

FILE COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
R. L. COLBURN COMPANY
215 West 7th Street
Los Angeles, California
File No. 8-3680

FILED

MAY 15 1964

SECURITIES & EXCHANGE COMMISSION

RECOMMENDED DECISION

Warren E. Blair,
Hearing Examiner

New York, New York
May 15, 1964

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BEFORE: Warren E. Blair, Hearing Examiner

APPEARANCES: Frank E. Kennamer, Jr., Esq.
San Francisco Regional Office of the
Commission for the Division of Trading
and Markets.

Gardiner Johnson, Esq.
221 Sansome Street, San Francisco,
California for R. L. Colburn Company,
Ray M. French, Norman Hudson, George
J. Flach and Samuel Apple.

Nature of Proceeding

These proceedings were instituted on December 14, 1962 by an Order for Public Proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether the allegations made by the Division of Trading and Exchanges, now known as the Division of Trading and Markets ("Division") concerning R. L. Colburn Company ("registrant"), George J. Flach ("Flach"), Ray M. French ("French"), Norman Hudson ("Hudson") and Samuel Apple ("Apple") are true; whether remedial action is appropriate pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act; and whether pursuant to Section 15A(b)(4) of the Exchange Act, Flach, French and Hudson, or any of them, should be found a cause of any order of revocation, suspension or expulsion.

In substance, the Division alleges that registrant, aided and abetted by Flach, wilfully violated Section 7(c) of the Exchange Act and Section 4(c)(2) of Regulation T by extending and maintaining credit and arranging to extend and maintain credit without compliance with Regulation T;

and wilfully violated Section 11(d)(2) of the Exchange Act by failing to disclose to customers that registrant acted as broker for both buyer and seller involved in the same transaction. The Division further alleges that French and Hudson caused such violations to occur through lack of supervision of the San Francisco office of registrant and that Apple holds membership on the San Francisco Mining Exchange ("Mining Exchange") as nominee of registrant.

At the hearing before this Hearing Examiner, an appearance was filed by counsel for the Division and by counsel on behalf of registrant, Flach, French, Hudson and Apple. Proposed findings of fact and conclusions of law and briefs in support thereof were filed by the parties in accordance with the Commission's Rules of Practice.

The following findings, conclusions and recommendations of the Hearing Examiner are based upon the record in these proceedings, including the testimony of witnesses and exhibits introduced at the time of the hearing.

Jurisdiction

1. Registrant has been registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act since January 1, 1936 and is a member of the National Association of Securities Dealers, Inc., a national securities association, and of the Mining Exchange, a national securities exchange. At all times pertinent herein, French has been president and a director of registrant; Hudson has been vice-president and a director of registrant; Flach has been manager of registrant's San Francisco office. Hudson and Flach are members of the Mining Exchange. Apple is an agent of the registrant in its Ventura (California) office but has no executive responsibility. Apple holds a membership in the Mining Exchange as nominee for registrant. The membership was placed in Apple's name as an incentive for him to remain with registrant. The membership will revert to French if Apple leaves registrant.

2. Registrant did practically all of the business in its San Francisco office through the facilities of the

Mining Exchange, and used the mails to send confirmations of transactions to its customers.

Extension of Credit

3. Division Exhibit No. 1, a sample consisting of 33 of registrant's customer accounts in its San Francisco office as of May 24, 1962, shows 55 instances during the period from June 30, 1949 through April 5, 1962 where debit balances were late for periods from 8 days to over 12 years. These debit balances which were created in connection with securities purchases ranged from slightly more than \$100 to an excess of \$5,000, with most balances being under \$300.

4. The customer accounts referred to were initiated as cash accounts. No application was made by registrant or Flach to the Mining Exchange or, apparently, to a national securities association to extend the time for settlement of the cash accounts nor was authorization obtained from the Mining Exchange or a national securities association for transfers of these transactions from cash accounts to general or margin accounts.

5. Registrant has other customer accounts in its San Francisco office in addition to those reflected in Division's Exhibit No. 1 in which payments for securities transactions have been late and where no action was taken to secure an extension of time through the Mining Exchange or to liquidate the transaction promptly.

6. In a few instances, margin agreements were obtained from persons whose accounts were listed in Division's Exhibit No. 1, and for the most part those agreements were not obtained until 1962. Even after the margin agreements were obtained, it does not appear that adequate margin was always maintained in those accounts.

Double Agency Transactions

7. Over the years, a great part of registrant's business has involved so-called double agency transactions wherein the registrant acted as the agent for both the buyer and the seller in the same securities transaction. When the registrant's Los Angeles office engaged in such a transaction, each of the confirmations sent to the buyer and to the seller would be stamped with a legend to the effect that the transaction was consummated by registrant as broker for both buyer and seller. A rubber stamp

with a similar legend had been in Flach's possession for some years previous to 1962 but for years was not put to use in registrant's San Francisco office. Numerous confirmations reflecting settlement dates in May and June 1962 were placed in evidence and such confirmations, which relate to double agency transactions effected by Flach for the registrant, do not contain adequate disclosure of registrant's dual capacity.

8. In connection with the operation of registrant's San Francisco office, Flach had discussions with representatives of the staff of the Commission prior to July, 1954 concerning the necessity for disclosure to customers when registrant effected a double agency transaction.

Lack of Supervision

9. Registrant followed the practice of having its San Francisco office keep books and records separate and apart from those of its Los Angeles office. Hudson and French kept in touch with the results of the San Francisco office by means of a monthly profit and loss statement and an annual financial statement.

10. Since at least 1949, Hudson and French did nothing to assure that the San Francisco office was complying with applicable rules and regulations except through correspondence with Flach. At no time did Hudson or French make or cause to be made any examination of registrant's San Francisco books. On those occasions when Hudson or French traveled to San Francisco, the trips were principally for pleasure, with business being discussed with Flach only incidentally.

Conclusions

11. During the period from about June 30, 1949 to May 31, 1962, registrant failed to promptly cancel or otherwise liquidate various transactions or the unsettled portions thereof in numerous customer cash accounts, and failed to apply for or obtain extensions of time to do so from an appropriate committee of a national securities exchange or a national securities association. Registrant's actions and inactions in this regard constituted wilful violations of Section 7(c) of the Exchange Act and Section 4(c)(2) of Regulation T.

12. During the period from about July 1, 1954 to May 31, 1962 registrant effected securities transactions for its customers without making the disclosure required when acting as broker for both buyer and seller in the same transaction. Registrant's omissions in this regard constituted wilful violations of Section 11(d)(2) of the Exchange Act.

13. Flach was placed in complete charge of registrant's San Francisco office. He was directly responsible for the operation of that office and for the wilful violations of registrant complained of herein, which he aided and abetted.

14. At no time did Hudson or French, who confined their activities to Los Angeles, undertake actual supervision of the activities of Flach or the operation of the registrant's San Francisco office. They were satisfied with making certain about the financial results achieved by Flach in San Francisco, but heedless of the means by which Flach accomplished those results. As principal officers and directors of registrant, Hudson

and French had the duty of keeping themselves informed about what was happening in the San Francisco office and could not escape responsibility or accountability for registrant's violations by allowing Flach to assume complete control of that office. ^{1/} Had Hudson and French or either one of them been diligent in watching over Flach's activities, the probability is that registrant's violations would not have occurred, or, if they had occurred, would not have continued for such an extended period of time. Their failure to supervise constitutes participation in the misconduct of registrant for which they may be held to account. ^{2/}

Public Interest

15. Until the present proceeding was instituted, registrant (which opened its office in 1928) had not been the subject of disciplinary action by the Commission, nor had Hudson or French ever had a complaint made

1/ Aldrich, Scott & Co., Inc., 40 S.E.C. 775 (1961)

2/ Reynolds & Co., 39 S.E.C. 902 (1960)

or a charge filed against them by any person, nor had they had formal proceedings instituted against them by any state or federal regulatory agency. No actual notice had been received by Hudson or French prior to May, 1962 that the San Francisco office had not been making proper disclosure on its double agency transactions, and no notice was received regarding the existence of Regulation T violations. The operations of the Los Angeles office of the registrant have never been the cause of a charge or complaint involving compliance with Regulation T.

16. Flach has been licensed as a broker by California since 1944. No charges have ever been filed against him by a state or federal regulatory body until the present proceedings were instituted. He has been president of the Mining Exchange since 1939 and has been manager of registrant's San Francisco office since September 30, 1939.

17. The record does not disclose that any customer of registrant, any securities firm, or any member of the

general public suffered financial loss in consequence of registrant's violations.

Recommendations

18. Although registrant's conduct does not appear to have caused an identifiable harm to anyone, that fact merely mitigates rather than excuses the long continuing violations of the registrant. However, it does not appear that revocation of registrant's registration or its expulsion from the National Association of Securities Dealers, Inc. is required in the public interest. Under the circumstances, the Hearing Examiner recommends that a suspension for fifteen (15) days of registrant's membership in the National Association of Securities Dealers, Inc. would be appropriate in the public interest. ^{3/}

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^{3/} It should be noted that although the Division and Respondents give attention in their respective Proposed Findings, Conclusions and Briefs to the question of whether the membership of R. L. Colburn Company in the Mining Exchange should be suspended, the question of such suspension is not raised in paragraph (e) of Section III or in any other paragraph in that Section of the Order for Proceedings.

19. In view of the immediate responsibility of Flach for the operation of registrant's San Francisco office during the entire time in question, he and not the principals who placed their complete trust and confidence in him should bear the greatest onus for registrant's conduct. Moreover, the Hearing Examiner concludes from all of the testimony and from observation of Flach while he was testifying, that Flach was aware of the need for full disclosure of registrant's dual agency for many years. In addition, the Hearing Examiner believes that Flach was well aware of the requirements of Regulation T, and chose to ignore them in the hope of improving the profit position of the San Francisco office which in turn would be of benefit to him by reason of his financial arrangements with registrant. Under the circumstances, the Hearing Examiner recommends that a suspension of Flach's membership in the Mining Exchange for a period of sixty (60) days would be appropriate in the public interest and that Flach be named a cause within the meaning of Section 15A(b)(4) of the Exchange Act of any

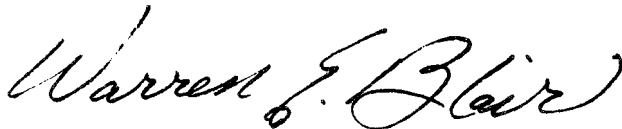
order of revocation, suspension or expulsion entered herein against registrant.

20. Although the Hearing Examiner concludes that Hudson and French are less culpable than Flach for the violations committed by registrant, they, as principals of registrant, neglected their obligation to the public at their peril. It is recommended that in the public interest the membership of Hudson in the Mining Exchange be suspended for a period of fifteen (15) days and that Hudson and French be named as causes within the meaning of Section 15A(b)(4) of the Exchange Act of any order of revocation, suspension or expulsion entered herein against registrant.

21. Because the membership in the Mining Exchange was transferred to Apple as an incentive, and because it does not appear in the public interest to require that Apple suffer for the activities of Flach, with whom he had no apparent relationship other than the coincidence of their association with registrant, the Hearing Examiner

recommends that no order of suspension or expulsion be entered affecting the membership in the Mining Exchange held by Apple. ^{4/}

Respectfully submitted,



Warren E. Blair,
Hearing Examiner

New York, New York
May 15, 1964

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4/ To the extent that the proposed findings and conclusions submitted by the parties are in accord with the views set forth herein they are sustained, and to the extent that they are inconsistent therewith they are expressly overruled.