IN THE MATTER OF

RICHARD N. CEA ET AL.*

File No. 3-785. Promulgated August 6, 1969

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

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Fraud in Offer and Sale of Securities

Excessive Trading

Where salesmen of registered broker-dealer, in offer and sale of security, made false and misleading representations and predictions concerning, among other things, financial condition and prospects of issuer and prospective rise in market price of its stock, and certain of such salesmen fraudulently represented that highly speculative securities they recommended to customers met investment objectives disclosed by such customers, or induced excessive trading in customers' accounts, *held*, willful violations of anti-fraud provisions of securities acts, and in public interest to bar salesmen from association with broker-dealer, and to revoke registration of broker-dealer controlling and controlled by certain of the salesmen and expel it from membership in registered securities association.

*James C. Conklin; Kenneth E. Fisher; Robert E. Kness; Frank P. Wayhart; C. A. Benson & Co., Inc., and Keystone State Investment Securities, Inc.

APPEARANCES:

Alexander J. Brown, Jr., Paul F. Leonard, Herbert E. Milstein, and *Burton H. Finkelstein,* of the Washington Regional Office of the Commission, for the Division of Trading and Markets.

Floyd L. Arbogast, Jr., for Richard N. Cea, James C. Conklin, Kenneth E. Fisher, and Keystone State Investment Securities, Inc.

Norman H. Rea, of Reding, Blackstone, Rea & Sell, for Robert E. Kness and Frank P. Wayhart.

FINDINGS AND OPINION OF THE COMMISSION

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

("Exchange Act"), the hearing examiner filed an initial decision in which he concluded that Kenneth E. Fisher, who was sales manager, and Richard N. Cea, James C. Conklin, Robert E. Kness and Frank P. Wayhart, who were salesmen for C. A. Benson & Co., Inc. ("registrant"), then a registered broker-dealer,[1] should be barred from association with any broker or dealer. The examiner further concluded that the broker-dealer registration of Keystone State Investment Securities, Inc. ("Keystone"), which is controlled by Fisher and Conklin and employs Cea,[2] should be revoked, and that Keystone should be expelled from membership in the National Association of Securities Dealers, Inc. ("NASD"). We granted petitions for review filed by respondents, they and our Division of Trading and Markets ("Division") filed briefs, and we heard oral argument. Our findings are based upon an independent review of the record.

FRAUD IN OFFER AND SALE OF SECURITIES

Between January 1963 and October 1964, the individual respondents, while in registrant's employ, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder in the offer and sale of certain securities.

Substantial amounts of the stock of Home Makers Savings Corporation ("HMS") were sold by each of the individual respondents to public investors during the period in question and false and misleading representations and predictions were made by them with respect to the company and its stock.

HMS, a Pennsylvania corporation, had been organized in February 1961 to sell household appliances. Shortly thereafter it marketed vitamin products, but by January 1963 it was solely engaged in marketing an antacid tablet called "Mr. Enzyme," which was manufactured for it by another company. HMS supplied the tablets in packaged form to The Norwich Pharmacal Company ("Norwich"), which by agreement with HMS in December 1962 became the exclusive distributor of Mr. Enzyme in the United States.

On May 29, 1963, the State of Pennsylvania imposed an embargo upon HMS's entire inventory of Mr. Enzyme for

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[1] Registrant's broker-dealer registration was revoked and it was expelled from membership in the National Association of Securities Dealers, Inc. *C. A. Benson & Co., Inc.*, 42 S.E.C. 952 (1966) and Securities and Exchange Act Release No. 7857 (April 8, 1966).

[2] Keystone's broker-dealer registration became effective in January 1965. Fisher owns 65 percent of its stock and is president and treasurer, and Conklin owns the remaining 35 percent of the stock except for one share owned by Fisher's wife, and is vice-president and secretary.

alleged misbranding in violation of state law. A few days later, on June 3, the State lifted its embargo and the United States immediately seized the inventory. The United States had alleged in a condemnation proceeding instituted on May 28, 1963 that the name of the product and the company's advertising material were false and misleading and violated the Federal Food, Drug and Cosmetic Act.[3] At about the same time, the manufacturer of Mr. Enzyme notified HMS that it had ceased production, and on June 17, 1963, Norwich informed HMS that it was discontinuing its distribution of Mr. Enzyme. Following the seizure, no new products were handled by HMS. It could no longer pay all of its bills and it dismissed most of its employees. A bank which had previously extended credit to the corporation refused to make any further loans. In May 1964, HMS vacated its offices owing back rent which it never paid.

HMS never operated at a profit. Its brief history was marked by continual losses and increasing deficits. It sustained net losses of $17,240 in 1961, and $100,060 in 1962. The company had a net operating loss in every single month of 1963. By March 1963, its current liabilities exceeded current assets, and by April 1963, its accumulated operating deficit was approaching $200,000 and it had a net worth deficit of $27,000. Thereafter both deficits steadily increased. HMS's net loss for 1963 was $110,231, and its net loss for 1964 was $18,732, with an accumulated operating deficit at the end of that year of $246,264.

Registrant received copies of all HMS financial statements for the years 1961–1963 shortly after the periods covered. It was also supplied with copies of statements prepared by HMS's accountants for each month of 1963. All HMS financial statements received by registrant were made available or distributed to registrant's salesmen. Moreover, the financial reports were discussed with the salesmen who were specifically told that HMS was unable to pay its bills and had a net worth deficit, and that the situation was deteriorating to the point where HMS faced possible bankruptcy. In addition, the salesmen were kept informed concerning the federal seizure of Mr. Enzyme, and they were told that the manufacturer would no longer ship and Norwich would no longer distribute the product, and that, as a result of the seizure, HMS sales had suffered a sharp drop. In the latter part of 1963, the salesmen

[3] Civil Action No. 63-427 (D.C.W.D. Pa.). In December 1965, a jury sustained the seizure.

were informed that efforts to reach a settlement with the United States had been unsuccessful up to that time.

Registrant was the principal market-maker in HMS stock and entered bid and ask, or ask, quotations for the stock in the daily sheets published by the National Quotation Bureau, Inc. almost continuously from January to June 1963 and, after the federal seizure, from August 1963 to July 1964 when it ceased entering quotations. Between the federal seizure in June 1963 and October 1964, only two numerical bids for HMS stock were placed in the sheets by dealers other than registrant. For most of such period, as all of the salesmen were aware, registrant maintained a "work-out" market for HMS stock in which it would not buy stock offered to it by customers and other brokers unless purchasers were available.[4] Salesmen were kept informed at all times as to whether registrant would buy stock from their customers and, if so, in what amounts. At times, they were required to keep individual records of their purchases and sales of HMS stock, which were constantly reviewed by registrant's management, and told to stay as close as possible to "a zero balance."

HMS stock, which was sold by the individual respondents during the period at prices ranging from $1^1/_8$ to $2^1/_8$, was recommended to customers both before and after the state embargo and federal seizure in late May and early June of 1963.

Cea sold 44,111 shares of HMS stock to customers in 127 transactions in 1963 and 1964. Of those shares, over 60 percent or 27,241 shares were sold after June 1, 1963. Prior to the embargo, Cea persuaded a customer, who told him she was interested primarily in long-term investments, to sell a stock listed on the New York Stock Exchange in order to buy HMS stock. He failed to disclose to this customer and to other customers to whom he recommended HMS stock adverse facts with respect to HMS's financial condition. Following the federal seizure, a customer who purchased 4,750 shares of HMS stock in four separate transactions between August 1963 and January 1964 questioned Cea concerning the federal action and was told that "there was nothing to worry about," that the price of HMS stock would recover from its decline, and that HMS would merge with Norwich. Cea stated to another customer, who purchased 400 shares of HMS stock in May 1964, that HMS was "going good" that the company had had "a little

[4] Registrant nevertheless entered bid as well as ask quotations in the sheets from August to mid-November 1963 during the "work-out" market.

trouble" with the Government but "everything was settled," and that the customer would triple his money within 6 months. Another customer was told that there was no truth in the federal charges, and that there was "nothing to worry about" since HMS would "win" the case. Certain of the customers who purchased HMS stock after the federal seizure following optimistic representations or recommendations by Cea were not told about the seizure or its substantial adverse impact on HMS's business, or about the company's precarious financial condition or registrant's "work-out" market under which the customers might be unable to sell their stock and thus be locked into the stock for the duration of such market.

Conklin effected 221 sales of a total of 64,170 shares of HMS stock during the period. Of such shares, over 53 percent or 34,430 shares were sold after June 1, 1963. Three customers, to whom Conklin sold HMS stock after the seizure, variously testified that he represented that there was no doubt that HMS would "win" the federal lawsuit within 40 to 60 days, that the lawsuit was "just a matter of routine," that the price of HMS stock was bound to go up and that purchasing it would be a good way to save money to send the customer's children to college, that HMS was a very good investment the value of which would "go much higher" than the price paid, and that with the money saved on HMS an investor might be able to retire early. One investor, who told Conklin he was purchasing stock with a view to early retirement, redeemed United States Savings Bonds in order to obtain cash to purchase HMS stock. It does not appear that Conklin induced him to redeem the bonds, but Conklin told him that he thought this was a good idea since the customer probably would do better with HMS. Conklin failed to disclose to the above customers and to a fourth customer to whom he recommended the stock HMS's deteriorating financial condition or, following the seizure, the impact of such seizure on its business, and registrant's "work-out" market. In fact, throughout 1963 Conklin continued to send to customers copies of HMS's 1962 annual report which, among other things, predicted substantial sales and profits in 1963 and annual sales of Mr. Enzyme of $7 to $10 million.

Fisher sold 38,493 shares of HMS stock to customers in 145 transactions during the period. Of those shares, over 65 percent or 25,038 shares were sold after June 1, 1963. Fisher persuaded a customer, who effected purchases before and after the seizure, to sell three listed securities to pay for the purchases. He represented prior to the seizure that the cus-

tomer would "do a lot better . . . financially" with HMS smock, that he "expected great things" from the company which would make more money for the customer, and, in August 1963, about two months after the federal seizure, that HMS stock was preferable to the listed stock the customer was selling because that stock "had not been doing anything at all for the last year or so." Fisher also stated to this customer that HMS would "win" the federal "lawsuit" and that the company would then make money and its stock rise in price. Fisher failed to disclose to him material facts concerning the company's financial condition or the existence of registrant's "work-out" market. Following the federal seizure, Fisher represented to a second customer that HMS was a "good company" and a "good investment," without disclosing to him or to another customer to whom he recommended the stock, the seizure, material financial facts, or the "work-out" market.

Kness, who left registrant's employ in December 1963, effected 47 sales to 25 customers of a total of 19,182 shares of HMS stock in that year. Of those shares, about 77 percent or 14,802 shares were sold subsequent to June 1. He told one customer in May 1963 that HMS was "rolling along" well and that she should buy more HMS stock before the price went any higher. No disclosure of the company's adverse financial condition was made to her. Kness had previously advised the same customer that, with an investment in HMS, she could probably double her money in about a year and she then purchased 100 shares. He represented to another customer, who made 11 purchases of HMS stock totalling 10,300 shares between April 30 and September 3, 1963, that HMS was a good stock that would make money. However, he failed to inform this customer and others to whom he recommended the stock of material facts concerning HMS's financial condition or, in connection with their purchases after June 3, of the federal seizure and registrant's "work-out" market in the stock.

Wayhart, who left registrant's employ in November 1963, sold 19,705 shares of HMS stock to 47 customers in 78 transactions in that year. About 43 percent or 8,490 shares were sold after June 1. Wayhart represented to one customer in March 1963 that HMS was making money. He told another customer, who purchased 200 shares of HMS at 2⅛ in May 1963, that the stock should go up at least another dollar in the near future. The customer purchased an additional 100 shares in September 1963 at 1½ based on Wayhart's representations that it was a good time to purchase more HMS stock since the price had

gone down, and that the customer should have her money back by Christmas by which time the federal action should be settled. No disclosure was made of the company's deteriorating financial condition or of registrant's "work-out" market. Wayhart sold a third customer 250 shares of HMS stock at 1 3/8 in August 1963 on the representation that the stock "had a possibility of going up to 9 [although] . . . he personally didn't think it would go higher than 7." Subsequent to this purchase, Wayhart sent the customer a copy of the company's 1962 annual report which, as noted above, made extravagant predictions as to future sales and profits. The same customer made another purchase of HMS stock in September 1963 after Wayhart told him he did not have to worry about HMS's finances since the company had Norwich's backing. When the customer asked him how HMS's business was going, Wayhart stated that "it was really not important information at the time [since] . . . the company's money was being spent for research and development and also to arrange distribution of [its] product in markets such as California." No disclosure was made of material adverse facts relating to HMS's financial condition, or of registrant's "work-out" market. Wayhart variously represented to other customer in September 1963 that he was sure HMS stock would go up a couple of points and make "good money," that a favorable conclusion to the federal litigation was imminent, and that the price of HMS would thereafter "greatly appreciate." Wayhart omitted to tell certain other customers to whom he recommended the stock before or after June 3, 1963, material facts concerning HMS's financial condition, the federal seizure, or the "work-out" market.

It is clear that the representations and predictions made to customers by the individual respondents were without a reasonable basis. Moreover, we have repeatedly held that predictions of specific and substantial increases in the price of a speculative and unseasoned security are inherently fraudulent and cannot be justified. Not only were optimistic representations and recommendations made to customers by respondents without disclosure of known or reasonably ascertainable adverse information which rendered them materially misleading,[5] but affirmative misstatements were variously made by

[5] See *Richard J. Buck & Co.*, 43 S.E.C. 998, 1005 (1968), *aff'd sub nom. Hanly v. S.E.C.*, 415 F.2d 589 (C.A. 2, 1969); *MacRobbins & Co., Inc.*, 41 S.E.C. 116, 120, 126 (1962), *aff'd sub nom. Berko S.E.C.*, 316 F.2d 137 (C.A. 2, 1963); *R.A. Holman & Co., Inc.*, 42 S.E.C. 866, 871 (1965), *aff'd* F.2d 446 (C.A. 2, 1966); *Van Alstyne Noel & Company*, 33 S.E.C. 311, 321 (1952).

Cea, Conklin, Kness, and Wayhart concerning the federal condemnation proceedings or the financial condition or operations of HMS.

Cea, Conklin and Fisher argue that certain of their customers were experienced investors who wished to speculate and did not rely on them in making their investment decisions, and that they themselves purchased HMS stock and still held such stock at the time of the hearings. They also assert that various customer-witnesses and registrant's president who testified as a staff witness were prejudiced against them, and that, in general, customers' memories were faulty so that they failed to recall much of the information concerning HMS supplied to them. Finally, they assert that, being "young and inexperienced," they relied on optimistic statements concerning HMS's prospects in the federal proceedings and otherwise which were made to them by registrant, HMS, and the attorneys for that company and Norwich. Along with Kness and Wayhart, they further contend that they did not intend to defraud the customers and that any violations committed by them were not willful.

The fact that a customer is experienced or wishes to speculate cannot excuse fraudulent representations made to him, nor is it necessary to show that he relied on such representations in order to establish violations of the anti-fraud provisions.[6] A Salesman's willingness to speculate with his own funds despite his knowledge of adverse factors cannot justify sales of a stock to customers through misrepresentations and a failure to disclose such factors.[7]

While certain customer-witnesses understandably may have been displeased by their monetary losses on HMS, and their memories may not have been as sharp as they might have been immediately following the events about which they testified, no sufficient basis has been shown for rejecting their testimony, especially since the representations made by several of the salesmen to their various customers bear a striking similarity.[8] The testimony of registrant's president as to the information furnished respondents concerning HMS's adverse financial condition, the seizure of its inventory, the effects of such seizure, and registrant's "work-out" market was not only corroborated by the testimony of registrant's secretary but by the individual respondents' own admissions. Moreover, the

[6] See *R. Baruch and Company*, 43 S.E.C. 13, 19 (1966), and cases there cited.
[7] See *Richard J. Buck & Co., supra*, at p. 1008.
[8] See *R. Baruch and Company, supra*.

hearing examiner, who heard the witnesses and observed their demeanor, credited the testimony of the customers and registrant's president, while concluding that contrary testimony by respondents "strain[ed] credulity."

In the light of the knowledge they possessed concerning HMS's affairs and deteriorating condition, respondents' claims of reliance on any optimistic statements made to them by others are frivolous. Irrespective of their training and experience, they should have been aware that representations should not be made to customers without a reasonable basis.[9] And any optimistic statements made to them by registrant, HMS, Norwich or their attorneys as to the outcome of the federal condemnation proceeding were hardly a reasonable basis for representing to customers that the action was simply a routine matter, had been already settled, or that victory for HMS was assured. Finally, it is well established that a finding of willfulness under Section 15(b) of the Exchange Act does not require an intent to violate the law; it is sufficient that the person charged with the duty knows what he is doing.[10]

Additional violations of the anti-fraud provisions were committed by Cea, Conklin and Wayhart in connection with their sales to certain customers of HMS stock as well as the unseasoned and highly speculative stocks of Copter Skyways, Inc. ("Copter"), Mr. Hot Cup, Inc. ("Hot Cup"), and Wyoming Nuclear Corporation ("Wyoming"). Those companies, like HMS, had operating losses, and information concerning such losses was supplied to registrant's sales staff.[11] The customers in question disclosed their financial situations and needs and investment objectives to the salesmen who falsely represented, expressly or impliedly, that the securities they recommended met those needs and objectives.

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[9] Cf. *Thomas Brown III*, 43 S.E.C. 285, 287 (1967).

[10] *Gearhart & Otis, Inc.* v. *S.E.C.*, 348 F.2d 798, 802–3 (C.A.D.C. 1965); *Tager* v. *S.E.C.*, 344 F.2d 5, 8 (C.A. 2, 1965).

[11] Copter was organized in 1960 to transport persons and property by helicopter. For the year 1962, it had a net operating loss of $99,773 which increased its deficit to $119,316. For the nine months ended September 30, 1963, it had a further operating loss of $43,501 and a deficit on that date of $162,817. Recognizing that Copter was failing, and anticipating that it would discontinue operations, registrant ceased trading in the stock in October 1963. In November 1963, Copter's stockholders voted to dissolve the company.

Hot Cup was incorporated in February 1963 to engage in selling and granting franchises for hot drink dispensers and ingredients. In March of that year, registrant was the principal underwriter of an intrastate offering of the stock. By September 30, 1963, Hot Cup had incurred a net loss of $40,813, and for the fiscal year ended September 30, 1964 had a net loss of $99,083, which increased its deficit to $139,896.

Wyoming was organized in 1959 to engage in mining, particularly of uranium. Its minimg claims apparently remained undeveloped throughout most of the period in question. During the period January 1 to November 30, 1963, Wyoming had a net operating loss of $20,573 and at November 30 had a deficit of $19,399 in retained earnings.

During the period in question, Cea recommended and sold stock of Hot Cup and Wyoming as well as HMS to one of his customers who had had little experience in the purchase of securities. The customer informed Cea that he needed about $1,500 to pay for his daughter's training as a nurse, did not wish to take any "wild chances" since he could not afford any loss, and was relying on Cea's judgment because he did not know anything about stocks and trusted him. Cea assured the customer that he did not have to worry, and that on Cea's recommendations he would make three times the amount he needed. During the same period, a widow in her late fifties who earned about $50 a week take-home pay and supported a grandchild was induced by Conklin to purchase the stocks of HMS, Wyoming, Hot Cup and Copter. The customer informed Conklin of her circumstances, and told him that she wished to make enough money to purchase a homestead which she occupied and which had previously been in her family for over 100 years. On Conklin's representation that she would do better, the customer was persuadee to sell listed securities in order to finance her purchases, and she told Conklin that she was borrowing money to make some of the purchases he recommended. In 1963, Wayhart recommended and sold shares of HMS, Copter and Hot Cup to a divorcee who earned about $350 per month, had savings of about $2,500, and was the sole support of her daughter who attended college. The customer informed Wayhart that she did not know anything about buying stocks and was primarily interested in purchasing shares of a mutual fund because she felt that such an investment would not be too risky and, in the long run, pay a better return on her money. Although Wayhart was admittedly amazed that anyone with this customer's limited income and assets wished to buy stock, he recommended purchase of the above securities and stated that, if they "paid off," the customer could then invest the proceeds in a mutual fund. The customer testified that she relied completely on Wayhart.

Cea and Conklin assert that their customers wished to speculate and were fully aware of the risks they were taking. The record shows, however, that the customers in question neither desired to speculate nor were told or knew of the risks involved. And, contrary to the contention of Cea, Conklin and Wayhart, it is not necessary to show a fiduciary relationship with their customers to hold them accountable for the recommendations made,[12] although it would appear that such a

[12] See *Anderson* v. *Knox*, 297 F.2d 702, 706 (C.A. 9, 1961), *cert. den.* 370 U.S. 915.

relationship existed under the circumstances. Wayhart's asserted inexperience and unawareness of the impropriety of his recommendations are negated by his admitted amazement that his customer even wished to buy stock in view of her limited means. Although the customers described their financial situations and objectives to these respondent salesmen, the salesmen recommended purchases of securities that were far from commensurate with the investment objectives disclosed by such customers. It was incumbent on the salesmen in these circumstances, as part of their basic obligation to deal fairly with the investing public, to make only such recommendations as they had reasonable grounds to believe met the customers' expressed needs and objectives. The recommendations they made clearly did not meet their responsibilities under that obligation.[13]

EXCESSIVE TRADING

We also find that Kness, from February 1962 through December 1963, and Conklin, from March 1960 through December 1964, willfully violated the above designated anti-fraud provisions in that they each induced a customer to engage in securities transactions which were excessive in size and frequency in light of the character of the customer's account.

Kness handled the account of a customer who earned about $9,000 a year as comptroller for a conference of churches. The money invested by him came from his wife's savings and from funds supplied by his mother-in-law. Prior to dealing with Kness, the customer had made only one small purchase of stock. He testified that he trusted and relied on Kness and that he never rejected any of Kness's recommendations or suggestions. Kness recommended purchases or sales about twice a week throughout the period, including a three-month period during which the customer, as Kness was aware, was confined to his home following a nervous breakdown. At Kness's suggestion, the customer left his stock certificates with registrant and signed and sent to Kness about eight blank stock powers which Kness told him would save time if stock had to be sold quickly. Kness admitted that the customer relied on him "to a degree" and "generally" followed his recommendations. He further conceded that "on occasion" it was his idea to turn over the customer's portfolio quickly.

The customer had an average monthly investment of $25,257 during the 23-month period in question and in that time made

[13] See *Mac Robbins & Co., Inc., supra,* 41 S.E.C. at 117–19. Cf. *Anderson* v. *Knox, supra.*

67 purchases totalling $95,061 and 26 sales totalling $47,038. The securities purchased in 27 transactions were held for less than 6 months, in 10 for less than 4 months, and in one for less than 2 months. His average monthly investment was turned over 3.76 times, or about once every 6 months. At the end of the period, the customer had a realized net loss of $1,849 and an unrealized loss in excess of $10,000. Kness earned $7,013 in commissions on sales to this customer, which accounted for 55 percent of his income from registrant in 1962, and 51 percent in 1963.

Conklin's customer was an engineer in his early forties who testified he earned about $8,400 per year, supported his elderly parents and had savings of about $17,000. Prior to dealing with Conklin, the customer had made only a single purchase of stock for about $200, and he received shares of his employer's stock, which was listed on the New York Stock Exchange, through a payroll plan. The customer testified that he trusted Conklin and always followed his recommendations which included selling his listed stock to purchase securities recommended by Conklin. The customer told Conklin to invest his "hard earned money" for him carefully since he was anxious not to lose it, and Conklin told him not to worry. Conklin testified that the customer informed him that he had annual earnings of about $12,000 but that Conklin "felt" that the customer had a lot of money. He admitted that the customer purchased only stocks which he recommended and almost never sold a stock except on his recommendation, and he knew the customer trusted him and was relying on his investment judgment. He also recalled the customer's remark about not wanting to lose money.

During the 58-month period, the customer had an average monthly investment of $27,772. He made 137 purchases of securities totalling $103,560 and 88 sales totalling $71,301. The securities acquired in 68 purchases were held in his account for less than 6 months, in 52 purchases for less than 4 months, and in 17 purchases for less than 2 months. His average monthly investment was turned over about 3.73 times, or about once every 15½ months. At the end of the period, the customer had a net realized loss of $21,089 and held securities which had been purchased from Conklin at a cost of $14,618 but had a market value of only about $1,615. Conklin earned a total of $8,603 in commissions on the account.

Kness and Conklin argue that they had no discretionary power over the accounts, that the customers exercised inde-

pendent judgment with respect to their purchases and sales, and that they thought that the customers, who would not furnish financial information to them, were wealthy. Kness states that his customer was "a trained accountant" while he himself was inexperienced, and that the customer instructed him to call "any time there was a market movement in the securities" he had purchased. Kness concedes, however, that the transactions in the customer's account "were abnormally high." Conklin testified that his customer told him he did not care how often his account was traded so long as he made money, and he asserts that he was not aware that trading in a customer's non-discretionary account may be considered excessive notwithstanding the customer's approval of each transaction.

It has long been established that a broker-dealer or salesman who uses his relationship of trust and confidence to a customer to cause an excessive number of transactions in the customer's account commits a fraud upon the customer, whether or not the account is a discretionary one.[14] In light of their customers' complete reliance on their judgment, the assertions that the two customers exercised "independent judgment" and that Kness's customer was "a trained accountant" are frivolous. Kness and Conklin had no reasonable basis for concluding that their customers were wealthy and Conklin knew that his customer had a modest income. In any event, that the customer may be of substantial means is no defense to a charge of excessive trading. Kness's customer denied that he told Kness to call him. Conklin's customer denied that he ever gave Conklin instructions to sell a stock if it did not go up in price or went down, and testified that he simply told Conklin to do whatever Conklin thought best. It is clear that Kness and Conklin, for their own benefit and contrary to their customers' best interests, induced excessive trading in their customers' accounts.

OTHER MATTERS

Respondents argue that they were not afforded an opportunity, as required by Section 9(b) of the Administrative Procedure Act of 1946 ("A.P.A."),[15] to achieve compliance with legal requirements prior to the institution of these proceedings. They further contend, pointing to our earlier administrative

[14] *E. H. Rollins & Sons, Incorporated*, 18 S.E.C. 347, 380 (1945); *R. H. Johnson & Company*, 36 S.E.C. 467 (1955), *aff'd* 231 *F.2d 523* (C.A.D.C. 1956); *J. Logan & Co.*, 41 S.E.C. 88, 98-99 (1962); *Samuel B. Franklin & Company*, 42 S.E.C. 325, 330 (1964).

[15] Now 5 U.S.C. 558(c) (1966).

action against registrant and its president based on fraud violations in the sale of HMS stock, that there was an undue delay in instituting the present proceedings. It is urged that such delay prejudiced respondents and requires that these proceedings be dismissed for laches. Kness and Wayhart additionally argue that the proceedings against them were barred by Pennsylvania's two-year statute of limitations applicable to forfeiture actions.

We find no merit in these contentions. There proceedings clearly fall within the exceptions expressly provided in Section 9(b) of the A.P.A. for "cases of willfulness or those in which [the] public . . . interest . . . requires otherwise." [16] Even assuming that our staff was aware of any violations by respondents when, upon its recommendation, we instituted proceedings against registrant and its president in May 1965,[17] the law is clear that the doctrine of laches or estoppel cannot be invoked against the Government acting in a sovereign capacity to protect the public interest.[18] In any event, respondents have failed to show any prejudice by virtue of the fact that the instant proceedings were not commenced until September 1966. Conklin and Fisher assert that they invested $25,000 in Keystone, and Cea states that, after leaving registrant, his new employer required him to take an expensive course of instruction. However, at the time respondents made these payments, they had no reasonable basis for assuming that proceedings would not be institutee against them. The payments were made prior to commencement of the May 1965 proceedings against registrant and its president and only a relatively short time after the period of the violations we found were committed by these respondents. Keystone became registered with us as a broker-dealer in January 1965, and Cea left registrant in November 1964 and began working for his new employer in December of that year.[19] The fact that Kness and Wayhart have remained in the securities business hardly

[16] See *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967); *Sterling Securities Company*, 37 S.E.C. 837, 838–39 (1957).

[17] The allegations in those proceedings charged only fraudulent representations in the sale of HMS stock during the period May 28 to December 31, 1963, and failure to file a financial report.

[18] See *Utah Power & Light Co.* v. *U.S.*, 243 U.S. 389, 409 (1917); *Guaranty Trust Co.* v. *U.S.*, 304 U.S. 126, 132 (1938); *S.E.C.* v. *Morgan, Lewis & Bockius*, 209 F.2d 44, 49 (C.A. 3, 1953); *U.S.* v. *Vulcanized Rubber and Plastics Co.*, 178 F. Supp 722, 726 (E.D. Pa. 1959); *N. Sims Organ & Co., Inc.*, 40 S.E.C. 573, 577 (1961), *aff'd* 293 F.2d 78 (C.A. 2, 1961), *cert. denied* 368 U.S. 968.

[19] The individual respondents also argue that our staff should have been alerted to their activities by two additional prior proceedings against registrant. However, neither of those proceedings involved violations similar to those at issue here, and the first related to a period of time before *Cea, Kness and Wayhart* were even employed by registrant. See *C.A. Benson & Co., Inc.*, 41 S.E.C. 427 (1963), and *C.A. Benson & Co., Inc.*, 42 S.E.C. 952 (1966) (review of NASD proceedings).

constitutes a showing of prejudice as to them.[20] Cea, Conklin and Fisher also claim that certain of registrant's records became lost by the time of the hearings, but the record fails to show that the absence of any such records prejudiced their defense. And the Pennsylvania Statute of Limitations does not apply to our proceedings under Section 15(b) of the Exchange Act.[21]

Cea, Conklin, Fisher, and Keystone further assert that they were prejudiced in a number of additional respects, including the manner in which the hearings were conducted. They urge that they should have been given the names of prospective customer-witnesses and allowed to examine the staff's documentary evidence well in advance, that customer-witnesses were unfairly permitted, in advance of their testimony, to refresh their recollections by reading assertedly biased statements they had previously been induced to give to our staff, and that respondents should have been allowed to cross-examine staff counsel as to the circumstances surrounding the taking of such statements. They further assert that investor-witnesses were influenced by reading newspaper accounts of the prior disciplinary action taken against registrant, that respondents' testimony at the hearings in the prior proceedings was improperly received in evidence, that a printer should have been permitted to testify as to the number of the various pieces of literature he printed for registrant, and that respondents were unfairly singled out from all of registrant's salesmen as subjects for disciplinary proceedings.

These contentions and assertions are similarly lacking in merit. The Division gave respondents one day's notice of the names of witnesses it intended to call, although it was under no obligation to do so.[22] Certainly it was not required to furnish respondents with a list of the witnesses as well as exhibits it intended to present "well in advance" of the hearings. The requested information was in the nature of evidence which need not be disclosed to a respondent before its introduction at the appropriate time during the course of the

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[20] *Cf. Russell L. Irish*, 42 S.E.C. 735, 742 (1965) *aff'd* 367 F.2d 637, 639 (C.A. 9, 1966), *cert. denied* 386 U.S. 911.

[21] See *Board of County Commissioners* v. *U.S.*, 308 U.S. 343, 351 (1939).

Nor are Sections 9(b) and 10(e) (now 5 U.S.C. 706) of the A.P.A., cited by respondents, applicable to the complained-of delay. The former Section requires the agency, where an application is made for a license, to hear and decide the case "with reasonable dispatch"; the latter, in defining the scope of judicial review, authorizes the reviewing court to "compel *agency action* unlawfully withheld or unreasonably delayed." See *Russell L. Irish* v. *S.E.C.*, 367 F.2d 637, 638–9 (C.A. 9, 1966), *cert. denied* 386 U.S. 911.

[22] *Dlugash* v. *S.E.C.*, 373 F.2d 107, 110 (C.A. 2, 1967), *aff'g F. S. Johns & Company, Inc.*, 43 S.E.C. 124, 141 (1966).

hearings.[23] The record does not show any impropriety by the Division in obtaining statements from customers, and those statements could be used to refresh their recollections.[24] Respondents were of course free to cross-examine customer-witnesses as to the manner in which staff investigators obtained statements from them. Absent some indication of irregularity, however, they were not entitled to examine staff counsel on that subject. Nevertheless, contrary to respondents' assertion, the examiner in fact permitted such examination. Further, the fact that a customer-witness may have read a newspaper account describing the outcome of our 1965 proceedings against registrant was not a basis for rejecting his testimony, but only a factor in weighing it. Nor were respondents harmed because the record of their testimony in those proceedings, introduced herein as admissions against interest, assertedly included "highly prejudicial" comments by the examiner and counsel in those proceedings. It does not appear that the hearing examiner in the instant proceedings, who is legally trained and judicially oriented, gave such extraneous matter any weight; and we have not done so.[25] Contrary to respondents' assertion, registrant's printer was not prevented from testifying as to the number of the various pieces of literature he prepared for registrant. His work orders containing that information were in fact received in evidence except for certain ones which were withdrawn or excluded as being outside the scope of the allegations of the order for proceedings. And there is no basis for respondents' charge that they were "singled out" from registrant's salesman "as some kind of punishment" for having testified on behalf of registrant and its president in the prior disciplinary proceedings. The misconduct alleged in the order for proceedings was the sole basis for their being named as respondents in these proceedings.

Kness and Wayhart complain of the examiner's rulings re-

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[23] *F. S. Johns & Company, Inc., supra.*

[24] *Nees* v. *S.E.C.*, 414 F.2d 211 (C.A. 9, 1969), *aff'd Century Securities Company*, 43 S.E.C. 371 (1967); *David T. Fleischman*, 43 S.E.C. 518, 520 (1967); III Wigmore, Evidence (3d ed. 1940), Sections 758-62.

[25] See *R. Baruch and Company*, 43 S.E.C. 13, 23 (1966). The same conclusion is applicable with respect to the initial decision in the prior proceedings which the examiner in the present proceedings assertedly consulted.

Respondents also claim that the transcripts of their prior testimony, which are in evidence in these proceedings, were not available to them when they were preparing their brief and could only have been obtained at "great expense". The division states, however, that it supplied respondents at their request with photostatic copies of about 30 exhibits, and knows of no request for copies of exhibits or to inspect exhibits which was denied or abridged in any way.

Kness and Wayhart contend that their prior testimony was a "form of entrapment" by the Division, which is difficult to understand since such testimony was given on behalf of registrant and its president. Moreover, Conklin and Fisher testified to the staff's conduct of interviews with them during its investigation and each stated that he was fully apprised of his constitutional rights.

jecting their efforts to call as witnesses customers who would have testified that no misrepresentations were made to them, and to recall all of the customer-witnesses for further cross-examination. We think the examiner was clearly correct. The credibility of the customers who testified in these proceedings and the validity of our findings based on their testimony would not be impaired even assuming that no fraudulent representations were made to other customers.[26] And the statement of respondents' counsel that he believed that three of the twenty-nine customer-witnesses, whom he did not identify, were "known racketeers" was hardly a sufficient basis for recalling all of such witnesses after they had already been cross-examined extensively and excused.[27]

Subsequent to our taking this case under advisement, respondents filed a motion, on which they asked for oral argument, requesting that the proceedings be stayed and our decision withheld pending disposition of an indictment returned on October 7, 1968 against the individual respondents for violation of anti-fraud provisions of the Securities Act, and the mail fraud and conspiracy statutes, in connection with the offer and sale of HMS stock.[28] The Division filed a memorandum in opposition to the motion.

Respondents assert that we or our staff caused to be brought before the grand jury the allegations which resulted in the indictment and which were derived from the hearings in the instant administrative proceedings. They argue that such action constituted an election to present the essence of the issues raised in these proceedings in the criminal action and that it "preempted" the instant proceedings since a guilty verdict would preclude respondents from selling securities without our approval and an acquittal would be *res judicata* "in great part" as to the issues raised herein. Respondents further assert that our issuance of an adverse decision against them prior to a jury verdict would be prejudicial to them because of the additional publicity and also in their defense to the criminal action. They also state that the delay would not injure the public since there were no allegations, nor has it been shown,

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[26] *Alexander Reid & Co., Inc.*, 40 S.E.C. 986, 993 (1962). See also *Crow, Brourman & Chatkin, Inc.*, 42 S.E.C. 938, 944 (1966). Cf. *Allstate Securities, Inc.*, 40 S.E.C. 567, 571 (1961).

[27] Kness and Wayhart further assert that this Commission is in the "anomalous position" of trying to make them "causes" of our previous order revoking registrant's broker-dealer registration. Respondents overlook Section 15(b)(7) of the Exchange Act, added in 1964, which enables us to proceed directly against associated persons and makes "cause" findings unnecessary.

[28] No. 68–202 Criminal (W.D. Pa.).

that they violated the securities acts subsequent to the period specified in the order for proceedings.

After due consideration, we conclude that oral argument on the motion for a stay would serve no useful purpose and that such motion should be denied.

As previously indicated, the indictment relates to only a portion of the allegations in the instant proceedings. Moreover, the Exchange Act provides several parallel and compatible procedures for the achievement of that Act's objectives, and the use of more than one avenue at the same time is permissible.[29] The specified administrative and criminal remedies are designed to serve different purposes, one to determine whether respondents should be barred or suspended from association with a broker-dealer or censured, and the other to determine whether they should be fined or imprisoned. A criminal conviction of a securities offense, rather than being a reason for withholding administrative action, is an express ground for remedial action under Sections 15(b)(5)(B) and 15(b)(7) of the Exchange Act.

Contrary to respondents' assertions, awaiting the outcome of the criminal action would not accomplish the same remedial purposes as a decision on the present administrative record. A conviction would not automatically exclude them from the securities business, although it would provide a ground for administrative remedial action if, after a hearing, it was determined that such action was in the public interest. Respondents would be free to engage in the securities business not only until final disposition of the criminal proceeding but also of an administrative proceeding based on such a conviction. An acquittal of respondents clearly would have no bearing on the charges in the instant proceedings unrelated to those involved in the criminal action, and indeed would have no effect on any of the charges since administrative allegations of willful violations need be proven only by a preponderance of the evidence and not beyond a reasonable doubt as in a criminal trial.[30] The fact that the period of time covered by the fraud charges against the individual respondents in the instant proceedings did not extend beyond December 31, 1964 is not controlling on the issue of whether the public interest would require respondents' immediate exclusion from the secu-

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[29] See *Kamen & Company* 43 S.E.C. 97, 108, n317 (1966); *Clinton Engines Corporation*, 40 S.E.C. 408, 413 (1963); *Security Forecaster Co., Inc.*, 39 S.E.C. 188, 192–93 (1959); *A.G. Bellin Securities Corporation*, 39 S.E.C. 178, 185–86 (1959).

[30] *Norman Pollisky*, 43 S.E.C. 852, 860 (1968).

rities business. Any violations subsequent to that date were not in issue and no showing in that respect was legally permissible. Finally, as to the claimed prejudicial effect of an adverse decision issued by us before the criminal trial, we are of the opinion that the judicial safeguards including the jury selection process and the court's instructions to the jury can be relied upon to assure an impartial verdict.

PUBLIC INTEREST

Respondents contend that the public interest does not warrant the sanctions imposed by the examiner. Cea, Conklin and Fisher assert, among other things, that they have not previously been the subject of disciplinary action, that they were young and inexperienced at the time of the alleged violations,[31] that they have already suffered from adverse publicity, that we have assessed lesser sanctions in comparable cases, that their exclusion from the securities business would deprive them of property without due process of law, and that Keystone's business consists mainly of the sale of mutual funds. Kness and Wayhart state, among other things, that they have no prior history of securities violations and have been employed by broker-dealers in supervised capacities for four years since the period covered by these proceedings.

We conclude that the various mitigative factors cited are insufficient to overcome the serious fraud of the individual respondents, and that as held by the examiner it is in the public interest to bar them from association with any broker or dealer. Since Keystone is owned and controlled by two of the wrongdoers, Conklin and Fisher, and employs a third, Cea, we think that, under all the circumstances, pursuant to Section 15(b) of the Exchange Act, it is appropriate in the public interest to revoke its broker-dealer registration and expel it from NASD membership.[32] The public should not be exposee to further risk of fraudulent conduct by those who have demonstrated their gross indifference to the basic duty of fair dealing required of persons in the securities business.[33]

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[31] Conklin was in his late twenties and Fisher in his early thirties. Cea, whose age does not appear in the record, was married and, as of October 1965, had 3 children. Cea and Conklin had been employed by registrant about 16 months, and Fisher had been in the securities business over 3½ years, prior to the respective periods of their alleged violations.

[32] See *R. H. Johnson & Company, supra*, 36 S.E.C. at 487–88; *Atlantic Equities Company*, 43 S.E.C. 354, 367 (1967), *aff'd sub nom. Hansen* v. *S.E.C.*, 396 F.2d 694 (C.A.D.C. 1968), *cert. denied* 393 U.S. 847.

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

An appropriate order will issue.

By the Commission (Chairman BUDGE and Commissioners OWENS, WHEAT and SMITH), Commissioner NEEDHAM not participating.