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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

CROW, BROURMAN & CHATKIN, INC.
30 Broad Street
New York 4, New York

File No. 8-9763

RECOMMENDED DECISION

FILED
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SECURITIES & EXCHANGE COMMISSION

Washington, D. C.
November 18, 1964

Irving Schiller
Hearing Examiner

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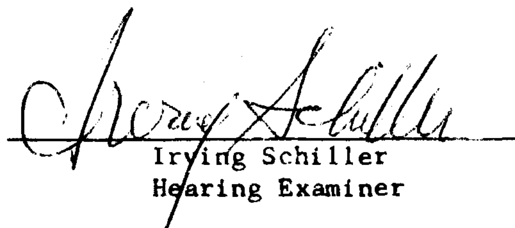
ERRATA

The appearance noted for Norman C. Eisenstadt and Joseph S. Lenchner should be changed to read as follows:

> William D. Matthews, Esq. of Whitlock, Markey and Tait, Esqs. and Edward M. Citron, Esq. of Pittsburgh, Pennsylvania for Norman C. Eisenstadt and Joseph S. Lenchner.



Irving Schiller
Hearing Examiner

Washington, D. C.

November 24, 1964

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

CROW, BROURMAN & CHATKIN, INC.
30 Broad Street
New York 4, New York

File No. 8-9763

RECOMMENDED DECISION

BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: Alexander J. Brown, Jr., David M. Butowsky and Michael J. Stewart, Esqs., for the Division of Trading and Markets.

Sylvestri Sylvestri, Esq. of Pittsburgh, Pennsylvania and Havens, Wandless, Stitt & Tighe, Esqs. of New York City for Crow, Brourman & Chatkin, Inc., Thomas Seberry Crow and Saul Brourman.

see errata

Edward M. Citron, Esq. of Gravelle, Whitlock, Markey & Tait, Esqs. for Norman C. Eisenstadt and Joseph S. Lenchner.

Courts Oulahan, Esq. for Gordon E. Whiteman.

Arnold A. Stahl, Esq. of Stahl & Neuman, Esqs., for John G. O'Neill.

Tony Rawe *pro se*.

These are proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the registration as a broker and dealer of Crow, Brourman & Chatkin, Inc. ("registrant") should be revoked, whether to suspend or expel registrant from membership in the National Association of Securities Dealers, Inc. ("NASD"), a national securities association, and whether under Section 15A(b)(4) of the Exchange Act Thomas Seberry Crow ("Crow"), Saul Brourman ("Brourman"), Tony Rawe ("Rawe"), David Daye ("Daye"), Edward S. Griffiths ("Griffiths"), Ray S. Sugden, Jr., ("Sugden"), William J. Price ("Price"), William J. Abbott ("Abbott"), Conrad C. Compton ("Compton"), Robert Oscar Bihler ("Bihler"), Joseph S. Lenchner ("Lenchner"), Donald R. DeVall ("DeVall"), Norman C. Eisenstadt ("Eisenstadt"), Michael Shaub ("Shaub"), Fred Riley ("Riley"), Gordon E. Whiteman ("Whiteman"), Jack Grover ("Grover"), Dorman E. Sisk ("Sisk") and John G. O'Neill ("O'Neill"), or any of them, are causes of any order of revocation, suspension or expulsion which may be issued.[1/]

1/ The securities acts amendments of 1964 (Public Law 88-467) amends, among other sections, Sections 15(b) and 15A of the Exchange Act. Since these proceedings were instituted prior to August 20, 1964, the date President Johnson signed the securities acts amendments of 1964, the references throughout this recommended decision will be to the provisions of the Exchange Act as in effect prior to August 20, 1964.

Section 15(b) of the Exchange Act, as applicable here, provides that the Commission shall revoke the registration of a broker or dealer if it finds that it is in the public interest and that such broker or dealer or any officer, director, or controlling or controlled person

(Registrant and all of the foregoing named individuals are hereinafter sometimes collectively referred to as "respondents".)

The order for proceedings alleges that from approximately August 1, 1962 to approximately April 30, 1963 all of the above-named respondents, singly and in concert, willfully violated and aided and abetted willful violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b), 15(c)(1) and 17(a) of the Exchange Act and Rules 17 CFR 240.10b5, 10b6, 15c1-2, 15c1-8 and 17a3 thereunder, in the offer and sale of the common stocks of Champion Industries, Inc. ("Champion"), P.C.S. Data Processing, Inc. ("P.C.S."), Youngwood Electronic Metals, Inc. ("Youngwood"), Bundy Electronics, Inc. ("Bundy") and Safticraft Corporation ("Safticraft").

After appropriate notice, hearings were held before the undersigned hearing examiner. Proposed findings of fact and conclusions

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of such broker or dealer, has willfully violated any provision of that Act or of the Securities Act of 1933 or any rule thereunder.

Section 15A(l)(2) of the Exchange Act provides for the suspension for a maximum of twelve months or the expulsion from a national securities association of any member who has violated any provision of the Exchange Act or has willfully violated any provision of the Securities Act of 1933 or any rule or regulation thereunder if the Commission finds such action to be necessary or appropriate in the public interest or for the protection of investors.

Under Section 15A(b)(4) of the Exchange Act, in the absence of Commission approval or direction, no broker or dealer may be admitted to or continued in membership in a national securities association if the broker or dealer or any partner, officer, director or controlling or controlled person of such broker or dealer was a cause of any order of revocation which is in effect.

of law and briefs in support thereof were filed by the Division of Trading and Markets and by respondents Eisenstadt, Lenchner and Whiteman.[2/]

The following findings and conclusions are based on the record, the documents and exhibits therein and the hearing examiner's observation of the various witnesses.

1. Registrant, a Pennsylvania corporation, became registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act on July 25, 1961 under the name of Frankstreet & Co. In March 1962 registrant merged with Crow & Co. and adopted its present name. In July 1962 registrant acquired certain assets and liabilities of Lenchner, Covato & Co., Inc. ("Lenchner Covato") and, in addition, continued the employment of practically all of Lenchner Covato's sales and other personnel. In December 1962 registrant acquired George O'Neill & Co., Inc., with offices in New York, Fort Lauderdale and Miami, Florida. This latter acquisition involved taking over customers'

2/ Registrant, Crow and Brourman participated in the proceedings but filed no proposed findings or brief. Respondents Grover, Bihler, Griffiths, Price, Riley, DeVall, Shaub, Daye and Sisk filed answers or notices of appearance but did not participate in the proceedings nor file any proposed findings or briefs. Respondent Sugden filed what may be considered a notice of appearance but no answer and respondent Compton, who was served with copies of the order for proceedings and the order fixing the time and place of the proceedings, filed no answer. Neither of these two respondents participated in the proceedings. Respondent Abbott filed an answer but did not participate in the proceedings except as a witness for the Division of Trading and Markets and did not file any proposed findings or brief. Respondent O'Neill testified in his own behalf but filed no proposed findings or brief. Kawe participated in part of the proceedings but offered no defense in his own behalf nor filed proposed findings or brief.

accounts and assuming liability for all customer credit balances, short positions and certain other net liabilities. Crow was and is president, director and beneficial owner of 10% or more of registrant's capital stock. Brourman was and is executive vice president, treasurer and a director of registrant. Registrant is a member of the NASD.

Fraudulent Sale of Champion Stock

2. The order for proceedings alleges, among other things, that during the period approximately August 1, 1962 to approximately April 30, 1963 registrant, in concert with the other respondents, made untrue statements of material facts and omitted to state material facts to purchasers of the common stock of Champion in willful violation of the anti-fraud provisions of the Securities Act and the Exchange Act.[3/]

3. Twenty-two witnesses testified as to the representations concerning Champion made to them by twelve of registrant's salesmen located both in the Pittsburgh and Florida offices. The salesmen told these customers, among other things, that the Champion stock would go up in price, that it could double or triple within six months, that it could or would go up to stated amounts ranging from one-half a point in two or three weeks to $6 or $7 within six months, that the stock would

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3/ The anti-fraud provisions referred to are Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2(17 CFR 240.10b-5 and 15c1-2) thereunder. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device 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 means of any other manipulative or fraudulent device.

move up when registrant started to liquidate a short position which it was maintaining, that Champion had already acquired one or two companies and was about to acquire or merge with other companies the effect of which would be to increase the price of the stock, that Champion was a very good buy, that it was anticipated that its earnings would be 25¢ per share and that Champion had great growth possibilities.[4/] Seven of the twelve salesmen made repeated telephone calls to the same customers and frequently a customer who had made one purchase was prevailed upon to make additional purchases of Champion stock and were told that either the price had increased or had dropped and the investor would do well by averaging down. One such salesman sold Champion stock to a customer on six separate occasions, four in January, once in February and once in March. Two of such salesmen sold Champion stock to the same customers on four separate occasions and four of such salesmen sold the same customers on three separate occasions.

4. Five of such salesmen induced their customers to sell other securities, some of which were listed on a national securities exchange, representing to such customers that they could do much better with Champion stock in terms of increase in the price of that stock than they could with the securities that they were then holding. Several customers further testified that when they requested registrant's salesman to sell Champion stock they were disuaded from doing and were told

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4/ Not all of the representations were made by each of the salesmen to each of the customers, however nearly every customer was told of the possibility of a price increase and that Champion had either already acquired or merged with one or more companies or was about to do so.

that the Champion stock would be sure to move up very shortly. In addition, a number of the customers were told that the president of Champion had prior experience in acquiring companies and in one instance had successfully increased the price of a stock up to $35 a share intimating that the said president might do the same for Champion.

5. There was no reasonable basis for the representations made to registrant's customers regarding price appreciation, acquisitions and mergers, earnings, or that an investment in Champion stock was a good investment for any particular customer. In fact all such representations were false and misleading. Champion had been organized in 1955 to manufacture and sell metal awnings. By July of 1962 Champion was a holding company whose only asset was United States Amusement Company which owned and operated three amusement park rides. For the year ended September 30, 1962 the United States Amusement Company had a net loss in excess of $9,000. It appears that the said company has been dormant since August 1962. In the latter part of July 1962 Champion purchased Forsberg Manufacturing Co. ("Forsberg") for $500,000. Under the terms of the purchase agreement $100,000 was paid in cash and the balance secured by Champion's promissory notes payable over a three-year period. The $100,000 cash payment was made by obtaining a week-end loan from a business associate of the controlling stockholder of Champion, which loan was repaid immediately by the execution of a mortgage by Champion on the plant and machinery of Forsberg.

6. Champion kept no books or records except for a check

maintained through September 1962. A financial statement for the year ended September 30, 1961 disclosed that Champion had a net operating loss of approximately $143,700 and a retained deficit of about $61,800. On or about November 30, 1962 Champion engaged an accounting firm to prepare a financial statement for the period ended September 30, 1962. On or about January 10, 1963 a financial statement was completed showing an operating loss of about $243,900 and a deficit of approximately $305,700.

7. On October 1, 1962 when the first note was due on the Forsberg acquisition Champion defaulted in payment. In November 1962 Forsberg had no funds available to meet its payroll or pay its creditors. In December 1962 Forsberg was in arrears in the payment of Federal taxes in the amount of approximately $12,000.

8. On February 1, 1963 the former owner of Forsberg sued Champion and its management for breach of contract and fraud in the management of Forsberg. On February 5, 1963 Crow loaned Champion $10,000 upon information that Champion was about to lose Forsberg. On or about February 19, 1963 Forsberg's prior owner took physical possession and control of the plant. On March 19, 1963 Forsberg filed a Chapter 10 proceeding under the Bankruptcy Act with schedules reflecting assets of approximately $272,000 and liabilities of approximately $338,000.

9. Any reasonable investigation by Crow and Brourman prior to undertaking the sale of Champion stock to its customers would have

disclosed the extent of the losses of Champion and its precarious financial condition. The only knowledge of Champion came from a visit to the Forsberg plant by Crow in the fall of 1962 at the suggestion of Abbott, one of his salesmen, and a conversation Crow had at the time with Albert N. Dukow, the president of Champion, who stated that he hoped to build up Champion through Forsberg and other acquisitions. Crow was not impressed with the Forsberg plant or its operations and was not interested in Champion. Nevertheless registrant without further information or investigation started its campaign to sell Champion in the first week of January 1963. Though Crow and Brourman requested financial statements on several occasions none were ever received and no financial information was ever given to any prospective investor. In the latter part of January or early February Crow and Brourman learned of Champion's inability to meet its first payment due on the Forsberg acquisition and at Dukow's request Crow loaned $10,000 to Champion, receiving about 14,000 shares of Champion stock as collateral. Sales of Champion stock continued without disclosure of such fact to customers.

10. On or about February 20, 1963 Crow and Brourman were informed that Champion was no longer in possession or control of Forsberg. They went to the Forsberg plant, consulted with Forsberg's attorneys and learned that Dukow had been ousted and a lawsuit started against Champion. There is some evidence in the record that instructions were presumably issued to registrant's salesmen to cease the sale

of Champion's stock until further notice. However, the record reflects that between February 21 and February 28, 1963, inclusive, registrant sold 7,215 additional shares of Champion. Registrant's sales apparently ceased for a two-week period between March 1 and March 15, 1963. On or about March 15 Dukow informed registrant that he had renegotiated the acquisition of Forsberg and on the strength of such representation and without any further investigation registrant immediately resumed sales of Champion stock. Between the period of March 15 through March 25 an additional 12,670 shares were sold. Between the period January 9, 1963 when registrant first commenced the sale of Champion stock to the end of March registrant sold approximately 112,500 shares.[5/]

11. The Commission has consistently held that a prediction of a specific or substantial increase in the price of a speculative security is a badge of fraud and cannot be justified.[6/] Though Crow and Brourman were informed of Champion's losses for the year 1961, each of the witnesses who testified as to the representations made to them emphatically denied ever being informed of such losses. Moreover, in

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5/ The record shows that registrant's total sales of Champion stock during this period amounted to 120,860 shares. Registrant's cancellations during the same period amounted to 8,350 shares leaving a net of total sales of 112,510 shares.

6/ J. A. Winston & Co., Inc., S.E.A. Release No. 7337 (June 8, 1964); Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962).

January 1963 the accounting firm engaged by Dukow had available the information concerning the huge losses of Champion for the year 1962, yet registrant made no effort to contact the accountants to learn the financial condition of Champion although Crow and Brourman knew the name of the accountants and could have readily ascertained the information. Obviously none of the investors were told of Champion's losses during the year 1962. In the face of the huge mounting losses any prediction of a price rise was completely unwarranted.

12. With respect to the representations made by registrant's salesmen to customers concerning mergers and acquisitions, it is clear from the record that other than the acquisition of Forsberg in July 1962, no other companies were ever acquired by Champion. There is evidence that in January 1963 Champion and Forsberg executed a contract to purchase Sterling Wholesale Hardware Co. of Chicago, Illinois for $300,000. At the time of the execution of the contract neither Champion nor Forsberg had available $300,000 to complete the contract for the acquisition nor were they able to finance such acquisition. By the end of January 1963 Crow and Brourman knew that Champion and Forsberg were unable to acquire Sterling. The misrepresentations concerning the acquisition of Sterling nevertheless continued. There is also some evidence in the record that Dukow contacted the managements of two other companies concerning possible merger or acquisition but no understanding was ever reached nor were any other contracts for acquisitions or mergers prepared.

13. It is abundantly clear from the record that the merger information which registrant had concerning Champion and Forsberg, coupled with the absence of financial information concerning either company, did not justify the representations made by registrant's salesmen that Champion stock would double or triple or increase in price or that Champion had acquired or was about to acquire a number of other companies which would result in a successful operation or a profitable company.

14. It is well settled that the making of representations to prospective purchasers without a reasonable basis, couched in terms of either opinion or fact and designed to induce purchasers is contrary to the basic obligation of fair dealing of brokers who sell securities to the public.[7/] Crow and Brourman testified that in recommending Champion as a vehicle for its salesmen to sell to customers they relied basically upon the hopes and expectations of Dukow concerning the future of Champion. They believed that Dukow would build up Champion by acquisitions or mergers and that Champion would be a good company to recommend to their customers as a speculation. Beliefs as to the future success of a company on the basis of inadequate information hardly served to furnish a reasonable basis for registrant's recommending the security to its customers and certainly not for the type of reckless representations made to them.[8/]

7/ Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962).

8/ N. Pinsker & Co., Inc., 40 S.E.C. 285, 291-292 (1960).

Registrant's lack of understanding of its duties and responsibilities as a broker-dealer to its customers is demonstrated by the fact that at the end of February 1963, having learned that Champion was in desperate financial condition and had lost its sole operating subsidiary, it nevertheless continued selling Champion stock and in March, after a short interval, resumed selling without further investigation upon the verbal assurances of Dukow that Champion was back in an operating position and would presumably still be a successful company. No disclosure was made to any of the customers sold in this period of the recent financial difficulties experienced by Champion.

15. The hearing examiner finds that in the sale of Champion stock in the period January through March 1963 registrant, together with or aided and abetted by Crow and Brourman, who were registrant's principal officers, directors and stockholders and both of whom were admittedly active in its management and operations, willfully violated the anti-fraud provision of Section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 17 CFR 240.10b5 and 15cl-2 thereunder.

Sales of Champion by Rawe, Daye, Griffiths, Sugden, Bihler, Price, Compton, De Vall and Grover

16. The Commission's order for proceedings alleges that the above-named salesmen sold Champion stock and in connection therewith made the false and misleading representations and omissions to state material facts set forth above. None of the foregoing individuals presented any

evidence on their own behalf. Since no evidence to the contrary was offered, the hearing examiner credits the testimony of the investor-witnesses regarding the statements made by each of the salesmen as well as their testimony as to the omissions to state material facts.

17. All nine of registrant's salesmen informed their customers in one manner or another that the price of the stock would increase, Daye saying the customer "should expect definitely an increase in price in six months"; Price, saying it would go up three or four points; Compton representing that the stock would go up to five or further; DeVall saying that Champion was in a short position at registrant and would go up shortly; Griffiths stating that it would go up one-half within a short time; Grover advising that it would rise a couple of points; Rawe saying that Champion would increase in value; Bihler representing that the investor would double his money in six months; and Sugden representing that it would go up to six or seven.

18. Seven of the nine salesmen informed their customers in one manner or another that Champion was embarked on an acquisition program and had either acquired or was about to acquire additional companies, Daye saying that additional requisitions were pending; Price saying that Champion was working on acquisitions and picking up companies; Compton stating that Champion was working on acquisitions; Griffiths saying that Champion was going to acquire a company; Rawe stating that mergers were imminent; Bihler representing that Champion was buying up concerns and Sugden stating that Champion will

merge.

19. All nine of the salesmen represented to their customers in one manner or another that Champion would be a good investment, Daye saying in March 1963 that it was a good time to buy Champion; Price telling one customer that Champion would make twenty-five cents a share; Compton saying to one customer that Champion was a hot stock; Griffiths stating that Champion was a good stock; De Vall stating that Champion was good at the price; Grover advising that the company had good aggressive management; Rawe saying that the stock was moving fast; Bihler representing that Champion anticipated earnings of twenty-five cents per share and that the outlook was excellent; and Sugden saying that registrant was promoting the stock of Champion and that it was a good company.

20. Each of the investors also testified they were never informed that Champion had a net operating loss for the year ending 1961 in excess of $140,000 and a retained deficit in excess of $60,000 nor of the net loss for the year ending 1962 in excess of approximately $244,000 nor of the total deficit as at the end of that period of approximately $305,000. Each of the investors who testified concerning their purchases after February 20, 1963, the date about when Champion lost Forsberg, were not informed of that fact.[9/] None of the

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9/ The record discloses that five of the nine salesmen sold Champion securities after February 20, 1963. Registrant's books and records disclosed that it sold Champion stock as late as March 25, 1963.

investor-witnesses were informed that Champion had no current books and records nor were any of the investor-witnesses told that neither registrant nor the salesmen were able to secure financial statements or information with respect to Champion. All but one of its investor-witnesses testified they relied on the representations made to them by registrant's salesmen and placed trust and confidence in them.

21. We have previously noted that there was no reasonable basis for the representations made regarding the price appreciation or earnings or that Champion was acquiring a number of companies or that an investment in Champion stock was a good investment for any particular customer and that all such representations were false and misleading.[10/] During the period that each of the salesmen made the extravagant and unwarranted representations concerning Champion they did so without seeing financial statements and without knowledge of the financial condition of Champion, a matter of essential importance to an investor who is being urged to purchase securities. During January 1963 sales meetings were frequently held at registrant's offices in which Champion was the chief topic of conversation. At the same time salesmen were constantly urged to increase their production with the clear implication that Champion was the appropriate vehicle for such purpose. During January and February 1963 registrant's salesmen in Pittsburgh and Florida concentrated their efforts on the sale of Champion stock and

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10/ See pp. 7 to 10, *supra*.

did not concern themselves with any investigation to determine whether the information they gave investors had any actual basis in fact. 11/ It is evident from the similarity of the representations, though the actual words used by the individual salesmen may have differed, that a pattern of fraud evolved in which prospective purchasers were urged to buy Champion as a good investment, as a stock which would increase in price, because mergers had been or were about to be effected and that great expectations could be anticipated. Certainly, none of the information which the nine salesmen had justified the foregoing exhuberant representations. Even though some of the investor-witnesses testified that they knew that the purchase of Champion was a speculation, the Courts have held that an investor nevertheless is entitled to the opportunity to evaluate the risk of loss, as against the hope of a lucrative return, from true statements of the financial status of the enterprise in which he is acquiring an interest. 12/ All of the salesmen in the instant case sold Champion without knowledge of the financial status of the company. The hearing examiner finds that in the sale of Champion stock in the period through March 1963 Rawe, Daye, Griffiths, Sugden, Bihler, Price, Compton, De Vall, and Grover willfully violated and aided and abetted registrant's willful violation of the

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11/ Brourman visited registrant's Florida offices in January 1963, held sales meetings with the registered representatives, gave them what information he had about Champion and told them they had to increase their production or the office would be closed. He also informed them that the salesmen in Pittsburgh were making money selling Champion.

12/ S.E.C. v. F. S. Johns & Co., 207 F. Supp. 566 (D. N.J. 1962).

anti-fraud provisions of the securities acts heretofore mentioned[13/] and should be named as causes of any order of revocation of registrant that may be entered by the Commission.

Sale of Champion by Whiteman

22. Whiteman was the only respondent who sold Champion and appeared at the hearings and offered evidence in his own behalf. Three investor-witnesses testified concerning the representations made to them by Whiteman regarding their purchases of Champion stock. One of these witnesses testified that Whiteman told them that Champion was being pushed by registrant, that it should be up two or three points within the next several months, that he had inside information that the price of the stock would increase, and that when the stock would go up fifty cents he would recommend that the customer sell and make a quick profit. He also informed that customer that the registrant was short 20,000 shares and when registrant would start to pick up the stock to cover its short position the stock would move up. In addition, he informed the customer that the company had a great growth potential, that he had his hands on 1500 shares which he could secure for the customer at less than the market and would sell the stock to the customer net without commission. To another customer, Whiteman said that he thought there was a good possibility that Champion would move very quickly, that it would go up fifty cents in two or three weeks and that within a period of a couple of months it should go up

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13/ See Footnote 3, *supra*.

$3 to $5, that a man by the name of Dukow was buying heavily into the company and would merge the company with some of his other holdings. To the third customer Whiteman stated that within two or three years he should double or triple his investment.

23. Whiteman does not deny selling Champion stock to his customers but urges that the representations he made to the three persons who testified were based upon information furnished to him by his superiors upon which he relied. The information which Whiteman received was both oral and in writing, the latter consisting of a copy of a letter on the stationery of Champion dated January 5, 1963 addressed to Crow and several teletype messages from registrant's office in Pittsburgh. At least two of the teletype messages purported to be typewritten notes of a telephone conversation between registrant's sales manager in Pittsburgh and registrant's manager of the Fort Lauderdale office, together with additional information placed on such notes by the manager of the Fort Lauderdale office. The notes indicated that Champion had acquired Forsberg, Sterling Hardware Co. of Chicago, Circle Air Products Co. of New York City, A & K Electric Corp. and Ultra Dynamics Corp. and planned to acquire a toy company. The earlier letter from Dukow to Crow stated that Forsberg had been acquired and that Sterling Hardware Co. was about to be acquired. Whiteman further testified that in addition he sold the stock to his customers after checking the prices of Champion in the pink sheets, and noting that the stock had risen from

14/ The record discloses that Whiteman offered and sold in excess of 5,000 shares of Champion to at least eight customers between the period February 12 and February 21, 1963.

75¢ to $1.50. He admitted telling a customer that he believed that the momentum of price of the stock would continue and carry the stock still higher. He also admitted telling the customer that when the stock increased at least fifty cents he would suggest selling. Whiteman testified that after receiving the information concerning the purported acquisitions by Champion he looked in some financial publications for information about it and finding nothing did not pursue the matter further.

24. On the basis of the record and Whiteman's own testimony there was no reasonable basis for the reckless representations made to customers, particularly since Whiteman although requesting financial information several times never had nor was able to obtain any financial information regarding Champion. There was nothing in the written information purportedly furnished to Whiteman which would provide a basis for the type of exhuberant representations made regarding Champion. Whiteman in fact testified that he "realized that I am at fault in selling the stock with not having a balance sheet or a financial statement or something around in front of me before I sell it." It is evident from his testimony that he was persuaded to offer the stock to his customers primarily because he firmly believed that the stock, having risen from 75¢ to $1.50, would continue to move up and thus provide a quick profit to his customers. Moreover, the record shows that during the period Whiteman sold Champion stock all of the salesmen in Fort Lauderdale office were concentrating their efforts selling that stock and Whiteman was caught up in the enthusiasm engendered in the

office regarding Champion and joined the distribution campaign being carried on. The Commission has held that the particularly high degree of inquiry required of a security salesman whose employer is engaged in the type of operation conducted in the Fort Lauderdale office during the period in question was not satisfied by Whiteman's reliance on the obviously inadequate information furnished to him by his employer.[15/]

25. Whiteman urges in mitigation of his conduct that he only sold a relatively small portion of the Champion stock distributed by registrant, that he relied on the information furnished by his employers, that he discontinued sales because he became convinced he could not secure the financial statements promised him by registrant, that he had never been subjected to any disciplinary proceedings before the Commission or elsewhere and that his employment as a registered representative by a stock exchange member firm has been impossible because of the instant proceeding. The hearing examiner has considered these arguments and concludes that Whiteman's conduct in ceasing sales does not, of course, provide an adequate explanation of the type of misrepresentations he made to customers nor excuse his prior failure to comply with the standards of fair dealing required of a security salesman to his customer.

15/ B. Fennekohl & Co., Securities Exchange Act Release No. 6898 (September 18, 1962); Harold Grill, d/b/a Program Planning Co., Securities Exchange Act Release No. 6989 (January 8, 1963).

26. The hearing examiner finds that Whiteman willfully violated and aided and abetted registrant's violation of the anti-fraud provisions of the Securities Acts referred to above and should be named as a cause of any order of revocation of registrant as a broker-dealer which may be entered herein by the Commission.

Fraudulent Sale of Safticraft by Registrant

27. The order for proceedings alleges that during the period approximately August 1, 1962 to approximately April 30, 1963 registrant, in concert with the other respondents, made untrue statements of material facts and omitted to state material facts to purchasers of the common stock of Safticraft in willful violation of the anti-fraud provisions of the Securities Act and Securities Exchange Act.[16/]

28. Seven witnesses testified concerning the representations made to them by five of registrant's salesmen in the Fort Lauderdale and Miami offices of registrant. The salesmen told these customers that the price of Safticraft would increase substantially, that within a period of three to six months it should increase to approximately $15 a share or that the stock should go up eight or nine points, that registrant would push the stock up, that Safticraft had earned $1.06 per share and would pay 10% stock dividend, that it was a good growing stock, that the company had lots of government contracts and that Safticraft would do six million dollars worth of business.[17/] At

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16/ See Footnote 3, supra.

17/ Though the record contains evidence of sales of Safticraft prior to December 1962 the hearing examiner has not considered any representations with respect to sales to customers prior to approximately December 13, 1962, the date registrant took over the operations of its Florida offices.

least two of the salesmen induced their customers to sell other securities suggesting that they could make more money purchasing Safticraft.

29. There was no reasonable basis for the representations made to registrant's customers regarding price appreciation, earnings or that an investment in Safticraft was a good investment for any particular customer. In fact, all such representations were false and misleading. Safticraft was incorporated in 1959 under the laws of the State of Delaware for the purpose of acquiring all of the stock of Dupont, Inc., a Louisiana corporation engaged in the manufacture of crew boats, barges, tugs, pleasure craft and special purpose marine equipment.

30. In April 1960 Safticraft filed a registration statement with this Commission offering 275,000 shares of its common stock at $3.00 per share which statement became effective on September 30, 1960. The underwriter named in the said registration statement was George O'Neill & Co., Inc. whose operations were taken over by registrant in December 1962. In 1962 Safticraft and Dupont began experiencing financial difficulties. On June 19, 1962 a judgment was recorded in St. Mary's Parish, Louisiana, where Safticraft and Dupont were located, against the companies for approximately $17,000. Two days later, another judgment was entered against Dupont for approximately $12,000. Between the period September 14, 1962 and January 16, 1963 judgments in the amount of approximately $56,500 were recorded against Safticraft and Dupont in the same Parish. Between the period

May 9, 1962 and March 25, 1963 tax liens were recorded in the same Parish against Dupont by the Federal Internal Revenue Service and the Department of Labor of the State of Louisiana totaling approximately $40,800. In addition, the Federal Internal Revenue Service levied an assessment against Dupont for unpaid taxes for the year ending 1959 in the amount of approximately $6,000; against Safticraft in the amount of approximately $51,500 for taxes owed for fiscal year ended October 31, 1960; and for approximately $77,700 against Safticraft and Dupont for unpaid taxes for the fiscal year ended October 31, 1961. On November 30, 1962 the Internal Revenue Service filed a lien on all of the property of Safticraft and Dupont for unpaid withholding taxes in the amount of approximately $30,000.

31. For the fiscal year ended October 31, 1961 Safticraft had no current books and records. For the fiscal years ended October 31, 1962 and 1963 Safticraft maintained no books and records. Dupont kept ledger sheets with entries on about 25% of the sheets to May 1, 1962 and entries on about another 25% of the sheets to July 31, 1962. Approximately 50% of the sheets were missing. No formal books or records were maintained by Dupont for the fiscal year ended October 31, 1962 or thereafter. In the first week of January 1963 the Dupont plant was closed down, the electricity and telephone cut off and its bank account closed. On March 1, 1963 an involuntary petition in bankruptcy was filed by three creditors against Safticraft and Dupont in the United States District Court for the Western District of Louisiana.

The petition was dismissed on March 26, 1963.[18/] On June 28, 1963 another petition in bankruptcy was filed in the same court against Safticraft and on September 24, 1963 Safticraft was adjudicated an involuntary bankrupt.

32. In December 1962 Crow and Brourman knew that the O'Neill company had underwritten Safticraft, that the stock had been sold to many Florida customers and that O'Neill, who was managing the Florida operations, continued to have an interest in the company and was making a market in the said stock. In the latter part of December 1962 or early January 1963 H. G. Kirkpatric ("Kirkpatric") informed Crow and Brourman that Safticraft needed working capital. Crow and Brourman sought to obtain financing for Safticraft through its banking connections in New York. On January 31, 1963 a bank officer advised registrant that no financing plan could be considered in light of the many suits and judgments pending against Safticraft as reflected in a Dun & Bradstreet report, a copy of which he sent to registrant. Current financial and other information was requested if the financing matter was to be pursued. Crow and Brourman testified that since early January 1963 they constantly sought financial statements from Kirkpatric but none were ever produced. Notwithstanding receipt of above information and the absence of financial statements registrant continued selling of Safticraft in its Florida offices during the period January through March 1963.

18/ The evidence discloses that on March 28, 1963, the Wall Street Journal carried an article referring to the dismissal of the bankruptcy proceedings and stating that a Federal tax lien was still in effect and the Dupont plant still closed.

33. Each of the investors who testified concerning the representations made to them also testified they were never informed that Safticraft and Dupont had no books and records, nor that registrant never received current financial statements, nor that judgments and tax liens were filed against Safticraft and Dupont. Those customers who were sold after the plant had been seized and closed in January 1963 were never informed of such fact. Crow and Brourman's explanation for continuing sales of Safticraft in light of their knowledge of the precarious financial condition of the company and the failure to receive current financial statements was in essence that Kirkpatric continually advised them that Safticraft was doing well and would be a successful company, that financial statements would be furnished shortly and that O'Neill who was presumably quite familiar with Safticraft's operations continued to have faith in the company. Blind faith and unwarranted reliance on assurances from officials of an issuer that a company is doing well is hardly a sufficient reason for a broker to recommend such company's stock to customers. Particularly is this true where, as in the instant case, registrant was advised by a reliable banking institution that financing would not be considered in the face of numerous judgments and tax liens and lack of financial statements. It was not until mid-April or early May that registrant issued instructions to cease further sales of Safticraft. Registrant's conduct manifests a clear lack of understanding of its duties and responsibilities as a broker to its customers and engaging in a course of business that may well be characterized in the language of the

securities acts, as operating a fraud or deceit upon purchasers.[19/]

34. The hearing examiner finds that in the period January through March 1963 registrant, aided and abetted by Crow and Brourman, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 17 CFR 240.10b5 and 15c1-2 thereunder in the offer and sale of Safticraft.

Findings as to Shaub, Grover, Sisk and Riley

35. The Commission's order for proceedings alleges that the above-named persons made false and misleading representations and omitted to state material facts regarding Safticraft. None of them presented any evidence in their own behalf. The evidence given by the said witnesses as to the material representations made by each of the salesmen and the omissions to state material facts thus stands uncontroverted in the record. The hearing examiner credits the testimony of the investor-witnesses.

36. Shaub, Grover, Sisk and Riley represented to the investor-witnesses that the price of Safticraft stock would increase substantially, Shaub representing that the price of Safticraft would rise to between $12 and $15 per share within three to six months, Grover saying the stock would be up a couple of points in a couple of months, Sisk representing that the stock should go up eight or nine points and Riley indicating a price rise. The four salesmen also informed prospective investors that the purchase of Safticraft would be a good investment;

19/ See footnotes 6 and 7, *supra*.

Shaub representing to one customer that Safticraft was a good growing stock, that it had lots of government contracts which could be discounted at banks, and to another customer that the company will do $6 million worth of business, Sisk saying that the company would make money and Riley, that the earnings were good. In addition, each of the investors who testified concerning the above representations also testified they were never told of the dire financial condition of Safticraft nor of the failure of Safticraft and Dupont to maintain any books and records, nor were they informed of the fact that no financial statements were available for the year 1962.

37. The findings made in the preceding section with respect to the absence of a reasonable basis for the representations made by registrant are equally applicable to the four salesmen in question who, in fact, made the representations and such findings are incorporated herein. None of these salesmen made any effort independently to obtain current information concerning Safticraft. Each of them willingly joined the campaign being conducted in the Florida offices of registrant to push the stock of Safticraft as evidenced by the similarity of the type of representations made to customers. Each of them manifested an utter lack of understanding of a broker's responsibility to his customer.

38. Though Sisk offered no defense in his behalf during the hearing he forwarded a communication to the hearing examiner after the record was closed, which the hearing examiner accepted as proposed

findings, stating that he became a registered representative of the registrant in December 1962 and sold Safticraft to the investor-witness who testified against him. He further states that his sales were made on the basis of information furnished to him by registrant including reports of Safticraft published by Value Line Survey, the latest of which was dated August 20, 1962. It is apparent from his own statement that he made no effort to obtain any current facts concerning Safticraft. Since Sisk sold Safticraft in February and March of 1963 he had ample opportunity to secure current information and certainly could have learned that Dupont's plant had been closed. His reliance upon information furnished him by his superiors, which was at least six months old, was under the circumstances unwarranted. His statement confirms the hearing examiner's finding that Sisk showed a lack of understanding of the duties and responsibilities of a securities salesman to his customers.

39. The hearing examiner finds that Shaub, Grover, Sisk and Riley willfully violated and aided and abetted registrant in willfully violating the anti-fraud provisions of the securities acts set forth above in the offer and sale of Safticraft and should be named as causes of any order of the Commission revoking registrant's registration as a broker-dealer.

Findings as to Abbott, O'Neill and Additional Findings as to Riley

40. The Commission's order alleges that Abbott was sales manager of registrant's Pittsburgh office, Riley was sales manager of

registrant's Fort Lauderdale office and O'Neill was sales manager of registrant's Miami office and in charge of all of registrant's activities in Florida. With respect to Abbott, the record discloses that he was originally employed as registered representative by registrant and from the early part of January to about the middle of February, 1963, he was sales manager in the Pittsburgh office. There is no dispute and Abbott testified that as sales manager his duties were to supervise his salesmen, listen to their conversations with customers and furnish them with whatever information they needed or wanted so as to enable them to sell securities to their customers. Abbott admitted that he originally brought Champion to the attention of registrant and in the latter part of December accompanied Crow to Champion's plant to overlook the operation. Abbott also admitted that early in January, 1963, he held a sales meeting in the Pittsburgh office, informed the salesmen that he had been impressed with what he had seen of Champion's operation, that he believed Dukow would provide aggressive management for Champion, that Champion had a good chance to succeed and if all the circumstances materialized the price of the stock could go up. Though admitting he listened to the salesmen's conversations with their customers he testified he never heard any salesmen represent the customers that the price of the stock would increase nor could he recall any other statements that were made by any particular salesman to any particular customer. Abbott further admitted that he spoke to Riley in Fort Lauderdale, knowing that Riley was the sales manager in that office, and furnished him with the information he had on Champion.

41. There is no dispute and O'Neill admits that he was in charge of the Florida operations of registrant from December 1962 through about April of 1963. He was present in the Miami office when Brourman spoke to the salesmen about Champion. He had been a member of the brokerage firm which underwrote Safticraft and testified that he was fully familiar with its operations, that he knew Kirkpatric, the president of Safticraft, and that he had recommended the purchase of that stock to his customers since approximately 1961. At the sales meetings which he held in the Miami office, Safticraft and Champion were constantly the topic of discussion during the period of January through at least April, 1963, and it is clear from the record that during that period that office was concentrating its efforts on both Safticraft and Champion.

42. Riley was admittedly the sales manager of the Fort Lauderdale office and supervised the salesmen there. Under his supervision both Safticraft and Champion were sold by the salesmen to their customers. Riley admittedly was present when Brourman visited that office in January 1963 and recommended Champion as a vehicle by which salesmen could earn more commission. The evidence in the record discloses that Riley communicated with Abbott in Pittsburgh, received information from him concerning Champion and transmitted that information to the salesmen under his supervision. Riley's duties also include listening to salesmen regarding the nature of representations made by them to customers. It is also evident that during the period January through March, 1963, the efforts of Fort Lauderdale office

were primarily concerned with the sale of Safticraft and Champion.

43. In fact, during the period January through March, 1963, registrant's activities in all three offices were concerned primarily with pushing the stock of Safticraft and Champion to its customers. In the Pittsburgh office, for example, registrant, during the period January and February, maintained thirty-eight telephones and its January telephone bill was in excess of $2400 and in February, in excess of $3100. During the latter month, in excess of 1,300 long-distance telephone calls were made and in January approximately 1,000 such calls were made.

44. In the opinion of the hearing examiner the pattern of fraudulent representations of the various salesmen in all three offices of registrant could hardly have occurred without the knowledge of each of the sales managers of each of the offices who, the record shows, were supposed to have been properly supervising their employees. Neither Abbott, O'Neill or Riley can escape their responsibilities by failing to use reasonable care to learn the nature and type of representation being made by the salesmen whom they were presumably supervising. Such misrepresentations as were made to customers were the result of the failure of each of the sales managers to act upon the knowledge which they had or should have had and to exercise their responsibility to supervise. To that extent each of them became parties to the misrepresentations. In addition, it is clear from the record that Riley himself made affirmative misrepresentations to his customers as indicated above. It is equally clear from the record that

O'Neill in a number of instances during February and March of 1963 attempted to dissuade customers from selling Safticraft stock, assuring them that Safticraft would continue to be a good investment, that he and his family owned Safticraft and were continuing to hold the stock and that he continued to have great faith in the company.

45. It is evident that the techniques used in registrant's offices to push the stock of Champion and Safticraft were those commonly associated with a "boiler room" and that Abbott, O'Neill and Riley were knowing participants in that operation. 20/ The hearing examiner finds that Abbott, O'Neill and Riley aided and abetted registrant's willful violation of the anti-fraud provisions of the securities acts mentioned above in the offer and sale of Champion and Safticraft and should be named as causes of any order of revocation of registrant as a broker-dealer that may be entered by the Commission.

Fraudulent Sale of P.C.S. by Registrant

46. The order for proceedings alleges that during the same period mentioned above registrant in concert with the other respondents willfully violated the anti-fraud provisions of the Securities Act and the Exchange Act in the offer and sale of P.C.S.

47. Seven witnesses testified concerning the representations made to them by four of registrant's salesmen. The salesmen told these customers, among other things, that the stock would move up in price in a short time, or that it would double in six months, or that the stock was sure to go up and a profit could be made on it, or that P.C.S.

20/ See Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962) Affirmed sub nom. Berko v. S.E.C., 316 F. 2d 137 (C.A. 2, 1963); Aircraft Dynamics International Corp., Securities and Exchange Act Release No. 7113 (August 8, 1963).

would merge with other companies and thereby enhance in value, or that registrant had inside information about the company and that the investor "couldn't possibly lose money on it," or that the company was making money, that its earnings were good and that it had a great potential.

48. There was no reasonable basis for any of above representations made to registrant's customers. In fact, all such representations were false and misleading. On or about January 15, 1963 P.C.S. furnished shareholders an annual report together with financial statements, a copy of which was received by registrant. The president's letter to shareholders accompanying the financial material informed shareholders that the company's earnings from operations fell from nineteen cents to six cents per share. On January 28, 1963 registrant's research department prepared a research report on P.C.S. which it furnished its salesmen for transmittal to customers. The report depicts net income per share for the fiscal years ended October 31, 1959 through 1962 and for the first two fiscal months of 1963. For the year ended 1962 the net income per share was stated as twenty-one cents with a note that the figure included a sixteen cent special credit. No further explanation was furnished. The record shows that in fact the earnings of P.C.S. dropped from nineteen cents per share in 1961 to six cents per share for the fiscal year ended October 31, 1962. The implication in the research report was that the company had earnings of twenty-one cents per share for the year 1962. The statement that the per share

earnings include a special credit of sixteen cents was far from adequate under the circumstances. 21/

49. The misrepresentation of the company's earning is intensified by the statement appearing immediately below the special credit notation. This statement reads:

> "It is expected that sales and earnings for 1963 should show a much better increase than 1962. . . (Underlining ours.)

Registrant's employee who prepared the research report testified that he discussed the manner in which the per share earnings for the fiscal year 1962 should be shown with Crow and Brourman and the method used to depict the earnings was inserted with their approval. In addition, the report stated under the heading "Conclusion" the following:

> "We feel that the data processing field, which in its current form is less than ten years old, is just starting to make the profits that could help the securities of its participants move forward, similar to the way other service companies' securities have done in the past two years."

Absent any explanation of the companies considered to be in the data processing field which was starting to make profits and a reasonable explanation of the similarities and differences between such companies and P.C.S., the research report is misleading in its implication that the securities of P.C.S. would move forward. On the basis of the research report prepared by registrant which it furnished to customers, the hearing examiner has little doubt in crediting the testimony of the

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21/ The special credit referred to in the report related to the receipt by the company of $50,000 upon the death of its prior president.

investor-witnesses who were told that the price of P.C.S. would increase and that the company's earnings were good.

50. We have previously noted the Commission's decisions holding that a prediction of a specific or substantial increase in the price of a speculative security is a fraud and cannot be justified.[22/]

51. The hearing examiner finds that in the sale of P.C.S. stock during the period alleged in the Commission's order registrant, together with and aided and abetted by Crow and Brourman, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c) of the Exchange Act and Rules 17 CFR 240.10b5 and 15c1-2 thereunder in the offer and sale of P.C.S.

52. The representations referred to above were made by Rawe, Bihler, Price and Compton. None of them presented any defense in their own behalf and the testimony of the investor-witness is uncontroverted and credited by the hearing examiner. Each of the salesmen told their customers P.C.S. should rise in price, the company was making money and that the company would merge with another company.[23/] The findings above with respect to the absence of reasonable basis for the representations made by registrant are equally applicable to the four salesmen who, in fact, made the representations. As in the case of the sales of

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22/ See page 10 and Footnote cited therein.

23/ Though the record reflects sales prior to August 1, 1962 the hearing examiner has not considered transactions prior to the period set forth in the order for proceedings during which violations allegedly occurred.

Champion and Safticraft these salesmen made no effort to ascertain whether any of the statements made to investors had any reasonable basis. Registrant was making a market in P.C.S. and these salesmen were content to offer the stock because of registrant's apparent interest in the security without consideration of the duties and responsibilities they owed to their customers.

53. The hearing examiner finds that Rawe, Bihler, Price and Compton willfully violated and aided and abetted registrant's willful violation of the anti-fraud provisions of the Securities Acts mentioned above in the offer and sale of P.C.S. and should be named as causes of any order of revocation of registrant's registration which may be entered by the Commission.

Registrant's Pricing Practices

54. The order for proceedings alleges that respondents also willfully violated the anti-fraud provisions of the securities acts in that registrant sold securities to customers at prices in excess of and having no reasonable relationship to the current market price as indicated by registrant's contemporaneous cost of such securities.

55. The charges of unfair pricing relate to registrant's transactions during the period about August 1, 1962 to approximately April 30, 1963 in the shares of stock of Champion, P.C.S., Youngwood and Bundy. Comprehensive schedules reflecting the purchase and sale price of the securities of the four companies during the period in question were prepared by the Division of Trading and Markets from

registrant's books and records including the registrant's firm trading account, order tickets and confirmations. The accuracy of the information set forth in the schedules was not challenged by any of the respondents.

56. With respect to the sale of Champion stock, the record shows that between January 8 and April 1, 1963 registrant sold about 120,800 shares to customers and purchased approximately 91,000 shares from broker-dealers and customers. The price at which registrant purchased the said securities ranged from 3/4 to 1-7/8 per share and the sale price from 1 to 1-7/8 per share. During the foregoing period registrant purchased shares of Champion on each trading date it sold such securities to customers except for one day, in January, two days in February and two days in March 1963. The price at which registrant sold Champion securities to customers in over 300 transactions represented mark-ups ranging from 7.6 to 66.6% with an average mark-up of 24.82%.

57. With respect to sale of P.C.S. stock, the record shows that between September 14, 1962 and March 15, 1963 registrant sold about 24,250 shares to customers and purchased approximately 25,700 shares from broker-dealers and customers. Out of a total of about 160 sales to customers all but four were sold at 3-3/4. In approximately 60% of such sales registrant purchased the said securities at 3 and the remaining 40% were purchased at prices ranging from 1-1/4

to 3-3/4.[24/] During the foregoing period registrant purchased shares of P.C.S. on each trading date it sold such securities to customers except for three days in October, four days in November, two days in December, 1962, two days in January and two days in February, 1963. The price at which registrant sold P.C.S. securities to customers represented mark-ups ranging from 20.8% to 114.2% with an average mark-up of 26.8%.[25/]

58. With respect to the sale of Youngwood stock, the record shows that between September 17, 1962 and March 13, 1963 registrant sold approximately 17,000 shares to customers and purchased approximately 18,600 shares from broker-dealers and customers. The price at which registrant purchased the said securities ranged from 2 to 4-1/8 per share and the sale price from 2-1/2 to 4-1/4. During the foregoing period registrant purchased shares of Champion on each trading date it sold such securities to customers except for four days in September, two in October, one in December, 1962, and six days in January and one in February, 1963. The prices at which registrant sold Youngwood securities to customers in fifty-six transactions represented mark-ups ranging from 16.6% to 45.5% with an average mark-up of 24.2%.

24/ Sixteen such purchases were made at a price of 3-3/4 and one isolated purchase at 5-1/4.

25/ The mark-up in all but 15 transactions was 25%. Out of the 15 transactions, one represented a mark-up of 114.2 and one a mark-up of 20.8%. Eight such transactions represented mark-ups of 36.3, one at 87.5, another at 85.7 and the remaining two at 40 and 46.3% respectively.

59. With respect to the sale of Bundy stock, the record shows that between August 1, 1962 and April 26, 1963 registrant sold about 23,500 shares to customers and purchased approximately 20,200 shares from customers. The price at which registrant purchased its securities ranged from 3/4 to 1-5/8 per share and the sales price from 7/8 to 1-7/8 per share. During the foregoing period registrant purchased shares of Bundy on each date it sold such securities to customers except for three days in August, two days in September, five days in October, two days in November, one day in December, 1962, four days in January, two days in March and three days in April, 1963. The prices at which registrant sold Bundy securities to customers in about 100 transactions represented mark-ups ranging from 8.3% to 150% with the average mark-up of 36.23%.

60. The percentage mark-up set forth above with respect to each of the four securities in question was arrived at by using the highest price paid by registrant on each day it sold such securities to customers and in the several instances in which no securities were purchased on the day a sale was made to a customer the price used was the highest cost to registrant the day before or the day after such sales except in three instances in Bundy in which the purchase price used for computation was two days prior to the sale to the customer.

61. The Commission has consistently held and the Courts have affirmed, that it is a fraud and deceit upon customers to effect transactions at prices not reasonably related to the current market prices and that a dealer's contemporaneous costs are the best evidence

of current market prices, in the absence of countervailing evidence.[26/]
It is evident from the record that during the periods registrant sold Champion, P.C.S., Youngwood and Bundy it purchased the said securities on each date it sold such securities to customers with relatively few exceptions and in those instances such securities were purchased within a day or two prior or subsequent to such sales. No evidence was offered by registrant to show that the purchase price in the mark-up transactions reflected above were not representative of the prevailing market at the time of the transaction with the customer or presented any reasons why its contemporaneous purchase prices should not be used as a basis for determining the fairness of registrant's prices to its customers. Registrant's justification for its pricing policies was offered by Crow who testified that the policy was to sell to the customer at the wholesale or inside offer price, which was the price at which securities were sold to dealers. This pricing policy resulted in charging customers unfair prices in light of the evidence that the market in the securities in question was dominated by registrant who was engaged in a retail selling campaign.

62. The Commission has held that where a dealer dominates the

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26/ Naftalin & Co., Inc., Securities Exchange Act Release No. 7220 (January 10, 1964); Maryland Securities Co., Inc., Securities Exchange Act Release No. 7232 (February 4, 1964); Samuel B. Franklin & Co. v. S.E.C. 290 F. 2d 719 (C.A.9, 1961), Cert. denied 368 U.S. 889; Maurice Barnett Jr. v. S.E.C. 319 F. 2nd 340 (C.A.8, 1963).

market in a security the dealer's own inside offer cannot be used as a basis for determining mark-ups.[27/] An examination of the evidence discloses that registrant dominated the market in the four securities in question. Lenchner Covato or its predecessor had acted as underwriter of the securities of P.C.S., Bundy and Youngwood[28/] and was making a market in such securities when registrant took over its operation. Registrant continued to make a market in the said securities.

63. Between about August 1 and November 12, 1962 Golkin Bomback & Co., Inc. ("Golkin") and E. W. Stewart & Co., Inc. ("Stewart"), Golkin's correspondent in Florida, entered daily quotations on P.C.S. in the National Daily Quotations Service (pink sheets). Between November 12 and December 14, 1962 Golkin alone appeared in the pink sheets and from the latter date through May 8, 1963 Golkin and registrant appeared in the said sheets on P.C.S. During the above periods no other brokers appeared in the said sheets except that another broker inserted a quotation on February 7, 1963.

64. From approximately August 1, 1962, through April 16, 1963, registrant and Golkin inserted daily quotations in the pink sheets on Bundy. No other brokers appeared in the pink sheets on Bundy during this period on a regular basis except that from about the middle of August through November, 1962, another broker-dealer entered bids only

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27/ General Investing Corporation, Securities Exchange Act Release No. 7316 (May 1964).

28/ Registration statements were filed with the Commission by Bundy and Youngwood which were declared effective in 1961 and by P.C.S. which became effective in 1962. (File Nos. 2-18723; 2-17957; 2-19105)

in amounts varying from 200 to 500 shares, which were consistently lower than registrant's bid. From approximately August 1, 1962 to the middle of March 1963 Golkin and other brokers entered quotations in the pink sheets on Youngwood on a regular basis. On April 2, 1963, registrant began entering quotations in the pink sheets on Youngwood and continued such listing until May 3, 1963.

65. The record is clear that Golkin's quotations on P.C.S., Bundy and Youngwood were inserted in the pink sheets as a result of an understanding between Golkin's trader and registrant's trader, Eisenstadt, whereby Golkin was assured of a market in the said securities and would receive 1/16 profit per share on all purchases and sales in the securities of the three companies. Golkin was authorized to execute all transactions up to 100 shares without prior clearance by registrant and all transactions in excess of that amount were cleared by registrant in advance. The record shows that registrant's trader teletyped daily quotations for insertion in the pink sheets to Golkin until some time in December 1962, when the teletype was discontinued and thereafter, by telephone. There is also evidence that on a number of occasions Golkin was instructed to insert bid and offer quotations in the pink sheets at a particular price and to trade only at lower prices.

66. With respect to Champion Crow testified that registrant was the dominant market maker in that stock from the beginning of January to at least March 1963. The record also discloses that on about 25 out of about 40 trading days between January 7 and

February 26, 1963 registrant had the high bid and offer or both in the pink sheets. In addition, during the period January through March registrant raised the bid or offer on nine occasions.

67. Thus, it is evident from the record that registrant maintained and dominated the market in P.C.S., Bundy, Youngwood and Champion. It is abundantly clear that from the fall of 1962 through March 1963 registrant was engaged in a retail selling campaign in all four securities. Under the circumstances the use of registrant's inside offer as a basis for computing mark-up was improper.[29/]

68. There is no dispute and Crow and Brourman admit that ultimate responsibility for determining the price at which securities were to be sold to customers was theirs. However, the record discloses that the mark-ups were arrived at as a result of conferences between Crow, Brourman, Eisenstadt, Lenchner and registrant's comptroller. At these conferences, registrant's position in the securities of P.C.S., Bundy and Youngwood was discussed and the amount of mark-up to be charged to customers was considered. Crow testified he relied primarily on the experience of Eisenstadt and Lenchner and that the discussions regarding mark-ups resulted in a policy determined by all of the participants at the conference. Eisenstadt and Lenchner were experienced traders, had

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29/ See Report of the Special Study of the Security Markets relating to the NASD's mark-up policy. H. Doc. 95, Pt.2, Chapt. VII, 88th Cong., 1st Sess. (1963) at p. 651; General Investing Corp., supra.

conducted such functions in Lenchner Covato prior to the time registrant took over the firm's operations and the policies regarding mark-ups were carried over from the Lenchner firm and continued by registrant. Eisenstadt and Lenchner, though admitting they participated in the conferences at which mark-ups were considered, urge that they "protested" that the spreads were too great and that the stock was being retailed at prices considerably higher than the wholesale market. Eisenstadt also testified he complained to Brourman about the large mark-ups consistently over a period of several months. Eisenstadt contends that ultimate responsibility for fixing the pricing policies rested with the management, to wit: Crow and Brourman, and that Eisenstadt and Lenchner were merely carrying out instructions as employees of registrant. In addition, Lenchner further argues that he became the trader on March 1, 1963 when Eisenstadt resigned and served as such for a period of only two weeks. Prior thereto he contends he was a registered representative and merely assisted Mr. Eisenstadt on occasion to relieve Eisenstadt during lunch periods or other absences from the trading desk.

69. On the basis of the record the hearing examiner is of the opinion that notwithstanding the fact that Crow and Brourman as principal officers of the registrant had ultimate prime responsibility for all of registrant's operations, Eisenstadt and Lenchner participated in the discussions regarding mark-ups and the final policy determination arrived at as a result of their participation. In addition, the hearing examiner was persuaded by the evidence that Eisenstadt and Lenchner were given

authority to operate in the trading room and exercised such authority over a period of months. Thus, for example, arrangements with broker-dealers to enter quotations in the pink sheets and the furnishing of prices was admittedly accomplished by Eisenstadt and Lenchner. Documentary evidence in the record discloses that the teletype messages between registrant and the Golkin firm were dictated by Eisenstat on a daily basis when that service was in operation and thereafter conducted by Eisenstadt by telephone. It is apparent from the record that Eisenstadt had wide discretion in the purchase and sale of securities on registrant's behalf and exercised such discretion.

70. Accordingly, the hearing examiner finds that registrant, together with or aided by Crow, Brourman, Eisenstadt and Lenchner, willfully violated Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rule 17 CFR 240.10b-5 and 15cl-2 thereunder in that they effected securities transactions with customers which were not reasonably related to the prevailing market as determined by registrant's same-day or substantially contemporaneous purchase price and which prices were unfair and that each of them should be named as a cause of any order of revocation of registrant as a broker-dealer which may be entered by the Commission.

Failure to Comply with Record Keeping Requirements

71. The order for proceedings alleges that registrant willfully violated the record keeping requirements of the Exchange Act and Rules thereunder. The record discloses, and registrant did not controvert the fact, that between August 1, 1962 and April 30, 1963 it failed to

show the time of entry of brokerage order memoranda reflecting purchases or sales of securities. Such failure was reflected on approximately 200 order slips constituting about 23% of registrant's orders relating to transactions in Champion and Bundy. Accordingly the hearing examiner finds that registrant willfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-3 thereunder and that Crow and Brourman, who shared responsibility for the maintenance of the records, aided and abetted in such willful violation.

Public Interest

72. The sole remaining question is whether it is in the public interest to revoke the registration of the registrant as a broker-dealer. On the basis of the record the hearing examiner concludes that it contains overwhelming evidence of serious misconduct, complete disregard of the financial welfare of customers and utter abdication of the fiduciary duties which a broker-dealer owes to his customers. The hearing examiner found that registrant willfully violated the anti-fraud provisions of the securities acts in the offer and sale of Champion, Safticraft and P.C.S., and engaged in the practice of selling securities to customers at prices in excess of and having no reasonable relationship to the current market prices as indicated by registrant's contemporaneous costs to the detriment of the customers and for its own profit. The practice of charging unreasonable mark-ups to customers not only violated the anti-fraud provisions of the securities acts but was inconsistent with the just and equitable principles

of trade in contravention of Section 1 and 4 of Article III of the Rules of Fair Practice of the NASD, of which registrant was a member.[30/]

73. The Commission has frequently emphasized that inherent in the relationship of every broker-dealer with his customer is the implied vital representation that the customer will be dealt with fairly and honestly.[31/] It is clear from the statements of more than forty of registrant's customers who testified regarding registrant's activities that no inquiry was made of the investment aims and needs of such customers nor was any information elicited from these customers by the salesmen as to their financial condition so as to determine the desirability of recommending any particular security to such customer. Nearly all of the witnesses who testified stated that they placed complete reliance on registrant's salesmen and were led to believe that the recommendations being made to them were in their best interests.

74. Registrant's manner of conducting business indicated a type of operation in which efforts were continually made to increase business without regard to responsibilities to customers. Sales meetings were conducted practically on a daily basis at all of registrant's offices at which salesmen were importuned to increase production.

30/ See NASD Manual, pp. G-1, G-6

31/ Pinsker & Co., Inc., 40 S.E.C. 285 (1960).

Commissions were increased to spur on such activities. Though attempts to increase production is not an evil per se the means and methods countenanced by registrant in permitting its salesmen to make unwarranted representations and the absence of proper supervision to prevent such representations evinces a lack of understanding of the fiduciary relationship between a broker and his customer. The type of misrepresentations made and omissions to state material facts which were known or should have been secured by registrant and its salesmen reveals a pattern of fraudulent or recklessly negligent conduct, which if not encouraged by Crow and Brourman, certainly not effectively sought to be restrained, resulting in conduct inimical to the best interests of customers.

Recommendation

In view of the willful violations found, it is respectfully recommended that the Commission enter an order finding that it is in the public interest to revoke registrant's registration as a broker and dealer and expel it from membership in the NASD. It is further recommended that the Commission find that Crow, Brourman, Rawe, Daye Griffiths, Sugden, Abbott, Bihler, Lenchner, Price, Compton, DeVall, Eisenstadt, Shaub, Whiteman,[32/] Grover, Sisk, Riley and O'Neill willfully

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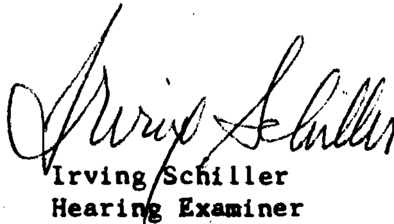
32/ Though the hearing examiner has found that Whiteman willfully violated the securities acts he is of the view that there are certain mitigating factors which may be considered by the Commission. Whiteman's candid testimony recognizing his fault in selling speculative securities without knowledge of the financial condition of the company shows, at least, an awareness of the responsibilities of a security salesman. In addition, consideration

violated and aided and abetted in registrant's willful violations of the provisions of the Securities Act and the Exchange Act and the respective Rules thereunder, set forth above, and that each of such individuals is a cause of any order of revocation or expulsion entered with respect to registrant. 33/

Respectfully submitted,



Irving Schiller
Hearing Examiner

Washington, D. C.
November 18, 1964

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should also be given to the fact that he made some effort to obtain information and discontinued selling Champion after ten days because he was unable to obtain supplemental information sought from registrant. If the sanctions in the recent amendments to the Exchange Act (Public Law 88-467, 88th Congress S.1642 effective August 20, 1964) were applicable, the hearing examiner would be inclined to recommend that Whiteman be suspended for a period of four months from being associated with a broker-dealer and thereafter permit him to be so employed under appropriate supervision.

33/ To the extent that proposed findings and conclusions submitted by the Division of Trading and Markets, Whiteman, Eisenstadt and Lenchner are in accord with the views set forth herein they are sustained and to the extent they are inconsistent therewith they are expressly overruled.