

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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SECURITIES & EXCHANGE COMMISSION

In the Matter of :
RICHARD BRUCE & CO., INC. (8-923) :
MELVYN HILLER :
GEORGE GRANAT :
STANLEY GROSS :
JEANNE S. EARLE :
AARON FINK :
ROBERT A. MONAHAN :
:

INITIAL DECISION
(PRIVATE PROCEEDING)

Sidney Ullman
Hearing Examiner

Washington, D.C.
December 19, 1966

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INITIAL DECISION
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BEFORE: Sidney Ullman, Hearing Examiner

APPEARANCES: Robert M. Berson, Howard A. Bernstein, and Bruce A. Rich, New York Regional Office, Attorneys for the Division of Trading and Markets.

Hartley J. Chazen, Seymour M. Heilbron, and Stanley Schrage, of Hays, St. John, Abramson & Heilbron, 120 Broadway, New York, New York, Attorneys for Richard Bruce & Co., Inc., Melvyn Hiller, Stanley Gross and George Granat.

Martin Frank of Feldshuh & Frank, 144 E. 44th Street, New York, New York, Attorneys for Jeanne S. Earle.

Milton Norman of Koenigsberg, Norman, Drangel, 15 Park Row, New York, New York, Attorneys for Aaron Fink.

1. Nature of the Proceedings

These are private proceedings instituted by the Commission by an order issued on May 5, 1965 (Order), pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 (Exchange Act) to determine whether the respondents have violated provisions of the Exchange Act and the Securities Act of 1933 (Securities Act) and rules thereunder, and if so, to determine what, if any, remedial action is appropriate in the public interest.

The Order alleges that Richard Bruce & Co., Inc. (registrant), Melvyn Hiller, its president, George Granat, its treasurer, and Stanley Gross, its vice president and secretary, together with its employees, Jeanne S. Earle, Aaron Fink, and Robert A. Monahan, during the period between July 1961 and June 1962, singly and in concert with each other engaged in improper activity and in fraudulent transactions in the offer and sale of common stock. The charges relate to the stock of two corporations, Honig's-Larkway, Inc. (Honig's) and Transition Systems, Inc. (Transition).

As to Honig's, the Order alleges that during the period from March 1962 to June 1962, respondents violated Section 17(a) of the

1/ Each of the officers is also a director of registrant and the beneficial owner or more than 10% of its common stock.

2/ Respondent Monahan did not contest the charges. He consented to an order by the Commission barring him from association with any broker or dealer. The Commission's order is dated June 23, 1965, but has not been made public because of the private nature of these proceedings. As used hereafter the term "respondent" does not include Monahan.

Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder, commonly known as the "anti-fraud provisions",^{3/} and that they also violated Sections 5(a) and 5(c) of the Securities Act by offering and selling the stock to the public when no registration statement was in effect as to these securities. As to Transition, the Order alleges that between July 1961 and June 1962, registrant, its officers, and respondent Jeanne S. Earle violated the anti-fraud provisions of the securities laws.

Following a motion made by counsel for the registrant and its officers for a more definite statement of the charges and an order by a Hearing Examiner granting the motion in part, the Division filed a statement indicating the following, with respect to the charges:

(a) As to Honig's, all of the respondents are charged with fraudulent activities in connection with the offering or selling of the stock, and the individual respondents are charged with aiding and abetting registrant's alleged fraud: Hiller, Gross and Granat are also charged with failing to supervise the firm's activities and employees. The violations of Sections 5(a) and 5(c) of the Securities Act are charged against all respondents and the violations are asserted to have occurred because of non-compliance with Regulation A

^{3/} The composite effect of the anti-fraud provisions, as applicable to this proceeding, 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 to defraud, an untrue or misleading statement of a material fact or a failure to state such fact where necessary, or any act, practice or course of business which operates or would operate as a fraud or deceit upon a customer, or by means of any other manipulative or fraudulent device.

thereunder, ^{4/} in that registrant offered the stock less than 10 days after the filing of an amendment to the notification, ^{5/} failed to furnish offering circulars to certain offerees and purchasers, ^{6/} and offered and sold the securities in fraud of customers. ^{7/}

(b) As to Transition, registrant is charged with violations of the anti-fraud provisions; Hiller, Gross, Granat and Earle are charged with fraudulent activities in connection with the offering or selling of the stock and with aiding and abetting registrant's fraud; Hiller, Gross and Granat are also charged with failing to supervise registrant's activities and employees.

^{4/} Regulation A, adopted under Section 3(b) of the Securities Act, provides for exemption from registration when an issuer offers securities with an aggregate public offering price not exceeding \$300,000 provided, among other things, that the issuer files with the Commission a notification and an offering circular containing certain minimum information.

The exemption is a conditional one based on strict compliance with the specific provisions and standards of the Regulation. Nevada Consolidated Mines, Inc., Securities Exchange Act Release No. 4717, August 20, 1964; Gold Crown Mining Corp., 39 S.E.C. 619 (1960).

^{5/} Rule 255(a) under the Securities Act provides that the notification must be filed at least ten business days prior to the date on which the initial offering of any securities is to be made under the Regulation. Under Rule 255(d) a new ten day "waiting period" begins with the filing of each amendment.

^{6/} Rule 256(a)(2), as pertinent here, prohibits the sale of securities under Regulation A unless the purchaser is given or sent an offering circular which would normally be received with or prior to the confirmation of the sale or payment therefor, whichever first occurs.

^{7/} The legal effect of fraudulent sales with regard to Sections 5(a) and 5(c) is referred to, infra.

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A hearing was held before me in New York City at intermediate dates between October 18, 1965 and January 19, 1966, at which all respondents were represented by counsel. It was stipulated that registrant made use of the mails and means of interstate commerce in all areas of these proceedings.

Following the conclusion of the hearing, proposed findings of fact, conclusions of law and a brief in support thereof were submitted by counsel for the Division of Trading and Markets (Division), similar documents were submitted by counsel for all of the respondents, and a reply brief was filed by counsel for the Division.

The findings and conclusions herein are based on the extensive record which developed in the proceedings, including the exhibits, on the documents filed on behalf of the parties, and on my observation of those respondents who testified and the many witnesses who were called by the Division and by the respondents.

11. Findings and Conclusions

Registrant

Registrant is a New York corporation which became registered with the Commission as a broker-dealer pursuant to the Exchange Act on June 4, 1954. Of the original founders or promoters, only Granat remained with the firm to the period under consideration. Hiller and Gross entered the firm in 1957. Although registrant ceased doing business in December 1963, its registration is still in effect. At the time of the hearing, registrant's officers and the employee-respondents, with

the exception of Granat, were engaged in the securities business with other firms, as discussed, infra.

During the period covered by the Order, registrant had its main office in the Borough of Manhattan, New York City, and during part of the period it maintained branch offices in Manhattan and the Bronx, and in Hollywood, Florida. In the Bronx office, which was on two levels, were about 20 to 25 salesmen, the large majority of whom worked only part-time as securities salesmen and many of whom worked at selling insurance as well as securities. The upper level of the Bronx office was also an insurance agency owned and operated by some of registrant's employees.

Hiller was primarily responsible for hiring and supervising registrant's salesmen and for running the business at its several offices. Gross was primarily responsible for the work of the back office at registrant's main office and he also ran its trading department. He and Granat also supervised business activities and personnel, but Granat had the primary function of bringing to the firm business situations which would result in underwritings either by full registration with the Commission or under Regulation A.

The testimony adduced on behalf of registrant indicated that in the Bronx office a high percentage of the firm's income was derived from the sale of listed securities, bank stocks, and mutual funds. In its Manhattan offices the firm was very actively engaged in the retail sale and trading of low-priced, speculative securities during the "hot" issue market which prevailed until the market break in May 1962, including securities which registrant had

underwritten or in which it was making a market. The policies of the firm with respect to the sale of securities were established by Hiller and Granat, and they are discussed in greater detail in connection with the charges of inadequate supervision of the firm's activities and employees.

Honig's

Granat was acquainted with some of the principals of Honig's, a retail discount business which operated three stores in the Bronx. Honig's was incorporated in 1960 in order to acquire the assets and business of two predecessor partnerships. Prior to entering the securities field Granat had been in merchandising. He brought the underwriting of the Honig's offering to registrant.

On December 1, 1961, Honig's filed a notification on Form 1A under Regulation A, for the offering of 100,000 shares of its common stock at \$3 per share. Originally, registrant was to be the underwriter, but in accordance with an amendment, registrant became managing underwriter and Reuben Rose & Co., Inc., a broker-dealer firm which was a member of the New York Stock Exchange, became co-underwriter. The underwriters were engaged on an "all or none best efforts" basis. The notification was amended three times in 1962: on March 2, March 22, and March 28.

After evaluating the testimony the Division's witness with respect to transactions in Honig's stock, I conclude that a relatively small amount of the testimony cannot be credited because of

the faulty memory or inaccuracy of witnesses. The testimony and evidence discussed below, however, has been credited and is the basis for findings of fact made herein.

Respondents contend that the offering and selling of the stock to the public commenced on April 4, 1962. Although this date was less than ten days after the last amendment to the notification, more important than this violation of the Securities Act are the Division's charges that offers and sales began long prior to the April 4 date, which is the date appearing on the offering circular.

The Honig's offering was completed on April 24, 1962, and the issuer received net proceeds in the amount of \$244,250. Registrant's blotters reflecting the sale of the stock in the offering were prepared by its cashier at the completion of the underwriting, 20 days after April 4, 1962. The customer ledgers were not created until the blotters had been prepared. No charge is made in the Order that registrant failed to make or keep current records of its sales activities as required by rules of the Commission, but the Division urges that the failure to record the sales currently indicates that they were being made prior to April 4, 1962. Whether or not this is a fair conclusion, it is clear that despite the testimony of Hiller that the firm had a strict policy against offers and sales under Regulation A prior to a permitted date, and despite the testimony of others that in line with such policy no persons were solicited prior to April 4, 1962, the date of the offering circular, there is

convincing evidence in the testimony of investor-witnesses and in the testimony of several respondents, as well, that telephone and personal solicitation took place in March 1962, as charged by the Division. Registrant and its employees sought to convey the impression that during the "hot" issue market prevailing in early 1962 it was not necessary to "sell" a low-priced new issue. It is true that many "investors" in the New York City area were screening certain periodicals for notices of forthcoming new issues, and that some would telephone the named underwriter, including registrant, requesting that they be given an opportunity to buy shares of the forthcoming issue.^{8/} Information concerning the forthcoming public offering of Honig's was widespread. For example, the Commercial and Financial Chronicle in its issue of January 18, 1962, listed the offering, described the business, and named registrant as underwriter. But the evidence also indicates, just as clearly, that although some of these "investors" were so eager to buy new issues that no sales-pitch was necessary, nevertheless, enthusiastic statements described below were made by some of registrant's employees. Additionally, adequate and appropriate interest apparently had to be generated in some customers by representations described below.

8/ Cf. Report of Special Study of the Securities Markets, Part 5, page 66: "The 'hot' issues which thrived in this climate, being the plainest evidence of the riches attainable through the purchase of stocks without regard to earnings or other fundamentals, also helped to nourish it."

Aaron Fink

Fink was employed by registrant as a registered representative from June 1960 to November 1962. He had no prior experience in the securities field. In selling Honig's stock, he testified he followed instructions given by Mr. Hiller regarding Regulation A offerings, saying:

" . . . we are not allowed to call clients prior to the effective date, weren't allowed to discuss, in any respect, the stock with anyone, and we put aside any questions by clients when they requested information about any particular new issues we were bringing about, as long as it was prior to the effective date."

However, Fink did not follow this procedure.

M.S. testified that Fink telephoned him in late March 1962, advised that Honig's was coming out as a new issue and asked if the customer wanted 100 shares. M.S. agreed to buy as many shares as Fink could get, and Fink advised at that time that he could get 100 shares. The following day Fink called and stated that 200 additional shares were available. M.S. had been buying stock from Fink since the latter part of 1961, and Fink knew of his interest in new issues.^{9/} Although it probably was not necessary to urge M.S. to buy Honig's stock, I find that in one of the conversations Fink stated that Honig's would probably earn about 50¢ per share and that the price of the shares should go to about \$10. M.S. received a confirmation

^{9/} M.S. testified that during the "hot" issue market he frequently contacted member firms with which he did business and had them put in indications of interest with broker-dealer firms underwriting forthcoming new issues.

dated April 5, 1962.

J.E. testified that two or three weeks before April 5, 1962, Fink told him that registrant was coming out with Honig's as a new offering at \$3 per share, that the company was opening another store, and that earnings and the price of the stock might increase. Fink advised that he might be able to get 100 shares for J.E. and the customer agreed to the purchase. He received a confirmation dated April 5, 1962.

In March 1962, D.Y. was called by Fink and informed that the Honig's issue was coming out. He asked to buy 300 shares but was told that he might be limited to 200 shares. Eventually, the customer received two confirmations dated April 5, 1962, one for 200 shares and one for 100 shares in the name of a neighbor. This was in accordance with his request in a subsequent conversation in which Fink advised that 300 shares actually were available. D.Y. was another customer who readily bought new issues because of their speculative potential and without regard for the intrinsic value of the stocks.

The testimony of R.B. indicated that he was called by Fink in March or April 1962, and was told that the Honig's offering was coming out, that the offering price of the stock was low and that this offered a good opportunity inasmuch as earnings of the business were good and would increase. Fink described the company as a good discount operation and said he expected the price of the stock to increase. The customer agreed to buy 200 shares but was later informed by Fink that only 100 shares were available. He received a confirmation dated April 5, 1962.

Dr. M.M.R. testified that either on April 4 or April 5, 1962, Fink advised him of the offering and stated that the company showed good earnings and that the price of the stock should double in a short time. Fink also represented that the financial condition of the company and its prospects were good, and the customer bought 100 shares and received a confirmation dated April 5, 1962.

D.K.B. and B.S. also received confirmations for 100 shares of Honig's stock dated April 5, 1962, after earlier discussions of the offering with Fink and their respective agreements to make the purchases.

At no time did Fink inform any of the above customers of the financial condition or earnings of Honig's.

Jeanne S. Earle

Mrs. Earle is a widow whose initial experience in the securities field began in January 1961 when she was employed by registrant as a registered representative. She became very much involved in the sale of Transition stock, as is indicated, infra, and she was also involved in sales of Honig's, being credited by registrant with commissions for the sale of 3650 shares in April 1962.

L.K.H., whose testimony is also discussed below in connection with purchases of Transition made through Mrs. Earle, testified that he was called by her on or about March 30, 1962, at which time she stated that Honig's had excellent earnings and was

coming out with a very fine report in the near future. She suggested that the customer had an opportunity to compensate for paper losses he was then sustaining on purchases of Transition stock; that this was a small issue of Honig's stock, practically oversubscribed, but that she could get a few hundred shares for him. She also advised that on release of the earnings report the stock would go to about \$10 a share. The witness agreed to buy 200 shares and received a confirmation dated April 4, 1962.

M.G., a taxi-driver, testified that while Mrs. Earle was a passenger in his cab on April 9, 1962, she described the Honig's stock being offered, informed him that all of her friends were buying it, and said she wouldn't be surprised if it went to \$8 per share. She also stated that when the stock reached \$8, she would take M.G. into the blue chips. She stated, further, that she might be able to get the stock for M.G. at \$3 per share by taking it away from someone who had already bought it. M.G. agreed to buy 100 shares and when he thereafter received a confirmation for the purchase of 100 shares at \$3 1/4 per share he paid this price. He did not receive an offering circular on the stock until four to six weeks later.

Other Sales of Honig's

S.R., a certified public accountant, bought 200 shares of Honig's during a telephone call which he made to Granat on or about April 5, 1962, during the course of which Granat stated that the

stock had good possibilities and that his firm would guarantee the price to S.R. at \$3 per share. The witness agreed to buy 200 shares, for which he paid by check dated April 5, 1962. He did not receive an offering circular until after he had made payment for the stock.

M.M., now a member of the New York City Fire Department, testified that at the end of March or on April 1, 1962, he called Monahan, who advised him of the forthcoming issue of Honig's, stated that the company was making money, and recommended he buy the stock, advising that the price probably would rise and yield a profit to M.M. The witness agreed to buy 300 shares. At that time, he was home on a three-day week-end pass from the Army.

G.P. testified that while he was on jury duty in February 1962, he learned of the forthcoming issue of Honig's and contacted Joel Jablons, then a salesman for registrant. Although he asked for 300 shares, he subsequently reduced his request to 100 shares. Thereafter, he received a confirmation for the purchase of 100 shares dated April 4, 1962.

J.A.E. testified that several weeks before April 1962, he visited registrant's office and spoke with either Granat or Hiller concerning the forthcoming issue of Honig's, and was told that the earnings were fair and that expectations for the company's business were good. He agreed to buy 500 shares and subsequently received a confirmation dated April 4, 1962, indicating a sale by G.G. (George Granat);

S.L. was a customer at the Honig's store and in February or March 1962, was asked by one of its salesmen whether he would be interested in the stock. He expressed an interest and thereafter, about one week before April 5, he received a telephone call from someone at registrant's firm. He was told that registrant had about 1000 shares of the stock unsold and he agreed to take 100 shares. Thereafter, he received a confirmation of the purchase dated April 5, 1962, which reflected that Granat was the salesman.

S.K., a sign-painter, testified that he learned of the forthcoming Honig's offer and ordered 200 shares of the stock from a salesman in registrant's Bronx's office about one month prior to April 5, 1962. Julius Becker, who operated the insurance agency on the floor above registrant's Bronx office, also was an employee of registrant. Becker handled S.K.'s insurance and also had securities transactions with him. During one of S.K.'s visits to Becker's insurance office, he testified, he went to the "stock exchange" on the floor below and placed the above-mentioned order with one of registrant's salesmen. S.K. further testified that following his receipt of an offering circular on Honig's and a confirmation for the purchase of the 200 shares, he cancelled the order. The confirmation was dated April 5, 1962.

During the summer of 1961, H.A.E met Bert Hiller at a vacation resort. Hiller identified himself as one of registrant's registered representatives, and in response to H.A.E.'s request,

agreed to contact him in the future regarding some new issue registrant might have. In March 1962, H.A.E. learned of the forthcoming issue of Honig's and called Bert Hiller, requesting a "prospectus" and ordering 100 shares. Thereafter, he received a confirmation for the purchase of 100 shares, dated April 4, 1962, indicating that Bert Hiller was the salesman, together with an offering circular. He was not prepared to pay for the stock and at his request the purchase was promptly cancelled by registrant.

M.K. testified that three or four days or perhaps one week before April 5, 1962, one of his acquaintances recommended the purchase of the forthcoming issue of Honig's and telephoned Jablons in his presence. M.K. spoke to Jablons and asked for 200 shares. Jablons expressed some doubt that he could get 200 shares but advised M.K. that he'd "put [his] name in." About one week later the witness received a confirmation for 100 shares dated April 5, 1962.

Honig's Financial Condition and Prospects

For the fiscal year ended September 30, 1961, Honig's had a net profit of \$56,411.15, and earnings of \$.275 per share on the 205,000 shares outstanding prior to the public offering now under consideration. These figures, among others, were contained in a "Statement of Income and Profit and Loss" for the period, which was contained in the offering circular. For the following fiscal year ended September 30, 1962, which covers a period of almost six months subsequent to the offering, Honig's earnings were \$.231 per share on

10/
314,000 shares then outstanding.

Registrant proposes a finding that Louis Robbins, the president of Honig's testified that it was contemplated that Honig's securities would be listed on a national securities exchange. The suggestion of the proposed finding is that the expectation or contemplation of such listing might provide a basis for some of the representations discussed above. However, the proposed finding does not accord with the evidence, for Mr. Robbins testified as follows in response to a question whether in 1962 the company contemplated listing its stock on a national securities exchange:

"Well, I would say that contemplate -- I mean, this is a thing that I guess I dreamt about, and we always discussed."

"We had hoped that eventually, after getting several acquisitions and building the business up, that we would hope that we would go into into [sic] a second issue and get more capital to get a bigger and better business."

"That was the extent of the growth. I mean, that is how you would grow, but there was no discussion of anything definite at that time."

Registrant also proposes a finding that "The record contains no testimony that, prior to April 4, 1962, Honig's officers and directors did not, in fact, contemplate declaring dividends or otherwise

10/ The increase from 205,000 to 314,000 shares came about as follows: 100,000 shares were issued and outstanding as a result of the offering; 9000 shares were issued in the acquisition by Honig's in May 1962 of all outstanding shares of Dollar-Wise Sales Co., Inc., a retail appliance operation.

adopting a regular dividend policy." Mr. Robbins answered a question whether Honig's contemplated paying dividends in the fiscal year ended September 30, 1962, as follows:

"Not after -- we had a lot of expenses, putting up a building and other things. We were looking to buy a couple of stores, and we felt that we had to build up the business first before you pay any dividends, you know, or any of that first."

Accordingly, although there is no finding herein of false or misleading representations that dividends would be paid in fiscal year 1962, the suggestion that an expectation of dividend payments might provide a basis for other representations discussed herein is not warranted.

Violations with Respect to Offers and Sales of Honig's

With respect to Section 5 violations, it is entirely clear that Honig's stock was offered to customers and was ordered by them long prior to the expiration of ten days from the last amendment to the notification on March 28, 1962. After consideration of all of the evidence on this issue, I reject the extensive testimony and argument by respondents that registrant's employees followed prohibitions from management against sales before the "effective date" or that they took only "indications

of interest" from persons who called prior to April 4, 1962.^{11/} On the contrary, the practice of selling the Honig's stock a substantial period of time prior to the April 4, 1962 date on the offering circular was known to Hiller and Gross, and was known to and engaged in by Granat. The fact that the scores of confirmations were all dated on April 4 and April 5, 1962 and mailed to registrant's customers on those days does not conceal the earlier activities of the

11/ Several of registrant's employees, including respondents Fink and Earle, testified with respect to their activities in new offerings under Regulation A prior to the date when sales could be made. The testimony indicates an absence of uniformity in practice and in general a lack of understanding of "indications of interest" which respondent's brief urges could be taken prior to April 4. For example, Herbert S. Kanter who managed registrant's branch office at 26 Broadway and supervised its four or five registered representatives, and who also worked at its main office at 80 Pine Street during a portion of the pertinent period, testified that he and the other registered representatives were told time and again by Hiller, Gross and Granat:

"We were to take no indications of any kind from customers. Actually, whatever way we could avoid -- avoid the whole matter."

Mrs. Earle testified that she kept the names of interested callers in her memory, and others testified that they discussed the issue briefly and made lists of interested customers. Monahan, whose testimony appears to be as credible as that of any of the scores of witnesses who testified in this proceeding, said that the restriction or limitation imposed on the salesmen by management was not to

"write out any order slips before we tell you it becomes effective, you know, a certain specific period of time when they come out and say start now, like a starting bell."

He also recalled that salesmen were given a copy of the offering circular before the issue could be sold.

Hiller testified that he forbade any discussion of a forthcoming issue with customers.

employees in offering shares and taking orders which were confirmed to the customers, without more, on April 4 and 5.^{12/}

The Division does not appear to be urging the point that the hundreds of sales which respondents contend were made on April 4 and 5 violated Regulation A because ten days had not elapsed from the last amendment of the notification, and in light of my findings with respect to the offers and sales in March, no great significance need be attached to such "admission" by respondents.

The Division contends that registrant also violated Sections 5(a) and 5(c) of the Securities Act by failing to send or give offering circulars to purchasers of Honig's within the time required by Rule 256(a)(2). (See footnote 6, page 3, supra). I find that the practice of including an offering circular with confirmations sent out on April 4 and 5 was adhered to, in general, although the credible evidence indicates one instance to the contrary.^{13/} Accordingly, while such failure constitutes a violation of Section 5, it should be noted, conversely, that registrant recognized its customers' option to cancel their orders or purchases on their receipt of the Honig's offering circular, and the evidence shows that such option was respected by the firm when requested by its customers.

^{12/} Although it was registrant's general practice to date and stamp order tickets as the sales were being made, this was not done with the Honig's original issue sales tickets, which are undated.

^{13/} M.G. received his offering circular several weeks after he made payment. The testimony of S.R. does not clearly indicate a violation.

In view of the clearly-established violations of Section 5, it is not necessary to discuss the more questionable argument of the Division that this Section was also violated by the selling activity discussed below in violation of the anti-fraud provisions.

The evidence indicates, with respect to violations of the anti-fraud provisions, that there was no reasonable basis for the representations with respect to anticipated increases in the price of the stock or increase in Honig's earnings. The firm had been in business a relatively short period of time, during which it had moderate or mediocre earnings. It appears that any expectation of a substantial or dramatic increase in earnings would have had to be predicated on speculative factors. The suggestions of expected listing of the stock on a national securities exchange and of the prospective payment of dividends have been rejected, and nothing in the evidence indicates a reasonable basis for optimistic statements of price increase or profit expectations from the purchase of the stock, or the expectation of a fine report to be issued by the company. The representations of the price increase fall within the ambit of the Commission's characterization of "hallmarks of fraud".

Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962); Albion Securities Co., Inc., Securities and Exchange Act Release No. 7561 (March 24, 1965). The other optimistic statements, made without reference to negative or speculative factors, were materially false and misleading.

Cf. Midland Securities, Inc., 40 S.E.C. 635 (1961); Underhill Securities Corp., Securities Exchange Act Release No. 7668 (August 3, 1965).

The legal effect of the violations is discussed, infra, in connection with the conclusions and the sanctions required in the public interest.

Transition

Transition was organized in December 1960 as a Delaware corporation, and at the time of the public offering of its common stock in an underwriting by registrant on June 28, 1961, it had not commenced operations and had no employees. Jesse L. Weinberger (J.L.W.), together with other men listed below, some of whom also were or had been employees of Sperry Gyroscope Company, agreed to develop an electronic device described as a "correlator" or special purpose computer, which would perform functions theretofore performed by more expensive general purpose computers, and the company was created for this purpose. The functions to be performed by this correlator and representations concerning its allegedly exciting and dramatic potential were the subject of thousands of pages of testimony and serious dispute during the hearing. These matters are discussed, infra, in as much detail as seems practicable.

At the time of the commencement of the public offering, the following persons were officers and directors of the company:

| | |
|-----------------|---|
| J.L.W. | President, Treasurer and Director |
| Erich Griminger | Vice-President for Engineering and Director |
| Donald R. Lull | Vice-President for Research and Development, and Director |

| | |
|-----------------------|------------------------|
| Robert M. Zweiman | Secretary and Director |
| Dr. Kenneth S. Miller | Director |
| Dr. Jack Ross | Director |
| William J. Vafiades | Director |

The prospectus used in the offering indicated that J.L.W., Griminger, Lull, Vafiades, and Miller each had an impressive background in engineering or mathematics.

At several points the prospectus mentioned potential Government contracts. For example, it stated that Transition proposed

"to engage in research in connection with, and if feasible, to develop correlation devices to be used principally for improving the performance of existing signal detection systems. . . . The company proposes to endeavor to obtain the funds for such research and development from governmental agencies which may be interested in the production of such devices."

And that

"It is anticipated, if such correlators can be developed, that the Government would be the principal customer and that the estimated selling price would be approximately \$10,000 per unit. . . .

"The company proposes to undertake this work under contract with governmental agencies which, in the opinion of the management, would have many useful applications for the devices with the defense program."

The prospectus also discussed the company's plans to lease or to purchase

"smaller types of analog and digital computers and to offer data processing services to governmental agencies and to industrial and commercial organizations. The company initially will seek to obtain moderate sized contracts offered by the various governmental agencies. . . with special emphasis on the study of missile and satellite programs and data obtained from their systems."

From the testimony of J.L.W., it appeared that an important aspect of the proposed correlator involved the elimination of non-essential and confusing signals, with the prospect that desired signals picked up by the device would be valid, more clearly defined, and therefore more meaningful in conveying the needed data. His testimony with respect to the specific fields in which the correlator, if produced, could have been used, was intentionally vague, misleading, imprecise and obscure, for reasons which appear below. But he indicated at the hearing that the correlator, if and when produced, could be used in the discovery of oil, in certain medical applications such as the interpretation of electrocardiograms and electroencephalograms, and in certain military operations with a classification of "secure-sonar".^{14/} In his testimony he denied that the planned correlator could be used either in cancer detection or in connection with the then-forthcoming orbital flight of Lt. Col. John Glenn, subjects on which there was testimony by several other witnesses.

J.L.W. entered into a contract with Transition providing for his employment for five years at an annual salary of \$18,000; Griminger and Lull had three-year contracts of employment at \$15,000 and \$10,000 per year, respectively; Dr. Miller agreed to act as "Mathematical Consultant" for three years at an annual retainer of \$3000; and Mr. Zweiman was engaged under retainer as counsel for the company. All of

^{14/} J.L.W. described "secure sonar" as follows":

". . . essentially the ship send out a signal which is mixed with noise and nobody can tell it is coming from a ship because it is mixed in the noise, but the ship can receive it back through an echo and put [it] through a correlator and determine the depth."

these employments were to commence upon completion of the sale of the shares in the underwriting.

The offering became effectively registered on June 28, 1961, following the filing of a registration statement on Form S-1 in April 1961. The underwriting was done under an "all or none best efforts" agreement under which registrant was to sell 72,200 shares of common stock at \$4.50 per share. Registrant had an option at the completion of the offering to buy warrants entitling the holders to purchase within 3 years an additional 3000 shares at \$4.50 per share, and it had the right to elect one nominee as a member of the Board of Directors. Hiller was elected a director at a meeting of the Board on September 6, 1961.

At the time of the offering, the company had about \$30,000 in cash and U.S. Treasury bills, the proceeds of the earlier purchase of common stock and warrants by the promoters of the company, i.e., J.L.W., Ross, and Griminger, by the other officers and directors of the company, and by other persons, including registrant's officers and its counsel.

Following the offering, an interim financial report prepared by accountants for the information of the management of Transition and covering the period December 22, 1960 to August 16, 1961, reflected a net loss from operations of \$5,453.79. In addition, a charge of \$79,470.91 against capital surplus resulted from the expenses of the offering. For the period December 22, 1960 to September 30, 1961,

Transition's income was \$1,479, derived from its investment of the proceeds of the offering in U.S. Government bonds: it had expenses of \$12,896 and a net operating loss of \$11,417 to that date.

Transition's offices were at Zweiman's law office in New York City from the time of its incorporation in December 1960 until December 1961, at which time it moved into a plant in Queens County, New York City. At the time of the underwriting no work had been done on the correlator and at least until December 1961 the product was in the planning stage, consisting of designs of individual segments, drawings and tracings. According to the testimony, a prototype design or "bread-board" model was developed sometime after the leasing of the plant in Queens, and J.L.W. testified that the company completed the development of a working model by April 2, 1962 and began testing it around that time. However, this seems doubtful.

The testimony of J.L.W. and of other witnesses indicated that in late March 1962, some nine months after the offering, Sony Corporation, a substantial and well-known Japanese company, had developed a device similar to the correlator and had displayed it at an Institute of Radio Engineers (I.R.E.) show attended by J.L.W. and his brother, Mandel Weinberger (M.W.). J.L.W. testified that he learned at that time that Sony could sell the device at one-half the proposed price of Transition's correlator. Moreover, Sony was equipped to service its device, whereas Transition was not.

The testimony of the Weinberger brothers as to what happened following the I.R.E. show is in sharp conflict with that of Hiller and other witnesses. J.L.W. contends that as early as July 1961, Hiller had been greatly disturbed about the price of Transition stock, which fell from the offering price of \$4.50 per share to approximately \$2.50 per share. He testified that because the correlator was not yet developed, he was refusing to accede to urgent demands for publicity on the product which Hiller made in order to maintain or increase the price of the stock. Hiller denies that he was exacerbated about the price of the stock, and contends that his concern derived from his inability, from the outset, to obtain any meaningful financial data about the company or any information about the status of development of the product, despite frequent and persistent efforts to obtain such information. In any event, on leaving the I.R.E. show, on or about March 28, 1962, the Weinbergers met Hiller and a brief conversation ensued. It is clear that the Weinbergers now decided that the correlator should be publicized and that Hiller should be the means for obtaining the publicity. It was agreed that Irving Gellis, a public relations man who on prior occasions had arranged for publicity desired by Hiller in connection with offerings being underwritten or promoted by registrant, would be engaged. (Under the circumstances discussed below the price of the stock had long since recovered from the drop which followed the offering; it had returned to the \$4.50 per share offering price in December 1961 and rose dramatically during

January, February and March 1962. On March 29, the price was \$13 1/4 bid). Hiller was glad to arrange for publicity he had long sought. In conjunction with the Weinbergers, Gellis prepared a press release for which J.L.W. furnished the technical information. As approved for publication on April 2, 1962 by J.L.W. after editing by M.W. "for grammar" (M.W. having been a public school teacher), the release, describing the correlator as "UNICOR", read in part as follows:

"RELEASE IMMEDIATELY

"NEW YORK, April 2 -- Transition Systems, Inc., of Woodside, N.Y., today announced a revolutionary development in the field of electronic instrumentation.

"The new development -- a fully automatic, all-purpose correlator -- is a machine which is expected to make significant scientific contributions to medical research, space navigation, oil exploration, seismic studies, servomechanism analysis, military electronics and many other fields.

* * * *

"According to Jesse L. Weinberger, President of Transition Systems, UNICOR sells for \$10,000 per unit and is within reach of every governmental, industrial and medical research laboratory budget. It can also be leased for a three-year period with a purchase option. It is available on a 30-day delivery schedule.

* * * *

"As an indication of UNICOR's outstanding features, Mr. Weinberger pointed out that it can be used effectively in a wide range of applications in almost every area of instrument recording, including such fields as noise analysis, vibration analysis, inertial navigation, medical and military electronics."

* * * *

The release appeared in at least two chemical magazines, and a portion of it was reprinted in the former New York World Telegram in April 1962. J.L.W. had asked Gellis to obtain "the widest possible distribution" in four named electronic publications "and other publications in the field."

It is my view that Hiller was greatly concerned by the early drop in the price of the stock as well as by his sustained inability to obtain desired information about the product, and that he had requested over a long period of time that the Weinbergers publicize the device, whatever its stage of development might be. But I am of the view that when the Weinbergers discovered Sony's competitive product at the I.R.E. show, they decided for their own reasons that the time had come to issue favorable and wide-spread publicity on the correlator, although no instrument had ever been produced or meaningfully tested by Transition. There was no valid basis for the statements in the press release concerning the correlator or its availability, and both Weinbergers were fully aware of this.

But the falsity of the printed release in its discussion of the correlator's potential seems mild when compared with the falsity of the representations spread verbally by M.W. both prior to and following April 2, 1962. Background support for this statement requires a discussion of the dramatic rise in the price of the shares in December 1961 and in the months which followed,

and a discussion of the heavy buying of the stock by a few persons who apparently were convinced of the product's potential.^{14/} It also invites a discussion, even more germane to this proceeding, of the activities employed by registrant and by Jeanne Earle in offering and selling the stock during the period of time involved.

Hiller's inability to obtain from J.L.W. or M.W.^{15/} any information about the status of development of the correlator even after he had become a director of the company in September 1961 was disturbing to him not only because of his position on the Board but also because he could not intelligently maintain a market in the stock. He was also embarrassed by an inability to give to people who knew he was a director any information about the company or its product. Moreover, although registrant was essentially a "trading" rather than a "retail" firm, it probably did relatively little trading in the stock because of Hiller's inability to obtain information. The testimony also indicates that at one time in late 1961 Hiller told some registered representatives of registrant not to recommend the stock and he terminated completely the trading in the stock with other brokers. But these situations, if they existed, were short-lived.

14/ Respondents produced a mass of testimony, discussed in the text, which was designed to justify registrant's selling activities in Transition stock.

15/ In August or September 1961, M.W. was engaged as a financial consultant to the company on a part-time basis at \$675 per month. He was paid this amount for a period of three years thereafter. The engagement was against the vote of Hiller alone, among members of the Board of Directors.

In November 1961, Herman Sinnet, whose background had been in the insurance field but who had recently become a partner in the broker-dealer firm, Stearns & Company, began acquiring Transition stock in the name of his sister through Allan Tarlow, a registered representative at the broker-dealer firm, James Anthony & Company. Tarlow had called registrant's office for a prospectus after having heard about Transition stock from another registered representative. He testified that M.W. called him and asked for information about the person making these purchases. A luncheon meeting at Delmonico's was arranged, during which M.W. told Sinnet and Tarlow about the "break-through" Transition had made with its device, which could be sold profitably for \$10,000, a small fraction of the price of computers currently in use, and he discussed the correlator's potential applications, including sonar detection, oil and space exploration, and medical applications. M.W. also discussed the company's asserted need for further financing to increase its production facilities.

Shortly after this luncheon, a meeting attended by the Weinbergers and Messrs. Sinnet, Tarlow and Zweiman took place, during which J.L.W. is asserted to have discussed the advantages of the correlator over the more expensive devices then currently used in oil discovery, space exploration and in other applications, and is also asserted to have stated that the correlator would be used in detecting heart disease and some types of cancer in women through the use of a color screen device. Tarlow and Sinnet testified that

M.W. represented that the company was "in the black" and would earn at least 50 cents per share in the current fiscal year ending September 30, 1962, and about \$5 per share in the following fiscal year. Sinnet indicated continuing interest in financing the company's needs and another meeting was arranged to be held on December 19, 1961, at the law offices of Bordon and Ball.

On December 19, 1961, Tarlow and Sinnet met with the Weinbergers, Dr. Miller and Lull, at the offices of Bordon and Ball to discuss the possibility of either merging Transition and another company controlled by Sinnet, or alternatively, Sinnet's acquiring a position in management, perhaps by his investment of \$250,000 in a debenture to be issued by the company. However, Sinnet's offer of funds was conditioned upon receiving more information about the company. Conversely, the Weinbergers indicated concern about losing control of the company, especially because the public offering had assertedly left them vulnerable, and nothing of consequence developed from the meeting.

The price of the stock rose and continued upward as Sinnet's acquisitions increased in volume in December and subsequent months. Tarlow testified that the buying "was in thousands". Sinnet testified that he bought from Griminger, as an "insider" under an investment letter, 4000 shares of stock and 1500 warrants during this period.^{16/}

^{16/} An investment letter states, in substance, that the purchaser is taking the shares for investment and not for distribution.

Rumors about the product's exciting potential and the Government's interest in it were fed by the rise in the share price. In January 1962, when the company hired a guard at its plant, it became "apparent", as M.W. had frequently stated, that the correlator was classified because of the Government's interest in it, and that management's reluctance at that time to release information on its status was a consequence of the classified nature of the product. ^{17/} Tarlow testified that at some time during the period December 1961 to February 1962, M.W. stated that the company's good cash flow permitted retention of the bonds purchased with proceeds of the underwriting, and that both Sinnet and he believed M.W., especially after they verified the fact that Bache & Co. was indeed still holding the bonds for the company. He also testified that both Weinbergers advised that they and the other employees of Transition had "the highest government security clearance".

A meeting in Philadelphia was arranged between representatives of Atlantic Refining Company and Transition's management for the purpose of discussing the correlator's potential in seismographic use. The meeting took place in February 1962 and was attended by J.L.W., Miller and Lull, on behalf of Transition. Several people testified that the Atlantic representatives concluded and announced during the meeting that the company could not use the device. But

^{17/} The guard was a Pinkerton Detective Agency man and J.L.W. testified that he was hired, among other reasons, because unauthorized persons were visiting the plant.

several other witnesses, including Sinnet and Tarlow, testified that following his return from Philadelphia, M.W. reported to them that the Atlantic people had offered them anywhere "from 30,000 to 40,000 shares of that company's stock in exchange for Transition Systems, making each share of Transition stock worth from \$40 to \$60 a share. . . ." Tarlow also quoted M.W. as stating that he expected an immediate order from Atlantic for the correlator in an initial amount of \$100,000.

During this period, efforts of Sinnet and Tarlow to learn more about the product, the company, and its management had proceeded through many channels, and they testified that information received from various sources seemed to support the asserted potential of the correlator and the ability and soundness of management. For example, Sinnet telephoned Mendelsohn, a member of Transition's original Board of Directors, then in Chicago, and verified the expertise of the company's management. Bob Casen, another registered representative of James Anthony and Company, became involved in attempting to verify information disclosed by the Weinbergers in the early part of 1962 while the price of the shares was moving from about \$4 to the area of \$14. Casen's desk at James Anthony and Company was next to Tarlow's, with whom M.W. frequently visited, and Casen testified that when he heard M.W. speak of the correlator he began buying Transition stock and "checking out" the company. Casen telephoned a friend at a "sophisticated electronics

firm" in Massachusetts and was advised by him of the technical specifications for a correlator. He informed Tarlow, who called the Weinbergers and M.W.'s response was: "If this is all we had, we would not be excited"

Tarlow testified that he and two other men borrowed \$20,000 from the mother of one of the men, and bought 1000 shares of Transition "after January" at \$15 per share and more, and he added: "Then we bought more on the way down". But prior to the middle of 1962, relations between the Weinbergers and Tarlow and Sinnet had deteriorated. Perhaps in May 1962, Tarlow requested an investigation by Bishop's Services, a firm specializing in private investigations in the New York City Metropolitan area. The Bishop's report did not reach him until July 2, nor was it meaningful. He testified that: ". . . by July 2nd I was already trying to get another job, because I was wiped out."

The information received by Sinnet and Tarlow on Transition, its product, and its prospects, was passed on to Hiller and Granat and to registrant's employees. The parties stipulated at the hearing that if Hiller were questioned in this area he would testify that he received from Sinnet, Tarlow, and M.W. substantially the same information as Sinnet and Tarlow testified they had received.

There were additional sources of similar information which reached Hiller and registrant's employees, but it is not practical or necessary to detail or discuss the cumulative testimony

of many witnesses called by respondents in order to prove that during the early months of 1962, M.W. spoke willingly and optimistically of the correlator and of potentially profitable deals pending between Transition and other companies, and that this information was relayed to Hiller and to some of registrant's registered representatives. Perhaps some mention should be made, however, of the testimony of Mrs. Lois Sensor Conn, a clerical worker who became a registered representative at registrant's firm in or about July 1961, and some further discussion also follows with respect to M.W.'s contact with Mrs. Earle.

Mrs. Conn (then Lois Sensor) heard about Transition stock through Sinnet soon after the price began to rise in November 1961. Sinnet referred her to Tarlow for information on the stock. ^{18/} Tarlow, she testified, advised her that the correlator "would detect 97% of all conceivable types of cancer" and she related this information to Hiller, whose initial reaction was that "it was a lot of garbage". But it appears that Hiller's skepticism and resistance were moderated by the recurrent receipt of glowing information about the device and by pressure from customers. Joel Jablons' testimony indicated that registrant's employees were being criticized by customers for not "letting them in"

18/ Sinnet denied on the witness stand that he knew Lois Sensor but I do not believe this testimony. If his testimony in more material areas, such as the representations made by the Weinbergers concerning Transition and its product, were not consistent with a plethora of credible testimony by other witnesses, perhaps it would not be credited in those areas.

on Transition, and that Hiller's inability to evaluate the rumors and the sharp price rise was a disturbing problem. Mrs. Conn also told Hiller that M.W., who had been her teacher in high school, advised her following one of his many visits to registrant's office in January or February 1962, that he was about to leave for Europe with a doctor from a New York City hospital for the purpose of demonstrating the correlator's potential in cancer detection.

Jeanne Earle and M.W. developed a relatively close personal relationship which appears to have extended over a period of at least several weeks. Mrs. Earle's testimony with respect to M.W. and the representations he made to her regarding the correlator was not sufficiently consistent or accurate to support detailed findings in this area. However, when weighed against the total denials of M.W. that any personal relationship existed or that he had ever spoken to Mrs. Earle concerning the correlator, her testimony is relatively reliable, and it supports findings that representations and claims similar to those discussed above were made to her personally by M.W., perhaps in the latter part of 1961 and the early part of 1962.

As indicated above, the primary purpose of this mass of testimony relating to statements on the correlator's potential and the company's prospects was adduced by respondents in order to explain, and in an effort to justify, the selling activity of registrant and

19/ M.W. was produced by the Division as a rebuttal witness. His testimony purported to discredit the mass of evidence that the Weinbergers had made glowing claims about the potential of the correlator and the prospects of the company. His denials were so broad and incredible that his testimony is totally discredited by me.

its employees and the conduct of registrant's business by its management. This requires, of course, a discussion of registrant's sales activity and practices in relation to Transition stock, as disclosed by the credible testimony.

Jeanne S. Earle

Mrs. Earle is the sole registered representative charged with violation of the anti-fraud provisions in the sale of Transition stock. The testimony of several investor-witnesses with whom she spoke supports the charges with respect to these violations.

In February 1962, H.H.H. was sales manager of a company in Chicago owned by W.D.V. and his brother, E.D.V. On the recommendation of W.D.V. that H.H.H. buy some Transition stock because of its recent sharp rise in price to \$10 or \$11 per share, H.H.H. telephoned Mrs. Earle to inquire about the company and the stock and to request a prospectus. He was advised that no prospectus was available and his efforts to learn the nature of the company's business were unproductive, except that he concluded from the conversation that Government contracts and classified work were involved. He ordered 200 shares at \$11.50 "mainly because of my conversation with Mr. W.D.V." Around the first of March 1962, H.H.H. visited registrant's office and spoke with Mrs. Earle in an effort to learn something about Transition. She brought him to Hiller, who advised that although he was on the Board of Directors of the company he could give no information. He told H.H.H. that he had bought a large number of shares of the stock at \$1 or \$1.50 per share.

E.D.V. also testified in the proceeding, stating that he heard of Transition in late January or early February 1962 through telephone conversations between Mrs. Earle and his brother, W.D.V., and that when his brother was not in the office, Mrs. Earle would sometimes speak with him or with the firm's secretary, L.B. Mrs. Earle described the stock as "terrific", advised him that it had potential and would go up, and strongly recommended purchase. In response to his inquiries concerning the nature of the company's business, she stated that it had a "hush-hush" deal for the supply of equipment to the Government. He was advised that no brochure or written material on the company was available. This witness did not make any purchase of the stock from Mrs. Earle, but on February 21, 1962 he bought 100 of the 200 shares previously purchased by H.H.H. In a subsequent conversation, according to his testimony, Mrs. Earle advised that "It's still a terrific buy, if at all possible, get more".

L.B., secretary of the firm, testified that she learned of Transition and the dramatic price rise of the stock from her employer, W.D.V.; that in February 1962, she spoke with Mrs. Earle and agreed to buy 100 shares at \$11 1/2 per share ; that in a subsequent conversation Mrs. Earle stated that the stock "was going to go between 30 and 35 to hold on to it." She also testified that in one of several conversations in which she asked for a brochure and for information on the company, Mrs. Earle informed her that no material was available, and that the company's business involved "a big project,

and we should wait and bide our time and there would be a brochure on it. . . ." She testified that Mrs. Earle "didn't know what the people were doing or anything. It was a hush-hush deal, or something like that. . . It was supposed to be Government, or whatever it was."

F.R. was the husband of W.D.V.'s daughter, who, in turn, was a friend of Mrs. Earle's daughter. (These relationships started the chain reaction resulting in the above-described transactions between Mrs. Earle and the aforementioned investors from the Chicago area). In January 1962, F.R. received a telephone call in which Mrs. Earle advised that she estimated the price of Transition stock would rise from its current price of \$5 to approximately \$40 per share in a period of about six months. She compared the stock with Texas Instrument stock which, of course, had a dramatic increase in price, and she advised that the witness buy Transition stock if he had any extra money. F.R. testified that in response to his inquiry about the company she advised that it had what he described as "a heart machine, some kind of medical device." She also informed him that the company's operation was a very secret one, involving the use of Government guards. F.R. bought 100 shares at \$5 1/8 per share as a result of this conversation, after discussing the matter with his wife. Approximately ten days later Mrs. Earle advised him to buy more stock if he could afford it, and he purchased 100 shares on January 17, 1962 at \$5 1/8 per share. She described the stock as an excellent buy,

said it was bound to go up, and inquired whether F.R. knew anyone else who would be interested in it. At that time F.R. suggested to Mrs. Earle his father-in-law, W.D.V., among other persons who might be interested.

F.R. bought an additional 100 shares just prior to his departure for Europe on March 26, 1962. He testified that prior to departure he had given Mrs. Earle authorization or direction to sell the stock if the price declined, but that when he returned from Europe at the end of September 1962, he learned that proceeds of the sale of 200 of his shares had been used by Mrs. Earle in purchasing several other stocks without his authorization.

L.K.H., whose testimony concerning a purchase of Honig's stock is discussed above, also testified that in late February 1962 he learned of Transition stock and called registrant's office. He spoke with Mrs. Earle, who said the company had a remarkable electronic device which would have far-reaching effects in space travel, medicine, and mining, and he bought 200 shares at \$16 1/2 per share. Mrs. Earle also advised that the device would be used on Colonel Glenn during his forthcoming orbital flight and that it would return to monitors on the earth medical information and data concerning bodily manifestations in orbit. On March 2, L.K.H. spoke with Hiller during a visit to registrant's office, and Hiller represented that Transition "would be another Calvar", a company whose stock had a spectacular rise in price over a short period of time. Hiller also reiterated some of the things Mrs. Earle had said with respect to the potential application

of the correlator in mining. Subsequently, at the time L.K.H. bought his Honig's stock, Mrs. Earle advised him that although the price of Transition had decreased following his purchase, it would definitely return to the price he paid and probably would go considerably higher.

L.C. testified that he made the following purchases of Transition stock as a result of telephone conversations with Mrs. Earle in late 1961 in which she expressed enthusiasm for the company and its product and recommended his purchase of the stock:

| | | |
|------------------|------------|------------|
| October 25, 1961 | 900 Shares | @ \$3.00 |
| October 25, 1961 | 100 Shares | @ \$2 3/4 |
| March 16, 1961 | 100 Shares | @ \$13 1/2 |
| March 16, 1962 | 125 Shares | @ \$13 1/4 |
| March 19, 1962 | 100 Shares | @ \$13 1/2 |
| April 3, 1962 | 25 Shares | @ \$15 1/4 |

At the time of the initial purchases of the stock, Mrs. Earle stated that she felt the stock would do very well, and would rise in price.^{20/} She informed the witness during a telephone conversation that the company was producing a device which would detect cancer and almost any illness in the human body, that the Government had an interest in it, and on several occasions she recommended that he buy the stock, which she described as "terrific". L.C. also testified that in December 1961 he visited registrant's office and engaged in a discussion with Hiller, Granat, Mrs. Earle and two men who were introduced as

^{20/} The witness testified to specific prices mentioned by Mrs. Earle, but this aspect of his testimony is not credited.

L.C. was one of several witnesses who were knowingly buying speculative rather than conservative securities. This does not negate the fact that fraudulent representations were made. R.A. Holman & Co., et al., Securities Exchange Act Release No. 7770, December 15, 1965.

analysts of Transition stock. He said that the analysts indicated they had just come from Transition's plant and described security measures indicating that the operation were shrouded in secrecy. ^{21/}

J.B. testified that in February 1962 he heard of Transition stock from some acquaintances, one of whom suggested that he call Mrs. Earle. He telephoned on February 23, 1962, stating that he would like to buy approximately \$1000 of Transition stock. Mrs. Earle suggested that he buy a round number of shares, which would amount to \$1350, advising that the stock was very good and that the company's product was a secret and was being manufactured behind guarded walls.

Mrs. P.V. testified that on February 28, 1962 she bought 100 shares of Transition at \$13.50 a share, about two weeks after a conversation in which, according to the witness, Mrs. Earle advised that the company's product was "very secret and guarded" and that the price of the stock was going to "skyrocket." She also testified that when she delivered the check in payment for the stock, Mrs. Earle stated that she would be making a good profit in a very short time and that "it could almost be an exchange of checks".

21/ The record is replete with testimony describing the inability of interested persons, including Hiller and other employees of registrant, to gain access to the plant because of the orders and directions of the Weinbergers and the hiring of the guard.

It is ironic but understandable that the total inability of Hiller, Sinnet, Tarlow and other persons with important interests in the company, to obtain meaningful information on the stage of development of the correlator and the state of the company's activities by attempted visits to the plant was sometimes accepted by supposedly sophisticated persons as a favorable aspect of the company's activity.

At no time did Mrs. Earle or anyone else at registrant's office advise any of the above witnesses of the financial status of Transition or its losses. The company's financial report for the fiscal year ended September 30, 1961 was available to registrant in January 1962, but no reference was made to it in the selling activity. Conversely, in response to an inquiry by L.K.H. concerning earnings of the company, Mrs. Earle responded that she knew nothing about them, and consistent with this failure or refusal to discuss or consider the financial aspects of the company, she advised several witnesses that no written material was available.

Registrant's Violations and the Inadequacy of Supervision

It is understandable that registrant's management may have been confused during the period when the price of the Transition stock began to rise on the relatively heavy buying of Sinnet. And subsequently, when Hiller and Granat received the information disseminated to Sinnet, Tarlow, Casen and others, concerning the potential of the correlator, registrant's management, or Hiller as the head man, had to make evaluations and decisions concerning the sale of the stock to the public. It is clear from the evidence that management took a considered risk in permitting sales. The record is replete with evidence of Hiller's inability to obtain meaningful information from Transition's management as early as July 1961 and continuing to May 1962, when he resigned as a director for that very reason. His frustration was well known to all of his associates, including the

registered representatives. But retail sales of the stock continued, despite the lack of reliable information, albeit cautionary instructions were given by Hiller to some of the registered representatives. ^{22/}

Hiller continued to regard the stock as a pure risk and speculation, and he doubted the validity of the information and rumor, most of which came indirectly through M.W. He had good reason to doubt, not only because of what he had heard about M.W., ^{23/} but also because of his inability to obtain meaningful information as a member of the Board and as president of the underwriter of the public offering. The correlator, which was never produced, had no potential for detection of cancer or heart disease, was never the subject of Government contracts or secrecy or under consideration for use in space, and the record is devoid of credible evidence that if produced it could have performed in any area. Hiller's efforts and those of many other people to gain access to the plant to verify rumors about production and backlog of orders were constantly frustrated. But Hiller permitted the selling to continue and failed to take steps which prevented the spreading of rumors and the irresponsible statements to customers. Registrant was derelict in its duty to the investing public in not adequately controlling the selling practices, carried on with intemperate predictions of price rises, unwarranted comparisons

22/ For example, Lois Sensor Conn testified that Hiller's instructions regarding Transition were

"To stay away from it, because you couldn't sell it, because you didn't know what to tell anybody. You couldn't say they were doing this, that or the other thing. There was no information, you couldn't tell anything."

He also told her, when filling unsolicited orders, to mark the order tickets "Unsolicited".

23/ Lois Sensor Conn had related to Hiller incidents reflecting seriously on M.W.'s character and reliability. It is not within my province to credit or discredit her account of the incidents. But I point out that she was one of the registered representatives hired by Hiller and retained on registrant's staff.

with other companies, and unqualified representations of profits and of the correlator's potential. Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965); Aircraft Dynamics International Corporation, Securities Exchange Act Release No. 7113 (August 8, 1963).

Moreover, I conclude that registrant, as an underwriter whose president was known to be a member of the Board of Directors of Transition, had acquired among many of its customers a reputation for knowledgeability with respect to Transition. It failed in its duty to the investing public if it accepted from Sinnet, Tarlow, Casen and others the information as to the potential of the correlator, even though some of the information was represented to have been in some way or to some extent verified or "checked out". Cf. Charles E. Bailey & Co., 35 S.E.C. 33 (1953); Isthmus Steamship & Salvage Co., Inc., Securities Exchange Act Release No. 7400 (August 20, 1964). Hiller's personal investigation was insignificant.

Nor can registrant justify the failure and refusal to furnish information with respect to the company which was available in Transition's prospectus. One function of a prospectus is to provide prospective purchasers with essential information, another is to provide the sales personnel of underwriters and dealers with authentic data as a basis for an honest and temperate sales presentation. The first function was disregarded, as was registrant's duty to disclose to its customers the lack of adequate information and the total inability of Hiller and others to verify other information by visits to the plant or by other means. These matters were material and under the circumstances the failure to disclose them was fraud. Cf. R.A. Holman & Co., Inc., et al., Securities

Exchange Act Release No. 7770 (December 15, 1965); Heft, Kahn & Infante, Inc., Securities Exchange Act Release No. 7020 (February 11, 1963).

The hiring practices of registrant left much to be desired. Hiller testified that he preferred to hire inexperienced sales personnel so that he might "mold them into his image" as salesmen. Unfortunately, they were not properly or adequately trained or molded. Cf. Securities and Exchange Commission v. Rapp, 304 F.2d 786 (1962), where the Court said:

"Moreover, he hired men with no knowledge of the intricate business of securities, cf. Charles Hughes & Co. v. S.E.C., 2 Cir., 139 F.2d 434, certiorari denied 321 U.S. 786, 64 S.Ct. 781, 88 L. Ed. 1077, thereby ensuring that the accuracy of their representations would be wholly fortuitous in so far as he did not control their every word. In these circumstances he cannot be relieved of responsibility ~~for~~^{for} their acts."

Mrs. Conn was totally inexperienced when she was permitted to act as a registered representative: Mrs. Earle remained inept, untrained and unqualified by temperament to sell securities. Registrant's management could not fail to be aware of the deficiencies in its sales personnel, hiring practices and training.

Respondents introduced testimony that it was Hiller's practice to monitor telephone conversations of registrant's employees at its main office, and that he frequently walked up and down the aisles listening to conversations in order to insure that no unwarranted representations were being made. It seems clear that unless the calibre and integrity of the sales persons were high and their training adequate, this kind of monitoring could not be effective and could not be reasonably expected to prevent or detect violations. That Hiller heard

none of the unwarranted statements made to customers with respect to Honig's or Transition would seem to support this principle, if support were required.

Nor is there evidence of procedures reasonably designed to prevent violations of the anti-fraud provisions in the selling practices of the registered representatives which took place away from registrant's premises. Respondents' brief argues that "Statements made in cabs (Earle), in taverns (Fink), . . . cannot be charged against the Corporate Respondents." However, this position is not supported even by evidence of the prohibition of "off-premises" selling by employees of registrant. Indeed, the record is to the contrary, and it is entirely clear that the sales people of the New York City offices were permitted, if not expected, to engage in such selling.^{25/}

Hiller, of course, was primarily though not solely responsible for the supervision of registrant's business activity. Granat and Gross also participated to some extent in hiring employees and in supervision of the business of registrant. Respondents' brief urges that supervision at registrant's firm was adequate and that it demonstrated an understanding of the responsibilities of a broker-dealer. The brief also urges that no charge of failure to supervise adequately has been sustained against any of the officers of registrant, because the procedures established by the firm complied with the requirements and standards of the Exchange Act relating to the prevention and

^{25/} As to the Bronx office, the hiring of part-time employees, most of whom appear to be insurance salesmen, would suggest an expectation of sales away from the office.

detection of violations of the securities laws. ^{26/}

However, it goes almost without saying that the Section 5 violations in Honig's activity were not only known to Hiller, Granat and Gross, but were directed by Hiller, participated in by Granat, and concealed by Gross in departing from the normal back-office procedures such as the preparation of blotters, the stamping of order tickets, and the preparation of customers' ledgers, among other procedures. And the above discussion regarding the inadequacy of supervision indicates the lack of appropriate procedures or system for detection and prevention of the anti-fraud violations which occurred in the sale of both the Honig's and Transition stocks.

Conclusions

From the above it follows that during the period from March 1962 to June 1962, registrant willfully violated the anti-fraud provisions in the offer and sale of Honig's stock and that all of the individual respondents willfully aided and abetted these violations;

26/ Section 15(b)(5)(E), added in August 1964, provides in part:

"For the purpose of this clause

(E) no person shall be deemed to have failed reasonably to supervise any person, if --

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with."

that all respondents willfully violated Sections 5(a) and 5(c) of the Securities Act in the offer and sale of Honig's stock; that during the period from July 1961 to June 1962, registrant and Jeanne S. Earle willfully violated the anti-fraud provisions in the offer and sale of Transition stock, and that Hiller, Gross, Granat and Earle willfully aided and abetted these violations by registrant; also that Hiller, Gross and Granat willfully violated the anti-fraud provisions during the period from July 1961 to June 1962, in failing reasonably to supervise registrant's activities with a view to preventing violations of the securities acts and the rules thereunder, as alleged in the Order.^{27/}

Scheme to Defraud

In support of the allegations in the Order to the effect that all of the respondents "singly and in concert" violated the anti-fraud provisions in activities in relation to Honig's stock, and that all respondents except Fink violated those provisions in activities in relation to Transition stock, the Division's brief urges an overall scheme to defraud "on the part of Richard Bruce, its principals and sales staff." The brief makes no distinction

^{27/} All of the violations were willful within the meaning of the securities acts, inasmuch as the acts and omissions were consciously and intentionally performed or omitted to be performed. Gearhart & Otis, Inc. v. S.E.C. 348 F.2d 798 (C.A.D.C., 1965); Crow, Brouman & Chatkin, Inc., Securities Act Release No. 7839, March 15, 1966; Lawrence Securities, Inc., Securities Exchange Act Release No. 7146, September 23, 1963.

between the scheme or concerted action alleged as to Honig's and that alleged as to Transition, but urges an "overall plan or course of conduct to defraud", in which registrant's

"principals and sales staff united their talents into a concerted fraudulent course of business activity. Their aim was to underwrite and to sell new issues of a speculative nature to the public by means of illegal and fraudulent sales techniques. These fraudulent activities were readily and willingly furnished by the respondents [sic] sales staff who were employed for this purpose."

And under the universally accepted and well-established principle that if an unlawful scheme has been proved, every member is responsible for all acts committed by every other member or co-conspirator,^{28/} the Division would impose upon each respondent in this proceeding complete and total responsibility for all of the improper activities discussed above.

In effect, the Division's brief urges that registrant operated as a "boiler room" which was used with the intent and for the purpose of defrauding the investing public, and each respondent is charged with knowingly participating in such overall plan to defraud. But the Division has failed utterly to sustain these charges, and, in fact, appears not to have made any serious effort to prove, even by inference, the existence of any agreement, understanding, or plan to defraud. As the

^{28/} Van Riper v. United States, 13 F.2d 961, 965 (2d Cir. 1926);
United States v. Borelli, 336 F.2d 376 (C.A. 2, 1964).

Court said in Borelli v. United States, 336 F.2d 376 (C.A. 2, 1964), referring to a conspiracy charge:

" . . . the gist of the offense remains the agreement and it is therefore essential to determine what kind of agreement or understanding existed as to each defendant."

No effort was made, as to any respondent, to delineate the scope of his participation in any agreement, understanding, or plan to defraud the public, and I reject the concept of conspiracy or "in concert" action as it is sought to be made applicable to this proceeding and to the respondents.^{29/}

The Public Interest and Sanctions

Registrant is responsible for serious violations of the securities laws and rules thereunder. Although the firm is no longer in business, in view of the nature and extent of the violations found, it is in the public interest that its registration as a broker-dealer should be revoked and that it should be expelled from the National Association of Securities Dealers, Inc.

Hiller bears the primary responsibility for all of registrant's violations and for the inadequacy of supervision over the activities of the firm and its employees. He is an experienced, knowledgeable and intelligent person, who took considered risks in

^{29/} Cf. Levine v. United States, 383 U.S. 265 (1966); Fabian v. United States, 358 F.2d 187 (C.A. 8, 1966); United States v. Peori, 100 F.2d 401 (C.A. 2, 1938).

permitting some violations of the securities laws, and who failed to detect other violations because of bad hiring practices and the inadequate supervision. However, I believe he had an honest view that Honig's business operations would be successful and he had faith in the future of its stock: I believe also, that he had no deliberate intent to defraud the investing public in the sale of either Honig's or Transition stock, albeit he was reckless in permitting, controlling, and directing sales of Transition. And his comparison of the stock with that of Calvar was, of course, ill-advised and fraudulent.

Isthmus Steamship & Salvage Co., supra.

The record indicates that over a period of several years of experience in the securities field, Hiller was censured once by the National Association of Securities Dealers, Inc. for an improper activity of a subordinate. It also indicates that registrant cooperated with the Commission in its investigation prior to the institution of this proceeding, and Hiller's testimony, while self-serving and not entirely credible, revealed substantial forthrightness.

At the time of the hearing and for about one year prior thereto, Hiller was employed as a trader for a small over-the-counter securities firm. His derelictions are sufficiently serious that in my view the public interest requires that he be barred from being associated with a broker-dealer in a supervisory capacity, and that he be suspended from association with a broker or dealer for a period of six months.

Granat was no longer engaged in the securities business at the time of the hearing and apparently at that time had no interest in returning to it. Granat's relationship with registrant was sufficiently important that although his managerial functions were secondary to Hiller's, he failed to carry out responsibilities of proprietorship

imposed upon him and he bears no small share of the blame for the inadequacy of hiring practices and supervision. He also bears responsibility for the violations in which he engaged personally. In my view he should be barred from association with a broker-dealer in a supervisory capacity, and he should be suspended for a period of three months from being associated with any broker or dealer.

Gross did not testify at the hearing. He was employed at that time as a trader by an over-the-counter broker-dealer. At registrant's firm Gross does not appear to have occupied a position which imposed upon him important responsibilities of supervision and no adequate basis appears for charging him with responsibility for the hiring of employees or for the fraudulent selling practices. However, he was responsible for the bad office practices followed in connection with the Honig's offering, and although record-keeping violations are not the subject of this proceeding, these practices indicate that he was aware of the Section 5 violations which took place in connection with the offering. I believe the public interest requires that he be suspended from association with a broker or dealer for a period of two months.

Fink was inexperienced when he began his employment with registrant. At the time of the hearing he was employed as a registered representative by a broker-dealer firm which is a member of the New York Stock Exchange. Even though he was not adequately trained, his testimony indicates that he knew he was violating the law in selling Honig's stock. I believe that the public interest requires that he be suspended from association with a broker-dealer for a period of two months.

Mrs. Earle also was inexperienced when she began employment with registrant and she, too, was inadequately trained. But the flagrant violations in which she engaged as a registered representative and her inability to refrain from exaggerations and inaccuracies as a witness convince me that as of the time of the hearing she had neither the temperament nor the ability to act as a registered representative without danger to the investing public with whom she would come in contact. I have considered the fact that she was misled by M.W. and that many of her representations to purchasers of Transition stock were authored by him. But for reasons indicated above, I believe that the public interest requires that she be barred from association with a broker or dealer.^{30/}

Accordingly, IT IS ORDERED, that the registration as a broker and dealer of Richard Bruce & Co., Inc. be, and the same is hereby revoked and the firm is hereby expelled from the National Association of Securities Dealers, Inc. and

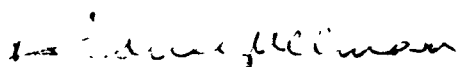
IT IS FURTHER ORDERED that Melvyn Hiller be and he is hereby barred from association with any broker-dealer in a supervisory capacity and suspended from association with any broker or dealer for a period of six months; that George Granat be and he is hereby barred from association with a broker-dealer in a supervisory capacity and suspended from association with a broker or dealer for a period of three months; that Stanley Gross and Aaron Fink be and they hereby are suspended from association with a broker or dealer for a period of two

30/ 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 rejected.

months; and that Jeanne S. Earle be and she hereby is barred from association with a broker or dealer.

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

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 Ullman
Hearing Examiner

Washington, D.C.
December 19, 1966