ADMINISTRATIVE PROCEEDING
FILE NO. 3-2338

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
CONRAD & COMPANY, INC. (8-8408) THOMAS D. CONRAD, JR. MARGARET J. CONRAD ROLAND L. GONZALES, JR. GARY G. BOOKER	

INITIAL DECISION

March 10, 1971
Washington, D.C.

Sidney Ullman
Hearing Examiner

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APPEARANCES: David P. Doherty and William R. Schief, Washington Regional Office, Attorneys for the Division of Trading and Markets.

Moreland G. Smith, Jr. of Shipley Akerman Pickett Stein & Kaps, Washington, D.C. (initially); thereafter, Jermiah D. Lambert, of Peabody, Rivlin, Kelly, Cladouhos & Lambert, Washington D.C. (temporarily), as attorneys for Conrad & Company, Inc., Thomas D. Conrad, Jr. and Margaret J. Conrad; and ultimately Thomas D. Conrad, Jr. pro se and for Conrad & Company, Inc. and Margaret J. Conrad.

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

BEFORE: Sidney Ullman, Hearing Examiner

These proceedings were instituted by the Commission pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") by order dated February 17, 1970 ("Order") to determine whether allegations against the respondents asserted by the Division of Trading and Markets ("Division") as set forth in the Order are true, to afford respondents an opportunity to defend against the allegations, and to determine what, if any, remedial action is appropriate.

Respondents

Conrad & Company, Inc. ("registrant") is a corporation with its principal place of business at Prince Georges Plaza, Hyattsville, Maryland. It has been registered with the Commission as a broker-dealer pursuant to the Exchange Act since 1958, initially under the name of Financial Planning Co., its current name having been adopted in July 1966. Registrant is a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to the Exchange Act ("NASD"), and has been since April 1969 a member of the Philadelphia-Baltimore-Washington Stock Exchange, a national securities exchange registered with the Commission pursuant to the Exchange Act. At one time registrant had a main office and five branch offices in the Washington Metropolitan area: it appears that it had three branch offices during the relevant period and the same number during the hearing. According to the testimony of respondent Thomas D. Conrad, Jr. ("Dr. Conrad") at the hearing, registrant at that time employed approximately 20 persons. A major portion of registrant's income was derived from the sale of mutual funds. Additional income resulted from the sale of other securities, from the sale of life insurance by its salesmen, from estate or financial planning and income tax preparation service (in season).

Dr. Conrad was registrant's president, general manager, chief operating officer and a director of the corporation; 1/ his wife, Margaret J. Conrad, also a respondent, was executive vice president and a director. They are sometimes referred to herein as the "Conrads". Dr. Conrad has beneficial ownership of approximately 40% of the stock of registrant and his wife has beneficial ownership of approximately 36% of the stock. Respondents Roland L. Gonzales and Gary C. Booker were employed by registrant as registered representatives and variously in administrative capacities indicated below.

Booker failed to answer or appear in the proceedings and under Rule 7(e) of the Commission's Rules of Practice was deemed in default. He has been barred from being associated with a broker or dealer. 2/ During the course of the hearing his deposition was taken in Florida, on motion of the Division. His testimony constitutes a basis for some of the findings herein.

The other respondents filed answers through their respective attorneys, denying generally the alleged violations. Gonzales appeared at the hearing, but at the opening thereof his counsel withdrew his answer and urged the acceptance by the Commission of a settlement proposal which previously had been offered by Gonzales but rejected by the Commission. The plea was predicated substantially

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1/ During the hearing Dr. Conrad testified that in July 1970 he resigned as president of registrant and was serving as its treasurer.

2/ Securities Exchange Act Release No. 9002, October 21, 1970.

on the argument that consideration should be given to sanctions that had been imposed upon Gonzales by the Public Securities Commission of the District of Columbia and by the Maryland Securities Commission for the same acts charged in the Order, and that further sanction was not required or appropriate in the public interest. Counsel urged that in any event Gonzales should not be barred from engaging in the securities business. Thereafter, Gonzales was called as a witness by the Division. The matter of sanctions against Gonzales is discussed below.

The Charges

In the Order the Division alleges, in substance, that during the period from April 1, 1967 to February 17, 1970 (the date of the Order) registrant violated and the Conrads wilfully aided and abetted violations:

-- of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in failing to accurately make and keep current certain of its books and records;

-- Section 17(a) of the Exchange Act and Rule 17a-4 thereunder in failing to maintain and preserve certain books and records including customer applications for mutual fund contractual plans;

-- of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in failing to file timely with the Commission a required report of financial condition for the calendar year 1968;

-- of Section 7(c)(1) of the Exchange Act and Regulation T promulgated by the Board of Governors of the Federal Reserve System,

(registrant also being aided and abetted by Booker) by extending, maintaining and arranging credit to and for customers on securities in contravention of that Section and Regulation.

-- of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder (the Commission's net capital rule);

-- of Section 15(b) and Rule 15b3-1 thereunder in failing promptly to file an amendment to registrant's Form BD, correcting information in its application for registration as a broker and dealer;

-- of Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder (with registrant also being aided and abetted by Booker) in effecting transactions in the securities of Svanholm Research Laboratory ("SRL") without sending to each customer a required notification disclosing registrant's capacity and other required information.

The Order also charges that registrant, Dr. Conrad and Booker, singly and in concert, wilfully violated and wilfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") in the offer, sale and delivery of SRL bonds when no registration statement was in effect as to said securities, and

-- that registrant and Booker, singly and in concert, wilfully violated and aided and abetted violations of Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder (anti-fraud provisions of the securities laws) in fraudulent sales of SRL bonds by means of untrue statements and without making required disclosures;

-- that Gonzales wilfully violated the anti-fraud provisions of the securities laws by converting to his own use funds belonging to registrant and to its customers and by failing to disclose to the customers such use of the funds; and finally

-- that registrant and the Conrads failed reasonably to supervise other persons under their supervision with a view to preventing violations of the securities laws committed by such persons, i.e. Booker and Gonzales.

Prior to the commencement of the hearing in this matter a pre-hearing conference was held, during and following which particulars of the allegations with respect to registrant and the Conrads were furnished by counsel for the Division to counsel then representing said respondents.

The hearing was commenced on July 13, 1970, and was held at various times between that date and September 15, 1970. Initially, registrant and the Conrads were represented by Mr. Smith, thereafter by Mr. Lambert, and ultimately by Dr. Conrad himself. Proposed findings of fact, conclusions of law and a brief in support thereof were filed by the Division on behalf of registrant and the Conrads; counsel for Gonzales filed a brief with respect to sanctions; and a reply brief was filed by the Division.

On the basis of the testimony and my observation of the witnesses, the exhibits introduced by counsel and the arguments made during the hearing as well as in the post-hearing documents, I make the following findings and conclusions.

Findings and Conclusions

As stated above, Gonzales' answer was withdrawn at the beginning of the hearing. He was the first witness called by the Division and he testified at length with regard to his conversion of funds received from registrant's customers while he was employed as a registered representative. His employment with registrant commenced in 1958 on a part-time basis and continued until January 21, 1969. He was employed part-time by registrant from 1958 until January 1965, and during this period he also worked at one time as a grocery store clerk and at another time as a hotel desk clerk. In January 1965 he became a full-time employee and in August 1966 he was made manager of registrant's newly opened branch office in Falls Church, Virginia. Thereafter, he served consecutively as manager of two other branches. In November 1968, he also was made registrant's mutual fund training director for the entire company and he continued in the same capacity until he left the firm on January 21, 1969. He also served on registrant's "Board of Consultants and Overseers" for over a year until termination of his employment. Prior to his part-time employment in 1958, Gonzales drove a milk truck.

Between the dates March 1, 1968 and January 31, 1969, as alleged in the Order, Gonzales violated the anti-fraud provisions of the securities laws in numerous acts of conversions of moneys received from customers for the purchase of mutual funds and other securities. Although Gonzales made the purchases, he used the funds for his own purposes rather than turn them over to registrant's cashier or bookkeeper. Gonzales'

testimony showed the following misappropriations beginning in March 1968:

On or about March 11, 1968, JPB turned over to Gonzales $670.05 for the purchase of 20 shares of Automatic Sprinkler Corporation. Gonzales entered the order but converted the funds to his own use because, as he testified, he was "a little financially stretched." Gonzales' commission account was charged by registrant in this amount on June 25, 1968, under the circumstances mentioned below.

On or about March 15, 1968, Gonzales received from Mr. and Mrs. PJM the sum of $268.70 for the purchase of 10 shares of Marriott Corporation. The order was entered but Gonzales converted the funds to his own use. Here too, on June 25 his commission account was charged in the amount he had received.

On or about April 26, 1968, Gonzales received $965.10 from Mr. and Mrs. JCR for the purchase of 10 shares of Occidental Petroleum, 20 shares of Sigma Capital and 50 shares of Worth Fund. The orders were entered but the moneys were converted by Gonzales. He repaid the funds by check to registrant on June 14, 1968.

In June 1968, Mrs. Conrad had discovered that moneys had not been received by registrant for the purchases made in March and April in the above three customer accounts. On calling the customers she was advised that Gonzales had received moneys for the purchases.

She discussed the matter with Gonzales, and ordered him to stop these activities. She also advised her husband of these conversions and Dr. Conrad received from Gonzales an apology for the improper activities. He advised Gonzales that his commission account would be charged in the amount necessary to reimburse the firm. As indicated above, on June 14, 1968, Gonzales paid by personal check $965.10 for the purchase made by Mr. and Mrs. JCR. On June 25, 1968, a charge of $670.05 was made against the commission account for the purchase of JPB and a charge of $268.70 was made for the purchase of Mr. and Mrs. PJM.

Gonzales' testimony indicated that no further discussion of significance regarding the above matters ensued between himself and either of the Conrads; that he continued in the position he then occupied as branch manager; and that he was never asked why he had taken the above-mentioned funds. He testified that at a managers meeting in December 1968 or January 1969, Dr. Conrad mentioned the conversions in connection with a discussion of proper training of salesmen.

Gonzales also testified that on August 17, 1968, he received from Mr. and Mrs. AWK a check in the amount of $8,750.88. The check represented the proceeds of the sale of shares of a mutual fund, following the mailing by registrant to the Fund of a dittoed form letter by Mr. and Mrs. AWK. The check for the proceeds was mailed either to registrant or to Mr. and Mrs. AWK. In either case it was endorsed and [redacted]turned over to Gonzales for the purchase of 824 shares of Competitive Capital Fund. The order was entered by Gonzales, but the check was deposited in his personal bank account. Thereafter, he issued his personal check

for credit to the account of Mr. and Mrs. AWK for $7,000 on August 20, 1968; $800 was paid by him on or about September 23, 1968; and he paid the balance of $951.64 on or about October 4, 1968. He testified that he had not been approached by anyone at registrant's office concerning the conversion or the delinquencies in the account of Mr. and Mrs. AWK, but that Mr. or Mrs. AWK was contacted by registrant's firm and had contacted him. He promised to take care of the matter and did so in the manner described.

On or about October 4, 1968 Gonzales received from RWL a check payable to RWL in the amount of $20,103.48, representing proceeds of the redemption, through registrant, of his holdings in Dreyfus Fund. Gonzales had mailed to the Fund Mr. RWL's request for this redemption. RWL endorsed this check in blank and turned it over to Gonzales for the purchase of shares of Putnam Vista Fund for $8,002.80 and shares of Enterprise Fund for $8,006.50. Gonzales testified that he issued to RWL his personal check for the difference of $4,094.18, entered the orders for the customer, and deposited the endorsed check in his personal account. Thereafter, on or about October 10, 1968, he issued a check in the amount of $8,006.50 to the credit of the RWL account; on November 11, 1968 he issued a check for $2,000 and on November 30, 1968 a check for $5,000.80 for credit to the account. The balance of $1,000 was paid by Gonzales' personal check on December 17, 1968. On or about that date Mrs. Conrad had contacted RWL because of the delinquency in his account and was advised that Gonzales had been paid in full in October. Mrs. Conrad telephoned Gonzales, who confessed to the receipt of RWL's money

in October. Mrs. Conrad advised her husband about this matter, but Gonzales testified that Dr. Conrad did not discuss it with him at that time.

On or about November 1, 1968, Dr. Conrad had appointed Gonzales the mutual fund training director of the firm. In this capacity he continued to sell securities and also received an override on the mutual fund sales of all other registered representatives. His duties included the hiring and training of registered representatives. (He testified that he also retained his position of manager of the Iverson Mall branch office until his resignation, but Dr. Conrad testified otherwise).

On December 30, 1968, Gonzales received $25.00 from WN for the opening of a mutual fund contractual plan. The application form and the money were retained by Gonzales. On January 10, 1969, WN gave Gonzales an additional $25.00. Subsequent to the termination of his employment with registrant on January 21, 1969, Gonzales mailed into registrant's office the $50 together with the mutual fund application of WN. The retention of the first $25.00 payment until January 10 was consistent with the practice of registrant, established by Dr. Conrad, to have the salesmen retain a deposit of a sum less than the $50 minimum required for opening an account.[3/] (The retention of the $50 after January 10, Gonzales testified, was due to his negligence and to his concern about terminating his employment).

3/ Another alternative offered and suggested by Dr. Conrad to salesmen was for them to advance the balance up to the required minimum and thereafter obtain such balance from the customer.

In January 1969, Gonzales owed registrant approximately $7,500 and this obligation was discussed with Dr. Conrad. It was agreed that Gonzales would submit a letter of resignation which would entitle him to his equity in registrant's retirement plan. He testified that after one week he was to be rehired. Accordingly, on January 20, 1969, he received from registrant a check under the retirement plan and gave to registrant his own check for about 75 percent of the amount, in payment of his obligation to the firm. On the following day, Gonzales testified, he informed Dr. Conrad that he would not return to work and that he intended to work for a competitor. Only thereafter, on January 22, 1969, did Dr. Conrad notify the regulatory agencies of the conversion by Gonzales "on six occasions so far as we have been able to determine", and request the "withdrawal of [his] license with the State of Maryland". Gonzales had retained, until he resigned on January 20, 1969, a position on the Board of Consultants and Overseers of registrant, a body which succeeded registrant's Board of Directors.

Over this period of time, March 11, 1968 to January 1969, Gonzales' several conversions were not discovered until, as to each of them, an unreasonably long time had passed. And after discovery of the representatives' propensity to use customer funds, Dr. Conrad to some extent condoned the conversions by not taking appropriate action. Even after the recovery from Gonzales of the funds misappropriated in the first conversion, a matter which Dr. Conrad considered of prime importance, insufficient attention was given to the need for corrective action to preclude recurrence. I find that Dr. Conrad failed reasonably to supervise

Gonzales with a view to preventing subsequent conversions after learning of the first conversions in June 1968. The appointment of Gonzales in November 1968 to a responsible position as training director of registrant's firm; [4/] the failure of Dr. Conrad to remove him from the Board and from other positions of responsibility, including retaining him in a position permitting the receipt of customer money; the failure to take appropriate disciplinary action; the failure to institute procedures which would preclude, or at least insure early detection of such conversions; the sponsoring of programs under which a salesman would retain funds of a customer, a practice which is not only loose and unbusiness-like but also one which is conducive to encouraging the misapplication or conversion of funds; and the failure to notify any regulatory agency until January 22, 1969, are indicia of inadequate and improper supervision. It seems clear that Dr. Conrad's plan to expand the company by increasing the activities and the number of branches was carried out at the penalty of having to hire and retain salesmen and other employees, as well as managers of branch offices, who could not be dealt with as severely as circumstances required.

In using the proceeds of checks payable to registrant's customers and other funds turned over to Gonzales by customers for the purchase of shares of securities, Gonzales wilfully violated both Sections 17(a) of the

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4/ Gonzales testified that he had agreed to become manager of registrant's Iverson Mall branch before his conversion of funds was detected. However, his appointment as mutual fund training director occurred after the discovery. He testified that in his opinion this was a promotion. Dr. Conrad urges that "this was a lateral transfer, bringing him under definitely closer supervision, relieving him from supervising representatives and resulted in a significant reduction in his income." The important factors are that Gonzales' opportunity for conversion continued, and that he did not regard the new position and title as discipline for his misappropriations.

Securities Act and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as charged in the Order, in those instances where use of the mails was involved, i.e. those relating to Mr. and Mrs. AWK in August 1968, and RWL in October 1968.[5/] Since the Exchange Act amendments enacted in 1964, Section 10(b) of that Act may be violated by fraudulent activity by "any [registered] broker or dealer or any person acting on [his] behalf . . . , irrespective of any use of the mails or any means of instrumentality in interstate commerce . . . ."[6/] Accordingly, I find that Gonzales wilfully violated this Section by each of his several conversions during the period commencing in March 1968 and ending in January 1969, each of which operated as a fraud on the respective customers and on registrant.[7/] I find, moreover, that the failure of Dr. Conrad, as manager of registrant's affairs, to take appropriate action between June 1968 and January 21, 1969, a period during which Gonzales converted to his own use a total of approximately $25,000, evidences a failure to reasonably supervise the employee with a view to preventing his fraudulent misappropriations of customer funds after the employer had learned of the proclivity of the salesman to engage in such activities.[8/]

5/ Southern State Securities Corporation, 39 SEC 728 (1960).

6/ Public No. 88-467, approved August 20, 1964 (78 Stat. 565).

7/ Wiles & Company, 40 SEC 214 (1960); SEC v. Lawson, 24 F. Supp. 360 (D.C.M.D. 1938).

8/ Empire Securities Corp., 40 SEC 1104 (1962); Reynolds & Co., et al. 39 SEC 902 (1960).

Mrs. Conrad has been an officer and director of registrant since its inception and has been its Executive Vice President at least since February of 1965. She testified that it was her responsibility to see that "the books, reports, statements and certificates required by the statutes are properly kept, made and filed according to law," and that she had the responsibility for supervising the activities of the cashier, bookkeeping and stock trading departments. She also testified that she had responsibility "to establish modern and efficient internal administrative procedures . . . and effectively supervise same."[9/]

I do not find her responsible for not taking appropriate disciplinary action against Gonzales, inasmuch as she was entirely subordinate to her husband in his capacity as managing head of the firm responsible for hiring, teaching and disciplining or terminating the employment of registered representatives. Nevertheless, I find that both she and her husband had responsibility for the adoption of proper back-office procedures. There was no evidence that after she had belatedly discovered Gonzales' conversions, the firm adopted procedures or initiated careful oversight to preclude a continuation of the improper practice. I find that Mrs. Conrad is chargeable with failing reasonably to supervise Gonzales in not having closely watched the accounts of his customers and in not either insisting upon or adopting adequate bookkeeping, back-office and internal controls to

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9/ The duties of the Executive Vice President of registrant are spelled out or listed in the firm's "Managers' Manual". They are so broad as to include the duty to handle "all corporate legal affairs", a responsibility which in any broad sense she was not, as a laymen, capable of handling. While I do not think it fair or practical to charge Mrs. Conrad with responsibility for all of the duties listed, there is no question but that as an officer, director, substantial stockholder and as wife of Dr. Conrad, she is chargeable with broad and extensive administrative responsibilities, and particularly those relating to records, bookkeeping and back-office procedures, as indicated infra.

prevent a continuation of the fraudulent practices after she had learned of the first misappropriation, with a view to preventing the subsequent violations.

It is true, as urged by respondents, that the evidence does not show that any customer lost money as a result of Gonzales' conversions. However, loss to customers is not a sine qua non of failure to properly supervise, and I conclude that both Dr. Conrad and Mrs. Conrad failed reasonably to supervise this salesman as indicated.[10/]

Sale of Svanholm Research Laboratory Bonds

This aspect of the proceedings presents a bizarre picture of the operations of an issuer of bonds, Svanholm Research Laboratories, ("SRL"), which were sold by registrant through its registered representative, Gary Booker. SRL was organized in June 1966 by Johann K.V. Svanholm ("Svanholm") as a sole proprietorship. It was incorporated in the District of Columbia on October 1, 1968 and Svanholm represented it to be a non-profit organization ". . . engaged primarily in research and consultation to help the government and groups in the industry to make progress in areas in which neither the in-house government resources nor profit industry can tangle with or can do."

Svanholm had been the president, treasurer and sole owner of SRL since its creation. He had no employment contract with SRL, but during the relevant period he drew from the corporation treasury as much as he personally needed for his living expenses, to the extent that funds in the treasury would permit. To the extent that funds were not available for payment of a salary to Svanholm, which he testified he

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10/ Cf. Reynolds & Co., et al., supra; Sutro Brothers & Co., 41 SEC 443, 481 (1963).

himself fixed at $15,000 to $20,000 between 1966 and 1970, Svanholm issued to himself corporate bonds. He testified he had invested everything he had in the corporation and he estimated this to be ". . . about $150,000 in time, effort and cash." This arbitrarily adopted figure includes an evaluation by Svanholm of the time and effort he had expended in having acquired graduate credits in electrical engineering.

Svanholm operated the company in the manner that a more realistic person would operate a personal venture rather than a corporation. For example, the "minute book" according to Svanholm, is a diary kept by him relating to the daily activities of the company. When asked whether SRL had a bank account he responded affirmatively, but on further questioning it developed that this was his personal checking account with Riggs National Bank. The corporation was in fact a personal "alter ego".

SRL never had any employees, did not maintain corporate books or generally accepted accounting records, and its "office" and "laboratory" were located in the basement of Svanholm's home in Hyattsville, Maryland. The corporation does not in fact enjoy tax exempt status as a non-profit corporation, despite representations to that effect by Svanholm.

A balance sheet as of May 20, 1969, containing a brochure prepared by Svanholm and delivered to registrant through Booker, stated that the office and laboratory equipment of Svanholm were valued at $14,700. This valuation was made by Svanholm on equipment such as typewriters and draft tables formerly owned by him personally but delivered to the corporation. No bill of sale or other document was created to evidence a transfer of title. Similarly, the automobile reflected on SRL's balance sheet was titled in Svanholm's name. Svanholm testified ". . .

I designated it as a corporation car and now it is a corporation car." This balance sheet disclosed no liabilities of SRL.

The balance sheet also reflected an asset of $7,626 of "Receivables good" allegedly representing work previously performed by SRL as of May 3, 1969, and a $90,650 asset for "Corporate Programs in Progress." The testimony of Svanholm indicates that SRL had no contracts to perform any work items listed under these categories. Conversely, Svanholm testified that one of the items included in the "Receivables good" category was performed on his own initiative shortly after the death of President Eisenhower and as a tribute to his memory. This "work" was entitled a "Semantic Reorganization for Department of Defense" and was delivered to an office within the Department of Defense. Basically, according to Svanholm testimony, it appeared to recommend a complete reorganization of the United States Government, called by Svanholm a "semantic reorganization". The work was done by him and the "charge" was expressed at the rate of approximately $250 per day. This recommendation was submitted to the Department of Defense on March 29, 1969, together with a bill for approximately $2,500 for 10 days work. 11/ Svanholm admitted that he had no prior discussions at the Department of Defense or elsewhere regarding this work. His theory of SRL's contract with the Government was explained: where someone at the Department of Defense, after reading a covering letter prepared by Svanholm, broke the seal

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11/ The cover page of the document included the following:

> "The effort is contributed for the Memory of President and General Ike Eisenhower who Honored the Constitution, Motherhood and God.
>
> Sincerely,
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> Invoice for 10 days enclosed Johann K.V. Svanholm
> President and P.E. Consultant"

of the envelope in which the SRL study was contained, the Government became obligated to pay for the work done by SRL, in accordance with the bill or invoice transmitted therewith.

SRL has not been paid for any work listed under the item "Receivables good", nor for any of the work listed under "Corporate Programs in Progress." With respect to the latter category, bills were submitted to Government agencies for those of the listed programs which were completed but not for those dropped by SRL prior to completion. All fees or charges asserted were rejected by the Government.

Because no payments had been received from the Government over a long period of time, according to Svanholm the corporation was in dire need of funds. He testified: "Our cash flow had stopped and the cash reserve was gone so this was very helpful to us that Conrad could help us and Mr. Booker leaned over backwards to help us sell these bonds." Prior thereto, Svanholm had been unsuccessful in his personal efforts to sell any SRL bonds in denominations of $1,000 to any of the 24 or 25 persons he had approached. The bond sales were made by Booker, as representative of Conrad & Co., under circumstances described below.

In May 1969, Svanholm telephoned registrant's Prince Georges Plaza office and spoke with Dr. Conrad with a view to having registrant sell SRL bonds in the face amount of $1,000 each. He stated that registration of the bonds was not required, inasmuch as his corporation was a non-profit organization. Dr. Conrad suggested that he visit

the office. When Svanholm did so on the same or the following day, apparently Dr. Conrad did not wish to see him and he was directed to Booker. He advised Booker that he wanted to sell nine or ten $1,000 bonds for SRL, asserted to be a non-profit corporation engaged in research and in solicitation of Government contracts. The proceeds of the sale, he stated, would be devoted to company operations.

Booker knew little or nothing about bonds, having had no prior experience with them, although he was assistant manager of registrant's Prince Georges Plaza office. He received from Svanholm a list of approximately 25 persons who were suggested as potential purchasers of the bonds. The listed people were for the most part officers of corporations and doctors and dentists known by Svanholm. They had been approached by Svanholm prior to his contacting registrant's office, but as stated above, Svanholm had been unable to sell any bonds.

Svanholm continued to visit Booker thereafter, and in extremely persistent manner pressured him with regard to sale of the bonds because of the corporation's need for funds. But Booker had not obtained from Dr. Conrad authorization for the sale. Dr. Conrad had asked his trader, Laurence Kaufman (age 22 at the time of the hearing), to check with the Securities and Exchange Commission with regard to a possible exemption from registration. Kaufman had been in the securities business for seven or eight weeks at that time, and at the hearing he testified that he knew nothing about the responsibilities of an underwriter of a new issue. 12/

12/ Kaufman was graduated from college in June 1968. For the next nine months he was not regularly employed but was a semi-professional chess player. He testified he commenced work at registrant's office approximately March 10, 1969, became a registered representative in the following month, was the stock trader and also had the title of Research Director.

Kaufman telephoned the Commission, as directed by Dr. Conrad, and received what might be described as a vague and imprecise answer or understanding, which he testified he related to Booker.[13/] He was not certain whether he related the substance of the telephone conversation to Dr. Conrad. He did tell Booker that he had learned that the sale to a small number of investors strictly for investment purposes (the number 20, he said, was mentioned as a guide), would be exempt from registration. Over a period of at least one or two weeks no clearance was given by Dr. Conrad to Booker for the sale of the bonds, but during this time Svanholm appeared at Booker's desk at least every other day trying to get Booker to commence the selling efforts.

During this period Svanholm provided Booker with a brochure in which was incorporated a balance sheet of SRL and other financial information, and a form of subscription agreement in which potential investors were assured that the bonds were "guaranteed". Thereafter, changes were made by Svanholm in the form of subscription agreement, and Booker eventually used a form employing the term "collection guaranteed."

There was no basis for the representation that the bonds were "collection guaranteed", whatever that term might have been intended to mean. Moreover, the brochure was false and misleading in carrying as corporate assets certain personal property, including the automobile titled in Svanholm's personal name; it was false in evaluating the "Receivables good" and the "Corporate Programs in Progress", thus

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13/ Booker also called the Commission but testified that he was told to "have his superior check it out more thoroughly."

representing that payments were due for work performed, whereas no contracts existed pursuant to which the work had been performed and, as stated above, no obligations to the corporation existed.

Although the brochure also represented that the proceeds of the bond sales were to be used for the operation and expansion of the corporation, proceeds from the first sales were deposited in Svanholm's personal bank account and were used for his personal expenses, including a trip to Paris, thence to Sweden, and ultimately for his return to this country.[14/] Svanholm also used some of the bond sales proceeds to purchase for himself, through Booker and registrant, a mutual fund contractual plan and an insurance policy on his life, naming his wife as beneficiary.

Dr. Conrad intentionally had remained to some extent on the periphery of the negotiations with Svanholm and the bond transactions. But in his testimony he attempted without success to convey the impression that he knew nothing of these negotiations and transactions until October 1969. To support this position he testified that he "would almost never be upstairs [in the Prince Georges Plaza branch office, one flight above the corporate headquarters] except on an occasional maybe once every two weeks, when I might be stopping in to see the manager of that particular office . . . ." Even apart from the other aspects of his testimony, designed, as discussed below, to remove himself from the bond transactions, his testimony that he did not know of

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14/ During this trip Svanholm visited the Paris Air Show, and this visit constituted the alleged basis for SRL's "work effort" for the Post Office Department recommending the use of helicopters in connection with the delivery of mail.

No arrangements had been made for this "work effort", but an obligation of $5,000 from the Post Office Department for the "Helicopter Study for Postal Delivery in the U.S." was one item (among others just as questionable) which comprised the total of $90,650 for "Work in Progress. . ." in a "Profoma [sic] Statement" as of 3 May, 1969, "certified" by Svanholm.

this persistent visitor is incredible. Svanholm's oft-expressed theory that movement of the stock market could be foretold by a study of sun spots was the subject of joking in the Prince Georges Plaza office. But there is more than circumstantial evidence contradicting his contentions that he knew nothing of Mr. Svanholm or of Booker's bond sale activity until long after the last sale, and that Booker had acted as an independent contractor who was never authorized to make the sales for registrant. The credible evidence is to the contrary.

Booker had attempted on numerous occasions, particularly under pressure from Svanholm, whose frequent visits occupied a great amount of his time, to ascertain whether or not the bonds could be sold. He inquired of Kaufman on numerous occasions, knowing that Dr. Conrad had asked Kaufman to check with the Securities and Exchange Commission as to registration requirements. But he was never advised that Kaufman's contact with the Commission was a basis for affirmative action. Conversely, Kaufman on at least one occasion advised Booker to check with Dr. Conrad. Booker did check on several occasions, and testified that eventually he was told by Dr. Conrad that he could go ahead and sell the bonds. Prior thereto, he had placed on Dr. Conrad's desk a copy of the SRL brochure and a copy of the subscription agreement discussed above. Whether or not Booker ever was told expressly by Dr. Conrad that he was authorized to sell the bonds is not clear. It is clear, however, that Dr. Conrad knew of Svanholm's persistent pressure on Booker, of Booker's interest in selling the bonds, of Kaufman's inability and unwillingness to decide or advise that sale without registration was permissible, of discussions with Kaufman and Booker, as stated below, concerning the commission to be charged for the bond sales and the commission which Booker would earn, and of the probability

that unless he gave orders to the contrary, selling efforts would be made. I believe his failure to give such orders was purposeful. It is also clear, despite his denials, that at least as early as June or July 1969, Dr. Conrad knew that the sales had been made. His sedulous effort to remain, to the extent possible, in the background with regard to the sales activity is obvious,[15/] but I find that he knew that registrant's office and its name were to be used in Booker's selling activity, and that he took no steps to prevent the sale of the bonds of this pathetic company, or to investigate its financial condition, its alleged non-profit status, the nature of its operations, or indeed whether it had any operations.[16/] His delegation to young Kaufman of the task of inquiring and determining whether registration was required is evidence of his desire to remain in the background and of his lack of responsibility as the executive head of registrant. He testified, at an investigation of the Division of Securities of the State of Maryland, as follows:

> "Some days later Mr. Booker approached me and said that he thought these bonds were -- well, very saleable, that he had some customers that were interested in these bonds, and that he wanted to know if it was all right for him to -- if it was all right to sell these bonds, and I told him that we would have to check out all the legal aspects of the thing since it was a new issue, underwriting, and that he should work with our stock trader whom I had delegated the responsibility to, to check on all -- to supervise all these various transactions. So, sometime seemed to be a couple weeks later, and our stock trader, Mr. Lawrence Kaufman came down to see me and said that Booker had approached him about some bonds

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15/ In the instant proceeding Dr. Conrad urged that Booker acted as an independent contractor in accordance with the language of the Representatives' Selling Agreement. Whether the possibility that this "theory" might be valid impelled Dr. Conrad to remain in the background prior to and during the bond sale activity is a matter for speculation only.

16/ Even cursory investigation and examination of the written material prepared by Svanholm would disclose to a person of Dr. Conrad's experience, sophistication and intelligence that the company's bonds were worthless. Not so with Booker, who was not sufficiently knowledgeable to evaluate SRL and the bonds.

and what was the story, and I said oh yes, I remember that, I would like you to check it out and see if they are exempt from registration as the man alleges they are, and if you can take care of all the legal details of it why I see no reason why we couldn't sell them for the man."

Nine bonds were sold by Booker during the period May 24 to June 20, 1969. Before the first sale, Kaufman had discussed with Dr. Conrad the commission to be charged by registrant and was told that it would be 8 percent. He related this to Booker, who, in turn advised Svanholm.[17/] Kaufman also discussed with Dr. Conrad the percentage of registrant's commission payable to Booker, and was told that it would be the same as the commission Booker earned on the sale of stock.

The bonds were not registered with the Commission, but Booker sold the nine bonds to the following persons on the dates indicated:

May 24, 1969	-	to E.L.D.	- 2 bonds for $2,000;
May 26, 1969	-	to B.W.W.	- 1 bond for $1,000;
May 27, 1969	-	to J.E.	- 2 bonds for $2,000;
June 20, 1969	-	to Mr. and Mrs. W.H.H.	- 4 bonds for $4,000.

JE was on the list furnished by Svanholm to Booker: the others, Booker testified in his deposition, were customers of registrant who were not on that list. Booker had telephoned the purchasers and arranged meetings at which each bought the bonds. Of course, no payments have ever been made by SRL to any of the bondholders, and the corporation has no funds.[18/]

Booker delivered to the purchasers copies of the fraudulent brochure (referred to by him as a prospectus) and of the subscription agreement. He advised them that the bonds were guaranteed, and that

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17/ Booker also testified in his deposition (taken in Jacksonville, Florida, on July 31, 1970, after he had resumed his former work of driving a truck), that he discussed with Dr. Conrad the commission to be charged Svanholm and the share he would receive. He was told that registrant's commission would be 8 percent and that he, Booker, would receive $27 per thousand dollar bond sold. He testified that when he related the 8 percent figure to Svanholm, both men agreed this was "kind of high".

18/ See discussion of insurance company refunds under Public Interest, infra.

they were backed by federal government contracts. He told Mrs. WHH in a telephone call that the bonds were "better than the U.S. Savings Bond," and that they might not be available after the following day. Virtually the same false representations of value and safety were made by Booker the next day when, pursuant to the telephone call, Mr. WHH visited the office of registrant and made the purchase. Booker also advised him that SRL was a non-profit company doing work for the State Department, the Department of Defense and the Pentagon. These were untrue statements with false implications created by Svanholm and passed on to customers by Booker.

No confirmations of the bond sales were sent by registrant or Booker, but the bonds were mailed to the purchasers by Svanholm in accordance with arrangements made with Booker. Svanholm received all proceeds of the first $5,000 in sales. When the $4,000 was paid by check of WHH in the last sale, the 8 percent commission due registrant for the total $9,000 of sales was deducted and the $720 was received by registrant in the following manner: registrant's check for $3,280 was given to Svanholm along with a check for $720; Svanholm endorsed the latter check back to registrant, thus discharging the obligation for commissions due registrant. WHH gave Booker a check for $4,554, and $554 was applied by registrant to an investment by WHH in the Oppenheimer Fund. These financial details appear to have been arranged by James S. Skinner, an accountant who was then Dr. Conrad's assistant.

As indicated above, one of the defenses urged by Dr. Conrad to charges based on the sale of SRL bonds is that Booker was not an employee

of registrant but was an independent contractor under a selling agreement between Booker and registrant.[19/] Therefore, Dr. Conrad urges, "we didn't control his activities." The argument gains nothing for registrant or for Dr. Conrad. That the employer-employee relationship between Booker and registrant existed is entirely clear, and this relationship is further demonstrated by the position of Booker as assistant branch manager of the Prince Georges Plaza office. Moreover, regardless of the nature of the relationship or its legal effect for some purposes, (such as liability vel non of registrant for negligence of Booker while driving a car), as stated in Weiss, Registration and Regulation of Brokers and Dealers (1965) at 34:

> "It is a basic design of broker-dealer registration requirements that a registrant be accountable for all violations of the federal securities laws committed . . . by an individual who effects and induces transactions in securities for the registrant, irrespective of whether the relationship be characterized as that of an 'independent contractor' or otherwise as between the parties."
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> Cf. Fred L. Carvalho, 41 SEC 620 (1963); SEC v. Rapp. 304 F.2d 786.

19/ In his testimony Dr. Conrad relied on provisions in a "selling agreement" with Booker, "whereby he was not an employee, but a representative of the company." He relied on provisions in that agreement which required a registered representative to turn over all funds received from customers each day (a practice not always required and not observed, as indicated above), and on such provisions as a representation by the salesman "that he has studied and is thoroughly familiar with the provisions of the Securities Act of 1933, as amended, and of all applicable state and municipal laws, and that he will fully comply therewith; that he will make all solicitations and sales strictly in accordance therewith. . . ." Dr. Conrad's testimony suggests that because his registered representatives had passed the NASD examination he considered this latter representation a realistic one on which he could rely.

At best, Dr. Conrad completely misunderstood the agency relationship between Booker and registrant despite his many years of experience in the securities industry. He told a Commission attorney that he never substituted his judgment for that of a salesman as to whether a security could be sold by registrant and that neither he nor registrant was responsible for the activities of a salesman.

A second position urged by Dr. Conrad is that he knew nothing of Booker's sales until October 1969, when a representative of the Maryland Securities Commission came to the office to investigate the bond sales. To the contrary, Dr. Conrad's assistant at the relevant time, James S. Skinner, testified that Dr. Conrad had met Svanholm in the office prior to any of the bond sales. Moreover, a letter written by Dr. Conrad on September 12, 1969 in response to an inquiry of August 27, 1969 from the Maryland Securities Commission states that "Mr. Svanholm called me soliciting our assistance in marketing seven $1,000 bonds for his non-profit corporation . . . . When he arrived I was busy; and he apparently proceeded to talk with one of our representatives, Mr. Gary Booker." The letter also states that Dr. Conrad was assured by Kaufman that no Securities and Exchange Commission filing was required and that "some weeks later" [20/] Dr. Conrad

> "[n]oticed an entry on the commission statement for Mr. Booker, which reflected the commission for the sale of the bonds. The handling of the commission was not exactly administratively proper, so I made a correcting entry. In doing so I inferred that $7,000 had been transacted by Mr. Booker for certain customers whose names were not known to me. The next thing I heard was when I received a letter from a local attorney requesting that the customer's money be refunded." [21/]

Thereafter, the letter states that Mr. Booker "has denied making such a statement [that the bonds were guaranteed by the United States Government]" and that Dr. Conrad credits this denial. However, in vague and incredible

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[20/] As appears below, this was in July 1969.

[21/] A letter of August 1, 1969, from Henry A. Babcock, discussed infra, demanded a refund of $4,000 on behalf of Mr. and Mrs. WHH.

fashion, the letter continues to plead ignorance of the bond sale transaction because it "was handled almost completely outside our company, and that I had no record of it on our books . . . . Nor can we locate who purchased these bonds [other than Mr. and Mrs. WHH] and that Mr. Booker has been unavailable." Mr. Booker's availability to deny that he stated the bonds were guaranteed, but his unavailability to advise the names of the purchasers of the bonds is not explained.

Dr. Conrad testified that either on the day that Svanholm telephoned or on the following day, Booker came to his office and stated that he would like to help "this man",[22/] and asked whether he would object. Dr. Conrad testified that he indicated to Booker that registrant "had no claim on this customer" (meaning, he now says, that Booker would not be improperly proselytizing) and that this terminated the conversation. He concedes that in a subsequent conversation Booker asked about commissions on the sale of bonds, but he states that he did not connect Booker's inquiry with Svanholm or any particular bond transaction. Although there followed other conversations with Booker about bonds, Dr. Conrad denies that he related them to Svanholm. He states that he had Kaufman check with the Securities and Exchange Commission regarding a possible exemption, after an inquiry by Booker for a customer who "was interested in raising some money and wanted to sell some -- I don't know as

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22/ Throughout his testimony Dr. Conrad persistently tried to avoid using the name Svanholm. Cf. fn. 23 infra.

though he said bonds -- he wanted to raise some money for his corporation."[23/] I find his testimony with regard to Svanholm, the SRL bonds, and conversations with Booker and Kaufman to be evasive and contradictory in many respects.

Moreover, Dr. Conrad was called in early August 1969 by Henry A. Babcock, a Maryland attorney representing Mr. and Mrs. WHH. Mr. Babcock asked for a refund of $4,000 his clients had paid for bonds. Dr. Conrad testified that ". . . the word or name Svanholm or any description of the transaction did not come up because I didn't give this man much time on the phone when he got through to me . . ." and that "I thought the lawyer was either trying to press me into buying something back myself from some customers because [they] bought something that went down in price or else he was a little naive himself."

He also testified that although Mr. Babcock threatened to bring suit if reimbursement was not made, nevertheless he could not recall when the conversation took place, except that "It was sometime between July the first and October the first. At the time I did not recognize the conversation to be the sale of any kind of bonds about which I believe I previously testified I talked with Booker and Kaufman." In response to a question whether he had asked Mr. Babcock the name of the customer he answered negatively, and stated that he did not pay much attention

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23/ Dr. Conrad's pains to avoid using the name Svanholm in his testimony in an effort to support his contention that he knew nothing of the bond sales until October 1969, were obvious. For example, he testified on cross-examination:

> ". . . I asked Mr. Kaufman to communicate with the Securities and Exchange Commission to determine their opinion and their regulations regarding the alleged exemption from registration for a non-profit corporation. Notice I didn't say this or that or Svanholm, I said a non-profit corporation. I recall that especially."

to the call because "[It] seemed to be from a crackpot." [24/] He further denied receiving from Mr. Babcock a letter reciting the name of the customers and of the security and details of the transaction. However, Mr. Babcock's letter of August 1, 1969 included all of this information, and his testimony contradicted that of Dr. Conrad. He testified that he telephoned Dr. Conrad on or prior to August 6, 1969, and in a discussion of the purchase transaction of his clients,Dr. Conrad at that time ". . . had a thorough familiarity with the contents of the [Babcock] letter."

At one point after Dr. Conrad had admitted that in July 1969 he had seen and "corrected" a computer commission statement of Booker's sales, he testified that the name "Svanholm" didn't signify to him any kind of underwriting or bond sale, because "we have a customer by the name of Svanholm who was both an insurance and mutual fund customer." Thereafter, he retracted his testimony that registrant had another customer named Svanholm.

In order to support his contention that he did not know the names Svanholm or Svanholm Research Laboratory until October 1969, Dr. Conrad's testimony reflected the sedulous effort noted above to avoid using the names Svanholm" or "Svanholm Research Laboratory". He spoke of "this man who called" or "this man", or the "individual who was speaking for the corporation", or he referred to "the non-profit corporation" (which it was not). His testimony, for this reason among others, was vague, imprecise, and contradictory. It varied in significant respects from testimony he had given before a representative of the Maryland Securities

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24/ Mr. Babcock's testimony at the hearing was lucid, direct, and credible.

Commission and from written correspondence with that Commission. When these conflicts were brought out in the questioning by Division counsel, Dr. Conrad testified that "The letter to Maryland [was] only a hastily written conclusion that was made through me as an investigator with lots of inaccuracies."

Dr. Conrad was asked by Division counsel about the initial "C" which appeared in red ink on Division's Exhibit 12, a memorandum prepared in June 1969 by Mr. Kaufman in order that he might receive an override on Booker's commission for the sale of the bonds. Kaufman gave the memorandum to Mr. Skinner, who marked it "Please approve" and submitted it to Dr. Conrad. The latter denied that a letter "C" thereafter made on the memorandum was his writing or his approval of a correcting entry thereafter made on registrant's records. He speculated with respect to the initial that among other possibilities "it could mean 'correct'. It could mean somebody could have been scribbling on that to see if their pencil worked." I find that the "C" is further evidence of contemporary knowledge by an officer of registrant of the bond sales and constituted the approval, either by Dr. Conrad or his wife, of the correcting entry thereafter made on or about July 25, 1969.[25/]

Accordingly, I find that in the offer and sale of the bonds Booker acted as an agent of registrant and that he did so with Dr. Conrad's expectation or knowledge that offers or sales would be made.

25/ Examination of Division's Exhibits 2A through 2H (customer ledger sheets for those of Gonzales' customers whose money was misappropriated and thereafter repaid by Gonzales into said accounts) reflects numerous "C" initials closely resembling the letter "C" on Division's Exhibit 12, under discussion. These numerous appearances are at a point in the respective ledger sheets where notations were made of the several repayments by Gonzales. Inasmuch as Mrs. Conrad was involved with these repayments and also with the books of registrant, it may be that this is her mark rather than that of her husband. However, the records contains no evidence of this, and no such conclusion can be drawn.

I conclude that during the period from approximately May 1, 1969 to June 24, 1969, registrant, Dr. Conrad and Booker singly and in concert wilfully violated and wilfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act in the offer, sale and delivery after sale of bonds of SRL when no registration statement was filed or in effect as to such bonds.[26/]

Inasmuch as registrant's daily blotters included no record of the sales of the bonds, and no confirmations of the sales were sent to the purchasers, I find, as charged in the Order, that during the period May 24, 1969 through June 20, 1969 registrant, wilfully aided and abetted by Dr. Conrad, wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, in failing to make and keep current its blotters, or other records of original entry containing an itemized daily record of all purchases and sales of securities,[27/] and copies of confirmations of all purchases and sales of securities.[28/] Despite Mrs. Conrad's responsibilities with regard to the records of registrant, I do not find that the evidence shows she had the requisite connection with or knowledge of the Svanholm transactions to support a charge that she wilfully aided and abetted the above violations.

The Order also charges (Par. II, I) violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder by registrant, aided and abetted by the Conrads and Booker. Under this Section and Rule, any

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26/ Interstate means (the telephone) were used in Svanholm's initial conversation with Dr. Conrad, and by Booker in connection with the sale of bonds. Cf. Myzel v. Fields, 386 F.2d 718 (C.A. 8, 1967; Lennerth v. Mendenhall, 243 F. Supp. 59 (N.D. Ohio, E.D., 1964); Ingraffia v. Bell Meade Hospital, Inc., et al. (US.D.C. E.D. La. Nov. 4, 1970) CCH ¶92,894.

27/ Rule 17a-3(a)(1) requires the making and retention of blotters or other records of original entry containing an itemized daily record of all purchases and sales of securities.

28/ Rule 17a-3(a)(8) requires the making and keeping of copies of confirmations of purchases and sales.

act of a broker or dealer designed to induce the purchase or sale of a security is a "manipulative, deceptive, or other fraudulent device or contrivance" unless the broker or dealer gives or sends to the customer written notification disclosing the capacity of the seller (e.g. as broker or as a dealer for his own account) and additional information required by the Rule. I find that registrant, wilfully aided and abetted by Dr. Conrad and Booker, wilfully violated the Section and Rule. Again, the credible evidence does not reflect that Mrs. Conrad wilfully aided and abetted this violation.

I find also that by permitting or by expressly authorizing the sale of the bonds when no investigation had been made by registrant,[29/] Dr. Conrad and registrant singly and in concert wilfully violated and wilfully aided and abetted Booker's violations of the anti-fraud provisions of the securities laws and the rules thereunder as charged in the Order.[30/] So, too, did said respondents wilfully violate and aid and abet Booker in wilfully violating the securities laws and rules thereunder by the use of the written material which contained misrepresentations and failed

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29 / In the proposed findings submitted for respondents, Dr. Conrad states that he made no investigation of SRL "because he had no knowledge of the sale or impending sale by Booker, although he was aware that 'some company' was talking with Booker and Kaufman and that certain regulatory exemptions and/or procedures were being investigated by Kaufman."

At another point the proposed findings state that because Booker made the offering "on his own account" without proper disclosures to or authority from Dr. Conrad, there was no reason for Conrad "to investigate the bonds, the prospectus, or the company. In fact, Conrad did not know of the existence of the prospectus or the actual sale of the bonds until several months after they had been sold by Booker. Therefore, Conrad cannot make any statement as to the truth of the prospectus." Considering the mass of evidence relative to Svanholm, SRL, and its "receivables", Dr. Conrad's continuing inability to comment as to the "truth of the prospectus" is consistent but entirely unrealistic.

30/ e.g. Leonard Lazaroff, Securities Exchange Act Rel. No. 7940, August 22, 1966, p. 4; Hamilton Waters & Co., Securities Exchange Act Rel. No. 7725, October 18, 1965, p. 4; Brown, Barton & Engel, 41 SEC 59, 64-65 (1962).

to contain material information.[31] The financial statement of SRL, for example, failed to state an alleged indebtedness which Svanholm claimed was owed to him by the corporation in a "substantial amount"[32] (estimated by Svanholm at the hearing to approximate $120,000). As urged in the Division's brief, the investors were given a subscription agreement which falsely assured them that the bonds were guaranteed, they were given material which falsely represented that the corporation had contracts and receivables, and that the proceeds of the bond sales would be used for the operation and expansion of the corporation's business. The misrepresentations were reaffirmed by Booker in conversations with the purchasers in which neither written nor verbal advice that the bonds were speculative was given. These were material misrepresentations and omissions and, as urged by the Division, they were made in violation of the anti-fraud provisions of the securities laws.[33] The purchasers of SRL

31/ A finding of wilfullness within the meaning of the securities laws and rules thereunder does not require an intention to violate the law. Hughes v. SEC, 174 F.2d 969 (C.A.D.C. 1949); Sterling Securities Co., 39 SEC 487 (1959).

32/ It is clear from Svanholm's testimony and from his prior actions that he would have paid this alleged indebtedness to himself, if and as soon as the corporation had the funds.

33/ e.g. SEC v. Broadwall Securities, Inc., 240 F. Supp. 962, 968 (SDNY 1965); Jack Perlow, Securities Exchange Act Release No. 7939, August 19, 1966 (misrepresentation concerning issuer's financial condition); Advanced Research Associates, Inc., 41 SEC 579, 582; MacRobbins & Co., 41 SEC 116 (1962) (misrepresentation concerning nature of issuer's business); J.P. Howell & Co., Inc., Securities Exchange Act Release No. 8087 (June 1, 1967); Alexander Reid & Co., Inc., 41 SEC 372, 375 (1963); Advanced Research Associates, Inc., supra, at 575 (misrepresentations concerning contracts of issuer); Idaho Acceptance Corporation, Securities Exchange Act Release No. 7383 (August 7, 1964); Associated Investors Securities, Inc., et al., 41 SEC 160, 171 (1962) (misrepresentations concerning use of proceeds); Idaho Acceptance Corp., supra; Realty Securities, Inc., 41 SEC 906, 908 (1964) (misrepresentation concerning safety of investment).

bonds were unsophisticated investors totally lacking in knowledge of the poor financial condition of the issuer; more specifically, of its debts and lack of assets or prospects for success, and of its deplorable management.

I also find that registrant and Dr. Conrad failed reasonably to supervise Booker with a view to preventing his violations.

Books and Records Violations

The Order charges several violations in the records of registrant and in the filing of required documents with the Commission. It alleges that from on or about April 1, 1967 to February 17, 1970, the date of the Order, registrant wilfully violated and the Conrads wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder, in failing to maintain and preserve customer applications for mutual fund contractual plans.[34/] Respondents urge that this Rule does not make clear the requirement for maintaining a file of such applications and that over the years no prior indication of such requirement had been given to registrant by any regulatory authority. Specifically, Rule 17a-4 requires the preservation for stated periods of the records required to be made by a broker or dealer pursuant to Rule 17a-3 and its subdivisions.

The Division argues that registrant's practice of sending all copies of the application forms to the particular mutual fund, to the custodian bank and to customers violates the Rule that a broker or dealer must retain a copy of such applications for the reason, among others, that "there is no record (or other record of original entry) representing a purchase and sale blotter as required by Rule 17a-3(a)(1)[35/] or memorandum of order

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34/ Division's proposed finding No. 87 asserts this failure as a violation of Rule 17a-3(b)(4), and respondent's brief at paragraph 87 asserts that said Rule 17a-3(b)(4) does not make clear the requirement for maintaining or preserving such applications. Inasmuch as there is no rule bearing that number it is assumed that the references are to Rule 17a-4, as charged in the Order and as urged in the Division's brief

35/ Referred to as Rule 17a-3(1) in Division's brief.

required by 17a-3(a)(6)."[36/] However, the language of Rule 17a-3 and its subdivisions requires a broker or dealer to "make and keep current" the various records mentioned in the 12 subdivisions of the Rule and no specific mention is made of customer applications. Of course, the retention of copies of such forms would be good business practice, and the failure to retain such copies is subject to criticism, but retention is not expressly required by the subsections mentioned above.[37/] Respondents contend that a record of the application with detailed and specific information would satisfy the purposes of the retention requirement. Although there is no substantial evidence that such a record with specific and detailed information was kept by registrant,[38/] and although good business practice was not followed, I believe that a finding of violation of Rule 17a-4 for the reasons urged above would be inappropriate.

However, the Division also asserts in its brief: "Additionally, [registrant] actually receives the copies of these applications from customers and does not retain them but sends them all to the custodian bank." Accordingly, the argument goes, registrant has violated Rule 17a-4(a)(4),[39/] which requires the retention of "Originals of all

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36/ Referred to as Rule 17a-3(6) in Division's brief.

37/ Division's brief cites Weiss, Registration and Regulation of Brokers and Dealers, 41-42 (1965) in support of its position. Mr. Weiss states that a broker-dealer who sells plans for accumulation of mutual fund shares will be in compliance with Rule 17a-4 if he maintains for each customer a card with appropriate notations, copies of the orders or subscription blanks signed by the customers, and makes necessary blotter entries. (Anything less would not be good business practice, but the author does not specify any subsection that would be violated by a failure to maintain copies of the customer application forms).

38/ Mrs. Conrad testified that "all of the information [from the application] is transferred to the [customer's account] card" commonly referred to as the "opening account card," but that cards are often erased and reused.

39/ It appears that the correct citation should be to Rule 17a-4(b)(4).

communications received and copies of all communications sent by such . . . broker, or dealer (including interoffice memoranda and communications) relating to his business as such." The application form, when signed by the customer and delivered to or left with the broker or dealer, constitutes a communication, and it follows that a copy thereof should be retained by the broker or dealer.[40/] Accordingly, the failure to retain and preserve such application forms or "communications" constitutes a wilfull violation of Section 17(a) and Rule 17a-4 thereunder. I find, also, that this violation was wilfully aided and abetted by Dr. Conrad and by Mrs. Conrad, as charged, for it was the duty of both to assure registrant's making and keeping required records. Empire Securities Corp., 40 SEC 1104 (1962); Aldrich Scott & Co., Inc., 40 SEC 775 (1961); Luckhurst & Company, 40 SEC 539 (1961); Thompson & Sloan, Inc., 40 SEC 451 (1961).

The Order further charges (Par. II H) violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder, in that from November 1, 1966 to the date of the Order registrant and the Conrads wilfully failed to file promptly an amendment to registrant's Form BD filed with the Commission, correcting information contained in the application for registration with regard to (1) its officers and directors, (2) its membership in a national securities exchange, and (3) the issuance by the Maryland Securities Commission of a Cease and Desist Order against registrant in September 1969.[41/]

40/ Weiss, op. cit. supra, 45-46.

41/ Section 15(b), as here pertinent, provides that an application for registration as a broker and dealer shall contain such information as to registrant as the Commission by rule requires. Rule 15b3-1 requires the prompt filing of an amendment correcting any information in the filed Form BD which becomes inaccurate.

Respondents' answer admits that registrant has been a member of the Philadelphia-Baltimore-Washington Stock Exchange since April 6, 1969, and it admits the failure to file promptly notifications with regard to each of the above matters. Respondents' brief states that "Mrs. Conrad had no responsibility to the Securities and Exchange Commission in this respect." I find, however, that Mrs. Conrad's responsibilities for completeness and accuracy of registrant's records were sufficiently broad to include the filing of documents such as amendments to the Form BD. Information with respect to the officers and directors, the membership in the Exchange and the Cease and Desist Order is material and should have been reported promptly.[42/] Accordingly, I find that registrant wilfully violated and that the Conrads wilfully aided and abetted violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

The Order charges (Par. II C) that from April 1, 1967 to the date of the Order, registrant wilfully violated and the Conrads wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, in failing to make and keep current certain books and records including ledger accounts and a securities record or ledger for each security.[43/]

In a broker-dealer inspection of registrant's records which began on March 3, 1969 under the aegis of an experienced supervisory investigator on the staff of the Commission, it took three men a total of 30 working

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42/ Peoples Securities Co., 39 SEC 641 (1960); Intermountain Securities Inc., 39 SEC 638 (1960); Cf. I.B. Morton & Company, Inc., 40 SEC 700 (1961).

43/ Section 17(a) of the Exchange Act, as pertinent here, requires every registered broker or dealer to make and keep such records as the Commission may prescribe. Rule 17a-3 enumerates the records required to be made and kept. They include the records which are the basis for the charge in the Order. The requirement to make and keep records embodies the requirement that they be true and accurate. Lowell Niehbur & Co., Inc., 18 SEC 471 (1945).

days to examine records that normally could have been examined in 3 working days. The records were found to be in a deplorable state for the period April 1, 1967 through the end date, February 28, 1969. Except as noted herein the proposed findings of the respondents do not refute but, rather, substantially concede the charges of the Division with respect to the records and their inadequacies. And the comments of auditors employed by registrant generally confirm,as noted below, a continuing inadequacy of its records over a period of years.

The evidence showed that of approximately 500 customer ledger accounts examined by the investigators as of February 28, 1969, 416 reflected an open securities balance, and no offsetting or balancing position could be found in 296 cases. From further examination of documents it was concluded that in at least 66 of the 296 cases, delivery of the securities had been made and receipted for, but had not been recorded in the customer ledger accounts. In the other 230 cases, the offsetting or balancing securities position could not be found in the records. In a large number of accounts (estimated at between 150 and 200) the records failed to reflect existing securities positions. It is clear, as charged, that registrant's customer ledger accounts were inaccurate and inadequate. Mrs. Conrad testified that she reviewed the customer ledger accounts during the relevant period, but that her review was confined to those which showed a debit or credit money balance. Dr. Conrad also reviewed the accounts.

Similarly, examination of broker accounts for the same period reflected sloppy bookkeeping, with many ledger accounts containing illegible entries, markings, and cross-outs,all of which made it impossible to understand the

status of the accounts. It was clear that here, too, there was a continuing failure to record receipts and deliveries of securities and that, as with the customer ledger accounts, registrant had no systematic, periodic or effective analysis of the accounts.

The Order also charges that registrant's security position records or ledgers were not accurately posted between April 1, 1967 and the date of the Order. Of 117 transactions listed on the purchase and sales blotters for the period April 18, 1967 to October 15, 1968 and selected for examination on a random sampling basis by a staff investigator, only eight were properly posted in the securities position records, 108 were not reflected therein, one transaction was improperly posted, and with respect to 28 transactions no securities position card title with the name of the security was maintained.

I conclude from the evidence that for the period April 1, 1967 to February 28, 1969, registrant wilfully violated and the Conrads wilfully aided and abetted the violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, in failing to make and keep current and accurate ledger accounts for customers and brokers; and that from April 18, 1967 to October 15, 1968, registrant wilfully failed to make and keep current securities records or ledgers for each security, in violation of Section 17(a) and Rule 17a-3, and that this violation also was wilfully aided and abetted by the Conrads. 44/

The Order charges (Par. IIE) that registrant wilfully violated and that the Conrads wilfully aided and abetted the violations of Section 17(a)

44/ The Commission has frequently stressed the importance of the requirement that books and records be kept current and accurate, particularly because the requirement bears significantly on the ability to determine whether other violations have occurred. Pennaluna & Company, Inc. et al., Securities Exchange Act Release No. 8063, April 27, 1967; Palombi Securities Co., Inc., 41 SEC 266 (1962); Midland Securities Inc., 40 SEC 333 (1960).

of the Exchange Act and Rule 17a-5 thereunder, in that registrant failed to file with the Commission, within the time required by the Rule, a certified report of financial condition containing information required by Form X-17A-5 for the calendar year 1968. The answer of respondents denies the charge, and states that registrant had received extensions of time for filing the report. Dr. Conrad testified that "pursuant to a number of extensions" the report was due on February 1, 1969. The report prepared by registrant's auditors was dated February 1, 1969, and was received at the Washington Regional Office of the Commission on February 24, 1969. Respondents' brief concedes that the filing was late, but urges that the lateness was due partly to the fact that the firm's auditors required an extended period of time to prepare the statement. Dr. Conrad testified that the report was submitted to the Commission "technically some 5 or 6 days late" and that the lateness was due also in some measure to the fact that it had been sent to the old address of the Washington Regional Office, although that office had moved to Alexandria, Virginia.

The evidence shows that the report was received by the Washington Regional Office approximately 116 days after the October 31, 1968 "as of" date of preparation. Rule 17a-5(d) provides that an application may be filed for an extension of time to a specified date "which shall not be more than 90 days after the [as of] date . . . ." Accordingly, the report was filed at least 26 days late. Moreover, Rule 17a-5(a)(B) provides that "such reports must be filed not more than 45 days after the [as of] date . . . ." Under this computation the filing of February 24, 1969 was approximately 71 days late.

The brief of respondents urges that the responsibility for filing this report was Dr. Conrad's and not that of Mrs. Conrad. I cannot agree that

Mrs. Conrad did not share the responsibility. The evidence of her postion in the company and of her responsibilities with regard to the back office procedures, including the many duties she assumed with the bookkeeping and records, indicates that she,as well as Dr. Conrad, had responsibility for the timely filing of the certified statement. I conclude that the statement was filed at least 26 days late, that registrant wilfully violated and that the Conrads wilfully aided and abetted the violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder.

Violation of Credit Regulations

In 1969 a staff investigator inspected registrant's records for the period January 2, 1968 to March 31, 1969, and thereafter prepared schedules, one of which purports to reflect violations of Section 7(c) of the Exchange Act and Section 4(c)(2) of Regulation T promulgated thereunder by the Board of Governors of the Federal Reserve System. 45 /

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45 / As pertinent here, Section 7(c) of the Exchange Act makes it unlawful for any broker or dealer who transacts business in securities through the medium of any member of a national securities exchange to extend or maintain credit in contravention of rules and regulations prescribed by the Board of Governors of the Federal Reserve System. (It was stipulated that registrant transacted business through the medium of a member of a national securities exchange). Section 4(c)(2) of Regulation T promulgated by the Board of Governors requires a broker or dealer to cancel or otherwise liquidate a transaction in which the customer has purchased a security in a special cash account and does not pay for it fully within 7 business days. Prior to July 29, 1968, Section 7(c)(1) of the Exchange Act, under which the Regulation T violations were charged in the Order, made it unlawful for a broker or dealer to extend or maintain credit "On any security . . . registered on a national securities exchange. . . ." in violation of regulations of the Board of Governors. (Underscoring supplied). On July 29, 1968, the underscored words were deleted by Public No. 90-437. A few of the transactions charged as violations of Section 7(c)(1) occurred prior to this amendment and related to over-the-counter stocks. Because of the underscored words then in the statute, I believe such transactions were not violations of Section 7(c)(1). However, Section 7(c)(2) prohibited credit on over-the-counter securities except in accordance with Federal Reserve regulations, which did not permit credit on the stocks involved. Inasmuch as these transactions were fully litigated as violations of Section 7(c) and of the 7-day provision of Section 4(c)(2) of Regulation T, I conclude that respondents were not misled or prejudiced by any mislabelling of the charge, and that violations of Section 7(c) or of Section 7(c)(2) of the Act may be found.

The schedule was prepared from registrant's customer account records, approximately 250 of which were examined by the investigator. Prior to its being offered in evidence the schedule was amended to withdraw four transactions shown by respondents to have been erroneously listed as violations. As amended, the schedule reflects 54 violations during the 15-month period. However, the Division also concedes that in two of the 54 situations the settlement date was incorrectly posted in registrant's books, and that no violations occurred. In the 52 violations now charged, payment was made within a range of 8 days (13 violations) to a high of 32 days. The average time lapse from purchase to payment was approximately 13 business days.

Respondents admit many of the violations but contest others on the basis of the dates of checks received from some of the customers. They contend that the dates are evidence of the dates of payment.

With respect to an alleged one day violation, an affidavit of the purchaser was submitted as proof that a check dated August 6, 1968 was made and delivered on August 5, 1968. Unorthodox as this procedure may be, the Division's reply brief does not contest it, and I accept the contention of respondents and find no violation in this transaction.[46/] However, I do not accept respondents' argument, as to several other violations, that the respective dates of checks received by registrant should be considered the dates of payment. As the Division points out, the Commission has taken the position in Wesco and other cases that because the payment must be received by the broker-dealer within the 7-day period,

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46/ In Wesco and Company, Securities Exchange Act Release No. 7928 (August 5, 1966), the Commission rejected similar affidavits as to three purchases. The Commission stated, as I do here, that acceptance thereof "would not materially affect [the] findings and conclusions herein."

the mailing of a check is not payment. Perhaps of more significance is the Commission's rejection of the argument that the books of a broker-dealer were inaccurate and failed to record correctly the dates of payment.[47/] In the instant case, even with a plethora of evidence that registrant's books and records were unreliable, it is not reasonable to conclude that the dates of the checks should be accepted as the dates of payment and that the specific book entries relied upon by the Division are inaccurate.[48/] There was no credible evidence that these checks were received by registrant on the dates thereof and that, as respondents contend, several transactions are thereby explained away and as to others the period of the violation should be reduced. These arguments are rejected. Accordingly, I find that in 51 transactions, registrant,wilfully aided and abetted by the Conrads, wilfully violated Section 7(c) of the Exchange Act and Section 4(c)(2) of Regulation T thereunder. I am not unmindful of the fact that 13 of the 51 violations were for a single day, and that although the evidence does not so reflect, it is likely that some of the payments may have been timely made.

Section 4(c)(8) of Regulation T in part prohibits the purchase of securities by a broker or dealer for a customer in a special cash account unless sufficient funds are already there, if within the preceding 90 days the customer had bought a security and then sold it without having made full payment for it within the 7 business days from the purchase.

47/ Madison Management Corp., Securities Exchange Act Release No. 7453 (October 30, 1964); Coburn and Middlebrook, Inc., 37 SEC 583 (1957).

48/ Registrant's "Managers' Manual" provides at page 130.2 that all incoming checks are entered and posted daily, but I do not rely on this,for there is evidence that this was not regularly done.

A second schedule prepared by the investigator following the examination discloses numerous violations of Section 4(c)(8) during the period charged, in the accounts of JTD, CH, and Gary Booker. The schedule shows 17 of the "90 day" violations in the account of JTD, 6 in the account of CH and 7 in Gary Booker's account.

The above-mentioned schedules also show that continuous running debit balances existed in the account of JTD during the period July 9, 1968 to February 5, 1969, with 16 "7 day" regulation T violations ranging from 3 days to 25 days. Similarly, the special cash account of Gary Booker reflects that "7 day" Regulation T violations occurred in 6 transactions during the period July 22, 1968 to January 28, 1969. Under Section 4(c)(1) of Regulation T, a broker or dealer may purchase securities for a customer in a special cash account which does not have sufficient funds to pay for the purchase, only if the purchase is "in reliance upon an agreement accepted . . . in good faith that the customer will promptly make full cash payment and . . . does not contemplate selling the security prior to making such payment."

The Commission has held in numerous cases that where, as here, late payments by a customer are repeated in numerous transactions, especially where accompanied, again as here, by many violations of the "90 day" Regulation, such activity evidences the absence of any good faith agreement by the customer, with resultant violations of Section 7(c) and of Section 4(c)(1)(i) of Regulation T. [49/]

49/ Coburn and Middlebrook, supra; Denton & Company, Inc., 37 SEC 739 (1957). See also 26 F. R. Bull. 1173 (1940), where it is stated that "Repetition of delays by the customer . . . would almost conclusively label his transactions as unable to qualify as bona fide cash transactions and would almost conclusively disqualify them for inclusion in the special cash account."

Accordingly, I find that registrant, aided and abetted by the Conrads, violated Section 7(c) of the Exchange Act and Rules 4(c)(8) and 4(c)(1) (as well as Rule 4(c)(2)) of Regulation T in the manner and during the periods set forth above. The violations were wilfull within the meaning of the Act.

Net Capital Violations

The Order charges that during the period from on or about January 31, 1969 to on or about February 28, 1969, registrant wilfully violated and the Conrads wilfully aided and abetted violations of Section 15(c)(3) of the Exchange Act and Rule 15(c)3-1 thereunder, in that registrant effected over-the-counter transactions in securities while its aggregate indebtedness exceeded 2,000 per centum of its net capital, and while its net capital was less than $5,000. (It was stipulated that over-the-counter business was transacted by registrant during the relevant period.)

The investigation in March 1969 resulted in a preliminary calculation of registrant's net capital position as of February 28, 1969, which disclosed no net capital violation by registrant. Thereafter, however, it was determined that registrant had failed to follow an industry practice of obtaining payment from other broker-dealers concomitant with the delivery of securities. Instead, registrant followed a practice of shipping securities "free" to purchasing broker-dealers. A schedule prepared by the supervisory staff investigator reflected that as of February 28, 1969, registrant had delivered "free" to broker-dealers, securities amounting to $35,722.58, for which payment had not then been received. In computing registrant's net capital position as of January 31, 1969, it was determined that such deliveries "free" to broker-dealers were in the amount of $28,625.89, for which it had not then received payment.

The Division contends that these unsecured receivables should not be included in computing net capital, inasmuch as Rule 15c3-1(c)(2)(B) requires the deduction of "assets which cannot be readily converted into cash." With the deduction of the $35,722.58 it was concluded that as of February 28, 1969, registrant was in violation of the Commission's net capital rule as follows:

Aggregate Indebtedness	$151,153.62
Required Net Capital Under Rule	7,557.68
Net Capital	5,745.50
Deduction on Proprietary Securities	15,005.25
Adjusted Net Deficit	9,259.75
Additional Capital Required	16,817.43

With the disallowance of such unsecured receivables as of January 31, 1969, registrant was determined to be in violation of the Commission's net capital rule as follows:

Aggregate Indebtedness	$ 64,322.38
Required Net Capital Under Rule	5,000.00
Net Capital	1,486.42
Adjusted Net Deficit	3,513.58
Additional Capital Required	3,513.58

Registrant's auditor testified to the effect that the unsecured receivables were readily convertible into cash and should not have been deducted in the computation. He conceded that industry practice is to draft securities to the purchasing broker, thereby insuring payment upon delivery.[50/] However, he testified, in accord with Capital Requirements Rule No. 325 of the New York Stock Exchange, that in his opinion such an unsecured receivable should be allowed for net capital purposes if, at the time of the "as of" date of the computation the receivable is not more than

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50/ As a matter of "public interest" documents were received in evidence showing that registrant had been advised by its auditor in 1967, 1968 and 1970, that "free" delivery is inconsistent with industry practice, is also risky, and that such unsecured indebtedness is an "unnecessary charge to net capital." The documents are discussed infra under "Public Interest and Sanctions."

30 days old. (He conceded that because of the "grace period" of 30 days an unsecured receivable would be allowed under this theory even though it was as much as 59 days old at the time of the "as of" date).

In light of the basic purpose of the net capital rule to protect investors and to insure public confidence in the securities industry it is essential that recognition be given to the importance of the principle that customer cash balances are payable promptly on demand. The inability to make prompt payment would not only endanger the position of the customer, but also,even apart from any danger, would tend to undermine his confidence in the industry. The Commission appears to have expressed its refusal to recognize credit for all unsecured receivables in a letter to the New York Stock Exchange dated February 10, 1971. In a recently issued and publicly released summary of that letter it was stated that:

> "One of the differences in approach between the Exchange's net capital rule and that of the Commission has been the 30-day liquidity gap. Whereas the Commission has refused to give credit for unsecured receivables, the Exchange has given credit for them if they were not more than 30 days old . . . .
>
> ". . . 30-day, 60-day, or 90-day payment hardly meets this requirement [to meet customer demands in a prompt manner].
>
> Accordingly, it was suggested that the Exchange's net capital rule require a full charge for dividends and interest receivable at all times. It was also suggested that the Exchange's net capital rule require a full charge for all other unsecured receivables, including tax refund claims and insurance claims."

The testimony of the auditor, including his argument that at the time of the "as of " date ". . . you don't know that you are not going to receive this money" within the grace period is not persuasive assurance of the liquidity of an unsecured balance.[51/] Unrefuted computations of

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51/ Cf. Matter of Patrick Clements, Securities Exchange Act Release No. 7443 (October 12, 1964).

the Division indicate, with respect to registrant's unsecured indebtedness resulting from such "free" deliveries, that the average length of time between delivery and payment was 48 days.

The auditor also testified that the account of registrant with Reynolds & Co. (during the relevant period this was phased out and a similar account was established with F.I. duPont & Co.) should have been considered an "omnibus account" and that unsecured receivables resulting from the "free" deliveries of securities would thus be regarded as assets, inasmuch as such account is "netted" for net capital purposes. His testimony with regard to the creation, existence, and nature of such "omnibus accounts" was vague and not convincing. He stated that in his computations of registrant's net capital as of the January 31 and February 28 dates he considered the Reynolds and duPont accounts as "omnibus accounts" because Dr. Conrad had told him orally that they had this status. I conclude that this approach did not refute the Division's contention that such unsecured indebtedness should not be allowed in computing assets for net capital purposes under the Commission's Rule for the reason that such indebtedness is not readily convertible into cash.

It follows that, as charged in the Order, registrant wilfully violated and the Conrads wilfully aided and abetted violations of the Commission's net capital rule during the period January 31, 1969 to February 28, 1969, inasmuch as the aggregate indebtedness exceeded the required minimum, and because as of January 31, 1969 registrant's net capital was below the required minimum of $5,000.

Public Interest and Sanctions

(a) Registrant and Dr. Conrad

The Division makes the point that not only have registrant and Dr. Conrad wilfully violated or aided and abetted the violation of the several statutes and rules discussed above, but they have also been guilty of numerous other violations for which sanctions have been imposed by regulatory authorities. 52/

52/ Following is registrant's "pattern of repeated failures" to comply with rules and regulations governing the securities industry.

On November 18, 1964, Financial Planning Co., the predecessor firm of registrant, was fined $100 and censured by the NASD for violations of certain NASD rules, including the failure to maintain complete customer ledgers in that the posting of debits or credits was made in a number of instances without explanation; Regulation T violations; and failure to maintain a securities position record. This NASD order further pointed out that it had previously determined that registrant was not maintaining a securities position record as required by SEC Rule 17a-3, that the NASD had so informed registrant by letter of February 15, 1962, and had received a written reply from Dr. Conrad dated March 2, 1962, assuring the NASD that such a securities position record had been initiated.

On December 6, 1967, the Virginia State Corporation Commission fined registrant $7,500 for allowing salesmen who were not registered in Virginia to sell securities to residents of Virginia. On November 25, 1969, registrant was fined $3,000 by the same Commission based upon similar findings.

On September 17, 1969, the Securities Commissioner of Maryland issued a Cease and Desist Order against registrant, based upon its sale of the unregistered SRL bonds.

In March 1970, the Philadelphia-Baltimore-Washington Exchange issued an order which, after a subsequent appeal, provided by letter of June 10, 1970, for suspension of Dr. Conrad and registrant from membership in that Exchange for a period of three months. This was based on the sale of the SRL bonds.

In September 1970, the Maryland Securities Commissioner suspended the registration of Dr. Conrad and registrant for a period of 28 days and fined registrant $5,000 for fraud in the sale of the SRL bonds in violation of the Maryland Securities Act.

On September 30, 1970, the Public Service Commission for the District of Columbia issued an order suspending Dr. Conrad's broker-dealer agent license for 90 days for failure to reasonably supervise the activities of Gonzales.

On October 12, 1970, the Philadelphia-Baltimore-Washington Exchange fined registrant $500 for failure to comply with the Exchange's net capital rule.

As of October 15, 1970, registrant had filed no amendments to its Form BD reflecting several of the sanctions listed above.

In this vein, Division counsel suggest that Dr. Conrad has displayed over the past several years a disregard for regulatory requirements and a disdain for the interests of the customers of his company. Counsel also point out (as has been indicated above) that Dr. Conrad's testimony is in large part utterly incredible, and that it is directly contradicted not only by his own prior sworn testimony and by his statements, both written and oral, but also by the testimony of several other witnesses. I agree with these contentions, and add that his testimony is contradictory and implausible in so many material aspects as to be virtually worthless when standing as the sole support for a factual assertion or proposed finding.

The many wilfull violations found to have been committed by registrant even apart from the record of its past violations, [53/] leads clearly to the conclusion that the public interest requires that registrant's broker-dealer registration be revoked and that it be expelled from membership in the NASD and the Philadelphia-Baltimore-Washington Stock Exchange. Dr. Conrad has been primarily and ultimately responsible for the poor record of registrant. His conduct of its business, his attitude of disrespect for the regulatory authorities and their prescriptions for the conduct of a broker-dealer business, his lack of respect for the rights of customers of registrant, and his carelessness with the truth make it clear that it is in the public interest that he be barred from association with any broker or dealer.

I am aware and mindful of the information supplied by respondents,

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53/ In considering the Gonzales and SRL violations in the light of prior sanctions imposed by regulatory authorities for the same activities of registrant and Dr. Conrad, I have regarded such prior sanctions as mitigating rather than aggravating factors.

after the filing of post-hearing documents, to the effect that after lengthy negotiations with registrant's insurer, an agreement was reached in January 1971, that the carrier would pay to registrant under a Brokers Blanket Bond, the sum of $10,400 to be applied to the claims of purchasers of the SRL bonds; that the terms of settlement with the purchasers provide for payment of 87½% of the principal amount of bonds held; that amounts in addition have been applied by agreement of the parties to counsel fees and other expenses of settlement; and that settlement has been effected or is close to effectuation with all bondholders excepting one whom it has not been possible to locate.[54/] The mitigating effect of these payments is considered but it appears minuscule when compared with the violations of registrant and Dr. Conrad.

Mrs. Conrad

Because of her close association with registrant for several years as officer and stockholder and her authority and responsibility for the back-office supervision and for the books and records, Mrs. Conrad was in a position to know of the inadequacies that persisted in back-office procedures and records despite administrative proceedings and sanctions by regulatory authorities and repeated warnings of improprieties by registrant's auditors.[55/] There is no evidence that she demanded of her

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54/ This information was furnished by copy of letter dated January 15, 1971 and by copy of affidavit of Dr. Conrad dated February 24, 1971, with attachments. Counsel for Division have not responded to or disputed the information in the letter or affidavit, copies of which have been made a part of the record as Hearing Examiner's Exhibit A.

55/ For example, reports of the company's auditors made in 1968 and 1969 and submitted to registrant were received as matters of "public interest" and deserve consideration with regard to sanctions appropriate for Mrs. Conrad as well as those appropriate for Dr. Conrad and registrant. The reports were highly critical of the record-keeping. A report dated February 2, 1968 recommended that broker accounts be analyzed regularly (Continued)

husband that necessary changes be made: there is much evidence that a conscientious official of registrant should have made such demand. Mrs. Conrad was fully aware that the firm's books and records were completely inadequate and failed to take or insist upon effective measures to correct the situation.

I do not assess against Mrs. Conrad the same degree of responsibility for the violations as I do against her husband. As chief operating officer, Dr. Conrad had the duty and responsibility to supervise his wife's activities as well as those of other employees. Without detracting from the very serious nature of the violations wilfully committed by Mrs. Conrad and the need, in the public interest, for the imposition of a significant sanction, I cannot fail to recognize her subordination to her husband in registrant's business, and I recognize, also, her greater respect for adherence to the truth in testimony in administrative proceedings.

Because it is not possible to conclude that Dr. Conrad's dominance over his wife's activities in the securities business will necessarily

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(Continued)

55/ during the month to correct errors promptly rather than "errors being allowed to remain on the records month after month." The report also recommended "development of a regular program of analysis of [customer] accounts on a systematic basis." However, no effective corrective action had been taken as of October 31, 1968, or as of February 28, 1969, as indicated in the examination by the Commission's staff investigators. The report also stated: "SEC regulations require that a securities position record be maintained in a daily basis", but that as of November 30, 1967, the date of the examination by the auditors, such a report was only partially maintained and it was necessary for the auditors to reconstruct the record in order to complete the examination.

The 1969 report of the company's auditors was dated February 1, 1969, and was made as of October 31, 1968. In part it stated, as to broker accounts, that evidence of reconciliation procedure "is still lacking, errors being allowed to remain on the record month after month", and, as to customer accounts, that "ledger records have not been maintained on a current basis during most of the year."

exist if he is not associated with any broker or dealer, I believe it is not necessary or appropriate in the public interest that Mrs. Conrad be barred from such association. I do believe, however, that it is in the public interest that she be suspended from association with any broker or dealer for one year.

Gonzales

The seriousness of the several conversions by Gonzales was not mitigated by understandable pressures such as family illness or temporary but pressing need for funds for an emergency.

There are, however, other mitigating circumstances urged by his counsel as a basis for a conclusion that no sanction against Gonzales need be imposed in the public interest, or that a sanction which would be appropriate, absent mitigating factors, should be substantially lessened because of such factors.

One of such factors is the suspension of Gonzales by the Maryland Securities Commission and the District of Columbia Public Service Commission for a period of 18 months from January 1969 for conversions which are the subject of the instant proceedings.[56/] A second factor urged in mitigation is the improper training received by Gonzales in Conrad and Company, and the lack of any other training in the securities business. Coupled with this is the plea that in the atmosphere generated by registrant's business activity, including in some form a condonation

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56/ Gonzales' counsel stated that his client terminated his activities in the securities business at the onset of the Maryland and District proceedings and the sanctions were therefore made retroactive. If so, the suspension ended in June 1970. As of the time of Gonzales' testimony he had not returned to the securities business.

of the salesman's retention of customer funds, Gonzales never had been given a true or full appreciation of the seriousness of misapplication or conversion of such funds. Nor, in this atmosphere, it is urged, did he hear "anything of respect or admiration for regulatory bodies."

Also stressed by Gonzales' counsel as a mitigating factor and viewed by me as most significant is the cooperation given the Division by Gonzales, and his alleged desire and effort to recant for his wrongful action. I credit his testimony and commend his effort to adhere to the truth and to cooperate with the Division. I recognize, at the same time, that his conduct is undoubtedly substantially motivated by a desire to be able to engage once more in the securities business.

After consideration of the evidence, the circumstances of his offenses and the mitigating factors, including his repayment of all sums misappropriated, I conclude that it is in the public interest that Gonzales be barred from association with a broker or dealer. This does not mean that he will not have the opportunity to return to the securities business upon application to the Commission for such permission and upon a showing that he will be properly supervised. On the contrary, I believe that after one year he should be permitted to make such application to the Commission upon such showing. Cf. Vanesco v. SEC 395 F.2d 349 (1968). Accordingly,

IT IS ORDERED that the registration of Conrad & Company, Inc. as a broker and dealer is hereby revoked, and said company is expelled from membership in the NASD and in the Philadelphia-Baltimore-Washington Stock Exchange;

that Thomas D. Conrad, Jr. is barred from being associated with a broker or dealer;

that Margaret J. Conrad is suspended from association with a broker or dealer for a period of one year from the effective date of this order;

that Roland L. Gonzales, Jr. is barred from association with a broker or dealer, provided, however, that after one year from the effective date of this order he is permitted to apply to the Commission for an order permitting him to become associated with a broker-dealer upon a satisfactory showing that he will be properly supervised.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this decision as to him. If any party timely files a petition for review or if the Commission takes action to review as to a party, this initial decision shall not become final with respect to such party. 57/

Sidney Ullman
Hearing Examiner

March 10, 1971
Washington, D.C.

57/ To the extent that the proposed findings and conclusions submitted by the parties are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are rejected. All contentions and proposed findings have been considered. Some have been omitted as not necessary to a determination of the issues.