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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
ALLSTATE SECURITIES, INC.
80 Wall Street
New York 5, New York
File No. 8-6044

FILED

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SECURITIES & EXCHANGE COMMISSION

RECOMMENDED DECISION

Washington, D. C.
February 17, 1961

Irving Schiller
Hearing Examiner

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RECOMMENDED DECISION

BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: Donald J. Bezahler and Leon C. Friedland
of the New York Regional Office of the Commission
for the Division of Trading and Exchanges
Edward S. Friedland for Allstate Securities, Inc.
and Vincent J. Sbarbati

The issue before the Hearing Examiner in these proceedings under Section 15(b) of the Exchange Act is whether it is necessary or appropriate in the public interest or for the protection of investors to suspend the registrant's registration as a broker-dealer pending final determination of whether such registration should be revoked.^{1/}

These proceedings were instituted to determine whether to revoke or, pending final determination, to suspend the registration of Allstate Securities, Inc. ("registrant"); whether, pursuant to Section 14A(1)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), registrant should be suspended or expelled from membership in the National Association of Securities Dealers, Inc., a registered securities association; and whether, under Section 15A(b)(4) of the Exchange Act Vincent J. Sbarbati ("Sbarbati"), President, Director and beneficial owner of 10% or more of the common stock of registrant is a cause of any order of revocation, or of suspension or expulsion from such Association, which may be entered against the registrant.

^{1/} Section 15(b) of the Exchange Act provides with respect to suspension of registration as a broker or dealer:

"Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors."

With respect to revocation, Section 15(b), as applicable to this case, provides that we shall revoke the registration of any broker or dealer if we find that it is in the public interest and such broker or dealer or a controlling or controlled person of such broker or dealer has willfully violated any provision of the Securities Act of 1933 or the Exchange Act or any rule thereunder.

The order for proceedings alleges, among other things, that between July 1959 and July 1960 registrant and Sbarbati willfully violated the anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act in the offer and sale of the common capital stock of Dwain Records, Inc. ("Dwain").^{2/}

Insofar as pertinent to a consideration of the suspension of registrant, the Commission's order alleges generally that registrant and Sbarbati solicited and induced certain persons to purchase and offered and sold to such persons the common stock of Dwain and in connection therewith registrant and Sbarbati made false and misleading statements of material facts and omitted to state material facts with respect to the stock of Dwain.

After appropriate notice, hearings were held before the undersigned Hearing Examiner on January 25, 26, 27 and 31, 1961. Proposed findings of fact and conclusions of law and a memorandum in support thereof were submitted by counsel for the Division of Trading and Exchanges and proposed findings and conclusions of law and memorandum in support thereof was submitted by counsel for the registrant.

^{2/} The anti-fraud provisions alleged to have been willfully violated 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(a) and (b) (17 CFR 240.10b-5 and 15c1-2(a) and (b)) thereunder. The composite effect of these provisions as applicable to this case is to make unlawful the use of the mails or facilities of interstate commerce in connection with the purchase or sale of any security by means of a scheme 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, deceptive or fraudulent device.

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 New York corporation, has been registered with this Commission as a broker-dealer since August of 1957. Sbarbati has been, and is, President, Director and beneficial owner of 95% of the common stock of registrant. The record shows that Dwain was incorporated in July 1959, that Sbarbati was instrumental in the formation of Dwain, and served as one of its five directors since inception. Registrant acted as underwriter in connection with a public offering by Dwain of 30,000 shares of its common stock at \$2.00 per share. The offering was completed by September 1959.^{3/}

^{3/} It appears from the record that registrant presumably relied on the exemption afforded by Section 3(a)(11) of the Securities Act with respect to the said public offering. Of the \$60,000 raised by the said offering registrant received a fee of \$15,000 and purchase warrants at 1¢ per warrant entitling it to purchase 20,000 shares of Dwain stock at the price of \$1.60 a share.

In addition to the 30,000 shares issued to the public the record reflects that another 30,000 shares was issued to the promoters, of which Sbarbati and a firm in which he had an interest, Spar Productions, received 6,000 shares.

2. The evidence adduced at the hearing shows that registrant, in the offer and sale of Dwain stock between July 1959 and July 1960, made false and misleading statements of material fact. According to five investor witnesses who testified concerning their purchases at prices ranging from \$2 to \$6-1/4 per share the representations made by registrant's salesmen and Sbarbati^{5/} included statements that the price of Dwain stock could go to \$15 or \$20, the stock was sure going to hit \$15, the stock would "make a phenominal gain in a short time," that the stock would increase at least two or three times, "that the rise would be meteorical," that Dwain was all set to sign a contract with a distribution company that has new stands all over the country, that the contract might be signed the next day, and that when word of this got out "this stock is going to take a jump," that the customer would make a mistake not to sell other securities to purchase Dwain since the salesman could practically guarantee that the customer would make money if he changed to Dwain, that several famous singers had already contracted with Dwain Records, that Dwain "was making money," that Dwain "would pay dividends on its anticipated huge earnings," and that registrant "had promoted Decca records" and there was "reason to believe that Dwain Records would also be a big success."

5/ Two investor witnesses testified that representations were made to them by a Joe Vincent. Though Sbarbati stated he was also known as Vincent Spar he denied using the name Joe Vincent, admittedly his first two names but conceded he might have used the name Vincent Joseph and that he sold Dwain stock to one of such investor witnesses.

3. According to the evidence adduced at the hearing all of these representations were false and misleading. Dwain's former president testified that from approximately October 1959 through June 1960 Dwain never made any money, that in fact it sustained continual losses, that he was in constant communication with Sbarbati concerning the company's operations^{6/} that Sbarbati received notices and attended several meetings of Dwain's board of directors at which the company's operations were discussed and that in February or March 1960 he informed Sbarbati that the company needed money and asked him if he could raise additional capital.^{7/} Dwain's former accountant testified that from the period of August 1959 through April 30, 1960 the company had no record of any net profits and sustained net losses throughout the entire period. He further testified that for the said period Dwain's total sales amounted to \$14,358.03, that its only other source of income was from royalties which, for the period, amounted to \$950 and that its expenses and purchases for the same period totalled \$60,478. He further testified that Dwain, as at April 30, 1960, would have needed an inventory of \$45,000 to break even and that in his opinion Dwain's inventory could not conceivably have been that high. The record further indicates that the accountant informed Dwain's officers on two or three occasions in March and April of 1960 of the company's precarious financial condition.

6/ The record reflects that from July to December Sbarbati's secretary countersigned Dwain's checks and thereafter until March 1960 Sbarbati countersigned such checks. Dwain's corporate minutes reflect that in March a resolution was adopted permitting either Sbarbati or one Jack Leventhal, the company's secretary to countersign checks. Moreover, the president also testified that frequently deposits were sent to registrant's office prior to their transmittal to the bank.

7/ Dwain's corporate minutes reflect that Sbarbati was present at a special meeting of directors held March 2, 1960, at which the impending need for additional finances was discussed.

4. It is evident from the record that Sbarbati conducted some negotiations on behalf of Dwain with Union News Company looking toward the possible distribution of its records on news stands operated by the latter company. Such negotiations were preliminary in nature and terminated in January 1960 without any understanding ever being reached concerning distribution of Dwain records. It is further evident from the record that Dwain never produced any hit record nor were there any stars under contract.

5. It is clear from the record that the optimistic representations as to the rise in the price of the stock, as well as the other representations, were unwarranted. As pointed out above, Sbarbati was familiar with Dwain's operations and certainly by March of 1960 was aware of the company's precarious financial condition. The Hearing Examiner finds that registrant's failure to disclose information concerning Dwain's mounting losses constituted an omission to state a material fact and rendered the predictions as to the rise of the stock materially misleading. The Commission has held that a prediction by a securities salesman or dealer to an investor that a stock is likely to go up implies that there is an adequate foundation for such prediction and that there

are no known facts which would make such a prediction dangerous and unreliable.^{8/} Not only was there no adequate foundation for predicting the stock would rise but the record reflects that Sbarbati knew that Dwain's operations had been steadily unprofitable and such fact would make a prediction of an increase in the price of Dwain stock dangerous and unreliable.

6. Registrant contends that there was no prima facie proof of the illegal activities charged in the Commission's order, that fraud must be proven, not presumed and that "suspicion, conjecture and surmise" as a basis for fraud is intolerable. In support of such contention registrant urges that two of the investor witnesses admitted that they were not told that the price of Dwain records would rise in the future but rather that the price of the stock might or could rise if the company was lucky or successful in future affairs and that the stock was represented and sold as a speculation.

7. The Hearing Examiner gives credence to the testimony of the investor witnesses that representations were made regarding the likelihood of substantial increases in the price of Dwain stock. The literature used by registrant which states that the prospects for capital gains are tremendous and that the stock "will, with a little work, be selling at many times its present price within a comparatively short time," tends to fortify this conclusion. Registrant's argument that where investors are told that a stock might rise if the company is lucky and

8/ Leonard Burton Co., Securities Exchange Act Release No. 5978 (June 4, 1959). See also A. G. Bellin Securities Corporation, Securities Exchange Act Release No. 5966 (May 18, 1959).

that the stock is a speculation is insufficient to establish fraud, is without merit particularly where as in the instant case a prediction that Dwain's stock might or could rise was no more warranted than a representation that the stock would rise.

8. The Hearing Examiner's findings of fraud in the offer and sale of Dwain's stock by registrant are not based upon presumption, suspicion, conjecture or surmise but premised upon credible evidence furnished by testimony of investor witnesses that registrant made representations which are found to be false and misleading statements of material fact and the conclusion that registrant omitted to state material facts concerning Dwain's operations.^{9/}

9. Registrant also contends that the proceedings were irregular and in violation of its constitutional rights because it was not granted reasonable opportunity to obtain counsel, that when counsel was obtained he was not given a reasonable opportunity to prepare for the instant hearing and that representatives of this Commission suppressed vital material evidence in its hands. The record shows that registrant was duly served with the Commission's order for proceedings approximately a week prior to the date fixed for the commencement of these proceedings. Two days prior thereto registrant requested the Commission to adjourn the hearings to permit "proper preparation and to obtain counsel," which request was denied by the Commission. At the opening of the hearing registrant and its counsel, who stated he had been retained the previous day

^{9/} The Hearing Examiner notes in this connection that, other than recalling two investor witnesses who stated they were told the stock might rise registrant failed to produce any affirmative evidence to contradict the representations which the investor witnesses testified were made to them.

requested an adjournment of the proceedings. In light of the Commission's action and in view of the fact that a number of witnesses were present in response to subpoenas, some of whom came from distant places, the Hearing Examiner offered to postpone the proceedings to the following day and when that was not acceptable to respondent suggested that the testimony of the subpoenaed witnesses be taken after which the Hearing Examiner would entertain an application for a further postponement to permit the registrant to prepare and present its defense. This suggestion was also rejected by counsel. Registrant and counsel thereupon withdrew and the Hearing Examiner proceeded with the hearing. The following day registrant's president, Sbarbati, appeared and again requested an adjournment and registrant's counsel, by telegram, made a similar request. Both requests were denied by the Hearing Examiner. The hearing continued and registrant's president remained in attendance for two days, participated in the proceedings and cross-examined the witnesses. At the conclusion of the Division's case registrant requested the Hearing Examiner to adjourn the proceedings to permit preparation and presentation of a defense and for such purposes requested the Hearing Examiner to issue eight subpoenas. Both requests were granted and on the adjourned date both counsel and registrant appeared and participated in the proceedings.

10. The Hearing Examiner is of the opinion, and so finds, that the statutory requirements of notice and opportunity for hearing has been met and the proceedings were not irregular nor in violation of registrant's constitutional rights. Registrant was afforded ample notice of these proceedings and had reasonable opportunity to secure ^{10/} counsel. Registrant's president appeared at three of the four hearing

10/ The record reflects that approximately two weeks before the hearings commenced registrant was advised by the staff of the Commission to obtain counsel.

days which these proceedings consumed and participated therein. In light of the foregoing and the fact that, at registrant's request, the proceedings were adjourned to afford registrant an opportunity to prepare its defense which it presented through its counsel, it is the opinion of the Hearing Examiner that registrant's contention that these proceedings were in violation of its constitutional rights is not supportable by the record and must be rejected.

11. In support of its argument that the staff of the Commission suppressed vital material evidence registrant urges that the Staff withheld the fact that the witnesses produced represented less than one-half of one percent of Dwain's issued and outstanding capital stock and that, although practically every stockholder has been solicited for information and evidence in support of the alleged illegal activities and violation by registrant, the great plurality of such stockholders have negated and denied the alleged illegal activities. This contention has no validity whatsoever and is rejected. The record contains no evidence of the number of stockholders solicited by the staff of the Commission nor is such information deemed relevant. Moreover, the record contains not one iota of evidence that any stockholders negated or denied the activities complained of in these proceedings.^{11/}

12. The contention that since only five investor witnesses were produced by the staff, representing an infinitesimal portion of Dwain stockholders, the conclusion should be drawn that all other stock-

^{11/} In that connection the Hearing Examiner notes that the record discloses that registrant, who acted as underwriter for Dwain's stock, maintained in its possession a list of stockholders of Dwain and had ample opportunity to produce such witnesses if they exist.

holders denied any wrongdoing on the part of registrant is completely unjustified. The evidence furnished by the investor witnesses who testified concerning representations made to them by registrant and its salesmen, which representations the Hearing Examiner has found to be false and misleading provides a sufficient basis under Section 15(b) of the Exchange Act to warrant the imposition of an order of suspension of such activities. In light of the violations found it is immaterial whether or not a plurality of ~~Dain~~ stockholders denied the alleged illegal ^{12/} activities.

13. Registrant finally contends that the Examiner did not have the power or authority to direct that a hearing be held in the revocation proceeding on February 20, 1961 in advance of the Commission taking the matter of suspension under advisement and issuing its finding and opinion and that the incorporation of the record of the instant hearing in the revocation proceeding prior to the issuance by the Commission of its findings and opinion on the question of suspension is patently erroneous. These contentions are not pertinent to a consideration of the issues in the suspension proceeding and are premature. Suffice it to say that the Hearing Examiner's authority to conduct the revocation proceedings following the suspension case is clearly set forth in the Commission's order of January 18, 1961, which order also directs that the record made in the suspension hearing shall be incorporated and made part of the record in the revocation hearing.

12/ See Hughes v. Securities & Exchange Commission 174 F2d969 (C.A.D.C.1949) where the Court found that a broker violated the fraud provisions of the Exchange Act and upheld a revocation order of the Commission even though 120 of the broker-dealer's 175 customers filed a brief, as amici curiae, saying they were well pleased with the broker's services.

Public Interest

Under Section 15(b) of the Exchange Act it is clearly contemplated that a suspension order should be issued where a preliminary showing is made that a registered broker or dealer has engaged in serious misconduct of a nature that would warrant revocation. The Hearing Examiner finds that the record contains a sufficient showing of misconduct to make it necessary and appropriate in the public interest and for the protection of investors to suspend registrant's registration pending final determination of the revocation issued. In addition to the findings made above, that registrant made false and misleading statements of material fact and failed to disclose material facts to investors, the Hearing Examiner finds that registrant's method of engaging in the securities business shows a lack of awareness and understanding of the responsible relationship between a securities dealer and customer. It is evident from the testimony of the investor witnesses that solicitations were made by telephone in some instances to distant customers unknown to registrant, where no effort was made to ascertain the customer's particular financial situation and investment objectives and where such customers were requested to decide hastily to buy securities of a speculative nature on the basis of oral representations promising quick profits by salesmen apparently adept in high-pressure selling techniques.

13/ The record discloses that three of the five investor witnesses who testified were sold Dwain stock by registrant on more than one occasion and one of such three was sold in four separate transactions in the months of October 1959, January, July and December of 1960 at prices ranging from 4-1/8 to 6-1/4.

The Commission has held that such treatment of customers is ^{14/} "neither fair nor in accordance with the standards of the profession."

Under the circumstances herein the Hearing Examiner concludes that public investors would be jeopardized by registrant's continued dealings with them and that registrant's privilege of continuing in the securities business should be withdrawn pending final determination of the revocation issue.

Conclusion

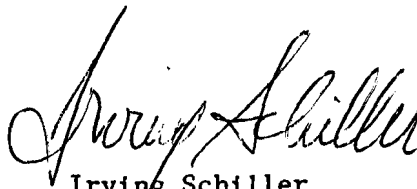
In view of the foregoing the Hearing Examiner recommends that the Commission issue an order forthwith under Section 15(b) of the Exchange Act finding it is necessary or appropriate in the public interest and for the protection of investors to suspend the registration as a broker and dealer of the registrant pending final determination of whether such registration shall be revoked.^{15/}

^{14/} Barnett & Co., Inc., Securities Exchange Act Release No. 6466 (February 8, 1961); Best Securities, Inc., Securities Exchange Act Release No. 6282, p.3 (June 3, 1960); Charles Hughes & Co., Inc. 13 SEC 676 (1943), aff'd 139 F. 2d434 (C.A. 2, 1943) cert. denied 321 US 786 (1944).

^{15/} To the extent that the proposed findings and conclusions submitted by the Division of Trading and Exchanges and registrant are in accord with the views set forth herein they are sustained and to the extent they are inconsistent therewith they are expressly overruled.

This recommendation is not to be construed as a determination of the issues other than that of whether registration should be suspended at this time; those issues which are the subject of further proceedings have not been considered herein and are not now before the Hearing Examiner.

Respectfully submitted,


Irving Schiller
HEARING EXAMINER

Washington, D. C.
February 27, 1961