UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
REED, WHITNEY & STONEHILL, INC. LEONARD LAZAROFF MILTON STEINBERG SEYMOUR TANKLEFF RUSSELL SILBACH	:
File No. 8-9837	:

INITIAL DECISION
PRIVATE PROCEEDING

Samuel Binder
Hearing Examiner

Washington, D. C.
October 20, 1965

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BEFORE: Samuel Binder, Hearing Examiner

APPEARANCES: David Marcus, Esq.
Alfred V. Greco, Esq.
On behalf of the Division of Trading and Markets
Securities and Exchange Commission

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These are private proceedings instituted by the Commission on February 15, 1965 pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act")[1/]. The issue presented is whether Reed, Whitney & Stonehill, Inc. (formerly Meadowbrook Securities, Inc.)[2/] ("registrant"), Leonard Lazaroff, also known as Leonard Lawrence ("Lazaroff"), Milton Steinberg ("Steinberg"), Seymour Tankleff ("Tankleff"), and Russell Siebach ("Siebach"), ("respondents") each of whom was an officer, director and stockholder holding more than 10% of registrant's stock, wilfully violated, singly and in concert, designated provisions of the securities acts[3/], and, if so, what if any, remedial action is in the public interest.

The order for proceedings alleges (1) that during the period between March 13, 1962 and September 1, 1962 the registrant, wilfully aided and abetted by Lazaroff, Tankleff, Steinberg, and Siebach effected securities transactions when its aggregate indebtedness

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1/ Section 15(b) of the Exchange Act, as applicable here, provides that the Commission shall revoke the registration of a broker or dealer, if it finds that such action is in the public interest, and that such broker or dealer, or any officer, director or controlling or controlled person of such broker or dealer, has wilfully violated any provisions of the Securities Act of 1933 or of the Exchange Act or of any rule thereunder.

2/ The respondent's name was changed from Meadowbrook Securities, Inc. to Reed, Whitney & Stonehill, Inc. as reflected in an amendment filed by registrant with the Commission on June 14, 1962. The respondent broker-dealer will be referred to as "registrant" whether the record reference is to Reed, Whitney & Stonehill, Inc., or Meadowbrook Securities, Inc.

3/ Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, and Sections 10(b), 15(b), 15(c)(1), 15(c)(3) and 17(a) of the Exchange Act, and Rules 10b-5, 15b-2, 15c1-2, 15c3-1 and 17a-5 thereunder.

exceeded 2000% of its net capital in wilful violation of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 (17 CFR 240.15c3-1) thereunder[4]; (2) that the registrant, Lazaroff, Tankleff, and Steinberg during the period between January 31, 1962 and August 31, 1962 wilfully violated the registration requirements of the Securities Act of 1933 ("Securities Act") in connection with the sale of the stock of Flex-I-Brush, Inc. ("Flex-I-Brush" or "issuer")[5]; (3) that the registrant, Lazaroff, Tankleff and Steinberg during the period between January 31, 1962 and August 31, 1962 singly and in concert wilfully violated anti-fraud provisions of the Exchange Act and of

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4/ Section 15(c)(3) of the Exchange Act, insofar as here pertinent, prohibits the use of the mails or interstate facilities by a broker or dealer to effect any transaction in any security, otherwise than on a national securities exchange, in contravention of the rules prescribed by the Commission under the act providing safeguards with respect to the financial responsibility of brokers and dealers. In the latter connection Rule 15c3-1 provides that no broker or dealer, with exceptions not applicable here, shall permit this aggregate indebtedness to all other persons to exceed 2000% of his net capital as computed as specified in the rule.

5/ The registration provisions alleged to have been violated are Sections 5(a) and (c) of the Securities Act which in pertinent part make it unlawful to use the mails or the facilities of interstate commerce to sell or offer to sell or offer to buy a security unless a registration statement is in effect as to such security or unless an exemption from registration is available. One of the issues arising in this case is whether the exemption from registration under Section 3(b) and Regulation A adopted thereunder was unavailable for the offering of Flex-I-Brush stock because of the alleged failure of Flex-I-Brush to comply with the terms and conditions of Regulation A adopted under the Securities Act.

the Securities Act in connection with sales of the stock of Flex-I-Brush[6/]; (4) that the registrant wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, and Siebach wilfully aided and abetted such violations by failing to file reports of financial condition as required for the years 1963 and 1964[7/]; (5) that the registrant and Siebach, during the period between March 13, 1962, and September 1, 1962 wilfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder in that they represented that registrant was ready and able to discharge its liabilities when they knew or had reasonable ground to believe but did not disclose that registrant had a net capital deficiency as computed pursuant to Rule 15c3-1, and was unable to meet its liabilities arising in the ordinary course of business; (6) that the registrant wilfully violated Section 15(b) of the Exchange Act and Rule 15b-2 thereunder

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6/ The anti-fraud provisions alleged to have been violated are Section 17(a) of the Securities Act, and Section 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5, 15c1-2 and 15c3-1 (17 CFR 240.10b-5, 15c1-2 and 15c3-1 thereunder). The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or of any interstate instrumentality to effectuate securities transactions by means of false or misleading statements of material facts, or any act or course of business which operates as a fraud upon customers, or of any other deceptive or fraudulent devices.

7/ Section 17(a) of the Exchange Act requires every registered broker or dealer to make such reports as the Commission may prescribe by rule or regulation as necessary or appropriate in the public interest or for the protection of investors. Rule 17a-5 provides that every registered broker or dealer must file a report of financial condition for each calendar year.

in that registrant failed to file an amendment on Form BD[8/], disclosing that the Commission in its Findings and Opinion of April 10, 1963, In the Matter of Sutro Bros. & Co., (Securities Exchange Act Relase No. 7052) found that Siebach aided and abetted wilfull violations of Section 7(c) of the Exchange Act and Section 7(a) of Regulation T.

After appropriate notice, hearings were held before the undersigned Hearing Examiner.

Respondents Tankleff and Lazaroff filed answers denying generally the allegations made against them and they appeared by counsel at the hearings held herein. Siebach addressed a letter to the Commission denying generally the allegations set forth in the order but did not appear at the hearing. Steinberg filed no answer but, during the hearing, counsel appeared on his behalf. The registrant filed no answer and did not appear.

The Division presented extensive evidence to support the allegations in the order and no evidence was offered in rebuttal by the respondents.

8/ Rule 15b-2 of the Exchange Act requires registered brokers and dealers to file Form BD, adopted by the Commission and to file material amendments thereto as specified in Item 8(c) of Form BD which, in pertinent part, requires information whether any officer, director or controlled persons has been found by the Commission to have violated any provisions of the Securities Act or the Exchange Act or any rule or regulation under either of said acts.

Opportunity to file proposed findings of fact and conclusions of law and supporting briefs was afforded all parties but the only proposed findings and briefs received were those filed on behalf of the Division and Tankleff.

The findings and conclusions hereunder are based upon the record, and observation of the witnesses, and after careful consideration of the pleadings, proposed findings, and briefs filed herein.

Registrant, a New York corporation, became registered with the Commission as a broker and dealer on August 2, 1961.

Lazaroff was President, Director and owner of 10% or more of the capital stock of registrant from July 19, 1961 to March 27, 1962. Steinberg was Executive Vice President, a Director and owner of 10% or more of the capital stock of registrant from July 19, 1961 to March 27, 1962 and Secretary-Treasurer, Director and owner of more than 10% of the capital stock of registrant from March 27, 1962 to June 14, 1962. Although registrant's broker-dealer application and the amendments thereto reflected that Tankleff was Secretary-Treasurer, a Director and owner of 10% or more of the capital stock of registrant from March 8, 1962 to March 27, 1962, the credible evidence in the record discloses that Tankleff,in fact, became Secretary-Treasurer, a Director and owner of 10% or more of the capital stock of registrant commencing with the end of December

1961 and continued in such capacity until at least March 27, 1962.[9/] Siebach is and has been the President, Director and owner of more than 10% of the capital stock of the registrant from March 27, 1962 to the present time.

Prior to becoming an officer and Director of registrant, Siebach had been employed by Sutro Bros. & Co., a registered broker-dealer.

On April 10, 1963, by order of the Commission, Siebach was found to have aided and abetted wilfull violations of Section 7(c) of the Exchange Act and Section 7(a) of Regulation T, In the Matter of Sutro Bros. & Co. (Securities Exchange Act Release No. 7052). Siebach admitted that he had become aware of the Commission's findings in the Sutro case as of May 1963, when he was the President and a controlling person of the registrant. However, registrant did not file an amendment to its Form BD to reflect such fact.

The registrant wilfully violated Section 15(b) of the Exchange Act and Rule 15b-2 thereunder and Siebach wilfully aided and abetted such violation in that the registrant wilfully failed to file an

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9/ During the hearing, Tankleff amended his answer to assert that he had become Secretary-Treasurer, a Director and owner of more than 10% of registrant's common stock commencing with the end of December 1961 and had severed all connection with the registrant at the end of February 1962 i.e., at a time prior to March 13, 1962, the earliest date at which the Commission's order alleged that registrant and its officers had violated the net capital rule.

amendment on Form BD disclosing that the Commission in its Findings and Opinion of April 10, 1963, In the Matter of Sutro Bros. & Co. (Securities Exchange Act Release No. 7052) found that Siebach aided and abetted wilfull violations of Section 7(c) of the Exchange Act and Section 7(a) of Regulation T.

Violations of the Net Capital Rule

The uncontradicted facts are as follows:

Computations based on registrant's books and records as of March 13, 1963 revealed that it had at that time a net capital deficiency under Rule 15c3-1 of $22,780.50.[10/]

Thereafter, the registrant submitted to the New York Regional Office of the Commission a misleading trial balance dated April 10, 1962 reflecting that its aggregate indebtedness did not exceed 2000% of its net capital. The balance sheet was misleading in that it did not reflect registrant's liability to Daniel Chernow, a customer, in connection with its purchase from him of 1,000 shares of National Industries stock at $6 per share. Had this transaction been recorded on the books of the registrant as it should have been, the trial balance would have reflected a deficiency as at April 10, 1962 of $1,102.26 in the registrant's net capital.

10/ In this computation of registrant's net capital under Rule 15c3-1 there was excluded from registrant's assets 1,000 shares of National Industries stock which registrant had purchased from Daniel Chernow at $6 per share. These were excluded pursuant to the provisions of the rule that assets which cannot be readily converted into cash are not includable in such computation. Pioneer Enterprises, Inc. 36 S.E.C. 199 (1955). See also Whitney, Phoenix Co., Inc. 39 S.E.C. 245, 249.

An analysis of a trial balance for registrant dated June 4, 1962 disclosed that the registrant needed $6,219.24 in order to comply with the Commission's net capital rule. This analysis was based upon an adjustment of the trial balance to include the $6,000 liability of the firm to Chernow.

Another trial balance of the registrant as of June 29, 1962 disclosed that the firm needed over $7,000 in order to comply with the Commission's net capital rule.

During all the times referred to hereinabove, the registrant executed numerous securities transactions when it was not in compliance with the net capital rule.

While no evidence was offered to rebut the evidence presented by the Division, which the Hearing Examiner credits fully, Tankleff claimed in his amended answer that he had severed his association with the registrant at the end of February, 1962 and that therefore he had not aided or abetted any violation of the net capital rule as alleged in the order. Tankleff, however, did not testify and offered no evidence to support the assertions made in his amended answer.

Tankleff's continuing association with registrant as Secretary-Treasurer, Director and more than 10% stockholder subsequent to the end of February 1962 was shown by the following facts.

There is no evidence in the broker-dealer registration file to reflect that he was not associated with registrant as of March 13, 1962. The broker-dealer registration file, instead, contains an amendment filed on March 9, 1962 by registrant executed by Leonard Lazaroff the president and principal officer of registrant on March 8, 1962 stating that as of that date Tankleff was Secretary-Treasurer, a Director and the beneficial owner of 10% or more of the securities of the stock of the registrant. The severance of Tankleff's association with registrant is reflected in an amendment filed by registrant executed by Siebach, as its President on March 29, 1962. The latter amendment reflected that Tankleff was Secretary-Treasurer, a Director, and more than a 10% stockholder as at March 13, 1962 and continued in such capacity until March 27, 1962. In this connection, the evidence discloses further that on March 9, 1962 Tankleff in the presence of registrant's cashier voiced objections to the action of the registrant in agreeing to purchase 1,000 shares of National Industries from Daniel Chernow, a customer of the registrant. His action in March 1962 in expressing these objections is wholly inconsistent with any claim that he had severed all connection with registrant at the end of February 1962. Further, the books and records of the registrant reflect that payments were made by registrant to Tankleff on March 16 and March 30, 1962 under the heading "Drawing Account - Seymour Tankleff". The evidence that Tankleff was still receiving funds from registrant's drawing account in March, 1962 is also inconsistent with his claim that he was not connected with registrant as an officer and stockholder subsequent to February 1962.

Tankleff's claim is rejected and the Hearing Examiner finds that Tankleff aided and abetted the registrant's violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder during March 1962.

Lazaroff, during the hearing, also claimed to have severed his connection as an officer, Director and 10% stockholder at the end of February 1962. However, the broker-dealer file contains an amendment signed by Lazaroff as "president" on March 8, 1962 which was filed with the Commission on March 9, 1962. The evidence further reflects that Lazaroff wrote a personal letter to Daniel Chernow dated March 9, 1962 in which he undertook to purchase 1,000 shares of National Industries at $6 per share and this letter was followed subsequently by a confirmation of this purchase issued by registrant 11/ which was mailed to Chernow. This confirmation reflected a trade date of March 15, 1962 and a settlement date of March 22, 1962.

11/ The Chernow transaction was permeated with fraud. Lazaroff telephoned Chernow in December 1961 and told him that if he would buy 1,000 shares of National Industries at $6 per share and if Chernow would give him a bank check that day for such stock he would "guarantee" Chernow two points within 60 days. Lazaroff told Chernow that he couldn't put his proposal in writing because the Securities and Exchange Commission wouldn't allow it. After Lazaroff failed to make good on his representations, Chernow threatened Lazaroff that he would go to the S.E.C. unless he got his money back. Lazaroff wrote his letter of March 9, 1962 to Chernow and caused registrant to mail a confirmation to Chernow but Chernow never got his money back. He obtained a judgment which he was not able to collect. Siebach, in the meantime, became associated with registrant and directed registrant's cashier not to record the Chernow transaction on registrant's books so that registrant would appear to be in compliance with the Commission's net capital rule.

The broker-dealer file does not reflect any further change in the management of the registrant until March 27, 1962 when Siebach executed an amendment to the broker-dealer file which was filed on March 29, 1962 reflecting that he had succeeded Lazaroff as president of the registrant. Lazaroff's claims are rejected and the Hearing Examiner finds that Lazaroff aided and abetted the registrant's violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder during March 1962.

The record further reflects that Steinberg was a principal officer, a Director and owner of 10% or more of the registrant's capital stock between July 19, 1961 and June 14, 1962 and that Siebach has been the President, a Director and owner of 10% or more of the registrant's capital stock from March 27, 1962 to the present time. Neither Siebach nor Steinberg have offered any evidence to rebut the evidence presented by the Division concerning these violations and the Division has,on the other hand, offered substantial and credible evidence in support of the allegations set forth in the order.

The Hearing Examiner finds that during the period from about March 13, 1962 to about September 1, 1962 registrant wilfully violated Section 15(c)(3) of the Exchange Act and Rule 17 CFR 240.15c3-1 thereunder and Lazaroff, Tankleff, Steinberg and Siebach wilfully

aided and abetted such violations in that said respondents effected transactions in and induced and attempted to induce the purchase and sale of securities (other than exempted securities or commercial paper, bankers' acceptance or commercial bills) at a time when the aggregate indebtedness of registrant to all other persons exceeded 2,000 percentum of its net capital computed in accordance with the provisions of said rule.

The Hearing Examiner further finds that the registrant and Siebach further wilfully violated Section 15(c)(1) and Rule 15c1-2 thereunder between March 29, 1962 and September 1, 1962 in that they represented that registrant was ready and able to discharge its liabilities when they knew or had reasonable ground to believe but did not disclose that registrant was unable to meet its liabilities arising in the ordinary course of business.

Violations of the Registration Provisions and False and Misleading Representations in the Issuer's Notification on Form 1-A and the Offering Circular

The Commission's order charges, among other things, that the registrant and respondents Lazaroff, Tankleff, and Steinberg violated the provisions of Sections 5(a) and (c) under the Securities Act (registration provisions) in that they offered to sell, sold and delivered after sale the common stock of Flex-I-Brush, Inc., using the mails and means of interstate commerce, when no registration statement was in effect as to such securities. The registrant,

which acted as the underwriter in connection with such offering, and the respondents claimed that an exemption from registration was available pursuant to a filing made by Flex-I-Brush, Inc. under Regulation A adopted under the Securities Act.[12/]

In general, and with exceptions not pertinent here, Regulation A, a body of rules adopted by the Commission covering offerings up to $300,000, provides an exemption from registration under the Securities Act if the issuer complies with its terms and conditions. The conditional character of the exemption afforded by Regulation A is carefully delineated in the language of Rule 252(a) which provides specifically that the exemption from the registration provisions under the Securities Act is available only "if [the securities are] offered in accordance with the terms and conditions" of the regulation. The "terms and conditions" include the filing of a

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12/ On November 27, 1961, Flex-I-Brush, a Delaware corporation, filed a notification and offering circular with the Commission purportedly pursuant to Regulation A under the Securities Act covering a public offering of 100,000 shares of its common stock at an offering price of $3 per share. The registrant was the underwriter. Flex-I-Brush, Inc. filed amendments to its Regulation A notification on December 29, 1961 and January 8, 1962, and offering circulars were filed January 21, 1962 and February 5, 1962. On March 27, 1963, the Commission issued an order temporarily suspending the Regulation A exemption from registration under the Securities Act with respect to the offering. The Commission, in the latter order, pointed out that it had reasonable cause to believe that the notification and offering circular were false and misleading as to material facts. The order afforded Flex-I-Brush, Inc.,an opportunity to be heard upon request. On May 27, 1963, Flex-I-Brush, Inc., having withdrawn its request for a hearing the suspension of the Regulation A exemption from registration under the Securities Act for the offering became permanent pursuant to the provisions of Rule 261(b) of Regulation A.

notification on Form 1-A, a form containing instructions requiring the issuer to provide specified information concerning the company and the offering it proposes to make. The issuer is also required to append to such form an Offering Circular in which it is also required to furnish specified information concerning the issuer and the securities which it proposes to offer.[13/] Rule 256 of the regulation requires the issuer to furnish persons to whom an offer or sale is made with a copy of the offering circular.

Where an issuer does not comply with the terms of Regulation A and the instructions to the forms adopted thereunder, either by omitting to disclose information required to be furnished under the regulation or by making false or misleading responses to the informational requirements, the exemption from registration provided under Regulation A does not become available and any public offering or sale of such securities involving the use of the mails or the instruments of interstate commerce without prior registration would constitute a violation of Sections 5(a) and (c) of the Securities Act. In addition, the filing and use of a false and misleading offering circular constitutes a violation of the anti-fraud provisions under the Securities Acts.

13/ Rule 100(a)(3) of the Securities Act (17 CFR 230.100) provides that "the term 'rules and regulations' refers to all rules and regulations adopted by the Commission pursuant to the Act including the forms and the notification accompanying instructions thereto."

In this case the registrant and the respondents used the mails and the instruments of interstate commerce to offer and sell the securities of Flex-I-Brush, Inc.

The burden of establishing the existence of an exemption from the registration requirements of the Securities Act rests upon the one who claims it. 14/

The Division offered credible and uncontradicted evidence which showed conclusively that the notification on Form 1-A and the Offering Circular filed by Flex-I-Brush and employed in the offering and sale of the securities by the underwriter and the individual respondents failed to comply with the informational requirements of Regulation A and was materially false and misleading, and thus the exemption from registration under the Securities Act afforded thereunder did not become available for the Flex-I-Brush securities offered and sold by the registrant and the individual respondents. In addition the use of such Offering Circular by the registrant and the respondents violated the anti-fraud provisions of the Securities Acts as well.

Specifically the evidence established that the issuer made materially false and misleading statements in its notification on Form 1-A and in its offering circular concerning its predecessor, 15/

14/ S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); S.E.C. v. Sunbeam Gold Mines Co., 95 F 2d 699 (9th Cir. 1938).

15/ Item 2 of Form 1-A.

the State where its principal business operations were conducted,[16] the orders which it had on hand for its product and the cost of producing such product, its financial condition[17] and the use which it would make of the proceeds.[18]

It may be observed that the information required to be furnished in forms where securities are to be registered require much more information about an issuer and its securities than that required in the forms under Regulation A. The prospectuses are also more exacting than are those for Offering Circulars under the regulation. Such circumstances do not furnish companies filing under Regulation A with a license to issue offering circulars which are misleading because they omit vital information about the issuer or the securities being offered or because some item in the form does not call for specific information which is material to an informed judgment about that particular security. Companies filing under Regulation A as well as those who register are under an affirmative duty to present the facts material to an informed judgment by offerees. They may not make false and misleading statements in Form 1-A and the Offering Circular and claim that an exemption from registration was available

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16/ Item 1 of Form 1-A.

17/ Paragraph 11 of Schedule 1 of Regulation A.

18/ Paragraph 6 of Schedule 1 of Regulation A.

because they made a filing under such regulation. The information required in Form 1-A and in Schedule 1 of Form 1-A for inclusion in the offering circular represents only the minimum amount of information concerning the company and the security to be offered in order to comply with the terms and conditions of Regulation A. Each one of the items of information requested in the instructions to Form 1-A and the Offering Circular is ipso facto deemed material, and any omissions or false or misleading responses constitutes non-compliance with the terms and conditions of Regulation A. If additional information is needed to make the information furnished in response to a particular item in the form of notification or in response to a paragraph under Schedule 1 not misleading, it must be supplied in order to comply with the informational requirements of the regulation. 19/

Among other things, Regulation A requires persons filing on Form 1-A to furnish the full name and complete address of each predecessor of the issuer and such regulation further provides that if the predecessor is no longer in existence to so state and give its last address prior to its dissolution.

19/ 1933 Act Rule 261(a)(2) provides that the exemption may be suspended if the offering circular "contains any untrue statement of fact or omits to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading." See also 1933 Act Rule 256(e) and 261(a)(3). See also North Country Uranium and Minerals Ltd., 37 S.E.C. 608; Profile Mines Inc., 38 S.E.C. 533 Aetna Oil Dev. Co. Inc. 40 S.E.C. 784, Salesology Inc. 38 S.E.C. 812, 813 (1959). And see Securities Act Release No. 4239, June 23, 1960; and Securities Act Release No. 4166, December 10, 1959, Edsco Manufacturing Co., Inc., 40 S.E.C. 865.

The term "predecessor of an issuer" is defined in Regulation A as a person the major portion of whose assets have been acquired directly or indirectly by the issuer. In this case the issuer represented falsely that the major portion of its assets were acquired directly from Paul Bauman and John Hromoko who were the principal officers of the issuer.

This answer was false since the major portion of the issuer's assets were acquired directly from Flex-I-Brush Corporation, which was the actual predecessor of the issuer and was a New Jersey corporation controlled by Bauman and Hromoko who held its stock and were its officers.

The predecessor, Flex-I-Brush Corporation, had been engaged in business from April 1959 to September 30, 1961, and its business was precisely the same as that in which the issuer proposed to engage, namely, the manufacture and sale of a paste filled plastic toothbrush. The place of its business was the same as that of the issuer and its equipment was the same as that of the issuer and its name was very similar.

During the period in which such predecessor was engaged in business it made no profits but instead sustained a loss of $30,955.34. Neither the Notification on Form 1-A nor the Offering Circular made any reference to this predecessor or its unsuccessful operations. Instead the issuer in the financial statement made a part of the Offering Circular labeled the losses as "Research and Development

Costs" and such document made no reference or explanation of the fact that the predecessor had sustained substantial losses in its business operations. In this connection, it should be noted that the Secretary-Treasurer of the issuer testified that the predecessor's assets and liabilities were assumed by the issuer. However, neither the body of the Offering Circular nor the financial statement made a part thereof reflected the fact that both the assets and the liabilities of the predecessor had been assumed by the issuer. Accordingly, the financial statement contained in the Offering Circular was highly misleading.

The disclosure of the history of the predecessor in this case was important to the exercise of an informed judgment by a prospective investor and the false and misleading statements concerning the issuer's predecessor and its past history and its operating losses were designed to mislead readers of the circular with regard to the history of the enterprise.

Form 1-A requires the issuer to state the name of the state in which the issuer's principal business operations are conducted or proposed to be conducted.

The notification and the Offering Circular state that the principal offices of the issuer are at 7400 N.W. 7th Avenue, Miami, Florida. The issuer's plant facilities were located in Lodi, New Jersey, and it had a sales office in New York City. No books or

records were maintained in Florida. There was no income from the Florida office. An officer in the Florida office expended a very small percentage of his time on behalf of the issuer, had no authority to sign checks and had never met Bauman or Hromoko the principal officers of the issuer, and so far as this record shows conducted no business there. The Florida office of Flex-I-Brush had no machinery or equipment.

The so-called Florida office consisted of a desk, a telephone, a box containing toothbrushes, and a cardboard sign in a one-story building occupied principally by a company called Florida Auto Supplies.

The representations of the issuer regarding where the principal business operations of the issuer were conducted were false and misleading.

The Offering Circular states that "The Company has orders on hand for 281,000 units". The facts were that the predecessor of the issuer had a contract with Melard Associates, Ltd. (Melard), a Canadian corporation, wherein the latter would act as its exclusive distributor in Canada. The Melard contract called for delivery of 250,000 units and provided that time was of the essence in the delivery of such units. No units were ever delivered. Moreover, the contract with Melard expired on the effective date of the Offering Circular.

Flex-I-Brush received no income in connection with the Melard contract and did not have the financial capacity nor the equipment to fill the Melard order.

The only liability of Melard, in the event of failure to perform, was the loss of its distributorship in Canada. After the cancellation of the Melard contract the issuer received a total income from sales in 1962 of $458.70. The Offering Circular was false and misleading in that it failed to disclose these facts.

The Offering Circular represented that the cost to the issuer of producing its product including overhead was 2.15¢ per unit, and that the sales price of the product ranged from 3-1/2¢ to 5¢ per unit. The Offering Circular was false and misleading in that it failed to state that the issuer needed a volume of 125,000 units per week to break even; that any lesser volume would mean a loss to the issuer; that the production cost of 2.15¢ per unit was based on a projected volume of 250,000 units per week; that the issuer's highest production was 2,000 units at a cost of 4 to 4-1/2¢ per unit, at which cost the issuer operated at a loss; and that the issuer did not have the capacity or the finances to produce at the cost of 2.15¢ per unit.

In November and December 1961 the issuer borrowed $1800 from registrant which was used as remuneration for its officers. This sum was advanced by the underwriter to the issuer in anticipation of proceeds to be received from the underwriting. The Offering

Circular stated that "To date none of the officers, directors or promoters of the Company have received any remuneration for their services in its behalf."

The Offering Circular and the Notification under Regulation A were false and misleading in respect to its statements about remuneration to officers.

The Offering Circular contains a section entitled "Use of Proceeds". In April 1962 the issuer loaned $1,100 to Seymour Newman one of the registrant's salesmen, from the proceeds of the underwriting.

In March 1962 counsel for the issuer advised Bauman, the secretary-treasurer of the issuer, that registrant's ownership had changed and in the latter part of March or in early April 1962 a Michael Hines informed Bauman that he was the new "head" of the registrant. At that time Bauman was informed that the registrant owed issuer $17,844.50, received from the proceeds of the offering but that the registrant was unable to pay these funds to the issuer. A short time thereafter Hines told Bauman that the registrant could not give the issuer its last check covering the proceeds of the underwriting in the amount of $5,800 unless the issuer would lend him (Hines) $3,300. The issuer then loaned Hines $3,300.

The Offering Circular was false and misleading in that it failed to disclose that part of the proceeds of the underwriting would be used to lend $3,300 to Michael Hines and $1,100 to registrant's salesman, Seymour Newman.

In addition to the failure of the issuer to meet the terms and conditions of Regulation A by making answers responsive to the items of information required to be furnished under Form 1-A and Schedule 1 thereof, the issuer made false and misleading statements in the Notification and Offering Circular. Additional false and misleading statements were made by the underwriter, its principal officers and salesmen in the distribution of the stock of the issuer. Furthermore the registrant and the other respondents failed to exercise diligence in investigating the issuer and its securities.

Failure to Exercise Diligence in Investigating the Issuer and its Securities

In offering Flex-I-Brush stock, the registrant, as underwriter, owed a duty to the investing public to exercise a degree of care reasonable under the circumstances of this offering to assure the substantial accuracy of the representations made in the Offering Circular.[20/] Registrant did not fulfill that duty. The background facts in this connection may be summarized as follows:

Counsel for registrant, introduced the officers of the issuer to the officers of the registrant in September, 1961. At such meeting the dire needs of Flex-I-Brush Corporation, the issuer's predecessor, for money particularly in view of its sustained losses during its entire period of operation were stressed, and counsel suggested a public issue.

20/ Charles E. Bailey & Co. 35 S.E.C. 33, 41.

During subsequent meetings held within the next two or three weeks at the office of the aforesaid counsel the officers of Flex-I-Brush Corporation brought the company's books and records to counsel's office where further discussion of a public offering took place.

Bauman the Secretary-Treasurer of the issuer, informed Lazaroff and Steinberg of the Melard order and told them that Flex-I-Brush Corporation needed money and equipment in order to fulfill the contract. Bauman repeatedly stressed the company's need for money. It was no secret to the conferees that the company had never had a profit and had sustained substantial losses throughout its operation.

The issuer's Offering Circular reflected that the only dollar figure for the issuer set forth in the "Statement of Assets as at October 31, 1961" was "Cash on Hand" of $9.37, and the same Offering Circular set forth a "Statement of Liabilities as at October 31, 1961" which reflected a total dollar figure of $10,943.88. Where as here, and particularly in the light of the unsuccessful history of the predecessor company, an issuer seeks funds from the public to finance a new and speculative venture the underwriter must be particularly careful in verifying the issuer's self-serving statements as to its product, and its prospects. 21/

None of the respondents ever requested a balance sheet, a profit and loss statement, a copy of any of the company's contracts, or the books or records of the corporation.

21/ e.g. Charles E. Bailey & Co. 35 S.E.C. 33, 42 (1953).

Lazaroff never visited the plant of the company, never visited the Florida "office" of the issuer, and never heard of Albert Steinberg, vice-president of the issuer purportedly in charge of the issuer's principal sales and executive offices in Florida. He conceded that the registrant did not go into too much detail, and that in fact he knew very little about the company, and that all he did prior to the underwriting was to look over the correspondence relating to the Melard contract, talk to Bauman about the development of the toothbrushes, send out samples of the toothbrush and solicit criticism from friends and customers. He contended that it was his counsel's job to investigate the issuer rather than the registrant's job.

Tankleff became a principal of the registrant before its offering of issuer's stock. While he discussed the 281,000 unit Melard contract and cost analysis with Bauman, he did not enter into any discussion involving a breakdown of the cost figures. In any event the Melard contract was cancelled on the effective date of the Offering Circular but the Offering Circular was never amended to disclose the facts regarding the Melard contract.[22/]

22/ An offering circular which is false and misleading in the light of the circumstances existing at the time of its use may not be used. Thus, even though an offering circular was not false or misleading when first used, it must be amended if, at any time when securities are being offered, it becomes false or misleading as the result of events which occurred after effectiveness. (Rule 256(e) under Regulation A) See, e.g. Bald Eagle Mining Co. 38 S.E.C. 891, 892-3 (1959); Diversified Collateral Corp., Securities Act Release No. 4446, January 31, 1962; Spirit Mountain Caverns, Inc., Securities Act Release No. 4447, January 31, 1962.

Tankleff either never took the trouble to find out the material facts concerning the issuer, for which the registrant acted as underwriter, or he knew and was unconcerned about the false and misleading character of the Offering Circular. In either event, he did not perform his duty as an officer of the underwriter to the investing public to exercise reasonable care to assure the substantial accuracy of the Offering Circular. Tankleff's alleged reliance on the issuer's self-serving statements in its Offering Circular when even the most superficial investigation would have disclosed their false and misleading character was, at the least, reckless and misplaced and not consistent with the existence of a responsible relationship between registrant and its customers.[23/] Despite their duty, particularly as principals of the underwriter to ascertain the material facts regarding a security before recommending it to its customers for purchase, Lazaroff and Steinberg failed signally to perform such duty and instead they launched the registrant upon a distribution distinguished chiefly by numerous false and misleading statements made to members of the public in the Offering Circular to induce them to buy the securities.

23/ N. Finsker & Co. 40 S.E.C. 285 (1960); A.G. Bellin Securities Corp. 39 S.E.C. 178 (1959).

Lazaroff, Steinberg, and Tankleff as the principal officers and controlling persons at the time of registrant's distribution of Flex-I-Brush must bear responsibility for the failure to verify the false and misleading contents of the Offering Circular.[24/]

False and Misleading Statements during the Distribution of Flex-I-Brush Stock

During the underwriting, the false and misleading Offering Circulars of Flex-I-Brush, Inc. were mailed by registrant, together with original confirmations, to customers. In addition Lazaroff, Tankleff, and Steinberg as well as salesmen employed by the registrant sold stock of Flex-I-Brush to customers by means of oral false and misleading statements, which frequently were made over the telephone.

It is crystal clear from the testimony and exhibits in the record that Flex-I-Brush was a highly speculative venture with enormous risks for the investor. In order to avoid the possibility of fraud and to meet the standards of conduct expected of a broker-dealer and its representatives it was incumbent upon registrant, Lazaroff, Steinberg, and Tankieff in offering and selling Flex-I-Brush stock, to make known these risks by giving prospective purchasers all available information concerning the company, and to refrain from expressing opinions which had no reasonable basis.[25/]

24/ Charles E. Bailey & Co., et al., supra.

25/ Leonard Burton Corporation, 39 S.E.C. 211 (1959).

Instead of acting in a responsible manner, the registrant, Lazaroff, Steinberg, and Tankleff chose to sell Flex-I-Brush stock by deluding purchasers into the belief that quick and large profits would come from a very rapid rise in the price of issuer's stock and by omitting any reference to the existence of the predecessor corporation and the large previous losses sustained by it.

For example, Tankleff sold one investor 300 shares of Flex-I-Brush stock at $3.00 per share by telling him that the product would be put on airlines, motels and railroads that it was a good investment and the stock would double in six months. He made no reference to the predecessor its unsuccessful business history or its financial losses. Similar representations of a spectacular rise in the stock were made by Steinberg to other customers. Salesmen employed by registrant made similar representations to customers some even predicting that the stock would go to $10 or $15 per share in a short time. One salesmen represented to a customer that the stock would open on the "Big Board" at $8 per share.

Lazaroff told a customer that he controlled the market in Flex-I-Brush and that the stock would go up. He also caused the registrant to mail Flex-I-Brush stock to a customer who had never ordered such security in lieu of having the registrant pay such customer the money which the registrant owed the customer as a result of prior securities transactions. Even after Lazaroff had severed his connection with the registrant and after he was well aware

of the fact the offering had been unsuccessful he assured a customer that the issuer's stock was "pretty good".

None of the respondents ever told any investor that the statements made in the Offering Circular were false and misleading, nor did they give any investor any information concerning the predecessor and its unsuccessful business history. Neither the predictions of price increases nor the other representations summarized hereinabove had any basis in fact.

As the Commission pointed out in Alexander Reid & Co., Inc. 40 S.E.C. 986, 990:

> A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a stock which he had undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration. Without such basis the opinions and predictions are fraudulent, and where as here they are highly optimistic, enthusiastic and unrestrained, their deceptive quality is intensified since the investor is entitled to assume that there is a particularly strong foundation for them. And it is not a sufficient excuse that a dealer personally believes the representation for which he has no adequate basis.

The Commission has pointed out that the anti-fraud provisions ". . . contemplate, at the least, that the recommendation of a security made to proposed purchasers shall have a reasonable basis and that they shall be accompanied by disclosure of known or easily ascertainable facts bearing upon the justification for the representations."[26/]

26/ Best Securities, Inc. 39 S.E.C. 931 (1960).

For more than twenty years it has been recognized that "basic to the relationship between a broker or dealer and his customers is the representation that the latter will be dealt with fairly in accord with the standards of the profession. The failure of a broker or dealer to disclose that his conduct does not meet such standards operates as a fraud on customers. The court in a landmark case [Charles Hughes & Co. Inc. v. S.E.C., 139 F 2d 434 (1934), cert denied, 321 U.S. 786 (1944)] recognized this so-called 'shingle' theory. . . ."[27/]

The Commission has repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and are responsible for violations of the securities laws committed by their firm through their agents.[28/]

By holding out the bait of a very large rise in the price of the stock in a very short time, and the purchasers' reliance on such misrepresentations, the purchasers were persuaded to make hasty decisions without the opportunity to reach an informed judgment.

There was no basis in fact for the representations made by Lazaroff, Steinberg and Tankleff and registrant's salesmen relating to large and rapid price increases, and the registrant and the respondents were aware of the lack of basis for such representations.

27/ Mac Robbins & Co., Inc. Securities Act Release No. 6846 (July 11, 1962).

28/ Bond & Goodwin Inc., 15 S.E.C. 584 (1944); E.H. Rollins & Sons, Inc., 18 S.E.C. 347 (1945); Kidder Peabody & Co. 18 S.E.C. 559 (1945); Charles E. Bailey & Co. 35 S.E.C. 33 (1953); Floyd A. Allen & Co., Inc. 35 S.E.C. 176 (1953) Lucylle Hollander Feigin 40 S.E.C. 549 (1961); Aldrich Scott & Co., 40 S.E.C. 775 (1961).

The Hearing Examiner finds that registrant, Lazaroff, Tankleff, and Steinberg used a false and misleading Offering Circular which they mailed to customers and that they and registrant's salesmen made use of fraudulent oral misrepresentations in the offer and sale of Flex-I-Brush stock.

The Hearing Examiner further finds that the written and oral misrepresentations constituting violations of Section 17(a) of the Securities Act together with the violations of Sections 5(a) and 5(c) of such Act and the violations of Sections 10(b), 15(b), 15(c)(1) and 15(c)(3) of the Exchange Act and Rules 10b-5, 15b-2, 15c1-2 and 15c3-1 thereunder were parts of a fraudulent scheme and course of business conceived and carried out by registrant, Lazaroff, Steinberg, and Tankleff to defraud purchasers.

Violations of the Financial Reporting Requirements under the Exchange Act

Section 17(a) of the Exchange Act and Rule 17a-5 thereunder impose a requirement upon all broker-dealers registered with the Commission to file certified reports of financial condition within each calendar year, not more than 45 days after such report.

The Staff of the Commission sent repeated notices by certified mail to registrant in 1963, 1964, and 1965 pointing out that the registrant had not filed its annual financial reports for 1963 and 1964 as required under the Exchange Act. The letters emphasized the registrant's obligation to file such reports and the possible consequences of failure to do so.

The Commission in John J. Murphy 38 S.E.C. 430 at page 432 pointed out that:

> The requirement that annual financial reports be filed is an important keystone of the surveillance of registrants and NASD members with which we and the NASD are charged in the interest of affording protection to investors, and it is obvious that full compliance with this requirement must be enforced.

The Hearing Examiner finds that the registrant violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder and Siebach wilfully aided and abetted such violation in that said respondents failed to file a report of registrant's financial condition as of a date within the calendar years 1963 and 1964.

Public Interest

In view of the serious nature and the large number of wilful violations committed by registrant, Lazaroff, Steinberg, Tankleff, and Siebach, the Hearing Examiner finds and concludes that it is in the public interest that registrant's registration be revoked and that pursuant to Section 15(b)(7) of the Exchange Act respondents, Lazaroff, (also known as Lawrence), Tankleff, Steinberg, and Siebach be barred from being associated with a broker or dealer.

Accordingly, effective as of the date that the Commission enters an order pursuant to this initial decision as provided for by Rule 17 of the Rules of Practice (17 CFR 203.17), and subject to the provisions for review afforded by that rule,

IT IS ORDERED that registration as a broker and dealer of Reed, Whitney & Stonehill (formerly Meadowbrook Securities, Inc.) be revoked and that Leonard Lazaroff (also known as Leonard Lawrence), Milton Steinberg, Seymour Tankleff, and Russell Siebach be and they hereby are barred from being associated with a broker or dealer. 29/

Samuel Binder
Hearing Examiner

Washington, D.C.
October 20, 1965

29/ 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 they are inconsistent therewith, they are expressly overruled.