and directly acquired by the Kaufmans from the issuant (sic) and were not covered by any filing under the Securities Act."

> "From September 4 to September 11, 1963, Registrant, as principal, through its sales representatives, sold 2,320 shares of Jayark stock short. This short position was covered by the shares acquired from Kaufman. The balance of the stock purchased from Kaufman was sold to the public in small lots by Registrant's sales representatives."

It is also stipulated that registrant used the mails and means and instrumentalities of interstate commerce while engaged in the transaction alleged in the order for proceedings and effected transactions otherwise than on a national securities exchange.

5/ As shown by other documentary evidence in the record this date should read "1963".

6/ Ibid.

The counterstatement of proposed findings, conclusions and brief filed on behalf of registrant, Colton and Fleischman admits the stock was unregistered and their intent to make a public offering and distribution in respect of the Jayark shares as, indeed, the law construes the transactions.[7/] They state, however, that they were "wholly unaware" that the stock was unregistered. They plead "ignorance and inexperience in such matters" and contend that these factors belie the wilfullness upon which a violation may be predicated. They urge, further, that they had no reason to suspect any defect in the Kaufman shares since they relied on Kaufman's written assurance that the shares were exempt from registration.

These respondents are asserting, in substance, a lack of intent to sell unregistered securities. But it has long been settled in broker-dealer proceedings that a finding of an intention to violate the law is not a prerequisite to a finding of wilfullness which requires only that registrant knew what it was doing.[8/] The cases cited in support of respondents' position offer them little comfort. Norris & Hirschberg, Inc.

7/ Securities Act, Section 2(11). See also Associated Investors Securities, Inc., Securities Exchange Act Release No. 6859 (July 24, 1962).

8/ Hughes v. S.E.C., 147 F. 2d 969 977 (CADC, 1949); Schuck v. S.E.C., 264 F. 2d 358, 363, 2.18 (CADC 1958); Thompson Ross Securities Co., 6 S.E.C. 1111, 1112; Henry P. Rosenfeld, 32 S.E.C., 731, 739, 740 (1951); Underhill Securities Corporation, Securities Exchange Act Release No. 7668 (August 3, 1965).

v. S.E.C.[9/] actually reaffirms the interpretation of "willfulness" in Hughes v. S.E.C., supra. United States v. Crosby[10/] is a criminal case which, of course, requires a different standard of proof and in which the court found "more than ample independent evidence supporting scienter on the part of both defendants."

It is eminently clear that no exemption was available to registrant[11/] nor does registrant assert it. The original public offering of Jayark stock in which registrant admittedly was an underwriter, occurred in 1963, the same year in which the unregistered shares were purchased by registrant from Kaufman. The record lacks details as to all the holders of Jayark's outstanding and unregistered securities. It is sufficient, however, that registrant, as an underwriter of the earlier issue must have known of the Kaufmans' relationship to the company and their status as controlling persons. And since registrant took the precaution of obtaining Kaufman's letter to it dated September 9, 1963, stating that Jayark's counsel has advised that the 3,750 shares "would be exempt from S.E.C. registration under existing regulations" (which registrant now admits was in error), registrant most certainly knew the shares were unregistered.

Under the circumstances present here acceptance of Kaufman's 'self-serving statements . . . without reasonably exploring the possibility

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9/ 177 F. 2d 228, (CADC 1949).

10/ 294 F. 2d 928 (CA 2, 1961).

11/ Rule 154 under the Securities Act. See also Securities Act Release No. 4445 (February 2, 1962) and Securities Act Release No. 6669 (February 17, 1964).

of contrary facts"[12] is insufficient to afford exculpation.[13] Moreover, reliance upon Kaufman's letter of September 9, 1963 does not preclude a finding of wilfullness within the meaning of Section 15(a) of the Exchange Act.[14]

Kaufman's letter referred to above was addressed to Riegel who was in communication both through correspondence and by telephone with Kaufman regarding the latter's offer to sell his 3,750 shares of Jayark to registrant. Over two months prior to registrant's purchase of Kaufmans' shares a letter on Jayark's letterhead dated July 3, 1963, discussing Jayark's negotiations for films for TV distribution, was written by Kaufman and addressed to Reigel at registrant. Further, the confirmation of registrant's purchase of these shares carried Reigel's name. Under these circumstances the same considerations discussed above regarding knowledge of Kaufman's relationship to Jayark, the reason for the Kaufman letter of September 9, 1963, reliance on that letter and the lack of any attempt to ascertain the actual facts are applicable with equal force to Reigel.

(b) Kramer-American Corp.

Kramer-American Corp. ("K-A") was engaged in the distribution and sale of tractors and other farm equipment. Vern Coggle ("Coggle") was its President and a director. It is stipulated that in June 1960

12/ S.E.C. v. Culpepper, 270 F. 2d 241, 251 (CA 2, 1959); See also Securities Act Release No. 4445, supra.

13/ Assurance Investment Company, Securities Exchange Act Release 7862, (April 15, 1966), p. 2; Securities Exchange Act Release No. 4445, supra.

14/ Morris J. Reiter, Securities Exchange Act Release No. 6849, (July 13, 1962). Nor does registrant's seeking of the actual opinion of Kaufman's counsel in October 1964, long after the event and actually subsequent to the institution of these proceedings aid its cause.

K-A effected a public offering of 60,000 shares[15/] of its stock pursuant to Regulation A of the General Rules and Regulations of the Securities Act; that options for an additional 150,000 shares were taken by Coggle and others; that between January 6, 1964 and February 26, 1964 registrant, as principal, purchased a total of 6,250 shares of K-A from Donald B. Brpwn ("Brown"), Ronald E. Landers ("Landers") and Ernest W. Chavis ("Chavis").

5,750 of the 6,250 shares were unregistered. Their source was the Coggle options. These unregistered shares include 2,500 of the 3,000 K-A shares sold to registrant by Brown in four transactions between January 10, 1964 and January 17, 1964, two sales by Landers totalling 1,250 shares on January 15, 1964 and January 20, 1964 and one sale by Chavis of 2,000 shares on March 3, 1964.[16/] The schedule of registrant's transactions in K-A stock discloses the sale of the unregistered shares to its customers, as principal.

It is registrant's position that it was unaware that the shares were unregistered at the time they were purchased and that its K-A stock transactions merely represented "business as usual."

Brown and Landers, both attorneys, testified in November 1964 in connection with the investigation of K-A. Brown had done legal work for Coggle, personally. Landers had represented K-A in certain legal matters since 1961. It is readily apparent that both acted as a conduit

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15/ The offering circular admitted into evidence indicates this figure is in error and should read "150,000".

16/ These are settlement dates.

for Coggle's trades in unregistered securities of K-A not only with registrant but also in larger transactions with other dealers. Brown testified he had never heard of registrant prior to the first transaction with Century; he has no recollection of arranging the transactions with registrant and although he may have had conversations with registrant he cannot recall any. Moreover, the names Colton and Kandell are not familiar to him. Landers testified that Coggle advised him registrant was making a market in the stock; he never had dealings with registrant before; he does not recall whom he dealt with at registrant; his business with Century was done by telephone.

Division seeks a finding based on the testimony of Brown and Landers that "registrant made these purchases with knowledge, or at least should have had knowledge of Coggle's beneficial ownership of the Brown and Landers K-A shares." Division relies on passages from Brown's testimony which constitute little more than mere assumptions on his part that the brokers through whom his sales of Coggle's stock were consummated knew he was acting for a client. Clearly this is not enough. And Landers' testimony that he probably didn't tell registrant he was acting for Coggle is, of course, of no assistance to the Division. Although the testimony of both Brown and Landers leaves much to be desired, it offers no support for the inference upon which the finding sought by the Division would be warranted.

But other evidence of the transactions contained in the record is more revealing. Martin Kandell, then an employee of registrant, conducted negotiations for and effected the purchase of K-A stock from Brown and Landers over the telephone after consultation with Colton.

Kandell had never done business with either of them previously and had never met them personally. Kandell testified that he had one transaction with Brown and registrant's records disclose Kandell as registrant's representative in respect of one such transaction for 500 shares carrying a settlement date of January 17, 1964. However, those records also disclose three additional purchases from Brown totalling 2,500 shares between January 10, 1964 and January 13, 1964, all carrying Colton's name as the representative. And of the two transactions with Landers, one is in Kandell's name and the other in Colton's.

The four transactions in which Colton's name appeared are left unexplained by respondents and particularly by Colton, the only respondent who took the witness stand in defense. In addition, respondents have made no attempt to explain the circumstances surrounding registrant's purchase of 2,000 shares of K-A on March 3, 1964 from Chavis. Registrant's books reflect Kandell as its representative in the transaction. Yet Kandell doesn't remember the name "Chavis".

The Commission's statements regarding the necessity for adequate inquiry by the dealer who is asked to sell a security also apply to the dealer who purchases as principal.

> "The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwirters, then searching inquiry is called for.
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> "The problem becomes particularly acute where substantial amounts of a previously little known securi ty appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933. In such situtations, it must be assumed that these securities emanate from the issuer or from persons controlling the issuer, unless some other source is known and the fact that the certificates may be registered in the names of various individuals could merely indicate that those responsible for the distribution are attempting to cover their tracks." 17/

Here, although "searching inquiry" was indicated, none, whatsoever was made. The interpretation of the record most favorable to registrant would result in the conclusion that it purchased 3,000 shares of the securities of a relatively obscure and unseasoned company from Brown and 1,250 such shares from Landers over the telephone within a short time without inquiry as to the source of the stock despite the fact that each of them was unknown to registrant. Moreover, the fact that 4,250 shares found their way into the market in so short a time should have put registrant on notice of the need for inquiry in respect of the Chavis transaction.

17/ Securities Act Release No. 4445, supra.

Accordingly, the Hearing Examiner concludes that in the offer and sale of the unregistered stock of Jayark and K-A registrant, Colton, Fleischman and Reigel[18/] wilfully violated Sections 5(a) and 5(c) of the Securities Act.

Excessive Mark-ups and Mark-downs

Division's proposed findings are predicated upon schedules it prepared from registrant's books and records together with mathematical computations based upon those records. Registrant does not challenge the accuracy of the schedules or the computations.

Division asserts that from about January 1, 1963 to April 22, 1964, registrant had 284 transactions in Jayark with mark-ups ranging from 5.2% to 42.9%. In 203 of these transactions the mark-up exceeded 10% and 18 were in excess of 40%. In 254 transactions in Homestead Gold Exploration Corporation ("Homestead") stock, mark-ups ranged from 5.1% to 43.9% in 145 transactions and included 131 transactions over 10% and eight over 40%. Mark-downs in 109 transactions ranged from 5.1% to 40% including 73 transactions were over 10%. In 113 transactions in the stock of Colorsound, Inc. ("Colorsound"), mark-ups in 54 transactions ranged from 14.5% to 54.9% including 10 transactions over 50% and mark-downs in 3 transactions were between 14.7% and 20%.

18/ Reigel in respect of Jayark only.

Division based its mark-up and mark-down percentages upon (1) the cost of registrant's purchases of a security on the same day it made sales of the security and (2) on the basis of the average cost where more than one purchase was made on the same day of the sale or within the contemporaneous period at different prices. The NASD's mark-up policy, a guide to determining fairness of the price charged by the broker-dealer states, in substance, that transactions should normally not exceed 5%. It notes that 5% or even a lower rate is not necessarily always justified and that in 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 of a security. 19/

The Commission has accepted and adopted the NASD's guide. The Commission has ruled on numerous occasions that unless countervailing evidence should establish a basis for a different standard, a dealer's own same day or contemporaneous cost in transactions involving low priced, over-the-counter securities, is the best evidence of current market price. 20/ Since, in respect of such securities, quotations by other dealers do not necessarily represent the price at which transactions are actually consummated, the Commission has refused to accept published quotations in lieu

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19/ NASD manual, p. G-3.

20/ Naftalin & Co., Inc., Securities Exchange Act Release No. 7220 (January 10, 1964); J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964); Costello, Russotto & Co., Securities Exchange Act Release No. 7729 (October 22, 1965); Arnold Securities Corp., Securities Exchange Act Release No. 7813 (February 7, 1966); J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7334 (June 5, 1964); Wesco and Company; Securities Exchange Act Rel. No. 7928 (Aug. 5, 1966).

of contemporaneous costs as the best evidence of prevailing market price.[21]

There is little question that contemporaneous costs as evidence of market price may be used in other than same day transactions where purchases and sales are closely related in time.[22] In Shiels, the purchase price was deemed contemporaneous cost despite lapses of seven and more days between purchase and sale and in Linder Belotti "the most nearly contemporaneous purchase within three days before and after sale" was utilized.[23] The same standards are applicable to mark-downs.

Registrant urges that because it was actually "making the market' in Jayark the concept of contemporaneous cost is not appropriate since, where no appreciable demand existed registrant, in its capacity as market maker, supplied prices consistent with the market. This position would eliminate pricing restrictions in respect of a security in which a broker-dealer was making the market. The mere statement of the contention indicates that it is untenable. Registrant also asserts a need to clarify the 5% policy as it is meant to apply to "risk" transactions or to sales from inventory. It is readily apparent from the cases cited above and from the substantial number of additional decisions by the Commission on the question of excessive mark-ups that

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21 / Naftalin & Co., Inc., supra.

22 / Naftalin & Co., Inc., supra; J. A. Winston & Co., Inc., supra, (Release No. 7337); Shiels Securities, Inc., Securities Exchange Act Release No. 7739 (Jan. 11, 1964); Linder, Belotti & Co., Inc., Securities Exchange Act Release No. 7738 (November 5, 1965).

23 / Thill Securities Corporation, Securities Act Release No. 7342 (June 11, 1964).

such contentions, in one form or another, have been considered and rejected.

Registrant objects to the use of average daily costs stating that it ignores risk or inventory position and disregards daily fluctuations, "there being no indication whether the prices were in fact weighted according to the number of shares bought". Since closeness in time suffices,[24/] the "same day" and "contemporaneous cost" concepts envision no distinction between purchases made prior or or subsequent to the relevant sale. Clearly, where several purchases were made on the same day, the use of either the lowest or highest cost would be unduly prejudicial to the registrant or the Division, respectively. Accordingly, the averaging principle would appear to be entirely justified. Secondly, it is readily apparent that only a relatively small number of the transactions in Jayark and Colorsound involved purchases at different prices on the same day[25/] and, in many instances, the differences in price were so small as not to result in a reduction of the mark-up percentage to an area consistent with the NASD 5% guide even if the highest cost were utilized. Although a

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24/ Shiels Securities, Inc., supra.

25/ The Division's schedule of registrant's Jayark transactions covering 284 transactions over a period of about 12 months shows such purchases on about 30 days. The Colorsound schedules covering 113 transactions in a period of about 7 months show such transactions on only about 10 days.

substantial number of same day purchases at varying prices is present in the Homestead transactions, those schedules are so replete with excessive mark-ups and mark-downs on same day transactions involving no varying purchase prices[26/] as to render the point of little importance in the overall picture.[27/]

Moreover, the transaction in which registrant purchased 3,750 shares of Jayark stock at $5.25 per share is of substantial significance in consideration of the issue of excessive mark-ups. At the opening of business on that day registrant was 729 shares long. By the close of business that day it was 273 shares short and continued in short position in progressively higher amounts until it received the shares on September 12, 1963. In the interim registrant's sales price to customers, commencing with its first short sale and through the end of business on September 12, 1963, included 19 sales, 18 of which were at 7-1/2, or a mark-up of 42.9%.

26/ The Homestead transactions reflect about 10 mark-ups between 10.8% and 33.3% in 54 transactions between December 6, 1963 and March 12, 1963 and 28 mark-downs of between 8.1% and 19.6% in the same period.

27/ Registrant's reliance on the Commission's decision in Shearson Hammill & Co., Securities Exchange Act Release No. 7743 (Nov. 12, 1965), is misplaced since the Commission not only specifically restricted the applicability of that decision to the circumstances present there which differ substantially from the facts in this case but also, at p. 24, fn. 57 of the decision, reiterated the rule supporting contemporaneous cost as the best evidence of market price.

It is concluded that the practices of registrant, Colton and Fleischman of charging customers prices not reasonably related to market price without disclosing that fact constituted violation of the securities laws.[28/]

Registrant's activities in respect of Jayark stock leaves no doubt that it dominated and controlled the market in Jayark, at the very least, for the period September, 1963 through April, 1964. Registrant commenced its quotations in the East Coast sheets and the Pacific Coast sheets in May, 1963 and maintained quotations in those sheets regularly through April, 1964. It is unnecessary to dwell on the question whether the presence of quotations of other brokers in the sheets affected registrant's domination and control of the Jayark stock. It is sufficient that for the period September 1963 through April 1964 registrant was virtually alone in both sheets[29/] resulting in the inescapable conclusion that registrant maintained and dominated the market in stock during that period. Registrant's failure to disclose this fact

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28/ W. T. Anderson Company, Inc., 39 S.E.C. 630 (1960); J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964); Charles Hughes & Co., Inc. v. Securities and Exchange Commission, 139 F. 2d 434 (C.A. 2, 1943); cert. den. 321 U.S. 786.

29/ One dealer maintained B/W quotes for 3 days in October 1963; one maintained numerical bid and asked quotations between October 28 and November 5, 1963 and changed to OW-BW on 7 days from November 8 through November 21, 1963. During 4 of the latter 7 days, one broker quoted an asked only for 100 shares and another offered a bid at 6 on one day. In addition, one broker inserted two B/W quotations and one asked quotation during 3 days in February, 1964, and two brokers each inserted one quotation during March 1964. It may also be noted that from November 4, 1963 to April 3, 1964 registrant's bids in the East Coast sheets were all OW/BW as were its bids for intermittent periods in the Pacific Coast sheets albeit these were interspersed with periods of numerical bid and asked quotations.

to its customers constituted a fraudulent device.[30]

Rule 10b-6 of the General Rules and Regulations under the Exchange Act provides, in substance, as applicable here, that a "manipulation or deceptive device or contrivance" is present where an underwriter or prospective underwriter in a distribution, or a broker-dealer or other person who has agreed to participate or is participating in a distribution, bids for or purchases for his own account any security which is the subject of the distribution. Registrant's brief admits its purpose and intent "to make a public offering and distribution" of Jayark stock. It is readily apparent therefore that its quotations in both the East Coast and Pacific Coast sheets directly subsequent to its purchase of the Jayark stock from the Kaufmans, as principal, constituted a violation of Rule 10b-6.[31]

Moreover, Rule 15c1-8 under the Exchange Act, as pertinent here,[32] in substance, defines as a fraudulent device or contrivance the representation to a customer by a dealer financially interested in the distribution of an over-the-counter security that such security is being offered "at the market" unless the dealer knows or has reasonable grounds to believe that a market exists other than that made, created or controlled by him. An examination of the quotations appearing in the East Coast and Pacific Coast sheets subsequent to September 4, 1963, the date of the purchase

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30/ Daniel & Co., Ltd., 38 S.E.C. 9, 12 (1957).

31/ J. H. Goddard & Co., Inc., Securities Exchange Act Rel. No. 7321, (May 22, 1964).

32/ Violations of this section and rule were alleged in the order for proceedings. Viewed in the context of the discussion in Division's brief at page 54, it is obvious that the reference to Rule 10b-8 in the subtitle on that page is a typographical error.

of Jayark shares from the Kaufmans, demonstrates conclusively the dominant role played by registrant in making and maintaining the market in Jayark stock. The prices registrant charged its customers 'carries with it the implied representation that such price is, or bears some reasonable relationship to, the prevailing market price."[33/]

33/ Landau Company, 40 S.E.C. 1119, 1126 (1962).

Registrant - Misrepresentations

The record discloses and it is undisputed that, as shown by a Research Report on Jayark issued by registrant, Jayark had suffered an operating loss of $21,615 for the five-month period ending October 31, 1962 and that as demonstrated by Jayark's Annual Report for 1963, the company had a deficit of $99,766.47 as of May 31, 1963.

Sometime in the late spring of 1963 Jayark commenced negotiations with Samuel Goldwyn Productions for the acquisition of a film library for presentation on television. Negotiations proceeded to a point at which all disputes had been adjusted and Samuel Goldwyn ("Goldwyn") shook hands with Kaufman and said "All right; we have a deal." Later Goldwyn's representative advised Jayark that Goldwyn would not complete the transaction "because he couldn't do so advantageously, from a tax situation standpoint."[34/]

Jayark had also commenced negotiations with Paramount Pictures Corporation ("Paramount") for a film library for exhibition on television. These negotiations were pending, although not pressed, at the same time the Goldwyn negotiations were taking place. When

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34/ The only witness who testified on the point indicated a lapse of a number of months between the opening of negotiations and the time Jayark was advised the deal was off. A letter from the Goldwyn Production's general counsel indicates the "discussions" began at the beginning of May 1963 and terminated toward the end of June 1963. The witness stated that either one of those dates could be correct.

Goldwyn indicated he would not consummate that contract Jayark proceeded with the Paramount negotiations which terminated, without an agreement having been reached, in September 1963.

The Division produced a number of witnesses[35/] who purchased Jayark stock between May 1963 and June 1964. These witnesses testified to the following representations made to them by various registered representatives of the registrant in the sale of Jayark stock:

(a) If the libraries were negotiated, "within two weeks the stock would go sky high, at least triple"; the stock would double within a week or two after the agreement was signed; the stock would probably go as high as $14 or $15 in a few months; after the contract was signed it should go to $9 or $10 in 6 or 7 months, maybe a year; you can double your money; after the announcement of the acquisition it would probably be a $10 stock; the stock would go from $7.50 to $10 or $11 or $12 by the end of the year; the stock should be going up appreciably after the announcement of the deal; the stock would be worth $10 or $12 in six months and $30

35/ DRB: GMR: AFW: HSD: IM: RM: FAB: JVH.

if the customer held it for a longer time; there was no limit to where the stock could go after the deal was completed; the salesman could guarantee that in two or three weeks the stock is probably going to double; "It had to double within the year from the $6 and $7 range to at least $10 and $12 and possible a $15".

(b) The movie deal was 99.9% sure of consummation; it had not yet been completed "because the man had a heart attack, he had a stroke"; there was no doubt that the deal would go through; the deal was firm and Paramount was waiting for a letter from the Internal Revenue Bureau as to how they would pay their income taxes on the package of films; Jayark had an option to purchase about 240 films that had never been shown on television before; Jayark's earnings are estimated at about $2.50 a share; Jayark had a $50,000,000 film deal they were just ready to sign and it would make Jayark as much as $10,000,000; Jayark was making money; after completion of the deal in a week or ten days the stock would no longer be available

at $7.50; the stock would never be worth less than $7.50; any time the customer wanted his $7.50 back it would be available; Jayark was the finest opportunity "to make a quick buck".

Virtually none of these witnesses were advised of Jayark's financial condition at the time of their purchases. Nor were two additional witnesses so advised.[36/]

Apart from the witness F.A.B., the testimony of the various investor-witnesses set forth above remains uncontradicted. After having heard these witnesses and observing their demeanor the Hearing Examiner credits their testimony.[37/] Moreover, neither Cook, Lambrum, Fleischman, nor Reigel testified at the hearing in their own behalf. Their failure to do so is deemed a factor of substantial significance warranting the inference that their testimony would have been adverse.[38/]

During the course of his testimony, Nees denied much of the testimony of F.A.B. and stated, in substance, he told F.A.B. that if the film library acquisition were consummated the stock

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36/ C. E. McC. and M.B.

37/ Except for the testimony of O.D. which will be discussed below.

38/ N. Sims Organ & Co., Inc., 40 S.E.C. 573 (1961); N. Sims Organ & Co., Inc. v. S.E.C. 293 F. 2d 78 (CA 2, 1961).

would have a good appreciation. Nees denies making any guarantees. He admits, however, stating that the stock would go "through" ten and possibly higher if the deal closed and the witness kept it for 6 months to a year. Having observed both Nees and F.A.B. and in view of Nees' obvious self interest, the Hearing Examiner credits F.A.B.'s testimony. Moreover, Nees failed to deny any of J.V.H's testimony which included price rise predictions and the "make a quick buck" representation.

The record establishes that representations by registrant's salesmen relating to the certainty of the T.V. deal, the cause of Jayark's failure to complete the contract, Jayark's option to buy films, its estimated earnings, the description of the T.V. transaction as a $50,000,000 deal, the anticipated $10,000,000 profit to Jayark, the unavailability of Jayark stock, that the purchaser could always get his money back together with other statements set forth above had no factual basis and were flagrant and deliberate untruths. In the light of the deficit and operating losses suffered by Jayark, it is manifest that the statement that Jayark was making money was false. Further, in 1963, prior to registrant's purchase of Kaufman's Jayark shares in the same year, registrant was an underwriter of a formal issue of Jayark stock and obviously, therefore, was aware of Jayark's financial condition. Nevertheless, registrant furnished

its salesmen with an undated document entitled "Not For Distribution" - "Office Use Only" which stated that Jayark is "now producing income and will continue showing profits for years to come" and "Jayark is now operating in the black"[39/]. It is manifest, therefore, that registrant knowingly furnished false information regarding Jayark's financial condition to its salesmen.

Obviously, the above mentioned representations did not meet the standards of the anti-fraud provisions of the securities laws that recommendations of a security shall be supported by and, indeed, imply an adequate and reasonable basis in fact[40/]. Moreover, the Commission has held repeatedly that predictions of specific and substantial increases in the price of a speculative security within a relatively short period are inherently fraudulent and cannot be justified[41/]. Here such predictions ranged from 10 to double to 30 to "sky high" and from within 2 weeks to within the year and included a guaranty that it would double.

39/ Since this document also states Jayark's "Fiscal year ends May 31, 1963" it must have been issued prior to that date.

40/ Leonard Burton Corporation, 40 S.E.C. 211 (1959); MacRobbins & Co., Inc., 40 S.E.C. 497 (1961); Best Securities, Inc., 39 S.E.C. 931 (1960; Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962); Underhill Securities Corporation, Securities Exchange Act Release No. 7668 (August 3, 1965).

41/ R. Baruch And Company, Securities Exchange Act Release No. 7932 (August 9, 1966); Hamilton Waters & Co., Securities Exchange Act Release No. 7725, (October 18, 1965); S.E.C. v. Johns, 207 F. Supp. 566 (U.S.D.C., N.J., 1962); Alexander Reid & Co., Inc., supra.

Nor does the fact that in many instances the prediction was conditioned on completion of the T. V. deal serve to justify it. There is no evidence that Goldwyn's apparent acceptance of the T.V. deal was ever communicated to registrant. Indeed, as late as July 3, 1963 Kaufman advised Reigel that his "negotiations" were still in progress. But even if the deal had been completed and the registrant so informed, the predictions of substantial price rises were unwarranted. Registrant had no knowledge of the provisions of the proposed agreement, of the nature of the film library, as to how those films would be received by the telecasters nor of any of the myriad considerations which may be involved in the success or failure of such a venture.

In addition, the record is replete with evidence that the investor-witnesses were not advised of the adverse information regarding Jayark's financial condition thus constituting further violations of the securities laws.[42/] And neither recognition by customers that they were purchasing speculative securities nor lack of reliance by customers upon the salesman's fraudulent statements absolve such representations.[43/]

It is well settled that registrant and its officers are responsible for the activities of registrant's salesmen on its

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42/ N. Pinsker & Co., Inc., 40 S.E.C. 291 (1960); Leonard Burton Corporation, supra.

43/ Isthmus Steamship & Salvage Co., Inc., Securities Exchange Act Release No. 7400 (August 20, 1964); Wright, Myers & Bessell, Inc. Securities Exchange Act Release No. 7415 (September 8, 1964).

behalf.[44/] Persons dealing with a securities firm properly may rely on the principals of the firm to protect them against fraud or other misconduct in the operation of their business and the rules place the responsibility for adequate supervision against violation of the securities laws on the firm's officials.[45/] A contrary rule "would encourage ethical irresponsibility by those who should be primarily responsible.[46/]

Thus, where willful violations have occurred by a firm's employees, failure to maintain and enforce a proper system of supervision constitutes the firm and its responsible personnel participators in such misconduct and willful violators of the securities laws.[47/]

Based upon the record and the foregoing it is concluded that in the offer and sale of Jayark stock registrant made false representations of material facts and omitted to state material facts; sold Jayark stock at prices not reasonably related to the prevailing market price; failed to disclose to customers its domination and

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44/ Associate Underwriters, Inc., Securities Exchange Act Release No. 7389 (August 14, 1964); Sutro Bros. & Co., Securities Exchange Act Release No. 7053 (April 10, 1963); Charles E. Bailey & Company, 35 S.E.C. 33, (1953).

45/ Bond and Goodwin, Incorporated, 15 S.E.C. 584 (1944); Thompson & Sloan, Inc., 40 S.E.C. 451 (1961); Sutro Bros. & Co., Securities Exchange Act Release No. 7052 (April 10, 1963); Reynolds & Co., 39 S.E.C. 902, 917 (1960).

46/ R. H. Johnson & Co. v. Securities and Exchange Commission, 198 F. 2d 690, 696-7 (1952); cert. den. 344 U.S. 855 (1952); John T. Pollard & Co., Inc., 38 S.E.C. 594 (1958).

47/ Reynolds & Co., supra.

control of Jayark stock; while underwriter of Jayark bid for and purchased Jayark stock for its own account; and knowing that no market existed for Jayark other than the market made by it, represented to customers that Jayark was being offered "at the market".

Accordingly the Hearing Examiner finds that registrant, Colton and Fleischman willfully violated Sections 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 10b-6, 10b-8 and 15c1-2, 15c1-8 promulgated thereunder. 48/

48/ On objections to questions as to Colton's former association with J. Logan & Co., a broker-dealer whose registration had been revoked (Securities Exchange Act Release No. 6848, (July 9, 1962), and as to Nees' former association with Pacific Coast Securities whose registration had been revoked (Securities Exchange Act Release No. 7486 (December 22, 1964), the Hearing Examiner reserved decision. Neither Colton nor Nees were named in the respective proceedings.

The Division's questions as to Nees' and Colton's former associations were undoubtedly predicated on the decision in U.S. v. Ross and Gordon, 321 F. 2d 61 (CA 2, 1963). In that case questions were deemed admissible which led to disclosure of the names of the firms by which the defendant had been employed formerly, the stock he sold, the nature of his sales "pitches" and that he made his sales over the telephone, in order "to show, by similar acts or incidents, that the act on trial was not inadvertent, accidental, unintentional or without guilty knowledge." Since no evidence of sales to customers by Colton was offered by the Division, the mere reference to Colton's earlier association with Logan & Co. is not sufficient to establish "similar act or incidents". Moreover, the revocation in Pacific Coast was based upon a stipulation and consent "without admitting or denying the allegations".

Further, since this is not a criminal proceeding involving punishment but one to determine whether the respondents are properly qualified to pursue their profession, the Hearing Examiner has serious doubt whether the respondents should not be confronted with all charges of violations of the securities laws through appropriate allegations in the order for proceedings rather than to be met with them for the first time at the hearing, without prior notice, as matters pertaining to the public interest under the "similar acts" doctrine.

Salesmen

Division's brief charges "unsuitability" in respect of witnesses, G.M.B., O.D. and M.B. Each witness is an elderly lady. Although the record is not clear, it may be assumed for this purpose that neither is wealthy. One is a widow, one divorced and one has a husband who contributes little to her support.

The "unsuitability" rule

> "is directed against the making of recommendations to customers under circumstances where there is no reasonable basis for considering the recommendation suitable to the customer, and we do not interpret it as applying solely to situations where information concerning the customer is known to or communicated to the broker or dealer."49/

G.M.B. has been purchasing securities for about 6 or 7 years commencing with an investment in mutual funds which she stopped because "that didn't to very much for me" -- "You don't get much on mutual funds". She has been Fleischman's customer since 1959. Obviously dealing in common stocks was her choice. M.B. has been purchasing securities since 1922. Her financial objective is to "make money". She has been Cook's customer for 8 or 10 years. She called Cook to suggest stock transactions more often than he called her.

O.D. not only had extreme language difficulties and, as pointed out in Division's brief, an inability to remember dates, but was so upset and ill at the prospect of testifying that much of her testimony

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49/ Gerald M. Greenberg, 40 S.E.C. 133, 137 (1960).

was completely incoherent. Even assuming her testimony would be credited despite these difficulties, it indicates that she had purchased securities before she moved to California in 1953. She has been dealing with Pambrun since 1961 and informed him that her objective was "capital gains and dividends, too." Every stock she had purchased through Pambrun had been sold at a profit.

Under the circumstances set forth above and in the absence of any evidence as to the nature of the securities purchased by these witnesses prior to the Jayark transactions, no reasonable basis has been presented upon which a finding of unsuitability may be predicated in respect of the isolated Jayark recommendations.

With the exception of Reigel, all the salesmen respondents sold unregistered Jayark stock. But, the record is devoid of any evidence indicating knowledge on their part of the source of the stock or the basis for the conclusion that it was unregistered. And since registrant was an underwriter of Jayark stock earlier in the same year at which time there was no question as to the propriety of the issue, only substantial evidence would warrant a finding of such knowledge. Accordingly, assuming that a finding of wilfullness is necessitated by the accepted definition of the term[50/], it is apparent that the evidence present here would not justify the imposition of sanctions.

50/ See footnote 8 infra.

Division has not produced proof that any of the salesmen were cognizant of registrant's activities resulting in excessive mark-ups and mark-downs. Nor does the record establish that the salesmen were aware that registrant dominated and controlled the market in Jayark stock. Undoubtedly, the salesmen must have known registrant was in the sheets in Jayark stock from time to time. But they should not be burdened with the duty to ascertain the record of registrant's regular activities in the sheets in order to determine whether it dominated and controlled the market. Absent proof of knowledge of the excessive mark-ups, mark-downs and of registrant's domination and control of Jayark stock, the salesmen should not be saddled with the responsibility such knowledge would impose, based only upon inference from the fact that registrant is chargeable with those violations.

Nees

As to registrant's information relating to the status of Jayark's negotiations with Goldwyn and Paramount, the record discloses only that registrant received the letter from Kaufman dated July 3, 1963, stating that the negotiations with Goldwyn[51/] are progressing fabulously and referring to the price as in the neighborhood of 35 million dollars. Not only is this a far cry from the $50 million dollar figure used by Nees, but his glaringly false and unwarranted representations including

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51/ Although the letter does not mention Goldwyn's name, it is presumed from Colton's discussion relating this letter to the testimony of the witness Goldstone, that the Goldwyn negotiations were the subject matter of the letter.

that Jayark would make $10,000,000 on the deal, it was making money, his predictions and guarantee of a price rise and his assurance to a witness that the latter could recover his purchase at any time[52/] constituted a reckless abandonment and disregard of his obligation for fair dealing in accordance with the standards of the profession. Moreover, since Nees' sales to witnesses occurred in late July 1963, after registrant's Research Report showing Jayark's operating losses was issued, he lacks even the excuse of registrant's earlier "Office Use Only" brochure which indicated Jayark "was in the black".

Cook

Cook sold Jayark stock to three witnesses in late July, in September and November 1963 and in June 1964. None of these witnesses were informed as to Jayark's financial condition. No extended discussion is needed to establish the importance of Jayark's deficit and operational losses to an informed investment judgment. Cook's representations as to Jayark's option to purchase 240 films and its estimated earnings of $2.50 a share are patently without foundation. And although his predictions of appreciation of the stock to one witness were conditioned upon announcement of completion of the TV deal, his predictions of substantial price rises to definite amounts to another

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52/ Jack Perlow, Securities Exchange Act Release 7939 (August 19, 1966).

witness carried no such condition.[53/]

Reigel

Reigel's violation of Section 5 of the Securities Act has been noted above. In addition, he sold Jayark stock to two witnesses in June 1963 and predicted to one that the stock would at least triple "if the libraries were negotiated". Further, to the direct question of this witness as to Jayark's financial condition his response that "everything was quite stable; quite satisfactory" is hardly in accord with the facts. It is significant that Reigel's brief does not deny knowledge of Jayark's financial condition but argues the untenable positions (1) that the information was not material to the witness and (2) that she did not cancel her purchase on receiving the information thereafter. The other witness advised Reigel that she would like to purchase Jayark if it would double, "Lets say in six months". Reigel's advice to her "to buy as much as [she] could" obviously implied she would realize her purpose.

Pambrun

Pambrun effected sales of Jayark stock to the witness, O.D., between October 1963 and March 1964 and had a conversation with a

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53/ Such representations are fraudulent even if "couched in terms of opinion and expectation"; Alexander Reid & Co., Inc., supra.

The charge that Cook caused two customers to sell "seasoned securities" to reinvest the proceeds in Jayark has not been established. One witness sold "Spencer Shoe Corp." and"Growth Properties, Inc." but there is no evidence as to the nature of these securities beyond their names. And in addition to the same absence of proof in respect of the securities sold by the second witness, i.e., First Lincoln Financial, First Surety and City National Bank of Beverly Hills, the record also demonstrates First Lincoln Financial was sold "because it was dropping" and not for the purpose of putting the proceeds into Jayark.

second witness whose deceased mother was his client. The difficulties surrounding O.D.'s testimony have been set forth above. The witness testified that Pambrun had told her that the stock could go to $10 if the contracts are completed successfully. However, a finding of violations of the securities laws and its attendant sanctions warrant a far better basis than the testimony of this witness which is deemed generally unreliable.

The second witness had a conversation with Pambrun in which the latter "was recommending Jayark stock". Pambrun said the stock was a speculation and if things worked out regarding the film library "the stock would appreciate, would move up". The witness testified that he "got the impression [Jayark] was not in bad shape", and that he was told nothing of Jayark's "profit and loss". It is not clear whether Pambrun was attempting to interest this witness in the purchase of Jayark stock or was furnishing information for transmission to the witness' mother who did not make her initial purchase until about 4 or 5 months later. In either event Jayark's financial condition should have been disclosed.[54/]

Accordingly, the Hearing Examiner finds that in the offer and sale of Jayark stock Nees, Cook, Reigel and Pambrun willfully violated Sections 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.

54/ The fact that the witness did not himself purchase Jayark stock is irrelevant; Jack Perlow supra.

Public Interest

The record contains no evidence of any prior violations of the securities laws by any of the respondents herein. However, it is readily apparent from the nature of the violations found against registrant that it is in the public interest to revoke its registration and to expel it from the NASD. Colton and Fleischman, registrant's partners, are responsible for registrant's activities and manifestly are not qualified to make independent decisions with respect to the duties owed to customers or to supervise salesmen. They should be barred from being associated with a broker or dealer with the proviso that after the expiration of one year they may apply to become associated with a registered broker-dealer in a non-supervisory capacity.

The flagrant misrepresentations and patently unconscionable guarantees by Nees compel the conclusion that it is in the public interest to bar him from being associated with a broker or dealer. In the light of the nature of the various violations set forth above in respect of the other respondents, Cook and Reigel should be suspended from being associated with a broker or dealer for six months and Pambrun should be censured. Accordingly

IT IS ORDERED that the registration as a broker and dealer of Century Securities Company be, and it hereby is revoked and that Century Securities Company be, and it hereby is expelled from the National Association of Securities Dealers, Inc., and

IT IS FURTHER ORDERED that Fred Colton and David T. Fleischman be, and they hereby are, barred from being associated with a broker or dealer, except that, after the expiration of twelve months from the effective date of this order, each of them may apply to become associated with a registered broker-dealer in a non-supervisory capacity; and

IT IS FURTHER ORDERED that Robert W. Nees be, and he hereby is, barred from being associated with a broker or dealer; that Jay B. Cook and William Reigel be, and they hereby are, suspended from being associated with any broker or dealer for a period of six months from the effective date of this order and that Pierre Lambrun be, and he hereby is, censured. 55/

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

55/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.

Sidney Gross
Hearing Examiner

Washington, D. C.
August 26, 1966