ADMINISTRATIVE PROCEEDING
FILE NO. 3-163

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

COSTELLO, RUSSOTTO & CO. (8-9178)
FRANK A. COSTELLO
BERNARD LIVINGSTON
JEROLD IRWIN KANTOR
MARTIN A. FLEISCHMAN
JOSEPH BARON
FLOYD EARL O'GORMAN

INITIAL DECISION

Sidney Gross
Hearing Examiner

Washington, D. C.
April 7, 1966

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INITIAL DECISION

ERRATA

The order appearing in the third full paragraph on page 22 of the initial decision is amended to include the following after the word revoked:

"That Frank A. Costello is barred from being associated with a broker or dealer;"

Sidney Gross
Hearing Examiner

Washington, D.C.
April 12, 1966

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Before: Sidney Gross, Hearing Examiner

Appearances: Edwin M. Rosendahl for Costello, Russotto & Co. and Frank A. Costello.

Jeremiah Casselman for Bernard Livingston.

Harold L. Orchid for Joseph Baron, Floyd Earl O'Gorman and Jerold Irwin Kantor.

Bernard R. Kaufman for Division of Trading and Markets.

This proceeding is brought pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"). It was instituted by the order for public proceedings issued by the Securities and Exchange Commission ("Commission") dated May 25, 1965, against Costello, Russotto & Co. ("registrant"), Frank A. Costello ("Costello"), President, director and owner of 95% of the registrant's stock during the period January 2, 1964 through March 30, 1964 ("the relevant period"), Bernard Livingston ("Livingston"), Jerald Irwin Kantor ("Kantor"), Joseph Baron ("Baron"), Floyd Earl O'Gorman ("O'Gorman"), all salesmen employed by registrant during the relevant period and Martin A. Fleischman ("Fleischman"), a salesman employed by registrant from the beginning of the relevant period to mid-March 1964.

The order alleges, in substance, that during the relevant period registrant and the other respondents, singly and in concert, wilfully violated and wilfully aided and abetted violations of the anti-fraud provisions of the Exchange Act [1/] and the Securities Act of 1933 ("Securities Act") in the offer, sale and purchase of the stock of Device Seals, Inc. ("Device"), Lou Kornhandler, Inc. ("Kornhandler") and Tabach Industries, Inc. ("Tabach"). [2/]

1/ The allegation of the order charging violation of Section "15(b)(1)" of the Exchange Act was amended to read Section "15(c)(1)."

2/ The anti-fraud provisions alleged to have been violated are Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. The composite effect of these provisions as applicable to this case is to make unlawful the use of the mails or means of interstate commerce in connection with the purchase or sale of any security by the use of a device to defraud, an untrue or misleading statement of a material fact or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by the use of any other manipulative, deceptive or fraudulent device.

Fleischman failed to file an answer as prescribed by the order for proceedings or to appear at the hearing. Accordingly, pursuant to Rules 7(e) and 6(e) respectively, of the Commission's Rules of Practice Fleischman has defaulted, the allegations of the order for proceedings are deemed to be true as to him and the proceeding is hereby determined against him.

Proposed findings of fact, conclusions of law and briefs have been filed by the Division of Trading and Markets ("Division") and on behalf of all remaining respondents. Division has also filed reply briefs.

Tabach is engaged in the manufacture of women's apparel. Its Consolidated Statement of Financial Condition as of November 30, 1963 discloses that Tabach suffered a net operating loss of $154,786.66 and showed a deficit of $105,213.83. On January 16, 1964, a meeting of the creditors of Tabach was held and a creditors' committee was formed. Directly following the meeting Julius Tabach ("J.T."), President of Tabach, accompanied by Tabach's accountant, among others, went to registrant's office since he knew registrant was trading in Tabach stock, and informed Costello 3/ of the fact that the creditors meeting

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3/ Registrant had been the underwriter in public offerings made pursuant to Regulation A promulgated under the Securities Act as to the stock of Tabach in March 1962, the stock of Kornhandler in October 1962 and the stock of Device in January 1963. Since these facts were stipulated between Division and respondents Costello and registrant only, they are not binding on the other respondents.

had been held.[4/] Tabach's accountant informed Costello that Tabach was "in pretty bad shape at this point." It's financial condition did not change substantially between November 30, 1963 and March 30, 1964.

Kornholder was engaged in the manufacture and sale of women's wear. Costello was a director of Kornhandler from November 1963 to July 1964. On February 18, 1964, Kornholder acquired California Girl, Inc., and Kornhandler changed its name to California Girl Manufacturing, Inc.[5/] A note to Kornhandler's consolidated financial statements for the three-month period ended March 31, 1964, discloses that for the year ended December 31, 1963, Kornhandler sustained a net loss of $70,000 and had a total accumulated deficit of $146,976.

As to Device, the record discloses only that it is engaged in the manufacture of glass to metal and ceramics to metal hermetically sealed items.

Registrant - Fraudulent Representations

The Division called 15 witnesses whose transactions with registrant during the relevant period included the purchase by 5 of these

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4/ Eventually the creditors of Tabach accepted a 40% settlement.

5/ The name, Kornhandler, used hereinafter shall also mean California Girl Manufacturing Inc.

witnesses of 3850 shares of Tabach, all but 100 shares at 3-1/2 and the 100 at 2-3/4; by 7 witnesses of 7420 shares of Kornhandler at prices ranging from 3-1/4 to 4; by 2 witnesses of 600 shares of Device at prices between 2 and 2-5/8; the sale by 5 witnesses of 1600 shares of Kornhandler at prices between 2-5/8 and 3-1/4 and by 1 witness of 300 shares of Tabach at 2-3/4. [6/] The mails were utilized by registrant in transmitting confirmations and securities to its customers in transmitting to registrant their checks in payment of their purchases.

Three witnesses [7/] testified as to the following representations by O'Gorman in respect of Kornhandler and Tabach stock:

> That Kornhandler would be selling for $7 per share in six months; it was going up; it was going great and no reason it would do anything but well; capital gains realized from the stock's rise in price would be worth more than the interest on bonds which O'Gorman recommended the customer sell to purchase Kornhandler; it was on the order of Bobby Brooks which had moved up tremendously and Kornhandler would do just as good; it was a rapid growth situation.
>
> That Tabach was doing well and would be selling for $8 a share by the end of the year; it would make some money in a year, its potential was very good.

6/ Some of the witnesses engaged in transactions in more than one of the three issues referred to above.

7/ H.A.S., M.M.B. and E.R.S.

Four witnesses[8] testified to the following representations by Kantor in respect of Kornhandler and Tabach stock:

> That Kornhandler was not going anywhere; dispose of it, it would not advance further; not going higher - and buy Tabach or another stock with proceeds of Kornhandler sales.
>
> That Tabach was a good buy; good investment; looked good; a budding company that should do well.

Three witnesses[9] testified to the following representations by Livingston in respect of Kornhandler and Tabach stock:

> That Tabach was a good investment.
>
> That if Kornhandler merged with California Girl the stock should increase in value; price of the stock should increase substantially; probability the stock would go on either the American or Pacific Stock Exchange and this should result in a substantial price increase in the stock; the listing should take the stock up a couple of dollars; it looked real good; a good healthy company.

Three witnesses[10] testified as to the following representations by Baron in respect of Tabach, Kornhandler and Device stock:

8/ G.W.A., R.G.A., A.J.S. and F.M.S.

9/ G.L., E.M.E. and C.G.

10/ J.S., N.E.W. and R.J.Z.

That Kornhandler would merge with California Girl and should go up because of extra proceeds and growth possibilities; that the stock should definitely be going up within a year; it was an excellent buy; a very good company; moving along; great prospects for the future.

To one customer to whom Baron had recently sold Kornhandler - that he should sell Kornhandler to purchase another stock which Baron felt was better.

That Tabach was an excellent company, doing well.

That another customer should sell Tabach to buy another stock.

Buy Device - registrant has only 200 or 300 shares left and expected to sell out completely - on a day on which registrant was long 3,729 shares of Device stock.

One witness 11/ testified to the following representations by Fleischman in respect of Device stock:

It's a hot issue; it would probably double or triple within the next two or three weeks; it's going up in volume; chance to make some good money; borrow as much as you can to buy as much as you can.

11/ R.P. O'G.

One witness 12/ testified that salesman Alex Stevens urged the sale of Kornhandler representing that it had reached its top; had gone as far as it would and it was a good time to get out.

Although some of this testimony has been contradicted by the salesmen-respondents, the Hearing Examiner, after having heard the witnesses and observed their demeanor, credits the testimony of the investor witnesses.

Despite the fact that Costello was informed of the meeting of Tabach's creditors and of Tabach's straitened financial circumstances, registrant failed to so inform its salesmen-respondents who sold Tabach stock. Further, although Costello was a director of Kornhandler, at least two of registrant's salesmen-respondents who sold Kornhandler stock were not advised by registrant of Kornhandler's losses and deficit. Thus, purchasers of the securities of both companies were not furnished information which, obviously, was vital to an informed investment judgment.

Moreover, registrant issued a "Research Report" late in January, 1964 and subsequent to the Tabach creditors meeting, which referred to five securities including Tabach and Kornhandler. The report describes Tabach in glowing terms. A recent acquisition is

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12/ R.O.E.

said to "represent a dynamic new phase of growth* * *." It includes a reference to "full scale production * * * unable to keep up with the West Coast demand * * *"; Tabach's backlog seems destined to exceed the capacity to produce * * *" But the report omits any mention of the creditors meeting which was held about 8 days before the report was received by one of the Division's witnesses 13/ nor does it furnish any information as to Tabach's financial condition. The report cites Kornhandler's merger with California Girl which, it states, is doing a sales volume in excess of $4,000,000 annually and has acquired another firm doing about $1,000,000 in volume annually. It also indicates that management contemplates further expansion but neglects to inform the prospective investor that Costello is a director of Kornhandler or of Kornhandler's operating losses and deficits.

In addition, during the relevant period and on the same day or within periods of a few days, some of registrant's salesmen recommended its customers purchase Tabach and Kornhandler while others were recommending to their customers the sale of these securities. Some customers were urged to sell their Kornhandler stock in order to buy Tabach or other securities, to sell other securities and buy Kornhandler and to sell Tabach to purchase other securities.

13/ W.E.J., Jr.

The record demonstrates conclusively that the registrant's optimistic representations in respect of Tabach and Kornhandler set forth above including price rises, bright prospects, increases in value resulting from merger and possible listing on an exchange and the cellence of the stocks not only were entirely unsupported by the adequate and reasonable factual basis implied by the representations but,[14/] in view of registrant's knowledge of the financial condition of these companies, were known to registrant to be false. Its extravagant predictions as to price rises in Tabach, Kornhandler and Device were clearly unwarranted and have been held repeatedly to be a "hallmark of fraud."[15/] Its conflicting recommendations during the same period as to the purchase and sale of both Tabach and Kornhandler are tactics which obviously "are contrary to the basic obligations for fair dealing borne by those who sell securities to the public."[16/]

In addition, registrant's failure to inform its customers of the adverse financial condition of Tabach and Kornhandler in either the oral representations by registered representations or registrant's

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14/ Leonard Burton Corporation, 40 S.E.C. 211 (1959); MacRobbins & Co., Inc., 40 S.E.C. 497 (1961); Best Securities, Inc., 39 S.E.C. 931 (1960); Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962); Wright Meyers & Bissell, Inc., Securities Exchange Act Release No. 7415 (Sept. 8, 1964).

15/ Hamilton Waters & Co., Inc., Securities Exchange Act Release No. No. 7725, (October 18, 1965): S.E.C. v. Johns, 207 F. Supp 566 (U.S.D.C., N.J., 1962); Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962).

16/ Ross Securities, Inc., Securities Exchange Act Release No. 7069 (April 30, 1963).

sales literature constitutes fraudulent omission of material facts.[17] And the favorable comparison of Tabach with Bobby Brooks "which had moved up tremendously," without appropriate qualifications, was unjustified and misleading.[18]

Further, neither recognition by customers that they were purchasing speculative securities nor lack of reliance by customers upon the salesman's fraudulent representation absolve such representations.[19]

It is well settled that registrant and its officers are responsible for the activities of registrant's salesmen on its behalf.[20] Persons dealing with a securities firm properly may rely on the principals of the firm to protect them against fraud or other misconduct in the operation of their business, ergo the rule places the responsibility for adequate supervision against violation of the securities laws on the firm's officials.[21] A contrary rule "would

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17/ N. Finsker & Co., Inc., 40 S.E.C. 291 (1960); Leonard Burton Corporation, supra.

18/ G. J. Mitchell, Jr. Co., 40 S.E.C. 409; Whitehall Corporation, 38 S.E.C. 259 (1958).

19/ Isthmus Steamship & Salvage Co., Inc., Securities Exchange Act Release No. 7400 (August 20, 1964); Wright, Myers & Bessell, Inc., Securities Exchange Act Release No. 7415 (September 8, 1964).

20/ Associate Underwriters, Inc., Securities Exchange Act Release No. 7389 (August 14, 1964); Sutro Bros. & Co., Securities Exchange Act Release No. 7053 (April 10, 1963); Charles E. Bailey & Company, 35 S.E.C. 33, (1953).

21/ Bond and Goodwin, Incorporated, 15 S.E.C. 584 (1944); Thompson & Sloan, Inc., 40 S.E.C. 451 (1961); Sutro Bros. & Co., Securities Exchange Act Release No. 7052 (April 10, 1963).

encourage ethical irresponsibility by those who should be primarily responsible.[22/]

Thus, where willful[23/] violations have occurred by a firm's employees, failure to maintain and enforce a proper system of supervision constitutes the firm and its responsible personnel participators in such misconduct and willful violators of the securities laws.[24/]

Registrant - Excessive Mark-ups

Computations prepared by the Division from registrant's books and records disclose that during the relevant period registrant made 59 sales of Device stock to customers at mark-ups ranging between 17.9% and 111.1%, 91 sales of Kornhandler stock to customers at mark-ups ranging between 23% and 35% and 69 sales of Tabach stock at mark-ups ranging between 18.2% and 52%. These computations are based upon the following formula:

(1) Same day purchases and sales;

(2) If sales were made from a long position the nearest preceding purchase constituted the basis for the computation;

22/ R. H. Johnson & Co. v. Securities and Exchange Commission, 198 F. 2d 690, 696-7 (1952); cert. den. 344 U.S. 855 (1952); John T. Pollard & Co., Inc., 38 S.E.C. 594 (1958).

23/ It is well settled within the meaning of Section 15(b) of the Exchange Act a finding of wilfullness does not require a finding of intention to violate the law. It is sufficient that registrant knew what it was doing. Hughes v. S.E.C., 147 F.2d 969, 977 (C.A.D.C., 1949); Schuck v. S.E.C., 264 F. 2d 358, 363 n. 18 (C.A.D.C., 1958); Thompson Ross Securities Co., 6 S.E.C. 1111, 1112 (1940).

24/ Reynolds & Co., 39 S.E.C. 902, 917 (1960).

(3) If sales were made from a short position the next subsequent purchase constituted the basis for the computation;

(4) Quotations of other dealers were not used since the quotations did not represent a "published market";

(5) Lapse of time between purchases and sales or sales and purchases did not exceed four days.[25/]

It is apparent from registrant's records that during the relevant period, on the same day it made purchases of Device stock it engaged in 27 sales of Device stock to customers at mark-ups of between 18% and 100% computed on the basis of prices paid by registrant in its purchases on the day of the sales; in 59 same day transactions in Kornhandler stock at mark-ups between 23% and 33% and in 34 same day transactions in Tabach stock at mark-ups between 25% and 52%.

It has been held, repeatedly, that in the absence of countervailing evidence, a dealer's own contemporaneous cost is the best evidence of current market price.[26/] Nor is there room for doubt that in same day transactions involving low priced, over-the-counter securities, contemporaneous cost is deemed market price.[27/] Since, in respect of such

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25/ Although registrant and Costello content that the Division ignored certain relevant circumstances, they do not indicate any objection to the mathematical accuracy of the Division's computations.

26/ Naftalin & Co., Inc., Securities Exchange Act Release No. 7220 (January 10, 1964); J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964); Costello, Russotto & Co., Securities Exchange Act Release No. 7729 (October 22, 1965).

27/ J. A. Winston & Co., Inc., supra; Costello Russotto & Co., Inc., supra; Arnold Securities Corp.; Securities Exchange Act Release No. 7813 (February 7, 1966); J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7334 (June 5, 1964).

securities, quotations by other dealers do not necessarily represent the price at which transactions are actually consummated, the Commission has refused to accept published quotations in lieu of contemporaneous costs as the best evidence of prevailing market price.[28/]

Moreover, there is little question that contemporaneous costs as evidence of market price may be used in other than same day transactions. Thus, the use of contemporaneous cost has been held to be appropriate where purchases and sales are closely related in time.[29/] And certainly, when viewed in the light of the Commission's decisions in Shiels, where the purchase price was deemed contemporaneous cost despite lapses of 7 and more days between purchase and sale and Linder, Bellotti, where "the most nearly contemporaneous purchase within three days before or after sale" was utilized, it becomes readily apparent that the Division has computed registrant's mark-ups in accordance with accepted principles.

Registrant and Costello urge, among other things, that consideration be given to registrant's "expense of sale (including commission) and overhead" presumably as "countervailing evidence". These are normal and usual expenses of sale, virtually ever-present, and do not justify the grossly unfair prices found here.[30/] The term "countervailing evidence"

28/ Naftalin & Co., Inc., supra. In any event there is not even the semblance of an independent market as to Device or Kornhandler and the quotations of other dealers on Tabach which, over the three month period, appeared on 19 days and consisted essentially of "asks", hardly constituted an independent market.

29/ Naftalin & Co., Inc., supra; J. A. Winston & Co., Inc., supra (Release No. 7337); Shiels Securities, Inc., Securities Exchange Act Release No. 7739 (June 11, 1964); Linder, Belotti & Co., Inc., Securities Exchange Act Release No. 7738 (November 5, 1965.

30/ Cf. Arnold Securities Corp., supra.

envisions expenses arising out of special circumstances[31] which certainly are not present here and as to which registrant has the burden of proof.[32]

Based upon the record and the foregoing it is readily apparent that during the relevant period, in the offer and sale of the Tabach, Kornhandler and Device stock registrant made false representations of material facts and omitted to state material facts; induced the sale of Tabach and Kornhandler stock by customers on the basis of conflicting representation and sold Device, Tabach and Kornhandler stock at prices not reasonably related to the prevailing market price. Accordingly, the Hearing Examiner finds that registrant and Costello wilfully violated Section 17(a) of the Securities Act and Sections 10(a) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder and that Costello wilfully aided and abetted such violations.

31/ Thill Securities Corporation, Securities and Exchange Act Release No. 7342 (June 11, 1964).

32/ Ibid.

The record at page 544 includes the following statement by the Hearing Examiner:

> "I do not think, however, that expense of sale has to be proved. I think we know there is always an expense of sale."

On its face, this statement may be construed to eliminate any need for proof of special circumstances by registrant. But the record is clear that the only matter under discussion was the expense of salesmen's commissions and the quoted statement was made in relation to the question whether the Division, in computing registrant's mark-ups took salesmen's commissions into consideration.

Thus, counsel for registrant stated thereafter, at page 544; "That is the only point I wanted to make, and I did want the witness to identify that on the particular exhibit, the Division's exhibit in the ballpoint pen that it did refer to those commissions involved."

Salesmen

Baron

Baron testified that his information as to Kornhandler came "from the management, from Kornhandler itself." The record contains no evidence, however, that Baron's sources of information in respect of the Kornhandler company were anything other than a series of advertisements by the company and certain articles about the company appearing in the California Apparel News and Women's Wear Daily. It is self-evident that the company's advertisements of its product offer no such support. The news articles dealt with the proposed merger with California Girl and a proposed franchise to a Japanese firm to manufacture and sell Kornhandler's designs in Japan. Apart from the highly unsatisfactory nature of newspaper articles as a source of information for representations in the sale of securities, there is little, if anything, in these articles to support Baron's highly optimistic statements in respect of the company and its stock.

Baron denies representing to one of the Division's witnesses[33/] that Kornhandler stock would go up in a year. But his obvious self-interest and the absence of any basis for disbelief of the witness impels rejection of his denial. He does not attempt to rebut the testimony of the other witness to whom he sold Kornhandler stock that he said it was an excellent buy, a good company, moving along. Although he testified that he informed both these customers that Kornahndler had been operating at a deficit or loss, the very inconsistencies apparent between his optimistic statements to them and the company's losses and

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33/ N.E.W.

deficit belies this testimony.

The record discloses no evidence that registrant informed its salesmen either as to Tabach's financial condition or that a meeting of Tabach's creditors had been held. All the salesmen-respondents deny that they were given such information. Indeed, the fact that Costello sold 1800 shares of Tabach stock held by a registered representative of registrant, as custodian for his children, without the salesman's consent and without offering any reason other than "the stock had no place to go"[34/], confirms this conclusion. Baron testified he never directly requested any financial information as to Tabach. Later in his testimony he said he "believes" he asked registrant for the information but never received any. But despite this lack of vital data Baron neither qualified his optimistic statements nor disclosed to customers the absence of financial information nor cautioned them as to the risk involved in purchasing the stock without such information as it was his duty to do.[35/] Moreover, Baron's representation to a witness[36/] that registrant had only 200 or 300 shares of Device on same day registrant's trading ledger discloses a long position of 3,729 shares, was obviously fraudulent.

34/ The salesman delivered the shares, accepted payment and, in effect, ratified the sale.

35/ B. Fennekohl & Co., Securities Exchange Act Rel. No. 6898 (Sept. 18, 1962); A. G. Bellin Securities Corp., 39 S.E.C. 178 (1959).

36/ N.E.W.

In addition, Baron gave conflicting advice to his customers. Within one week he recommended that one sell Tabach and that another buy Tabach. The recommendation to sell was made in connection with Baron's recommendation that the proceeds be used to purchase another security. Further, within about three weeks Baron advised the same customer to purchase and then to sell Kornhandler stock and to use the proceeds to purchase Tabach stock. In both cases of conflicting recommendations the registrant's purchase and sale prices of the stock varied little or not at all for the period between the conflicting recommendations. Such tactics obviously do not comport with the standards of fair dealing imposed upon the seller of securities.

O'Gorman

The Hearing Examiner finds no basis for the acceptance of O'Gorman s categorical denial of virtually all of the representations ascribed to him by three Division witnesses in respect of Kornhandler and Tabach stock. His unsupported representations expressing exuberantly optimistic predictions of price rises and his unjustified comparison of Kornhandler with another security are palpably fraudulent. Moreover, although at one point O'Gorman denied that he obtained any financial information regarding Kornhandler until after the relevant period, he testified later that his source of information was the same advertisements and newspaper articles upon which Baron assertedly

relied and which actually were introduced into evidence as O'Gorman's exhibits. These included an article dated December 23, 1963, noting prospective approval by the California Division of Corporations of Kornhandler's merger with California Girl and containing certain financial information in respect of Kornhandler showing a deficit of $82,948.01.

O'Gorman testified, first, that he didn t know whether he advised customers of Kornhandler's deficit. After completion of his testimony he was recalled and testified that he had furnished the information to his customers late in February 1963, when he received it. It is noteworthy that Baron testified that the article of December 23, 1963 came to his attention "possibly a week, or so, after it was in the paper." Moreover, O'Gorman's testimony implies that one customer 37/ purchased 2,750 shares of Kornhandler between March 6 and March 24, 1963 after being told of its poor financial condition. The Hearing Examiner rejects O'Gorman's assertions and finds that he withheld important financial information from his customers.

Moreover, what has been said above in respect of a salesman s responsibility to advise customers purchasing Tabach stock of the absence of financial information applied with equal force to O'Gorman.

Kantor

Of the four witnesses who testified as to representations by Kantor in respect of Kornhandler and Tabach stock, three owned Kornhandler stock and were advised to sell. Two were urged to use the proceeds to

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37/ E.R.S.

buy Tabach and one to buy another stock which registrant was also selling at that time. The fourth witness, who apparently held neither Tabach nor Kornhandler, was urged to buy Tabach.

The unanimity of the three holders of Kornhandler stock that Kantor stated, in effect, that it would go no higher, militates overwhelmingly against Kantor's denials that he made such representations. He had no financial information regarding either Tabach or Kornhandler. Neither his visit to the Tabach plant in August of 1963 nor his favorable opinion of the future of stretch fabrics, constitute the adequate support required as the basis for the representations that Tabach stock was a good investment and the company was "budding" and had good potential. Admittedly, he had no other information to support his statements and absent adequate support they constituted fraud. The only basis he asserts for recommending the sale of Kornhandler is that each of the customers would be making a profit. But when taken together with his recommendations in each case that the proceeds be used to purchase Tabach or another security in which registrant was dealing, it becomes apparent that Kantor was engaged in a switching operation.

Livingston

Livingston recommended the purchase of Kornhandler to two witnesses and the purchase of Tabach to a third. While he denies he

represented to one witness that if the merger with California Girl occurred the price of Kornhandler stock should increase substantially, the testimony of a second witness that he represented that the stock probably would go on an exchange which would result in a substantial price rise - should take the stock up a couple of dollars - remains uncontradicted. Livingston admits he saw a financial statement of Kornhandler early in January 1964 and "believes" he advised his customers that Kornhandler was operating at a loss. It is hardly credible that Livingston would have told the same customer of the company's losses and substantial deficit and indicated in the next breath that it was a "good, healthy company".

Further, despite Livingston's fascination with the stretch fabric industry and his favorable impression of Tabach resulting from a visit to its plant, his inability to obtain financial information in the face of his specific requests therefor made of both J. T. and Costello should have put him on notice of the increased necessity for the disclosure to his customers of the absence of such data.

All Salesmen-Respondents

The record does not support Division's assertion that the salesmen-respondents bear responsibility for the registrant's excessive markups. On the other hand, despite the denials of Baron, Kantor and O'Gorman, of knowledge of what recommendations the other salesmen were making in respect of Kornhandler and Tabach stock, the Hearing Examiner is constrained to find that they had such knowledge. The physical layout of their offices was such that they each sat in a small cubicle having

walls, topped with glass, which did not exceed 4 to 5 feet in height. Each of the three named above admitted they could hear the other salesmen. Livingston, however, had a private office of his own with floor to ceiling walls and while in his office he could not hear the others. Nevertheless, he readily admits he had occasion to hear other salesmen recommend sale of Kornhandler and Tabach. If he was aware of these recommendations, the conclusion is inescapable that the others also must have known what their associates were doing. It follows that all salesmen-respondents share responsibility for the violations of the securities laws resulting from the sale of securities through conflicting recommendations.

Accordingly, based upon the record and the foregoing it is concluded that in the offer and sale of Tabach, Kornhandler and Device stock, Kantor, O'Gorman, Livingston and Baron wilfully violated and wilfully aided and abetted in registrant's violations of Sections 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder.

Public Interest

The record contains no evidence in mitigation of the violations of the securities laws found above against registrant and Costello. Indeed, the Commission recently dismissed an application by registrant and Costello for review of an order of the NASD finding, in addition to record-keeping violations and improper extension of credit in violation of Regulation T issued by the Board of Governors of the Federal

Reserve System, that these respondents charged excessive mark-ups during the period February, 1962 through August 1963 in transactions involving the stock of five issuers.[38/] Obviously, registrant and Costello s excessive mark-up practices are of long standing. The Hearing Examiner concludes, therefore, that the public interest requires the broker-dealer registration of registrant should be revoked and Costello should be barred from being associated with a broker-dealer.

On the basis of the record and the nature of the violations found herein it is also concluded that in the public interest O'Gorman and Baron should be barred from being associated with a broker-dealer and Kantor and Livingston should each be suspended from being associated with a broker-dealer for a period of six months.

In view of Fleischman s failure to defend he should be barred from being associated with a broker-dealer.[39/]

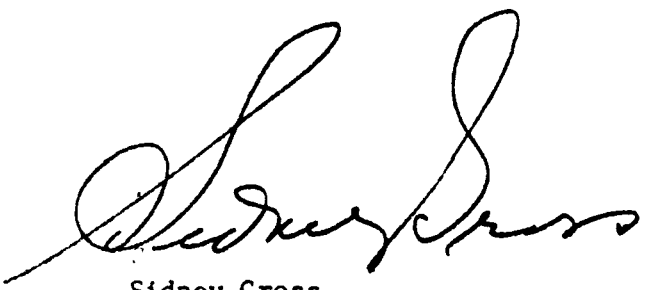
Accordingly, IT IS ORDERED that the registration as a broker and dealer of Costello, Russotto & Co. is revoked; that Floyd Earl O'Gorman, Joseph Baron and Martin A. Fleischman are barred from being associated with a broker or dealer; and that Bernard Livingston and Jerold Irwin Kantor are suspended from being associated with a broker or dealer for six months from the effective date of this order.

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

38/ Costello, Russotto & Co., supra.

39/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 14(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.



Sidney Gross
Hearing Examiner

Washington, D. C.
April 7, 1966