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UNITED STATES OF AMERICA

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Before the

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SECURITIES AND EXCHANGE COMMISSION

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R. J. HAYES & CO., INC.
27 William Street
New York 4, New York

(File No. 8-10478)

RECOMMENDED DECISION

IRVING SCHILLER
Hearing Examiner

Washington, D. C.
October 2, 1962

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Before the

SECURITIES AND EXCHANGE COMMISSION

R. J. HAYES & CO., INC. :
27 William Street :
New York 4, New York :

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RECOMMENDED DECISION

BEFORE:

Irving Schiller, Hearing Examiner

APPEARANCES:

Irene Duffy and Warren E. Blair, Esqs.
of the New York Regional Office of the
Commission for the Division of
Trading and Exchanges

Howard Myles Schwinger, Esq.
for R. J. Hayes & Co., Inc.

These proceedings were instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the application for registration as a broker and dealer of R. J. Hayes & Co., Inc. ("applicant") should be denied or permitted to become effective and whether under Section 15A(b)(4) of that Act Ralph James Hayes ("Hayes") is a cause of any order of denial which may be entered.^{1/} By order of the Commission dated April 23, 1962 the effective date of registration has been postponed until final determination of the question of denial of registration.

The order for proceeding alleges that applicant and Hayes omitted to disclose material facts concerning Hayes' employment with broker-dealers during the past ten years in willful violation of Section 15(b) of the Exchange Act and Rule 17 CFR 240.15b-1 thereunder; that during November, 1960, Hayes offered, sold and delivered after sale, unregistered shares of the common stock of Ultra-Sonic Precision Co. Inc. ("Ultra-Sonic") in willful violation of Sections 5(a) and (c)

^{1/} Section 15(b) of the Exchange Act, as here pertinent, provides that the Commission may deny registration to a broker or dealer if it finds that such denial is in the public interest and that such broker or dealer or any officer, director or controlling person of such broker or dealer, whether prior or subsequent to becoming such, has willfully violated any provision of the Securities Act of 1933 or of the Exchange Act or of any rule thereunder or has willfully made or caused to be made a false or misleading statement in any application for registration or document supplemental thereto.

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 registered securities association if such broker or dealer or any partner, officer, director or controlling or controlled person of such broker or dealer was a cause of an order of denial of registration which is in effect.

of the Securities Act of 1933 ("Securities Act");^{2/} that, during the
aforesaid period of time, Hayes, while employed as a broker-dealer,
made untrue statements of material facts and engaged in transactions,
practices and a course of business which operated as a fraud and deceit
upon certain persons in willful violation of Section 17(a) of the
Securities Act and Section 10(b) of the Exchange Act and Rule
17 CFR 240.15b-5 thereunder^{3/} and, that in selling the shares of Ultra-
Sonic, Hayes failed to give offering circulars to the person to whom
the securities were sold in willful violation of Rule 256 adopted by
the Commission under Section 3(b) of the Securities Act.^{4/}

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- 2/ Sections 5(a) and 5(c) of the Securities Act in pertinent part make it unlawful to use the mails or facilities of interstate commerce to sell or deliver after sale any security unless a registration statement is in effect as to such security, or to offer to sell a security unless a registration statement has been filed as to such security.
- 3/ As applicable here, these Sections of the Acts and the Rule make it unlawful to use the mails or means of interstate commerce in connection with the purchase or sale of any security by the use of a device to defraud, an untrue or misleading statement of material fact, or any act, practice or course of business which operates or would have operated as a fraud or deceit on a customer or by any other means of manipulative, deceptive, or fraudulent device.
- 4/ Rule 256 as here pertinent, prohibits the sale of securities under the claimed exemption of Regulation A unless an offering circular is given to the persons to whom the securities were sold, or is sent to such person under such circumstances that it would normally be received by him, with or prior to any confirmation of the sale or prior to payment.

After appropriate notice, hearings were held before the undersigned Hearing Examiner. Proposed findings of fact and conclusions of law and a brief in support thereof were filed by the Division of Trading and Exchanges and a reply brief was filed by Hayes.

The following findings and conclusions are based upon the record, the documents and exhibits therein and the Hearing Examiner's observations of the various witnesses.

Failure to Disclose Prior Employment.

1. On February 16, 1962, applicant filed with this Commission an application for registration as a broker-dealer pursuant to Section 15(b) of the Exchange Act. An amendment thereto was filed on March 12, 1962. The application discloses that Hayes is President, Director and owner of 80% of applicant's stock as joint tenant with his wife who is also a Director and Secretary-Treasurer of applicant.

2. The record discloses that Hayes was employed as a cashier by Arden Perin & Co., Inc. ("Arden"), a registered broker-dealer firm, from July 7 to July 22, 1960 at a salary of \$150 a week and that he was employed by Omega Securities Corp. ("Omega"), another registered representative from November 29 to December 16, 1960. At the time of his employment by the latter firm Hayes signed an application for registration as a registered representative which was approved by the National Association of Securities Dealers, Inc., a national securities association registered under Section 15A of the Exchange Act. During his employment by Omega Hayes effected several transactions as a registered representative of the said firm.

3. Neither the application for registration nor the amendment reflects that Hayes was employed by Arden and Omega. The record shows that prior to the date the amendment was filed Hayes was informed by the staff of the New York Regional Office of the Commission that the broker-dealer registration application form requires that he disclose any and all connections with, or financial interest in any broker or dealer within the past ten years.

4. Hayes urges that his failure to disclose such information was inadvertent since he considered himself "a temporary fill-in employee" at the Arden firm and "did not consider himself to have accepted employment" with the Omega firm. The Hearing Examiner is of the opinion that the explanation is not substantiated by the record nor does it afford a sufficient basis for failure to comply with the requirements to disclose all prior connections with brokers or dealers called for by the broker-dealer application registration form.

5. The Hearing Examiner finds that applicant and Hayes willfully violated Section 15(b) of the Exchange Act and Rule CFR 240.15b-1 thereunder by willfully omitting to include the information relating to the employment of Hayes, by Omega and Arden. A finding of willfulness within the meaning of Section 15(b) of the Exchange Act does not require a finding of intention to violate the law; it is sufficient that it be shown that applicant knew what it was doing.^{5/} In light of the instructions given Hayes by the staff of the Commission concerning disclosure of all broker-dealer connections there is no doubt that Hayes

^{5/} Hughes v. S.E.C., F.2d 969, 977 (C.A.D.C.1949); The Whitehall Corporation, 38 S.E.C. 259, 270 (1958).

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was aware of what he was doing.

Violation of the Anti-Fraud Provisions

6. In November 1960, Hayes was employed by Merritt, Vickers Inc. ("Merritt") as a cashier and registered representative. On November 3, 1960 Merritt, as underwriter, commenced a public offering of the common stock of Ultra-Sonic pursuant to the exemption under Regulation A. About a week prior to the commencement of the offering Hayes requested Merritt for an allotment of the Ultra-Sonic stock stating he believed he could assist in the distribution and bring new accounts to the firm. Merritt's president testified that he instructed his employees, including Hayes, that they could not purchase any of the Ultra-Sonic securities for their own accounts and that it was the policy of the firm not to permit any of its employees to purchase for their own accounts any stock which was being publicly distributed by the firm as underwriter. Upon Hayes' representation that he had or could obtain customers for the Ultra-Sonic stock he was allotted 2,000 shares. The record reflects that Hayes sold 1,800 shares of the Ultra-Sonic stock to thirteen persons.^{7/} No question arises concerning the bona fides of the sales of 1,100 of such shares to six persons. With respect to the

6/ There is some evidence in the record that Omega terminated Hayes' employment because of continued absences and the failure of Hayes to make timely payment for some securities he purchased necessitating cancellation of the transaction by Omega. There is a strong indication that for these reasons Hayes may have wanted to withhold disclosing his association with Omega.

7/ The record shows that orders for the remaining 200 shares were cancelled by Merritt.

remaining 700 shares Hayes stipulated and the Hearing Examiner finds:

(a) On November 3, 1960, the date the public offering of the Ultra-Sonic stock commenced, Hayes opened fictitious accounts at Merritt in the names of seven persons representing to Merritt that such persons were the true purchasers of the 700 shares of Ultra-Sonic stock;

(b) None of the seven persons directly or indirectly authorized the opening of accounts or had knowledge of the accounts established in their names at Merritt. None of these persons ordered or purchased any of the Ultra-Sonic stock or had any beneficial interest therein;

(c) Hayes failed to disclose to Merritt that seven of the accounts he opened were his personal accounts, that he paid for the said 700 shares of stock and that he had sole beneficial interest therein;

(d) On November 4, 1960 Hayes, for the purpose of selling the 700 shares of Ultra-Sonic stock, opened fictitious accounts in the names of the same above-mentioned seven persons at S. Schramm Co., Inc. ("Schramm"), a registered broker-dealer firm, and represented to such firm that said persons were the true owners of the Ultra-Sonic stock. He failed to disclose to Schramm that he, Hayes, was the beneficial owner of the said stock;

(e) Hayes had no authorization from any of the seven persons to open accounts at Schramm or to sell any securities on their behalf;

(f) On November 4, 1960 Schramm, at Hayes' request, sold the 700 shares of Ultra-Sonic stock at \$3 per share. Checks in payment were issued in the names of the seven persons purportedly the sellers of the stock. Hayes obtained the checks, endorsed the names of the payees without their knowledge or authority and retained the proceeds of the sale;

(g) Between November 20, and November 29, 1960 letters of instruction were received by Merritt purportedly signed by the persons in whose names the fictitious accounts had been opened, directing the said firm to deliver the Ultra-Sonic stock to Schramm. Such letters were prepared and the signatures affixed by unidentified persons at the request of Hayes;

(h) Hayes was never authorized by the aforesaid persons to prepare the said letters of instruction nor to affix their signatures thereto.

7. Three of the seven persons in whose names Hayes opened the fictitious accounts at Merritt and Schramm^{8/} testified they never authorized Hayes to open an account at either firm, never authorized the purchase or sale of the Ultra-Sonic stock, never paid for the purchase of the said stock or received the proceeds of the sale of the said stock, never received confirmation of the purchase or sale of the said stock and never authorized Hayes to sign their names to the letter of instruction to Merritt or to endorse their names to the checks issued

^{8/} Two of said persons were husband and wife in whose name Hayes had opened a joint account at Merritt and Schramm.

in payment of the sale of the said stock. The record shows that the United States mails were used in connection with these purchases and sales.

8. The Hearing Examiner finds that Hayes, in carrying on the activities as set forth above, employed a device, scheme or artifice to defraud, made untrue statements of material fact and omitted to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made not misleading and engaged in a course of business which operated as a fraud and deceit in willful violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 17 CFR 240.10b-5 thereunder.

9. The Hearing Examiner further finds that Hayes' conduct was in willful violation of Section 3(b) of the Securities Act and Rule 256 thereunder. The public distribution of the Ultra-Sonic stock was made pursuant to a claimed exemption under Regulation A which, among other things, requires that an offering circular be furnished to purchasers concurrently with or prior to the offering.^{9/} When Hayes, who was engaged in and participating in the distribution, purchased the Ultra-Sonic stock with the obvious intention of resale, the distribution of said stock could not be said to have been completed. The Commission has held that a distribution of securities comprises the entire process by which in the course of a public offering the block of securities is

^{9/} Rule 256(a) promulgated under the Securities Act of 1933.

dispersed and ultimately comes to rest in the hands of the investing public.^{10/} Therefore, Hayes' resale of the Ultra-Sonic stock the day after he purchased it constituted a continuation of the public offering.^{11/} The Hearing Examiner finds that the failure to furnish an offering circular in connection with such resales was a willful violation of Section 3(b) and Rule 256 thereunder.

10. It is well settled that the exemption from registration provided by Regulation A is predicated on compliance with the terms and conditions of the Regulation.^{12/} Failure to deliver an offering circular in the circumstances noted above resulted in non-compliance with one of the terms and conditions essential to the availability of the exemption. Since the exemption afforded by Regulation A was unavailable and the record shows that no registration statement was filed or in effect as to the Ultra-Sonic stock the Hearing Examiner finds that the resales by Hayes described heretofore were in willful violation of Sections 5(a) and (c) of the Securities Act.

^{10/} Lewisohn Copper Corp., 38 S.E.C. 226, 234 (1958)

^{11/} In fact, the record discloses that the public offering was not completed until January 26, 1961.

^{12/} General Aeromation, Inc., Securities Exchange Act Release No. 4536 (September 1962).

Public Interest

11. In view of the above willful violations the remaining question is to determine whether it is in the public interest to deny registrant's application for registration as a broker and dealer. The Hearing Examiner has found that Hayes sold unregistered securities, failed to disclose prior employments in his application for registration as a broker-dealer and participated in fraudulent activities.

12. Hayes asserts that he commenced his employment in the securities field at the age of twenty years, has had no formal instruction or training in the field, received little during his brief period therein and that his training ground was the market place and his teachers were those who frequent the same. Hayes further urges that he now fully understands the responsibility that attaches to his work, the care and judgment that must be exercised and the ethical standards that must be adhered to. Finally, he asserts denial of the application would serve no purpose but to bar a young man who has learned his lesson the hard way and who would be a credit to the securities field after the benefit of this experience. The Hearing Examiner has given consideration to these factors but in his opinion they are not sufficient to overcome the serious nature and the extent of the violations mentioned above. There appears to be no excuse for Hayes' conduct in establishing fictitious accounts in two broker-dealer firms without disclosure to either firm of the nature of the accounts. Regardless of the use made of it, the maintenance of a fictitious account by a registered representative in and of itself is contrary to the "high

standards of commercial conduct and just and equitable principles of trade."^{13/} Moreover, the record indicates that at the time the public offering of the Ultra-Sonic stock commenced, Hayes was aware that there were "heavy indications of interest" in the issue and expected the market price of the stock to increase, at which time he hoped to dispose of his stock at a quick profit. The record discloses that Hayes accomplished what he set about to do, for within a 24-hour period he sold 700 shares at \$1 per share profit. Hayes' appropriation of a part of the distribution of the Ultra-Sonic stock and immediate resale above the public offering price was a violation of his obligation to make a bona fide public offering of the securities concerned.^{14/} The Commission has criticized activities in which a person participating in a distribution engages in "free riding" as conduct inconsistent with just and equitable principles of trade.^{15/}

13. Hayes' inexperience is no excuse for establishing fictitious accounts to mask his activities. Nor does Hayes' youth and inexperience afford a sufficient reason to overlook his conduct. In considering whether it is in the public interest to permit persons to engage in the securities business a determination should be made as to whether the

^{13/} Article III, Section 1, NASD Rules of Fair Practice.

^{14/} See Leonard H. Zigman, Securities Exchange Act Release No. 6701 (January 5, 1962).

^{15/} First California Co., Securities Exchange Act Release No. 6586 (July 6, 1961).

applicant possesses basic qualifications to engage in such business. Weighed in the light the Commission's basic objective of raising standards in the securities industry ^{16/} it is clear from the record that Hayes does not possess even minimum qualifications to engage in such business and, more important, has by his conduct demonstrated a complete lack of understanding of the high standards of fair dealing which should be maintained in the industry. In this connection, it should be noted that Hayes evidenced lack of candor concerning the fictitious accounts when first questioned about them by the Commission staff. Moreover, the record reflects that in November 1960 Hayes prepared and filed an application for registration as a broker-dealer to which was attached a financial statement listing Hayes' assets. Included was list of customers' names to which Hayes arbitrarily affixed the value of \$5,000 merely to make the financial statement "look nice." ^{17/} In light of the foregoing the Hearing Examiner is of the opinion and finds that it is in the public interest to deny applicant's application for registration as a broker-dealer. ^{18/}

^{16/} See N. Sims Organ & Co., Inc., Securities Exchange Act Release No. 6798 (May 4, 1962).


^{17/} The application was withdrawn prior to becoming effective.

^{18/} To the extent that the proposed findings and conclusions submitted by the Division of Trading and Exchanges and applicant and Hayes are in accord with the views set forth herein they are sustained and to the extent they are inconsistent therewith they are expressly overruled.

Recommendation

In view of the willful violations found and Hayes' past conduct it is respectfully recommended that the Commission enter an order pursuant to Section 15(b) of the Exchange Act finding that it is necessary and appropriate in the public interest to deny registration to applicant as a broker and dealer. It is further recommended that the Commission find that Hayes participated in or aided and abetted in applicant's willful violation of the designated provisions of the Securities Act and the Exchange Act and the Rules thereunder and that within the meaning of Section 14A(b)(4) of the Exchange Act Hayes is a cause of any order of denial which may be entered herein.

Respectfully submitted,


Irving Schiller
Hearing Examiner

Washington, D. C.
October 2, 1962