IN THE MATTER OF

M.V. GRAY INVESTMENTS, INC.

MAXEL V. GRAY

File No. 3-1811. Promulgated May 20, 1971

Securities Exchange Act of 1934—Sections 15(b) and 15A

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Sale and Delivery of Unregistered Securities

Misrepresentations in Sale of Securities

Failure to Comply with Record-Keeping Requirements

Failure to Comply with Net Capital Requirements

Improper Extension of Credit

Failure to Promptly Amend Application for Registration

Where person associated with registered broker-dealer firm sold and delivered unregistered securities and made misrepresentations in their sale, and firm, aided and abetted by such person, failed to comply with record-keeping and net capital requirements, improperly extended credit to customers, and failed promptly to amend application for registration, in willful violation of Securities Act of 1933 and Securities Exchange Act of 1934, *held*, in public interest to revoke broker-dealer's registration and expel it from membership in registered securities association and to bar associated person from association with any broker-dealer with provision for permitting supervised association after specified period upon appropriate showing.

APPEARANCES:

Allen Schwartz and *David D. Joswick*, of Miller, Canfield, Paddock and Stone; *Loren Gray*, of Gray and Thompson; and *Carl L. Shipley* and *Moreland G. Smith, Jr.*, of Shipley, Akerman, Pickett, Stein & Kaps, for M.V. Gray Investments, Inc. and Maxel V. Gray.

Mark A. Loush and *Hugh H. Makens*, for the Division of Trading and Markets of the Commission.

FINDINGS AND OPINION OF THE COMMISSION

Following hearings in these private proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934

("Exchange Act"), the hearing examiner issued an initial decision in which he concluded that the registration as a broker and dealer of M. V. Gray Investments, Inc. ("registrant") should be revoked, and that registrant should be expelled from membership in the National Association of Securities Dealers, Inc. He further concluded that Maxel V. Gray, who was president and principal stockholder of registrant, should be barred from association with any broker or dealer, with the proviso that after one year he may become so associated upon an appropriate showing that he will be adequately supervised. We granted petitions for review of the initial decision filed by respondents in which exception was taken to various findings and conclusions of the examiner, and by our Division of Trading and Markets ("Division") which excepted to a finding by the examiner that an allegation relating to failure of supervision was defective. Respondents and the Division filed briefs, and we heard oral argument. On the basis of an independent review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

Registrant became registered with us in 1964 and engaged in business in the State of Michigan primarily in the sale of mutual fund securities.

TRANSACTIONS IN UNREGISTERED SECURITIES

The record establishes that in October and December 1967, Gray willfully violated the registration provisions of Section 5(a) of the Securities Act of 1933 in the sale and delivery of Class B common stock of American Monitor Corporation ("Monitor"), an Indiana corporation, when no registration statement was in effect under that Act with respect to such securities.

Around August 1967 Gray agreed with three officers of Monitor, who owned 26,100 of its 30,000 authorized Class B shares,[1] to buy 400 of their shares at $100 a share and up to 1,600 more of such shares at the same price if the officers determined that it was necessary for them to supply additional capital to Monitor by purchasing more shares from it. It was understood that at least some of the additional shares to be disposed of by the officers would be sold to a number of Gray's customers. By early October Gray had purchased 200 shares and registrant 100, and, following notification of Monitor's

[1] The company also had 1,000 shares of Class A stock outstanding which were owned by the three officers and which contained restrictions on transferability but otherwise had the same rights as the Class B stock.

officers' desire to sell additional shares, in October Gray sold 405 shares to over 20 employees of registrant at $100 and 1,015 shares to over 45 other persons at $120 per share. As sales were effected the Monitor officers in turn purchased from Monitor an equivalent number of new shares at $100 per share. In December 1967 Gray sold, out of the 200 shares previously purchased by him, 91 shares to 14 persons at $175 per share.

Respondents assert that Gray did not commit any willful violation because he relied on the advice of counsel for Monitor, obtained at his request, which was that it was permissible for the Monitor officers to sell their personally-owned shares to him as an individual and for him to resell such shares, and that he purchased his 200 shares for investment and sold some of them only because he needed immediate cash for fertilizer for a crop he owned and was pressed by friends who wanted to purchase Monitor shares.

We find that Gray sold shares for an "issuer"[2] in connection with a distribution, or sold shares purchased from an issuer with a view to distribution; accordingly, he was an "underwriter" as defined in Section 2(11) of the Securities Act. A distribution of securities comprises "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public." [3] A willful violation is established since the record shows that Gray knew he was selling and delivering unregistered securities.[4] We note that, while Gray was told of the legal advice given the Monitor officers, he did not himself consult that or other counsel for advice although the facts known to him at the least called for further and more direct inquiry. Under the circumstances he was not entitled to rely on the self-serving statements of the Monitor officers and their recital of their counsel's opinion as to the legality of the transactions.[5] We also cannot accept Gray's assertion that he bought the 200 shares, which he acquired by early October, for investment rather than distribution. The resale of some of those shares a few months later at a profit of $75 per share is inconsistent with such assertion, and his stated reasons for the

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[2] Section 2(11) defines the term "issuer" to include in addition to an issuer, a person controlling the issuer.

[3] *Lewisohn Copper Corp.*, 38 S.E.C. 226, 234 (1958).

[4] It is well established that a finding of willfulness does not require an intent to violate the law; it is sufficient that the person charged with the duty intentionally commits the act which constitutes the violation. See *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965), and cases there cited.

[5] See *S.E.C.* v. *Culpepper*, 270 F.2d 241, 251 (C.A. 2, 1959); *A. G. Bellin Securities Corp.*, 39 S E.C. 178, 184 (1959).

resales are not sufficient under the circumstances to justify resale of "investment" stock.[6]

MISREPRESENTATIONS IN OFFER AND SALE OF SECURITIES

The record establishes that Gray willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder in connection with his sales of Monitor stock in October and December 1967.

Monitor was organized in June 1966 and is engaged in the business of developing and manufacturing diagnostic chemicals for hospital and laboratory use. In August 1967 it had five or six employees, including the three officers, was marketing only two products at least one of which was similar to one made by a number of competitors, and although several products were in development, it had no patents. Its financial reports reflected sales of $8,200 through December 1966 and $26,200 from January through April 1967, net sales of $57,241 and $27,190, respectively, for the fiscal year ending June 30, 1967 and for three months ending September 30, 1967 and net losses for those two respective periods of $10,278 and $19,722.[7]

Gray told customers that he thought the Monitor stock would be a good investment which would probably eventually make money for the customer, that Monitor was probably breaking even, and that he thought the company would "go places" and its stock would go up in price over a period of time and had good growth possibilities if kept from 3 to 5 years. Gray had no reasonable basis for his optimistic representations and predictions, and he knew in August 1967, but did not tell customers to whom he recommended the stock, that Monitor had been losing money. In addition, in the case of one customer with whom Gray had a relationship of trust and confidence, he realized profits which were not disclosed to her of $4,000 on the sale to her of 200 shares in a riskless transaction.[8]

[6] Respondents have also suggested that a private offering exemption provided by Section 4(2) of the Securities Act may have been available. However, apart from the fact that Section 4(2) by its terms exempts only "transactions by an issuer," the record does not show that the persons who purchased the Monitor stock had access to the kind of information which would be disclosed in a registration statement so as to meet the exemptive test enunciated by the United States Supreme Court. *S.E.C.* v. *Ralston Purina Co.*, 346 U.S. 119, 127 (1953).

[7] By April 1967 the Monitor officers had acquired 18,000 shares of Class B stock for $6,000 in cash, or about 33 cents per share, and an additional 8,100 shares of such stock in lieu of past due salaries. The book value was about 86 cents per share.

For the year ended June 30, 1968, Monitor had net sales of $231,045 and a net loss of $105,690.

[8] We note that, contrary to respondents' contention that a relationship of trust and confidence did not exist, the customer, a widow, testified that Gray was her "confidante" and lawyer, sold her cars and, with one exception, advised her in all her undertakings, and that she generally followed his investment recommendations and could not recall any specific instance of not doing so.

The making of predictions and representations, whether couched in terms of opinion or fact, which are without reasonable basis is violative of the antifraud provisions of the securities acts.[9] Gray is not aided by stressing that he told customers that an investment in Monitor stock was speculative; such statement did not constitute a sufficient disclosure of Monitor's adverse financial condition.

FAILURE TO COMPLY WITH RECORD-KEEPING REQUIREMENTS

The record supports the examiner's finding that registrant, willfully aided and abetted by Gray, willfully violated the record-keeping requirements of Section 17(a) of the Exchange Act and Rule 17a–3 thereunder in failing to accurately make and keep current certain required books and records.

An inspection of registrant's records by our staff between November 18 and 25, 1968 disclosed that the general ledger and the money balances in customers' ledger accounts had not been posted since August 31, 1968 and that receipts and deliveries of securities in the customers' ledger accounts had not been posted since December 1967, and that registrant did not maintain a record of collateral in connection with outstanding bank loans as of September 30, 1968, securities position records since February 1968, and securities-in-transfer records. In addition, registrant did not prepare monthly records of aggregate indebtedness and net capital from December 31, 1967 through December 31, 1968 and monthly trial balances for most of such period.[10]

Respondents assert that Jerry Vollmer, the employee who maintained registrant's records from December 1967 to December 1968, concealed the true status of the records and told Gray that necessary records were being maintained and were virtually current; that Gray, who had defective vision and knew no accounting, was limited in his ability to check on Vollmer; and that a record of pledged securities was maintained since registrant's auditors supplied such a list to our staff in November 1968. They also argue that the examiner's findings that Gray knew of record-keeping deficiencies must be set aside

[9] *Alexander Reid & Co., Inc.*, 41 S.E.C. 372, 375 (1963).

[10] The State of Michigan summarily suspended the registrations of registrant and Gray during the period from December 6, 1968 to January 30, 1969, because of charges which included alleged deficiencies of registrant's books and records and misleading statements in sales of unregistered Monitor shares. The condition of registrant's records was such that, even though registrant's business had been suspended during that period, an accountant and three other persons worked about 60 hours a week for about one month in an effort to rehabilitate them, with two other persons being engaged in such endeavor on various occasions.

because those findings were based on the testimony of Vollmer who they assert was a hostile witness and a "perjurer."

The record shows that Gray had been alerted to and was told about deficiencies in registrant's books and records. In connection with a previous inspection by our staff of registrant's books in December 1966, Gray received a letter indicating deficiencies in various records including the customer ledger accounts and the collateral and position records which we have found deficient in these proceedings, reciting the specific record-keeping provision covering each of those situations, and stressing the importance of compliance with our record-keeping requirements. About February 1968 he was informed by Vollmer that receipts and deliveries of securities were not being posted in customers' ledger accounts and that he did not have the time to post such records himself. An officer of registrant also told Gray that registrant did not prepare a monthly trial balance, and Gray knew it did not prepare computations of net capital. Gray thus had knowledge of the deficient status of certain of the records in question and must be held responsible for the violations that occurred. He cannot be exonerated because of his vision defect or a lack of a background in accounting, or by the fact that Vollmer incorrectly told him that registrant need no longer keep separate securities position cards because such data was contained in other records. Even if such data, or the data as to pledged securities, could be derived from other records, it would be no defense to the failure to maintain required records in the prescribed form.[11]

With respect to the testimony of Vollmer, the hearing examiner who observed the demeanor of all the witnesses, credited such testimony and rejected the testimony of Gray in certain respects, and we find no basis for disturbing his assessment. Respondents' assertion that Vollmer was a "perjurer" whose testimony must be disregarded is based not on his testimony in this proceeding, but on the fact that a balance sheet for registrant as of May 31, 1968, which Vollmer prepared pursuant to Gray's instructions and signed, although not under oath, and which was filed with the Michigan Securities Bureau, incorrectly showed cash in bank of $17,747 instead of an overdraft of $7,253.[12] Since Vollmer did not sign the financial

[11] *Cf. Associated Securities Corporation*, 40 S.E.C. 10, 18 (1960).

[12] Vollmer testified Gray told him to treat a loan by registrant to Gray of $25,000 which had not been repaid as an "in transit item" on the balance sheet, and Vollmer thereupon entered that amount under cash in bank.

statement under oath, it is not precise to characterize him as a "perjurer." In any case, it may be noted that even the testimony of a perjurer need not be disregarded, even where it is proved or conceded that part of the testimony itself is false, although the perjury and partial falsity are factors to be taken into account in assessing the weight to be given to his testimony.[13] In addition, while Vollmer might be viewed as hostile to respondents because he had been dissatisfied with his position at registrant and was discharged, we do not think that this or any other factors presented to us are sufficient to discredit him as a witness or render his testimony unacceptable.[14]

FAILURE TO COMPLY WITH NET-CAPITAL REQUIREMENTS

We find, as did the examiner, that registrant, willfully aided and abetted by Gray, willfully violated the net capital requirements of Section 15(c)(3) of the Exchange Act and Rule 15c3–1 thereunder. Registrant had net capital deficiencies, as computed under Rule 15c3–1, of $22,725, $43,692, $38,670, $102,655 and $9,469, respectively, on April 30, May 31, June 30, September 30 and October 31, 1968.

Respondents argue that investors were not subject to risk of loss because registrant remained liquid and could have met the net capital requirements by selling its securities had Gray known of the deficiencies. They also assert that the violations were caused by Vollmer's failure to keep applicable records and provide Gray with figures.

The net-capital Rule was designed to assure the financial responsibility of broker-dealers, and the exposure of customers to the risk posed by violations of the Rule is in itself the abuse at which the Rule is aimed.[15] By effecting transactions when its net capital position was not in compliance with our requirements, registrant willfully violated those requirements.[16] Moreover, Gray had received an earlier warning from our staff following its inspection in December 1966, referred to above, indicating that registrant had a net capital deficiency as of November 30, 1966, and emphasizing the continuing obligation

[13] *Cf. Shelton* v. *United States*, 169 F.2d 665 (C.A.D.C., 1948), *cert. denied* 335 U.S. 834. See 3 Wigmore, *Evidence*, p. 674 *et seq.* (3rd ed. 1940). This view would apply *a fortiori* in administrative proceedings, where rules of evidence are more liberal. See 2 Davis, *Administrative Law Treatise*, pp. 276, 303–4 (1958). *Cf. Charles P. Lawrence*, 43 S.E.C. 607 (1967).

[14] The record does not support respondents' claim that Vollmer deliberately and secretly maintained registrant's records improperly.

[15] See *Blaise D'Antoni & Associates, Inc.*, v. *S.E.C.*, 289 F.2d 276, 277 (C.A. 5, 1961); *Metropolitan Securities, Inc.*, 41 S.E.C. 365, 368 (1963); *Bennett-Manning Company*, 40 S.E.C. 879, 882 (1961).

[16] *Churchill Securities Corp.*, 38 S.E.C. 856, 859 (1959).

of compliance with our net-capital Rule. In addition, he was informed by Vollmer a number of times that registrant did not have adequate net capital or had a net capital problem, and in July 1968 the Michigan Securities Bureau advised him that registrant was not in compliance with Michigan's net capital requirements as of May 31, 1968. Under the circumstances Gray should have been particularly sensitive to the need for achieving compliance with our net capital Rule. However, he did not even inquire whether Vollmer was making net capital computations and, indeed, knew that such computations were not being made during 1968, although he had advised our staff in February 1967 that net capital was computed at regular intervals according to instructions given by our inspector.

IMPROPER EXTENSION OF CREDIT

We also find that registrant, willfully aided and abetted by Gray, willfully violated the credit-extension provisions of Section 7(c) of the Exchange Act and Regulation T promulgated by the Board of Governors of the Federal Reserve System. Registrant in 184 instances in 1968 failed promptly to cancel or liquidate purchases effected in cash accounts of customers who did not make full payment within seven business days, with payment in 155 instances ranging up to 29 days late, in 21 instances from 30 to 59 days late, and in 8 cases 60 or more days late.

FAILURE TO AMEND APPLICATION

Registrant, willfully aided and abetted by Gray, willfully violated Section 15(b) of the Exchange Act and Rule 15b3–1 thereunder, in that it failed promptly to amend its application for registration as a broker-dealer to reflect changes in its officers. Such changes, including the designation of Vollmer as treasurer, were made in February 1968 but were not reported in any amendment filed with us until January 1969.

FAILURE TO SUPERVISE

The order for proceedings charged that respondents failed to supervise the persons under their supervision with a view to preventing the violations by registrant aided and abetted by Gray that were specified in such order. The hearing examiner, while noting that the record established a failure of supervision with a view to preventing those violations, held that the charge in the order for proceedings was defective because of the failure to allege any violation by the personnel subject to respondents' supervision.

Under Section 15(b)(5)(E) of the Exchange Act, a remedial sanction may be imposed if a broker-dealer or associated person "has failed reasonably to supervise, with a view to preventing violations . . ., another person who commits such a violation, if such other person is subject to his supervision." We do not construe that provision to require that a violation by another person subject to supervision be specifically alleged in order to reach the responsible supervisor. We are of the opinion that the charge respecting failure of supervision was not defective and fully apprised respondents of the issues raised, and that the record supports the charge. In view, however, of the findings we have made that registrant willfully aided and abetted by Gray willfully violated the underlying provisions in question, we do not base any conclusions as to the appropriate sanctions upon a finding of failure of supervision to prevent such violations.

OTHER MATTER–

We find no merit in various additional contentions advanced by respondents.

Respondents are not aided by pointing to Section 9(b) of the Administrative Procedure Act, 5 U.S.C. 558(c), under which a registration may not be suspended or revoked unless an opportunity to achieve compliance with lawful requirements is afforded before the institution of proceedings. These proceedings clearly fall within the Section's express exception with respect to cases of willfulness or those in which the public interest requires that opportunity for compliance not be given. Nor can we agree with respondents' argument that in view of the sanctions that may be imposed these proceedings are in the nature of a criminal proceeding and require the imposition of stricter evidentiary standards than ordinary remedial proceedings. In proceedings under the Exchange Act such as these, which are remedial in nature, allegations of willful violations of the securities acts need be proven only by a preponderance of the evidence.[17] This has been the standard of proof consistently used in broker-dealer administrative proceedings, and it satisfies the requirements of Section 7(c) of the Administrative Procedure Act, 5 U.S.C. 556(d), that administrative agency action be supported by "the reliable, probative, and substantial evidence."[18]

[17] *Norman Pollisky*, 43 S.E.C. 852, 861 (1968); *Underhill Securities Corporation*, 42 S.E.C. 689, 695 (1965).
[18] *Norman Pollisky*, *supra*.

Finally, we reject the contention that the examiner's finding that Gray predicted that the investor would eventually make money on the Monitor stock was based on new charges raised in the Division's proposed findings filed after the hearings and were therefore improper. In our opinion that finding was properly based on the allegations in the order for proceedings, as amended, that Gray willfully violated designated antifraud provisions of the securities acts in that, among other things, he sold the Monitor stock, which was speculative, in disregard of certain important information relating to the issuer and made false and misleading statements concerning its financial condition and operating losses. We think it clear that such allegations were sufficient to apprise respondents of the nature of the misconduct charged.

PUBLIC INTEREST

Respondents urge that the sanctions imposed by the examiner are too harsh. They stress, among other things, Gray's visual handicap, that registrant's books and records were brought up to date, and that registrant has retained a prominent certified public accounting firm and adopted procedures designed to prevent future deficiencies. They also assert that Gray was inexperienced in public distributions and relied upon the advice of counsel, and that after new counsel for Monitor advised him that his Monitor sales might have been improper he and Monitor took the matter to the Michigan Securities Bureau and he offered to guarantee rescission of all the sales that had been made.[19]

The assessment of what sanctions are appropriately imposed upon those who have been found to have violated the securities acts entails an examination and balancing of various considerations. Those acts embody a comprehensive regulatory scheme designed to protect the public interest in maintaining the integrity of the securities markets. As an integral part of such scheme, Section 15 of the Exchange Act authorizes the exclusion from the securities business or restriction of the securities activities of broker-dealers and associated persons

[19] In January 1969 Gray submitted an undertaking to the Michigan Securities Bureau to rescind the transactions he effected in Monitor stock upon request of the purchasers, and notices were sent out by the Bureau advising purchasers that violations appear to have been committed in connection with their transactions and of their rights of rescission under Michigan law if such violations were established.

who have acted contrary to the statutory standards and requirements if we find such sanction is in the public interest. It reflects Congress' recognition that such sanctions may be necessary for the effective maintenance of those standards and requirements. They serve to restrain the particular respondents as well as others in the securities industry from committing future violations, and thereby fulfill the remedial objective of our administrative proceedings. Where upon consideration of the nature and extent of the violations and the surrounding circumstances a limited exclusion or restriction of a respondent is deemed sufficient, its duration and scope are properly fixed with a view to adequately impressing upon him through its impact the necessity of avoiding a repetition of his specific misconduct and the need for scrupulous propriety in all aspects of his securities activities in the future. We have attempted to exercise the discretionary power reposed in us to select in each case the measure of sanction that will accord investors protection, through not only the restraint imposed on the particular respondent but also the example set for others, without visiting upon the wrongdoer adverse consequences not required in achieving that protection.

We have appraised respondents' misconduct in this case together with the mitigative factors asserted by them in light of the requirements of the public interest and the interest of investors. The serious and pervasive violations disclosed by the record demonstrated an inability or unwillingness on the part of registrant and Gray, who was its president and controlling stockholder, to operate a securities business in conformance with applicable requirements. Among other things, we note that registrant's new office procedures were adopted only after the institution of these proceedings. Gray's visual impairment cannot mitigate the violations we have found of our record-keeping and net capital requirements in view of his knowledge of problems in those areas and the prior warning given him by our staff concerning such requirements, and he himself made misrepresentations in his sales of the unregistered Monitor securities. We conclude that it is in the public interest to revoke registrant's registration as a broker and dealer and expel it from membership in the National Association of Securities Dealers, Inc.

With respect to Gray, we consider that it is appropriate, as did the examiner, to bar him from association with any broker or dealer, but under all the circumstances we are of the opinion that it would be consistent with the public interest to

provide that he may become employed in a supervised capacity after six months, upon a showing of adequate supervision.[20]

An appropriate order will issue.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG; Chairman CASEY not participating).

[20] In a submission filed on May 5, 1971, while these Findings and Opinion were in the process of being issued, respondents recited, among other things, that registrant is now operated by Gray's son and others who were not employed by it at the time of the activities in question and that Gray himself would not engage in the securities business except with our approval, and urged that only a sanction of censure should be imposed on registrant. We reject this belated suggestion. We do not consider that the facts asserted are sufficient to warrant any change in the conclusions with respect to the appropriate sanctions that we have reached on the basis of our review of the record and for the reasons set forth above. We also note that the fact, to which respondents also call attention, that Vollmer died after the close of the record is clearly irrelevant.

The exceptions to the initial decision of the hearing examiner are overruled to the extent that they are inconsistent with our decision and sustained to the extent that they are in accord.