IN THE MATTER OF

THOMAS D. CONRAD, JR.

MARGARET J. CONRAD

ROLAND L. GONZALES, JR.

CONRAD & COMPANY, INC.

File No. 3-2338. Promulgated December 14, 1971

Securities Exchange Act of 1934—Section 15(b)

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Action

Offer and Sale of Unregistered Securities

Failure to Furnish Required Information

Failure to Comply with Net Capital, Record-Keeping and Reporting Requirements

Improper Extension of Credit

Misappropriation of Funds

Failure of Supervision

Where president of registered broker-dealer authorized and participated in offer and sale of unregistered bonds and was responsible for a failure of supervision with respect thereto, failed to have bond sales recorded on registrant's books and to have registrant make copies of confirmations and send purchasers required written information, and, together with registrant's executive vice-president, failed to exercise proper supervision to prevent misappropriation effected by branch manager of funds paid registrant by customers for securities purchases, failed to have registrant comply with net capital, record-keeping and reporting requirements, and allowed improper extension of credit; *held*, in public interest to bar president and branch manager from association with any broker-dealer and to suspend executive vice-president from any such association for one year.

APPEARANCES:

Alexander J. Brown, Jr., William R. Schief, and *David P. Doherty,* for the Division of Trading and Markets of the Commission.

Jeremiah D. Lambert, of Peabody, Rivlin, Cladouhos & Lambert, for Thomas D. Conrad, Jr. and Margaret J. Conrad.

Roger W. Titus, of Chadwick & Titus, for Roland L. Gonzales, Jr.

FINDINGS, OPINION AND ORDER

Following hearings in these proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that Thomas D. Conrad, Jr., president of Conrad & Company, Inc. ("registrant"), then a registered broker-dealer,[1] should be barred from association with any broker-dealer, that his wife, Margaret J. Conrad, registrant's executive vice-president, should be suspended from such association for one year, and that Roland L. Gonzales, Jr., a former branch manager, should be barred from such association with the proviso that, after a year, he might apply for permission to become so associated upon a satisfactory showing that he would be properly supervised. We granted a petition for review filed by the Conrads which took exception to the sanctions imposed on them and to certain of the examiner's findings against Conrad. We also ordered review, pursuant to Rule 17(c) of our Rules of Practice, of the examiner's decision with respect to the issues which were before him concerning Gonzales. Respondents and our Division of Trading and Markets ("Division") filed briefs and we heard oral argument. On the basis of our independent review of the record with respect to the matters before us, we make the following findings.

VIOLATIONS RELATING TO SALES OF BONDS OF SVANHOLM RESEARCH LABORATORES

The examiner found that, in May and June 1969, Conrad willfully violated the securities acts in connection with the offer and sale of bonds of Svanholm Research Laboratories ("SRL") by Gary Booker,[2] who at that time was an assistant branch manager of registrant, in willful violation of registration and antifraud provisions of the securities acts.

SRL, whose activities the examiner aptly characterized as "bizarre", was incorporated in 1968 as a "non-profit" company, and, according to its president, Johann K. V. Svanholm, en-

[1] No review was sought of the hearing examiner's order revoking registrant's broker-dealer registration.

[2] Booker, a respondent in these proceedings, did not appear or answer the allegations in the order for proceedings, and was barred from association with any broker or dealer. Securities Exchange Act Release No. 9002 (October 21, 1970).

gaged primarily in research and consultation to assist the government and industry groups in areas in which they could not themselves achieve progress. It had no employees, and its office and "laboratory" were located in the basement of Svanholm's home. A balance sheet included in a brochure given to customers by Booker listed as SRL assets $14,700 worth of office and laboratory equipment and a $2,000 automobile.

However, although Svanholm testified he had transferred those assets to the corporation, he admitted he had not executed any documents evidencing transfers of title. The remaining assets listed on the balance sheet consisted of "receivables good" in the amount of $7,626 and "corporate programs in progress" with an estimated value of $90,650. However, those items represented neither money actually due SRL nor work performed by it under contract.[3]

Booker sold nine unregistered SRL bonds at $1,000 each to unsophisticated investors who were unaware of SRL's lack of assets or prospects for success. In addition to the brochure referred to above which falsely represented that SRL had contracts and receivables, customers were given a subscription agreement which falsely stated that the bonds were guaranteed. In addition, Booker variously represented to customers that the bonds were backed by the Government, that they were guaranteed, and they they were better than U.S. Government bonds.

Conrad has not sought review of the examiner's finding that he failed to exercise reasonable supervision over Booker with a view to preventing Booker's registration and antifraud violations. As to the examiner's finding that Conrad himself violated the antifraud provisions in connection with the SRL bond sales, Conrad correctly points out that the order for proceedings herein did not charge him with such violation, and that finding must accordingly be set aside. As to the remaining findings of the examiner which Conrad challenges, that in connection with the SRL sales he willfully violated the registration provisions of the Securities Act and willfully aided and abetted registrant's violations of certain provisions of the Exchange Act and rules thereunder, we sustain the examiner.

We cannot accept Conrad's contentions that Booker's offer and sale of the SRL bonds were unauthorized and that Conrad

[3] For example, Svanholm testified that one of the items carried as a receivable was a plan for "the complete reorganization of the U.S. Government" which he had submitted to the Department of Defense entirely on his own initiative but for which he asserted the Government became obligated to pay, in the approximate amount of $2,300, when the Defense Department opened the envelope containing it after reading a covering letter which stated that an invoice was enclosed.

was not aware of Booker's activities until some months after the SRL transactions had occurred. On the basis of our examination of the record, we find that Conrad played a principal role in causing the SRL bonds to be offered and sold by his conduct authorized the transactions.

In May 1969 Svanholm telephoned Conrad stating that he wished to raise capital for SRL through bonds which would be exempt from registration because the corporation was nonprofit. Conrad told Svanholm that registrant had not previously engaged in any underwriting but that he would be willing to meet with him. When Svanholm came to registrant's office, however, Conrad stated that he was unable to see him, and Svanholm talked with Booker. The latter then sought Conrad's permission to sell the SRL bonds and asked him what registrant would charge Svanholm for selling them and what his own compensation would be. Conrad stated that registrant would charge an 8 percent commission, the amount it received on sales of mutual fund shares, and that Booker's commission would be $27 on each $1,000 bond sold, but that before Booker could begin to sell Conrad would have to check out the legal aspects. Conrad then instructed an employee who acted as a trader for registrant, a young man about 21 years old without prior experience in the securities business who had been hired a few months previously and admittedly knew very little about the responsibilities of underwriters with respect to new issues, to call our staff to ascertain if the SRL bonds were exempt from registration as Svanholm claimed. When Booker again asked Conrad for permission to sell the bonds, Conrad referred him to the trader, stating that he had delegated to the latter the responsibility to supervise the bond transactions and that if sales could be legally effected it would be "all right". The trader called our staff and without mentioning SRL asked general questions respecting exemptions from registration. He was told of the various criteria for determining whether or not a private offering exemption is available, but was cautioned that those criteria merely provided guidelines and not a definite formula and that such availability depended on the facts of each case. On the basis of that call, the trader told Booker that it would appear "just on the face of it" that the bonds were exempt from registration since Booker was only planning to sell them to a very small number of investors for investment purposes. He also relayed that opinion to Conrad. Thereafter, as noted above, Booker proceeded to offer and sell the bonds.

We concur with the examiner's conclusion that Booker acted

with Conrad's expectation or knowledge that offers or sales of the SRL bonds would be made. From what he had been told by Conrad and the trader, Booker would reasonably have concluded that he was authorized to proceed with the SRL offering. In fact, it appears that Conrad, while seeking to avoid the appearance of responsibility in the event questions were raised, fully intended Booker to reach that conclusion. Under the circumstances, it is clear that by his conduct Conrad authorized the SRL offering, and that he participated in Booker's violation of the registration provisions.[4] Conrad's actions subsequent to the bond sales lend support to that finding. In June or July 1969, he initialled his approval of a "memorandum of order" describing the bond sales which was drawn up by the trader in order that the appropriate commissions would be paid by registrant,[5] and, in July 1969, he made a correcting entry on Booker's commission statement reducing Booker's commission on the SRL sales.

We reject Conrad's further arguments that the SRL offering was a "private" one exempt from registration, and that any violation by him was not willful because he believed, on the basis of the information the trader received from our staff, that registration was not required. The SRL bonds were offered to persons who clearly did not have access to the same kind of information that registration would have supplied. Under such circumstances, the facts that the number of offerees was small and the bonds were by their terms non-transferable did not suffice to make the offering private.[6] And not only would any reliance by Conrad on the opinion of the inexperienced trader be wholly unjustified, but on the record before us we cannot credit Conrad's claim of reliance. His delegation to the trader of the responsibility for determining the need for registration can only be viewed as part of a deliberate effort to avoid responsibility for the SRL sales. We conclude that the examiner correctly found that, in connection with the offer and sale of SRL bonds, Conrad willfully violated and willfully aided and abetted violations of the registration provisions of Sections 5(a) and 5(c) of the Securities Act.

We also affirm the examiner's findings that Conrad willfully aided and abetted registrant's willful violations of Sections

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[4] See *System Investment Corp.* v. *Montview Acceptance Corp.*, 355 F.2d 463, 466 (C.A. 10, 1966); Restatement (Second), Agency § 26 (1958).

[5] The trader received an override on Booker's commission for sale of the bonds.

[6] See *S.E.C.* v. *Ralston Purina Co.*, 346 U.S. 119 (1953); *Gilligan, Will & Co.* v. *S.E.C.*, 267 F.2d 461 (C.A. 2, 1959), *cert. denied* 361 U.S. 896.

15(c) (1) and 17(a) of the Exchange Act and Rules 15c1–4 and 17a–3 thereunder, in that the SRL transactions were not recorded on registrant's books, copies of confirmations were not made, and bond purchasers were not furnished with written notification of registrant's capacity in connection with the sales and the amount of its commissions. Our rejection, as set forth above, of Conrad's defense of lack of knowledge of the transactions is equally applicable with respect to these findings. Nor is there any merit in his further contention that the bond purchasers' subscription agreements with SRL constituted the required confirmations. Those agreements made no reference to registrant or to the commissions it was receiving on the sales.

MISAPPROPRIATIONS BY GONZALES

During the period from about March 1 to October 31, 1968, Gonzales 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 that he converted to his own use over $26,000 paid to registrant by customers for securities purchases. In June 1968, after Gonzales had misappropriated about $2,000, Mrs. Conrad discovered his conversions and notified her husband. Gonzales apologized for his misconduct and was allowed to retain his position as branch manager[7] and to charge off the money he still owned the firm to his commission account. However, Gonzales thereafter misappropriated an additional $24,000.

The Conrads were found by the examiner to have failed to exercise reasonable supervision over Gonzales with a view to preventing his violations and they have not sought review of such finding. As the examiner noted, Gonzales was permitted to continue to sell securities and receive customers' money after discovery of his first misappropriations in June 1968, and there was no evidence that procedures were adopted to prevent a recurrence. Even following discovery by Mrs. Conrad of Gonzales' additional misappropriations in December 1968 she and her husband did nothing, Gonzales having by then repaid the money he had taken, until late in January 1969 after Gonzales had informed Conrad that he was leaving the firm to work for a competitor, at which time Conrad notified regulatory agencies of Gonzales' misappropriations.

[7] Gonzales was also permitted to retain his membership on registrant's "Board of Consultants and Overseers," a successor body to its board of directors.

OTHER VIOLATIONS

The examiner further found, and the Conrads have not challenged on review, that Conrad and Mrs. Conrad willfully aided and abetted willful violations by registrant of:

1. Section 15(c) (3) of the Exchange Act and Rule 15c3–1 thereunder in that registrant effected securities transactions with net capital deficiencies of $3,514 as of January 31, 1969 and $16,817 as of February 28, 1969.

2. Section 7(c)(1) of the Exchange Act and Sections 4(c)(1), 4(c)(2) and 4(c)(8) of Regulation T adopted thereunder by the Board of Governors of the Federal Reserve System in that registrant failed to cancel 51 transactions when customers did not make payment within the required time, and improperly continued to effect securities purchases for three accounts.

3. Section 17(a) of the Exchange Act and Rules 17a–3, 17a–4 and 17a–5 thereunder in that registrant failed to maintain accurate ledger accounts for customers and brokers and security position records, to retain copies of certain communications, and to file a timely financial report for 1968.

4. Section 15(b) of the Exchange Act and Rule 15b3–1 thereunder in that registrant failed to amend its application for broker-dealer registration promptly to correct information with respect to its officers and directors, its membership in a national securities exchange, and the issuance of a cease and desist order against registrant in September 1969 by the Maryland Securities Commission based on registrant's sale of the SRL bonds.

PUBLIC INTEREST

The Conrads contend that the public interest does not warrant the sanctions imposed on them by the examiner. They claim that the examiner gave insufficient weight to the fact that substantial restitution was made to the SRL bond purchasers through registrant's insurance company, that most of the violations found against them relate to supervisory deficiencies which should not bar them from association with a broker-dealer in a non-supervisory capacity, and that Mrs. Conrad was completely under Conrad's control and had no independent responsibility.

We are of the opinion that the sanctions imposed by the examiner on the Conrads are fully warranted. The record amply demonstrates not only Conrad's unfitness for assuming any proprietary or supervisory role with a broker-dealer, but for engaging in the securities business in any capacity. The

numerous violations and the supervisory failures found with respect to him are compounded by the lack of candor he displayed in these proceedings.[8] As the examiner found, his testimony was in large part "utterly incredible," and directly contradicted by his own prior sworn testimony and statements. As to Mrs. Conrad, she was not merely a figurehead in registrant's business but exercised substantial managerial functions. She was responsible for registrant's back office, an area in which, as can be seen from the many violations found, serious deficiencies existed. Moreover, as noted above, after Mrs. Conrad first discovered Gonzales' misappropriations she did nothing to institute supervisory procedures that could have prevented a recurrence of his misconduct. In assessing a lesser sanction against her than her husband, the examiner took into account her subordinate role to Conrad. Finally, under the circumstances, the fact that the SRL bond purchasers were able to recover some of their money from registrant's insurance company does not constitute a significant mitigative factor.

Gonzales argues that the same or a lesser sanction than that assessed by the examiner should be imposed on him. He points to the fact that he has already been suspended for 18 months by Maryland and the District of Columbia for the same misconduct, and states that, since the suspension expired on July 21, 1970, he has voluntarily refrained from re-entering the securities business pending the outcome of these proceedings. He further asserts that no customer loss resulted from his misappropriations, that the Conrads condoned his actions, and that he has cooperated with all regulatory agencies.

In the light of Gonzales' serious misconduct, we consider that, despite the factors advanced in mitigation, his unqualified exclusion from the securities business is required. As has been seen, even after his first misappropriations had been discovered, and he had been given a second chance, Gonzales engaged in additional conversions of funds. We do not believe that giving him yet another chance is consistent with the protection of investors and the public interest.

Accordingly, IT IS ORDERED that Thomas D. Conrad, Jr. and Roland L. Gonzales, Jr. be, and they hereby are, barred from being associated with any broker or dealer; and that Margaret J. Conrad, be and she hereby is, suspended from any

[8] *Cf. Financial Counsellors, Inc.*, 42 S.E.C. 153, 157 (1964); *John G. Abruscato*, 43 S.E.C. 209, 214 (1966).

such association for a period of one year. The suspension of Margaret Conrad shall commence as of the opening of business on December 20, 1971.

By the Commission (Chairman CASEY and Commissioners OWENS NEEDHAM, HERLONG and LOOMIS).