ADMINISTRATIVE PROCEEDING
FILE NO. 3-5037

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

SHAW HOOKER & CO.
ARTHUR A. GAMBARASI
LEROY ZACK TAYLOR

(File No. 8-2213)

FILED
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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Washington, D.C.
March 11 , 1977

Irving Sommer
Administrative Law Judge

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APPEARANCES: Leroy V. Amen and Steven N. Machtinger, for the Commission's Division of Enforcement.

Arthur L. Lempert, of Layman and Lempert, for respondents Shaw Hooker & Co. and Arthur A. Gambarasi.

Leroy Zack Taylor, _pro se_.

BEFORE: Irving Sommer, Administrative Law Judge

This public proceeding was instituted by order of the Commission dated June 15, 1976, thereafter amended in various particulars ("Order"),[1/] pursuant to Sections 15(b), 19(h)(2) and 19(h)(3) of the Securities Exchange Act of 1934 to determine whether the Respondents[2/] Shaw Hooker & Co. ("Registrant") and Leroy Zack Taylor ("Taylor") wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and whether Registrant and Arthur A. Gambarasi ("Gambarasi") failed reasonably to supervise persons subject to their supervision

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1/ The Commission by order of September 8, 1976 amended its original order by adding paragraphs E and F to Part I thereof reciting that on or about February 18, 1970 Registrant and Gambarasi were permanently enjoined by the United States District Court for the Southern District of New York from violating Sections 5(a), 5(c) and 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. (SEC v. Dumont Corporation, et al., 69 Civil Action No. 1420). The amended order further recites that on or about October 8, 1971 Registrant and Gambarasi having consented thereto and without admitting or denying the allegations made against them, were found by the Commission to have violated Sections 5(a), 5(c) and 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 and 10b-6 thereunder, and sanctions were imposed.

2/ This initial decision has application only to the three respondents named in the caption, inasmuch as Robert Lowell Haisman ("Haisman"), a respondent originally named by the Commision submitted an offer of settlement which the Commission accepted. Securities Exchange Act Release No. 12909 (1976). However, since the violations alleged against the respondents remaining in the proceeding involve Haisman, there will be necessary reference to Haisman and his activities as it relates to the remaining respondents.

and the remedial action, if any, that might be appropriate in the public interest.

Registrant and Gambarasi appeared through counsel who participated throughout the hearing. Taylor appeared pro se. As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by the parties.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

FINDINGS OF FACT AND LAW

The Respondents[3/]

Respondent Shaw Hooker & Co. ("Registrant") is a partnership with its main office located at 111 Sutter Street, San Francisco, California, and has been registered as a broker-dealer under the Securities Exchange Act since June 1938, and is a member of the National Association of Securities Dealers, Inc. ("NASD") and the Pacific Stock Exchange.

Arthur A. Gambarasi is a general partner of, and owns a 95% interest in the Registrant. He began his

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3/ As previously indicated, this initial decision has application only to Respondents Shaw Hooker & Co., Arthur A. Gambarasi and Leroy Zack Taylor. However, certain findings respecting Haisman, based on the record herein, are essential in order to place the findings and conclusions respecting the remaining respondents in proper factual and legal perspective.

association with the securities business in 1928, and specifically with the Registrant in 1935. During the "relevant period" (from on or about August 1, 1974, to on or about November 15, 1974) Gambarasi was the chief administrative officer and supervisor of Registrant's total operation.

Leroy Zack Taylor was employed by Registrant from July 26, 1974 until October 31, 1974. He became an NASD registered representative on November 11, 1971. Prior to working for the Registrant he was employed by various securities concerns, i.e., First California Company, Robert Scott Co. and W.E. Hutton. He is currently employed by Reynolds Securities, Inc., a broker-dealer located in Palo Alto, California.

Robert Lowell Haisman was employed as a registered representative by the Registrant during the "relevant period". His prior experience in the securities field included employment by Merrill Lynch, Dean Witter, and Reynolds Securities.

Background

A general description of the respondents and the nature of the business conducted will be set forth to provide the necessary background for the decision.

Shaw Hooker & Co. ("Registrant") conducted a general securities business prior to the relevant period herein. Arthur Gambarasi was and still is the chief partner (he owns a 95% interest). During the latter part of July 1974 Gambarasi was introduced to Taylor, a NASD registered representative who was unemployed. After a number of conversations Registrant agreed to open a brokerage office in San Mateo, California. Both Taylor and Haisman (who had been introduced to Gambarasi by Taylor) were to staff this office which was to deal in option trading. In essence, these respondents wrote call options on the Chicago Board Options Exchange ("CBOE") for approximately 40 customers which were covered by warrants purchased with the proceeds of the writing of the options.

The general transaction was as follows: The customer wrote an uncovered (underlying stock was not owned) call option for a certain numer of shares (usually 5,000) of American Telephone & Telegraph ("AT&T") to be delivered for $45 per share (price $2-2.50), on or before April 28, 1975. This sale resulted in a credit to the customer's account of $10,000 to $12,000. Simultaneously or shortly thereafter the customer purchased AT&T warrants permitting purchase of a similar amount of shares at $52 on or before May 15, 1975. The total cost of these warrants was between $6,250 and $7,500 (price $1.25-1.50). The purchase was effectuated by

the customer without the need for any expenditure of money, since there was a credit balance in his account. If the price of AT&T did not exceed $45 by the time the option expired, the credit balance (less commissions) was the customer profit. However, for every dollar that the stock rose over $45 there was a potential loss of $5,000, going up to a total potential loss of $35,000 (if the price went to $52). The loss was limited to this figure inasmuch as the customer could exercise his warrants at $52.[4/] Due to a rising market, and the inability of the customers to meet margin calls, the customers' positions were sold out with a loss to the Registrant of over $300,000 which it owed to Davis Skaggs & Co., the CBOE clearing firm. A number of customers also sustained losses. There resulted numerous court actions between Registrant and various customers each alleging liability for these losses on the other. These court actions are mentioned so as to complete the recitation, but are of no moment in this administrative

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4/ Haisman's investor customers were dealing in AT&T warrants and options. Taylor's customers dealt in Atlantic Richfield Company ("ARCO") warrants and options. The principle involved was identical. Taylor's customers wrote uncovered call options for delivery of ARCO at $80 per share on or before April 28, 1975. The sale resulted in a credit to the customer's account. At or about the same time the customer purchased call options exercisable at $90, and warrants corresponding to the number of ARCO shares represented by the options. Based on the number of shares involved there was a potential profit of $5,000 for every 1,000 shares of ARCO represented by the options and warrants, and a potential loss of $6,500 - 7,000 if the price of ARCO rose above $80 (Taylor opined that the warrants would appreciate $3 for every $10 increase in price of ARCO stock).

proceeding.

The Division's Charges

The Order as amended alleges that during the relevant period Registrant, Haisman and Taylor through use of jurisdictional means wilfully violated and wilfully aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the offer, sale and purchase of securities in that they

1) employed schemes, artifices and devices to defraud,

2) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of circumstances under which they were made not misleading, and

3) engaged in acts, practices and deceit upon purchasers, prospective purchasers, and sellers of securities.

The fraudulent and misleading acts and omissions included *inter alia*: guaranteeing quick substantial profits with little or no capital investment, executing securities transactions without proper authorization, opening new accounts without proper authority, obtaining signatures under false pretenses, failure to detail and explain the speculative nature of warrant trading, failure to fully elucidate to customers the high risks involved in warrant and option trading and the risks attendant in

engaging in trading on margin.

In addition, Registrant and Gambarasi are charged with having failed reasonably to supervise persons under their supervision with a view to preventing the violations of the securities laws alleged in the Order.

ANTIFRAUD VIOLATIONS

Haisman

The Registrant admits and the record shows that Haisman wilfully violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder in that he made false statements of material fact and omitted to state material facts necessary in order to make the statements made, under the circumstances in which they were made, not misleading, in connection with his representations to his customers concerning options transactions elicited on their behalf.

Haisman advised his customers that trading in options and warrants was "riskless", "a sure thing", and that the customer could make a profit without investing any money. He opened accounts for customers without their approval or knowledge, and at times either falsely listed their income and net worth or counseled them to do so, stating it was necessary to have a substantial income and net worth to open the account. Haisman generally conveyed the impression to all the customers

that investing in warrants and options was a fool-proof method of making money without any investment. Haisman's customers were totally unaware of the possible serious pitfalls in warrant and option trading. He had no basis for his vividly optimistic statements promising nothing but profits. Haisman's statements made in connection with the offer, sale and purchase of securities, and each and every one of them was either false, misleading or fraudulent.

Taylor

Taylor, who conducted option transactions for his own customers in Atlantic Richfield Company ("ARCO") stock was charged in the Order for Proceedings with the identical violations ascribed to Haisman (See Division's charges). Here the similarity ends, but abruptly. There is no evidence that Taylor stooped to a number of unconscionable devices listed and described aforesaid by Haisman. Thus, the evidence negates any conduct on Taylor's part such as executing warrants without authority, opening accounts without customer knowledge or approval, and guaranteeing a riskless investment. The Division recognizing this, muted its allegations in their brief to a charge of antifraud violations in two respects (1) Taylor's complicity in Haisman's scheme by lulling Haisman's customers into a false sense of security and (2) Taylor's course of business directly affecting his own customers.

I find no merit in the Division's argument that Haisman and Taylor participated in a scheme to defraud in which Taylor on his part lulled Haisman's customers.

The gist of a conspiracy is a concerted action by two or more people for the purpose of carrying out an unlawful or criminal act.[5/]

Proof of formal agreement is usually lacking, but circumstantial evidence of its existence can be inferred from surrounding circumstances.[6/]

Such evidence is lacking herein. The surrounding circumstances fully demonstrate that Taylor was not acting in concert with Haisman in the warrant and option trading business. The blatant fraudulent activity pursued by Haisman included wild predictions of no risk investments, opening accounts without authority, obtaining investors' signatures under false pretenses and guaranteeing of quick substantial profits. Taylor as previously noted was not involved nor did he in his business capacity engage in such nefarious misrepresentations. They both were involved in dealing with different stocks with substantial price differences and their

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5/ U.S. v. Falcone, 311 U.S. 205 (1940); Carter v. U.S., 333 F.2d 354 (C.A. Kan. 1964).

6/ Calderon v. U.S., 196 F.2d 554, 555 (C.A. 10, 1952); Billings Associates, Inc., et al., 43 S.E.C. 641, 646 (1967).

method of operations differed drastically. The accidental and wholly unexpected fleeting contact which Taylor had with a small minority of Haisman's customers by telephone negates the existence of any concerted effort by both of them, and furthermore in no way demonstrates a pattern of conduct which could be considered as evidence of "lulling". The decisions[7/] which the Division cites for the proposition evidencing Taylors' complicity in Haisman's scheme are inappropriate and irrelevant. The cases cited are mail fraud actions wherein the parties were all guilty of acting in concert in a fraudulent manner. This cardinal element is absent. Accordingly, the Division's allegation of Taylor's complicity in a scheme to defraud is found to be unsupported by the record. Moreover, it is apparent that Taylor, a respondent appearing *pro se* was not given adequate notice of the conspiracy allegation, and as such could not present an informed defense thereto.[8/]

7/ Division's Brief, p. 54.

8/ As the United States Supreme Court recognized in *Morgan v. United States*, 304 U.S. 1, 18 (1937):

> "The right to a hearing embraces not only the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them. The right to submit argument implies that opportunity; otherwise the right may be but a barren one. Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard on its proposals before it issues its final command."

(continued)

Three customer witnesses testified with respect to the representations made by Taylor. They testified in a quiet, reserved and straightforward manner and gave the distinct impression of being truthful. Their testimony as to the representations made to induce them to enter the securities transactions is entirely credited. One of these investors Melvin Gibson called his prior registered representative, and spoke to Taylor who informed him that he had taken over the account and could help. Taylor inquired whether Gibson had done any option trading, which was answered in the negative. He told Gibson he had been watching Atlantic Richfield and "he thought I could make a pretty quick $4,000 within about a three-month period." Later on Gibson testified this period could be six months. Taylor suggested that he invest in options and that there was "practically no chance of losing money." Taylor stated that $2,000 was needed for the margin account, and that if things really went bad "I would not lose any more than $2,000." As part of his sales representation, Taylor used a prepared worksheet to demonstrate the warrant and option transactions. Gibson

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8/ In N.L.R.B. v. Johnson, 322 F.2d 216 (6th Cir., 1963), an order of the Board was set aside inasmuch as reasonable notice of the charge to be adjudicated was not given. The Court found at page 220 that "the discriminatory discharge was an issue unrecognized by the respondent and not one that should have been readily perceived from the progress of the proceedings." See also Jaffe & Co. v. S.E.C., 446 F.2d 387, 394 (2d Cir., 1971).

did not understand these transactions and said so, whereupon Taylor responded that it takes a lot of study. "The more you work with it, the more you will understand it." At the time of this investment, it was necessary for Gibson to file account cards and other statements with the Registrant. The evidence shows that the "CBOE customer information card" which details among others, the net worth and net income of the customer falsely listed Gibson's net worth as $25,000 and his net income as $18,000. He testified that both his net worth and income were substantially less, and that he had not entered such amounts on the card. The surrounding circumstances fully warrant a conclusion that Taylor was responsible for filing this false information which was forwarded to the Registrant apparently to demonstrate that option and warrant trading were suitable for this unsophisticated relatively lower income customer.

Taylor used a similar approach in persuading Masuo Tsuda, a landscape contractor to invest in options and warrants. There, too, the customer was assured that there could be no loss greater than $2,000 (amount deposited in margin account). The same worksheet was used to demonstrate warrant and option trading, again to no avail. Tsuda did not fully understand and comprehend the concepts being advanced by Taylor. When asked at the hearing by Taylor, "Did you understand it at that time, could you understand it now"? his reply was, "I doubt it."

Surprisingly, Taylor retorted, "with this illustration I have gone through, I doubt if you could either." Tsuda testified he relied on Taylor in making the investment. "We didn't know enough to ask intelligent questions. We just left it to Zack to take care of it. That's all." He concluded, "what else can I say. If I knew it all, I don't think I would have gone into it."

Taylor's approach to James D. Mitchell, a man engaged in sales management was much the same. Mitchell had at one time used Taylor for mutual fund transactions. He had no other security experience or dealings in options and warrants. Taylor persuaded Mitchell to invest in warrants and options by stating that he could not lose more than $2,000 (the amount deposited by Mitchell in the margin account). Mitchell further testified that Taylor also assured him that "while there were some risks -- there is a possibility to make some good money . . ." Mitchell relied wholly on Taylor stating, ". . . I don't know anything about the market, you will have to do the investing."

With respect to Miss Christine Modica another customer investor (she was not called to testify), Taylor was asked whether she understood the option transactions which he had recommended to her, and for which she invested $2,000. His answer was, "she did not understand."

Taylor denies the allegation that he omitted to fully apprise his customers of the risks and speculative nature of dealing in warrant and options transactions, arguing that his worksheet [9/] presented all the sides of the question. The record will not sustain this position. Not only did the witnesses testify to their utter confusion as to these transactions, but Taylor himself acknowledged that they had less than a full understanding of these transactions. As one of the witnesses stated, ". . . If I knew it all, I don't think I would have gone into it." This can be applied to all the investors. Had they been fully apprised by Taylor of the true facts concerning the speculative nature of their securities transactions, their conduct could well have been predisposed to negating these type activities. Moreover, while Taylor denied that he omitted detailing to these customers the risk involved in a margin account, the record fully shows he lulled them into thinking their loss would be limited to no more than $1,000 or $2,000. His allegations and representations were false and misleading. Furthermore, it is clear that there was no reasonable basis for the predictions Taylor made of quick profits, "practically

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9/ However, his worksheet was unintelligible to all the customers, and Taylor himself agreed that this was so. The Commission has stated the disclosure requirements of the Act require that speculative features of an offering in the registration statement and prospectus be described "so clearly that it will be plainly evident to the ordinary investor." This principle is appropriate to a worksheet designed to promote sale of securities. See Universal Camera Corp., 19 S.E.C. 648, 654 (1945).

no chance of losing money","possibility to make some good money." Such predictions of profits within relatively short periods in such a highly speculative field as option and warrant trading is inherently fraudulent and cannot be countenanced. It is also clear that Taylor knowingly inserted false financial data so as to qualify Gibson as a customer-investor.

I reject the argument and assertions made by Taylor that there was no wilful intention to commit any of the violations alleged.

The foregoing omissions to advise the investors of the speculative nature of these transactions, the omission to fully describe the risks of margin trading, the misleading prediction of profit potentials, and the false preparation of an investor's financial status, all under the circumstances here present, constituted a wilful[10/] violation of the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Shaw Hooker & Co. (Registrant)

The Division further charges the Registrant with wilful violations of the securities acts' antifraud sections

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10/ Tager v. Securities and Exchange Commission 344 F.2d 5, 8, (C.A. 2, 1965): "It has been uniformally held that 'wilfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the rules or acts"; Haight & Company, Inc., 44 S.E.C. 507 (1971), affirmed without opinion (C.A.D.C. June 30, 1971).

based on the fraudulent misdeeds of Haisman and Taylor, under the doctrine of respondeat superior. The Court of Appeals in five circuits has affirmed this concept. See John Hopkins University v. Hutton, 422 F.2d 1124 (C.A. 4, 1970), cert. denied, 416 U.S. 916 (1974); Armstrong, Jones & Co. v. S.E.C., 421 F.2d 359, 362 (C.A. 6, 1970), cert. denied 398 U.S. 958 (1970); Lewis v. Walston & Co., 487 F.2d 617 (C.A. 5, 1973); Fey v. Walston & Co., 493 F.2d 1036 (C.A. 7, 1974); Holloway v. Howerdd, 536 F.2d 690 (C.A. 6, 1976) and S.E.C. v. Management Dynamics, Inc., 515 F.2d 801 (C.A. 2, 1975).

Respondents' argument that its liability, if any, be based not on the respondeat superior doctrine, but on the "controlling person" of Section 20 has been rejected in recent court decisions. See S.E.C. v. Management Dynamics, Inc., supra. In S.E.C. v. Geon Industries, Inc., 531 F.2d 39, 55 (1976) Judge Friendly "cited with apparent approval, the cases in which liability has been imposed on brokerage firms for acts of their employees."

As stated by the Commission in Sutro Bros. & Co., 41 S.E.C. 470, 479 (1963): "Registrant as a firm can only act through its employees and agents, and the wilful violations of its employees in the course of their employment must be

considered the wilful violations of the firm." See also H.F. Schroeder & Co., 27 S.E.C. 833, 837 (1948); Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961); Mississippi Valley Investment Company, et al., Securities Exchange Act Release No. 12683 (1976).

Respondents' contention that the Commission has no power to impose sanctions herein since the persons committing the violations are no longer associated with the Registrant is meretricous, and arises from a singularly warped reading of the Act. Section 15(b)(4) of the Exchange Act plainly states the Commission may impose sanctions on brokers or dealers for fraudulent acts committed by ". . . any person associated with such broker or dealer, whether prior to or subsequent to becoming so associated . . . ." To hold otherwise would be to emasculate the antifraud provisions of the Act, and to restrict the scope of liability under the Act, clearly contrary to the Congressional intent and to the various court interpretations thereon.

Respondent also cites Black & Company, Inc., [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79921 (S.E.C. Administrative Proceeding File No. 3-3460, July 12, 1974), in support of its allegation that there is no derivative liability herein. They have misread Judge Markun's decision which approved the respondeat superior liability therein, but for the purposes of imposing sanctions did so on the basis of failure to supervise.

Accordingly, I find that Registrant wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Failure to Supervise

The Division further argues that Registrant and Gambarasi failed reasonably to supervise with a view to preventing the alleged violations by persons who were subject to their supervision and who committed such violations. 11/

Registrant and Gambarasi assert that every reasonable step was taken to supervise both Haisman and Taylor in selling options. In this connection Gambarasi testified that prior to entering the option business he contacted other brokers, including Davis Skaggs & Co. for advice on the problems faced, that he obtained various forms from Davis Skaggs & Co. which were used in opening option accounts and obtaining necessary background information on the customers. With reference to Haisman and Taylor, both underwent pre-employment investigations by Gambarasi, and they came well recommended. Gambarasi alleged that he personally informed both men that they were to make no promises or guarantees of any kind in selling securities, and that the customers be given a full explanation of the option transactions. Gambarasi

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11/ Section 15(5)(E) of the Exchange Act as added by the 1964 Amendments provides that failure to reasonably supervise a person subject to supervision who commits violations of the Securities Act or Exchange Act or the rules and regulations thereunder is a basis for remedial action against the offending supervisor.

stated he spoke to the representatives on the telephone daily, and visited the San Mateo office two to three times a week for approximately an hour or two, and spoke to the men over coffee. He further alleged that upon opening an account various forms were required to be completed, including an account card, which detailed a propsective customer's full background including net worth, net income and investment goals. He testified that he approved all new accounts that were opened (on a rare occasion Mrs. Price his partner would do so) and kept a close surveillance on all business activities in the firm including the option trading. In short, the respondents allege that notwithstanding their close supervision, they sustained large losses in option trading as a result of the criminal activity of both Taylor and Haisman, who were acting in concert with many of the customers with a view to defrauding the Registrant. They vehemently maintain that this fraud was carried on stealthily by Haisman and Taylor, and there was no way they could have discovered it; however, as soon as it was brought to light, Gambarasi alleges he stepped in, discharged both Haisman and Taylor and within three months had closed the San Mateo office.

The record does not support the allegations of the Registrant and Gambarasi that reasonable supervision was given herein to Haisman and Taylor. The record does support a finding that Gambarasi, as the managing partner and supervisor

of the registered representatives made a flimsy investigation prior to hiring them in a business he was not acquainted with and had not dealt with before, i.e., option trading. Moreover, compounding this serious error Gambarasi followed a general policy of noninterference while Haisman was earning huge commissions for both the Registrant and himself, and in carrying out his fraudulent procedures as described aforesaid, and thereby failed to discharge his reponsibilities to institute and maintain reasonable supervisory procedures designed to prevent violations of the securities laws and regulations.

In opening an account with Davis Skaggs & Company, Gambarasi acknowledged that "option trading involves a high degree of loss and that such trading should be undertaken only by sophisticated investors who are capable of evaluating, carrying and bearing such risk." As such, this called for the utmost diligence and close supervision of the entire operation. Although he was forewarned and knew of the risks inherent in such trading, and the pitfalls awaiting both the firm and the investing public, he relied entirely on two generally inexperienced and unknown representatives to set up an office and deal in options. The help he received from Davis Skaggs & Co. was centered overwhelmingly in supplying forms. They did not direct him in carrying out option trading. For this, Gambarasi relied on Haisman and Taylor. While he states he investigated Haisman's background, this was only perfunctory

in nature. He disregarded the fact that Haisman was discharged from another firm because of lying about his age, as being inconsequential. Apparently it was not so, because this lying representative, who was not closely supervised continued to lie and spread havoc among investors, touting options illegally as described previously. While Gambarasi testified he relied on these experienced representatives in option trading, had he done a more thorough investigation he would have discovered that Haisman had been in the securities business for no more than three years (at least six months in training time) with no real, lasting or sustained experience or expertise in option trading; likewise, Taylor was a neophyte in the securities business, as well as having minimal option trading experience. Thereby the entire operation was tainted from its inception. Gambarasi negligently relied on two less than experienced representatives to run a new business. Actually, Taylor who had only known Haisman about six months recommended him to Gambarasi, and Gambarasi without any real solid basis hired him. From there the situation went downhill. The inexperience of these two representatives in an intricate and speculative field should have been a red flag to Gambarasi to proceed with caution before hiring these two operators.

He did not adequately investigate both men and hired them. Thereafter, there were other red flags raised which

should have alerted him to the serious state of affairs taking place. In the first month of operation, Haisman's commissions were over $8,000 and the Registrant over $20,000. No other salesmen in the firm even came close, with such sum being equal to the commissions an ordinary salesman made in a few months. Such incredible sales volume and commissions for Haisman and the Registrant apparently created euphoria there. Surely this huge volume of option trading should have alerted Gambarasi to make diligent inquiries as to the nature of the transactions, spot check with a few of the customers as to their backgrounds, their investment program and net income and net worth. Instead, he was willing to bask in the sunshine of fantastic commissions for the house. Diligent and vigorous checking into even a small sample of these transactions would have brought the fraud to life. Instead nothing was done at this stage. While the Registrant had procedural and supervisory rules governing its representatives, even these were not fully complied with by Gambarasi. While new account cards were required to be reviewed by a partner, a great many option cards failed to have the initials of Gambarasi attesting to such review. Furthermore, there were some option customers' cards missing, as well as incomplete. While Gambarasi discounts these findings as minor and trivial, they portray a general picture of laxness and incomplete supervision over the two representatives. The responsibility to actively and closely

supervise all phases of a broker-dealer operation is serious.[12] That Gambarasi had never operated an option trading business, and had not operated a branch office, together with his own admission of the risks attached to option trading, should have alerted him. These factors called for closer supervision than customary. Gambarasi states he called the office daily and went there two or three times weekly. These short visits were no more than social calls, with no investigation or supervision being carried out.

I find that Registrant and Gambarasi failed to maintain a proper system of supervision and internal control, and failed to enforce with reasonable diligence the system it had. Accordingly, it is concluded that Registrant and Gambarasi, who was responsible for Registrant's supervision, failed reasonably to supervise Haisman and Taylor in the respects found above with a view to preventing the fraudulent and manipulative violations of the Act and regulations committed by the stated representatives.

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the respondents. The Division recommends that Taylor be barred

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12/ *Sutro Bros. & Co.*, 41 S.E.C. 443 (1963).

from association with a broker-dealer[13] in a supervisory capacity and suspended from association with a broker-dealer for a period of one year. As to the Registrant and Gambarasi the Division recommends that each be suspended for thirty days, and that Registrant's future activities exclude dealing in options and maintaining a branch office unless there is Commission approval.

Taylor urges that he committed no wilful violations and conducted himself truthfully in dealing with his customers, explaining the complete transactions to them, using a worksheet. He calls attention to a hearing before the NASD concerning this matter in which he was exonerated of any fault. In addition he points to his voluntary appearance and cooperation with the investigation herein.

I have considered the various factors urged by Taylor as mitigation. The representations made by him were not of the same illicit character as found to have been made by Haisman, and as previously noted, the record does not support the charge that Taylor acted in concert with Haisman in a scheme to defraud customers. In considering the sanction to

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13/ While the Division requested that Taylor be suspended from association with any investment company or investment advisor for one year and thereafter be permanently barred from any supervisory position therein, it would be inappropriate inasmuch as the proceedings were brought under the Exchange Act.

be imposed on Taylor I have taken into consideration that his prior record was good together with an assessment of his demeanor at the hearing.

By noting and considering these factors, I do not mean to suggest that there was any justification for Taylor's misconduct. However under all the circumstances, I conclude that it is appropriate in the public interest that he be suspended from association with any broker-dealer for ten business days.

The Registrant and Gambarasi urge that no sanctions be imposed herein. Their basic argument is that they are the victims of the fraudulent conduct of Haisman and Taylor, and suffered grievous losses therefrom. They reiterate that they were "the victim, not the villian . . . " herein. In determining what remedial action is appropriate in the public interest as to the Registrant and Gambarasi, I have taken into account that Registrant has been in business for over 40 years, and Gambarasi has been in the securities business since 1928, with prior disciplinary action being had against them on only one occasion. Furthermore, Gambarasi is now 78 years of age, and has indicated he has no intention of opening any branch office or engaging in any large scale option trading business, merely contenting himself to continue in the phase of the securities business he has always conducted, i.e., investment

securities, not pure speculation. He impressed me as a man of integrity, who has suffered a lifetime of hurt in the short three-month interval when this storm engulfed his firm. While Gambarasi was to some extent caught up in the fraudulent actions of his representatives, he cannot absolve himself from the ensuing catastrophe. As the controlling and supervising partner he failed to render the necessary supervision to head off and foreclose the fraud. The large volume of option trades as seen by the commissions generated on the part of Haisman should have alerted him. That he moved swiftly and closed the branch office after he finally recognized the fraud taking place, while commendable cannot excuse his previous laxness. On the other hand, Gambarasi has been in the securities business for a considerable time, and has a good reputation, which has been severely tarnished as a result of the publicity attendant upon this entire happening.

Under the circumstances, and in view of the excellent reputation that Registrant and Gambarasi enjoy in the financial community, it is concluded that censure will suffice to cause Registrant and Gambarasi to recognize and seriously consider for all time, the need for utmost diligence in carrying out their responsibilities to the investing public and to seek informed assistance when entering into an unchartered securities field wherein their expertise is limited.[14/]

14/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with the initial decision, they are accepted.

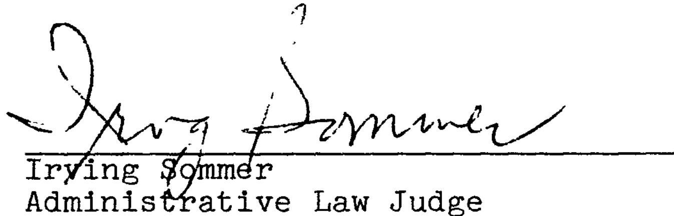
Accordingly, IT IS ORDERED:

1) Leroy Zack Taylor is suspended from association with a broker-dealer for ten business days from the effective date of this Order;

2) Shaw Hooker and Company and Arthur A. Gambarasi be, and they hereby are censured.

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

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to a Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review the initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Irving Sommer
Administrative Law Judge

Washington, D.C.
March 11, 1977