ADMINISTRATIVE PROCEEDING
FILE NO. 3-417

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
RICHARD J. BUCK & CO. (8-4276) ARTHUR GLADSTONE CHARLES ARTHUR FEHR MORTIMER W. HANLY FREDERICK C. STUTZMANN, JR. STEVE CHARLES PARAS	INITIAL DECISION (Private Proceedings)

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Washington, D. C.
June 26, 1967

James G. Ewell
Hearing Examiner

Filed 6-30-67

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STEVE CHARLES PARAS	:

INITIAL DECISION

(Private Proceedings)

BEFORE: James G. Ewell, Hearing Examiner

APPEARANCES: Joseph C. Daley, Roberta S. Karmel, Claire S. Meadow and Bruce A. Rich, of the New York Regional Office of the Commission, for the Division of Trading and Markets.

Nixon, Mudge, Rose, Guthrie & Alexander, by Robert R. Thornton and Robert Thomajan, of Counsel, for respondent Richard J. Buck & Co.

Maurice & MacNamee, by Philip F. Calcina and Charles MacNamee, of Counsel, for respondents Charles Arthur Fehr, Mortimer W. Hanly and Steve Charles Paras.

Windels, Merritt & Ingraham, by Andrew N. Grass, Jr. and Charles M. Taylor, of Counsel for respondents Arthur Gladstone and Frederick C. Stutzmann, Jr.

These are private proceedings instituted by order of the Commission on December 3, 1965 pursuant to Sections 15(b),[1/] 15A[2/] and 19(a)(3)[3/] of the Securities Exchange Act of 1934 ("Exchange Act") to determine what, if any, remedial action should be taken against the respondents named in the caption hereof, by reason of alleged willful violations of certain provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act.

The Commission's order for proceedings (Order), aforesaid,[4/] alleged in substance that during the period from September 1, 1962

1/ Section 15(b) of the Exchange Act, cited above as amended and as applicable here, provides that the Commission shall censure, suspend for a period not exceeding 12 months or revoke the registration of a broker-dealer if it finds that it is in the public interest and that such broker or dealer or any person associated with such broker-dealer has willfully violated any provisions of that Act or of the Securities Act of 1933 as amended or any rule thereunder.

2/ Section 15A(1)(2) of the Exchange Act as applicable to this case provides for suspension for a maximum of 12 months or the expulsion from a registered securities association of any member, or for suspension for a maximum period of 12 months or barring any person from being associated with a member thereof if the Commission finds that such member or person has violated any provision of the Exchange Act or rule or regulation thereunder or has willfully violated any provision of the Securities Act of 1933, as amended, or any rule or regulation thereunder.

3/ Section 19(a) of the Exchange Act as amended, referred to above, provides that the Commission is authorized if, in its opinion, such action is necessary or appropriate for the protection of investors -

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

4/ For convenient reference a copy of the above Order is attached as Appendix "A".

to about December 31, 1963 respondents Arthur Gladstone ("Gladstone"), Charles Arthur Fehr ("Fehr"), Mortimer W. Hanly ("Hanly"), Frederick C. Stutzmann, Jr. ("Stutzmann") and Steve Charles Paras ("Paras"), singly and in concert, willfully violated and willfully aided and abetted violations of the anti-fraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, together with Rule 10b-5 thereunder, in connection with transactions involving the offer and sale of the common stock of U. S. Sonics Corporation ("Sonics") by means of untrue statements and omissions of material facts; and that said respondents, among other things, in effecting such transactions did

(1) offer and sell said securities, which were speculative and unseasoned, without diligent inquiry regarding the financial condition and history of operations of the issuer of such securities,

(2) made use of high-pressure selling tactics on the basis of deceptive and inaccurate representations without disclosure of the material facts referred to above,

(3) issued and delivered confirmations of sales of such securities to customers who had neither ordered nor otherwise agreed to purchase the same,

(4) in connection with the offer and sale of said securities also made false and misleading statements and omissions of material facts concerning, among other things, the following: (a) price appreciation of

Sonics stock, (b) the earnings and financial condition of Sonics, (c) its prospects and present and future plans of operation, and (d) mergers with other companies together with ownership of the company's stock by certain respondents.

In addition to the foregoing, the order for proceedings alleged that respondent Richard J. Buck & Co. ("registrant") willfully violated and willfully aided and abetted violations of Sections 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act together with Rules 10b-5 and 15c1-2 thereunder in that during the period above mentioned and in connection with the activities described above said registrant failed reasonably to supervise the conduct and activities of its employees.[1/] Following service of the Commission's Order, answers were duly filed by all respondents interposing in effect a general denial of the charges alleged in said Order.

After appropriate notice a hearing was held before the undersigned in the New York Regional Office of the Commission commencing on March 30, 1966 and continuing on various successive

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1/ The composite effect of the cited anti-fraud provisions, as applicable here, is to make unlawful the use of the mails or facilities of interstate commerce in the sale or purchase of securities by means of a device to defraud, a false 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.

dates through July 20, 1966. The oral testimony of some 30 or more witnesses was taken comprising in excess of 5,000 pages, together with documentary exhibits almost equal in volume. All parties were represented by counsel as indicated on the facing sheet hereof and at the conclusion of the hearing a schedule for the submission to the examiner of proposed findings and conclusions of law together with briefs in support thereof was provided. Such proposed findings with supporting argument were duly filed by counsel for all parties and these have been carefully considered. On the basis of the record as thus constituted and from observation of the testimony and demeanor of the witnesses the undersigned makes the following findings:

BASIC FACTS

The Registrant

The record shows that Richard J. Buck & Co., the registrant, is a partnership headed by Richard J. Buck, Sr. and his son, Richard J. Buck, Jr. which commenced operations in New York City in or about 1942 and engaged in a general brokerage business in securities. It expanded its operations over the years until at the time of the commencement of these proceedings it maintained a number of branch offices extending over the eastern seaboard including also Puerto Rico, the Virgin Islands and Caracas, Venezuela. The only offices here concerned, however, are those located in the metropolitan area of New York City, particularly

two new branch offices which were opened and commenced operations in early February 1963 at Forest Hills, Queens County, New York, which is about ten miles from downtown New York and at Hempstead, a town in Nassau County on Long Island, about twenty miles from downtown New York. The main office of the registrant is located at No. 4 Albany Street, New York, in the downtown financial district and all billing and record keeping operations are centralized in that office which exercises general supervision over all branches of the firm, numbering about 12 and employing about 160 persons.

Thus, it should be noted that all confirmations for the purchase or sale of securities were sent by mail from the New York office to various customers wherever located. Daily blotters, however, were maintained in the various branch offices and copies thereof forwarded to the main office in New York which also maintained daily blotters on all transactions of all branches of the firm.

Edwards and Hanly

For several months prior to the period involved in these proceedings, all of the individual respondents were in the employ of the broker-dealer firm of Edwards and Hanly with a principal office at Hempstead, Long Island and branch offices in Flushing, a suburb of New York City, and at Huntington, a large residential community situated on the north shore of Long Island, in Suffolk County and about thirty-five miles east of New York City. One of the principal partners of this firm was Mortimer G. Hanly, (hereafter referred to as Hanly, Sr.), whose son, Mortimer W. Hanly (hereafter referred to as Hanly, Jr.) - a respondent in these

proceedings - was employed as manager of the firm's branch office in Huntington. The firm engaged in a general brokerage business in securities and occasionally acted as an underwriter or participant with other firms in various underwritings. The principal business of the firm, however, involved securities transactions in the over-the-counter market.

In the late summer and early fall of 1962 Hanly Sr. became involved in a disagreement with other members of the firm and resigned. Following his resignation said Hanly approached Richard J. Buck & Co. (hereafter referred to as Buck & Co.) with the view of persuading that firm to open one or more branch offices on Long Island suggesting Hempstead and Forest Hills as promising locations. As a result, Hanly, Sr. became a partner of Buck & Co. in the fall of 1962 and arrangements were made to open branch offices in the locations mentioned. Hanly, Jr. was placed in charge of the Hempstead branch which, as previously noted, commenced operations in February, 1963.

When word got around that the Hanlys were leaving the Edwards and Hanly firm, certain salesmen employed by that firm - which included all of the respondents in this proceeding - made application to join Buck & Co. as registered representatives with exception of Stutzmann who left Edwards and Hanly at about the same time to join the broker-dealer firm of Paine, Webber & Jackson where he remained only about three months and then also joined Buck & Co. as a registered representative.

During the late summer and fall of 1962 the record shows that respondents Gladstone and Fehr had been employed not only as registered representatives but also as managers, respectively, of branch offices of Edwards and Hanly located at Jackson Heights in the Borough of Queens and at Huntington, Long Island so that when plans were completed by Buck & Co. to open branch offices in Forest Hills and Hempstead, as aforesaid, it was decided to place Gladstone and Fehr in charge of the Forest Hills office as co-managers with equal authority and jurisdiction which both men appear to have exercised successfully without difficulty or friction. Hanly Jr., as previously mentioned, became manager of the Buck & Co. Hempstead office. The record further shows that upon completion of these arrangements the Forest Hills office also commenced full brokerage services to the public in February 1963.

In addition to the foregoing it should be noted that besides the registered representatives who became respondents in these proceedings Edwards and Hanly employed one Alfred Roach as general sales manager who, in addition to the usual supervisory duties of that office, also functioned as a "finder" of new underwritings or participations therein and of so-called "special situations" for recommendation to customers where deemed appropriate. One of the latter was the common stock of Ilikon Corporation which, during the period here involved, was engaged in research, development and marketing of a new process for the manufacture of aluminum cans. Roach recommended the stock to the salesmen at Edwards and Hanly as a promising "special situation," and a substantial amount of said

stock was thereafter sold to a number of customers, many of whom realized substantial profits following a dramatic price advance and stock split.

As a result of the favorable experience with Ilikon - of which Roach subsequently became a director - several registered representatives of the Edwards & Hanly firm, together with Gladstone, Fehr and Hanly, Jr., accompanied Roach to a stockholders' meeting of Ilikon in Boston. On the return trip by plane Roach told said registered representatives about U. S. Sonics Corporation (Sonics) which he described as a company engaged in the research, development and manufacture of electronic components and devices with a plant in Cambridge, Massachusetts and under management headed by some of the principal sponsors of Ilikon, notably a group headed by one Josiah Scott, reputedly of substantial means, and a member or close relative of the well-known wealthy Dupont family.

Roach further stated that Sonics stock had previously sold as high as $30 but was then selling in the over-the-counter market at about an $8 level, the reduction in price having been brought about by recapitalization of the corporation and write-off against current earnings of large initial research and development costs. Roach also added that the company had patents pending, or applied for, covering an electronic device of an entirely new design which had the capability of revolutionizing certain phases of the radio and television industry. The patents, aforesaid, covered what is called in the industry a "solid state intermediate

frequency filter (abbreviated "I-F" filter), a device which is claimed to have virtually universal application in radio and television circuits for achieving selectivity of various electronic impulses or frequencies. It further appears that the conventional I-F filter generally in use is composed of a wire-wound device containing a number of parts of considerable size and requiring manual adjustment; whereas the Sonics device consists of solid ceramic material utilizing no moving parts and is contained in a very small capsule about the size of an aspirin tablet. Thus, its function and market potential were enthusiastically compared to the development and application of transistors in replacement of the familiar tubes in radio circuity. The market for such a device being obviously world-wide and Sonics having already reached a point where it was about to engage in mass production of this as well as other electronic devices (to be described more fully below), Roach stated that in his opinion Sonics had enormous potential and could be recommended to customers as an excellent speculation - indeed, one that would probably compare favorably with Ilikon.

U. S. Sonics Corporation

The record shows that Eric Kolm and his wife, Dr. Carol Kolm, organized Sonics in 1958 and first conducted business in the basement of the Kolm residence in Cambridge, Massachusetts. Its early operations were financed entirely out of the personal funds of Kolm and his wife, both of whom were graduates of the Massachusetts Institute of Technology and had had several years experience as engineers and scientists in the electronics field, particularly

radio and related devices for the transmission of sound. Eric Kohm became president and director and Dr. Carol Kohm secretary and director of the company, but the latter resigned these offices in or about June 1963 because of marital difficulties which ended in divorce and complete separation from the affairs of the corporation under circumstances that will be more fully dealt with below.

The company's initial operations were concerned chiefly with the research, production and sale of "ceramic transducers," a device which is somewhat similar to the I-F filter described above but of more conventional design for use in various sound transmitting mechanisms such as hydrophones for detection of sound under water. Transducers are also used in certain electronic medical equipment and therefore command a fairly wide market.

During the period from 1960 through the fall of 1962 and early 1963 Sonics manufactured and sold hydrophones and transducers to Western Electric Company and the Bell Telephone Laboratories for use in connection with certain warning systems and sonar buoys supplied by those companies to the United States Government. By the time Sonics had reached production of these items it had greatly expanded its operations and plant so that in February 1962 it leased and occupied a plant of approximately 45,000 square feet with 200 employees including a corps of from 15 to 20 electronic engineers and scientists.

The expansion described was made possible by a public offering in 1959 of 73,300 shares of Sonics stock under a

Regulation A exemption for small issues, from which approximately $160,000 was realized. Thereafter, an additional sum of $950,000 from the private sale of 119,000 shares of treasury stock to a group of investors headed by Josiah Scott, heretofore mentioned, was received. A long-term loan of $250,000 was also negotiated with Bessemer Securities Corporation of Wilmington, Delaware, which, in addition, purchased 100,000 shares of Sonic stock at $2.50 per share, yielding an approximately equal amount of cash.

Although during its first year the company had established production and sales from which it realized a modest profit, the history of subsequent operations reflected substantially increasing deficits because of the large sums expended for research and development - particularly in connection with the ceramic "I-F" filter, already described. Thus, the company showed a loss of about $854,226 and an accumulated deficit of $1,047,273.00 at December 31, 1961 and by the end of June 1963 such losses had risen steadily and continuously to a total deficit of $2,046,936. In fact, the record shows that although the company had progressed to the point where it had produced and sold large quantities of hydrophones and other devices mentioned, its sales of these items experienced a severe slump in 1962 due to a cutback in government orders to its prime contractors for this type of material following cessation of the Cuban crisis in the late fall of 1962, and early 1963 — leaving the company with a large inventory of unsold finished goods. In order to extricate itself from these unfavorable

developments Sonics concentrated its efforts on the development, production and marketing of the ceramic I-F filter, which efforts achieved a measure of success but never reached a sound production basis due to a large proportion of rejects of the finished product because of latent defects which presented problems that management of the company had not been able to solve completely during the entire period here pertinent.

In any event, in order to find solutions of the difficulties described and to proceed with the development and production of the I-F filter on a mass production basis, Sonics retained Arthur D. Little & Co. as consultants to design and estimate the cost of an automatic filter assembly plant. The result was an estimate of $250,000 which Kolm testified the company would be unable to finance because of the huge accumulated deficit and the fact that the Scott and Bessemer interests had already declined to make further advances to the company due, in part at least, to management's inability to overcome satisfactorily the manufacturing defects mentioned above. Kolm therefore decided to endeavor to place the filter on the market by entering into licensing agreements with both foreign and domestic manufacturers and distributors of radio and allied products; and in furtherance of this plan, succeeded in negotiating licensing contracts on a royalty basis with companies in West Germany, Japan and South America. Initial payments of from $25,000 to $50,000 were received from each of these companies but the only one which actually produced any of

the filters was Stemag A.G. of West Germany. And while that company's production commenced in the latter part of 1963 the impending bankruptcy of Sonics, more particularly referred to below, soon intervened with the result that little if any royalty payments under the German contract were ever received.

Thus, according to the testimony of Kolm, president of Sonics, the mounting deficits described had caused a serious and persistent shortage of working capital with the result that in the fall of 1963 certain trade creditors representing a relatively small amount of debt brought bankruptcy proceedings against the company which resulted in a decree adjudicating the company a bankrupt on December 27, 1963.

In this connection it should also be noted that on August 12, 1963 Josiah Scott purchased all of the patent rights owned by Sonics together with all of its right title and interest in the three foreign license agreements heretofore mentioned and transferred the same to a new company called Sonus Corporation (Sonus) which, according to Kolm, eventually succeeded in placing the ceramic I-F filter and certain other products covered by the Sonics patents and patent applications on the market. Kolm also testified that, while he had been unable to retain a controlling interest in Sonus, the successor corporation, he is now its president and principal executive officer.

With further reference to the Sonics foreign licensing

agreements it should be noted that the Japanese agreement was with Mitsumi Corporation and required the approval of the Japanese Government before it could be placed in operation. Such approval however had not been obtained up to the time of the bankruptcy so that no production commenced and no royalty payments were ever received.[1/] A similar situation developed in the contract entered into in June 1963 with a company known as L.I.F.E. of Argentina wherein it appears that the initial payment was made upon the signing of the agreement but no production was ever commenced and, of course, no royalties were ever paid. Thus, although the foreign license agreements appeared to offer a lot of potential the record shows that their negotiation dragged over many months and resulted in further delays even after signature; so that, even up to the time that the bankruptcy petition was filed, they still remained for Sonics a merely potential and unrealized source of income.

1/ Subsequently, according to Kolm, a new Japanese licensing agreement was entered into with the Matushita Corporation which is reputed to be one of the largest manufacturers of radio and TV in Japan. This contract however was negotiated by the Sonus Corporation and is relevant here only to show that although the contract with Mitsumi had not become operative, a successful contract had later been put into effect. In fact, Kolm testified that both Stemag and Matushita had finally overcome the technical difficulties which had caused the large percentage of rejects heretofore mentioned regarding the I-F filter and had achieved mass production of the item. However, no actual figures reflecting these results were offered so that while respondents are entitled to the benefit of Kolm's testimony which was not controverted it still remains in unsupported and general terms.

By reason of the foreign license stalemate and ever-increasing expenditures for plant operation, plus the high cost already mentioned of automatic machinery for mass production, the management of Sonics decided to endeavor to obtain licensing agreements with certain domestic manufacturers to produce and market the ceramic I-F filter on a royalty or percentage basis under the best terms obtainable. A considerable number of companies were contacted, the principal ones being General Instruments Corporation ("General Instruments"), Texas Instruments, Incorporated ("Texas Instruments") and Automatic Radio Corporation.

During the course of these negotiations it appears that 1,000 ceramic I-F filter units were submitted to General Instruments for testing and installation in radio sets but certain defects were found to exist in the product with the result that no manufacturing agreement was entered into.[1/] A similar situation developed with Texas Instruments which tested the product extensively but concluded that the Sonics patents would not provide adequate protection against possible infringement suits, particularly by Clevite Corporation which was already producing and marketing a similar product. Texas Instruments also took the position that the Sonics filter would not be competitive in the company's field of operation and terminated the negotiations in a letter dated July 29, 1963. (See Appendix E attached.)

1/ Kolm testified he was advised in late March 1963 of General Instrument's refusal of a license contract.

Automatic Radio Corporation, a large customer of General Instruments, also tested the Sonics filters and placed an order for 1,000,000 units but cancelled it almost immediately due to the fact that early shipments of the product revealed serious defects. Similar attempts were made to interest Delco Corporation, a subsidiary of General Motors Corporation, and also Tung Sol Electric, Inc. but these efforts were unsuccessful for various reasons. In any event the domestic licensing program had produced little hope of success even at mid-summer of 1963, so that Sonics' management, in desperation, decided to seek a merger with another company having the capability of taking over the entire Sonics operation. Several companies were approached, including New England Transformer Co. which seemed the most promising and was discussed at a stockholder's meeting in September or October 1963, a few months prior to the bankruptcy. However, Kolm testified that none of these efforts ever proceeded beyond the talk stage and all ended in failure.

In addition to the I-F filter program Sonics also developed a pool alarm device in the early part of 1963, utilizing the hydrophone transducers and other components which had been left over following cancellation of the Navy contracts for hydrophones. It was the company's plan to market the pool alarm device in department and sporting goods stores and such other outlets as would be in a position to sell it to owners of swimming pools throughout the

country, the purpose of the alarm being to warn such owners of accidental or unauthorized entry.

By way of summary, the foreign license agreements not having yielded any appreciable returns to Sonics except the initial down payments; and vigorous efforts to effect license agreements with domestic companies capable of manufacturing and marketing the product having been fruitless, such unfavorable developments were undoubtedly the principal factors bringing about the financial difficulties which finally led to bankruptcy. Thus, Sonics' inability to finance the mass production of its products and its failure to obtain foreign or domestic licensees to carry forward this vital aspect of the business not only placed the company in a position where it was unable effectively to produce or market its products on a commercial scale, but also made it impossible to obtain additional financing from its former backers with the result that it was no longer able to survive.

Moreover, the record shows that Sonics operated at a deficit every year following its first year of operation when it had a small net income of slightly over $2,000. By the end of 1960, however, it had sustained a loss from operations amounting to $147,959 with an accumulated deficit of $193,047. In 1961, the net loss was $854,226 and the accumulated deficit increased, as previously noted, to $1,047,273. In 1962, the loss was $671,944 with a deficit of $1,719,217, and for the six-month period ended June 30, 1963 the loss amounted to $327,719 and the accumulated deficit rose to

$2,046,937. [See certified financial statements placed in evidence as Division Exhibits 14, 15 and 16.][1/]

Besides the losses and deficits mentioned, it should also be noted that the ratio of current assets to current liabilities for Sonics appears to have been at .6 for the year ending December 31, 1962 and .34 for the six months ended June 30, 1963, showing practically no working capital for both of these periods which immediately preceded and in fact extended well into the period when the bulk of Sonics' stock was being sold to the public by these respondents.

Indeed, in this regard it is of particular importance to note that Kolm testified that the financial statements for the year-end 1962 were made available at a meeting arranged by Roach and attended chiefly by a number of analysts and representatives of various brokerage firms in New York, which meeting took place on July 31, 1963. Kolm addressed the meeting - hereafter sometimes referred to as the "analysts' meeting" - which was also attended by Gladstone, Fehr and Roach together with three or four customers of Buck & Co. who had purchased Sonics shares and requested permission to attend. During the course of the meeting Kolm described the operations of the company and made particular reference

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1/ References to Exhibits placed in evidence or marked for identification will be hereafter designated as follows:

Division's Exhibits - "DX"; Buck Exhibits - "BX"; Gladstone Exhibits - "GX"; Fehr Exhibits - "FX"; Hanley, Jr. Exhibits - "HX"; Paras Exhibits - "PX" and Stutzmann Exhibits - "SX". References to the transcript of testimony will be designated by "R" and the page number.

to the operating loss of $671,000 in 1962 and the large accumulated deficit of $1,719,217; but endeavored to soften the impact of such bad news by stating that the losses were attributable to large expenditures that had been made necessary for research and development of the I-F filter and to overcome certain difficulties in manufacturing techniques which he indicated were serious, but well on the way to solution. He also placed great emphasis on the fact that a license agreement had already been signed with Stemag of West Germany and that a similar contract with Mitsumi, Ltd. of Japan was expected to be consummated within a few weeks. In addition, Kolm stated that it had been and would in future be the policy of the company to make financial information available to stockholders or any other authorized persons.

Moreover, the record shows that Josiah Scott also attended the analysts' meeting and although he did not address the meeting he participated in the general discussion among those present including Gladstone. The latter, it will be recalled, had become personally acquainted with Scott through Roach several months prior to the meeting and had communicated with him by telephone regularly from time to time for the purpose of obtaining information about Sonics at first hand from this prominent director and financial backer of the company. In fact, the testimony shows that Gladstone also obtained information regarding Sonics from one Feltham, secretary and treasurer of

Sonics[1/] with whom Gladstone had also acquired at least a telephonic acquaintance.

Besides the operating and financial difficulties described, the record shows that Eric Kolm became involved in marital difficulties with Dr. Carol Kolm, his wife, which ended in divorce in 1963 and eventual resignation and separation of Mrs. Kolm from the company in or about May or June of that year. As a result of the marital difficulties described it further appears that Mrs. Kolm decided to dispose of all of her holdings of approximately 100,000 shares of Sonics stock, an amount which was approximately equal to that of her husband. In furtherance of these plans she attempted to sell her stock as fast as possible through various brokers and it is respondents' contention that the overhang of such a large offering of stock had a depressing effect on its market value and caused a precipitant decline. The Division on the other hand contends that the decline was caused principally by disclosure of the unfavorable news regarding the serious financial condition of the company which began to be felt as early as April and May of 1963 and was revealed at a stockholders' meeting held at that time.

1/ Indeed, Kolm testified that the financial records of the corporation would be furnished not only for 1962 but for prior years and current periods so far as available upon a proper showing - from which it is clear that respondents in exercise of due diligence could have obtained documented information regarding the financial condition and history of Sonics as well as the status of its current operations.

In any event, in order to prevent a further depressing effect of Mrs. Kolm's efforts to dispose of her holdings, the management of Sonics succeeded in blocking the transfer of Mrs. Kolm's shares by the transfer agent of the corporation until such time as she had produced at least prima-facie evidence, in the form of a "no action letter" from the Registration Division of this Commission, that the shares could be sold without violation of the registration provisions of the Securities Act. Such a letter was secured on July 31, 1963 which enabled Mrs. Kolm to proceed with immediate liquidation of her holdings. Accordingly, due to a combination of all of the unfavorable factors hereinabove described, the stock exhibited an almost constant decline from its 8-1/2 dollar level in January and February 1963 to less than $2 in August when all of the patents and lease agreements were assigned to Scott. From then on the stock continued to decline until it reached zero at the time the petition in bankruptcy was filed.

Finally, despite the virtually uninterrupted decline of Sonics stock from January 1963 to the advent of bankruptcy, the record clearly and fully establishes - in fact by their own admissions - that respondents continued their solicitation of purchases of the stock by customers without making any independent investigation whatever of the worsening of the company's finances and operating difficulties or the causes thereof - such as its progressively

mounting deficits and inability to achieve mass production; the licensing stalemate and failure of merger negotiations. Instead, respondents chose to rely entirely on rosy information and prospects of success fed to them by Kolm, Scott, Feltham and Roach - in rash disregard of their solemn obligation under the Federal securities laws to use due diligence to assure that material information given to customers in the course of recommending transactions in securities shall be accurate, adequate, have a reasonable basis in fact and be not subject to qualification because of unfavorable information that is known or should have been known or ascertained by diligent inquiry at the time.[1/]

With the foregoing as background, the evidence bearing on the issues raised in the Commission's Order will now be discussed.

1/ See MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962); aff'd sub. nom., Berko v. S.E.C., 316 F. 2d 137 (2d Cir. 1963); Van Alstyne, Noel & Co., 33 S.E.C. 311 (1952); J. Logan & Co., Securities Exchange Act Release No. 6848 (July 9, 1962); and Investment Service Company, Securities Exchange Act Release No. 6884 (August 15, 1962).

FINDINGS OF ULTIMATE FACTS AND CONCLUSIONS OF LAW

Alleged Misrepresentations by Respondents in the Sale of Sonics Stock in Violation of the Anti-fraud Provisions Cited Above

Transactions by Gladstone

The testimony as a whole clearly indicates that Gladstone was the prime mover in the offer and sale of Sonics stock during the period under review. As already mentioned, Gladstone became personally acquainted not only with Kolm but with Josiah Scott shortly after the plane trip returning from the Ilikon meeting in Boston. As a result of this contact and at the urging of Roach, who was also personally acquainted with Scott and had achieved close association with him in connection with an underwriting by Edwards and Hanly of an issue of stock put out by Puerto Rican Capital Corporation of which both Scott and Roach were directors,[1/] Gladstone decided to push the offer and sale of Sonics as a potential money maker.

1/ In the above connection, it should perhaps also be noted that Puerto Rican Capital Corporation was subject to a Federal court injunction at the instance of this Commission prohibiting the company and its principals from violation of the Investment Company Act.

It will be recalled that Roach as general manager of Edwards and Hanly had also functioned as a finder of underwritings and so-called "special situations," several of which had been quite successful by way of price appreciation including Ilikon; and when Roach decided to promote Sonics as a special situation of tremendous possibilities and promise, Gladstone conceived the idea that it would be an excellent stock to feature with the view of stimulating new business upon joining the Buck organization which took place shortly after. In this regard it is also pertinent to note that in the early fall of 1962 the management of Edwards and Hanly had determined to reduce the percentage of compensation to be paid to its branch managers and registered representatives which caused considerable dissatisfaction, bringing about the departure of both Gladstone and Fehr, followed almost immediately by the resignation of Paras, Hanly and Stutzmann, all of whom subsequently joined Buck & Co. However, before leaving Edwards and Hanly the record shows that several hundred shares of Sonics were sold to customers by Gladstone, Fehr and Hanly Jr. and these transactions will be more particularly referred to below.

It will also be recalled that when it was agreed by the Buck management that Gladstone and Fehr would become co-managers of the new Forest Hills branch, Gladstone advised the salesmen that Sonics would be a good stock to recommend to customers as a special

situation of great potential and that it should stimulate business. To put this advice into practice Gladstone urged several of his own clients to invest in Sonics and their testimony will now be reviewed.

Mr. H. G., who had been a client for several years, was one of the first customers approached by Gladstone as a good prospect for Sonics and testified that he is general manager of a suburban branch of a large department store chain, that his earnings range between $35,000 and $45,000 per year and that he had maintained an active trading account with Gladstone for several years. In early February 1963 Gladstone gave him an enthusiastic sales pitch on Sonics stating that the company had made an important breakthrough in the electronic field by research and development of a ceramic filter which had a "fantastic" potential because of its virtually universal application in radio and TV circuits. He also made particular mention of the company's development and production of the pool alarm device, heretofore described, which Sonics was planning to market through department and sporting goods stores; and by reason of Mr. H. G.'s position as a department store manager he, Gladstone, thought the pool alarm might be of special interest to him as a new product to be featured in the stores. As a result, Mr. H. G. decided to invest in Sonics and on February 14 placed an order with Gladstone for 2,000 shares at $6 net per share. On February 18 he ordered 3,000 additional shares at the same price making a total investment of $30,000.

About two or three months later the market price of Sonics dropped two or more points, whereupon the witness became concerned and visited the Sonics plant in Cambridge and also prevailed upon one Lloyd Kenev, a friend and analyst in the employ of the well-known broker-dealer firm of Goodbody & Co. to visit the plant and report back as to his opinion regarding the operation. Mr. H. G. further testified that during his own survey he found the plant operating definitely in low gear with only a few employees - probably 15 or 20; and that Kenev reported that while the company apparently had considerable potential he considered it to be what he described as an "iffy situation." Nevertheless, he, Kenev, bought a couple of hundred shares for himself shortly thereafter. However, when the stock had declined to around four or five a month or two later, Kenev suggested to Mr. H. G. that he dispose of his holdings in Sonics. On discussing this with Gladstone, the latter strongly advised against it stating that he still believed in Sonics and urged him instead to buy more at the then current lower price in order to "average down." As a result, the witness purchased 1500 additional shares through another broker. His reason for not placing this order with Gladstone, though, was not disclosed.

In the early part of Gladstone's presentation regarding Sonics, it is pertinent to note that Gladstone, through Roach, had arranged a meeting for Mr. H. G. with Kolm in late January or early February 1963, prior to the above-mentioned purchases. This meeting took place in a New York restaurant and is frequently

referred to in the testimony as the "dinner meeting." It was attended by Roach, Fehr, Gladstone, Mr. H. G., Kolm and one Hockschartner, a publicity agent for Sonics. Prior to the meeting the record shows that Gladstone had furnished Mr. H. G. with a document referred to in the testimony as "the 14-page report" which purported to be a description of the history and operations of Sonics prepared by a securities analyst. This report appears to have been supplied to Gladstone by Roach who had removed the title page prior to turning it over to Gladstone with the remark that it was to be considered "confidential" and that the name of its author could not be disclosed. It was, nevertheless, bandied about the office that the report had been prepared by an analyst in the employ of an organization called Value Line which had a good reputation in the investment field and was reputed to be the manager of two or three large mutual funds. The "14-page report," aforesaid, which was placed in evidence as Gladstone Exhibit No.7 presented a glowing picture of Sonics' research and development facilities and particularly the tremendous potential of its ceramic filter as a device that would revolutionize the entire radio and TV industry in the manner described. During the course of the meeting Kolm exhibited samples of the company's products and was questioned at length by all of those present regarding the statements in the 14-page report which Kolm however testified he had never even seen before and that it had not been prepared pursuant to his request or instructions.

In this regard it should be noted that examination of the above-mentioned report reveals many admittedly flamboyant statements which were unsupported. It also failed to include any financial statements or other documented financial information which in fact are conspicuously absent. Nevertheless, despite its somewhat spurious origin the record shows that the report was made available to all of the salesmen at both the Forest Hills and Hempstead branch offices and was frequently referred to by many, if not all, of the individual respondents in their solicitation of the sales of Sonics stock. In some instances it was even furnished to prospective customers without any words of caution as to its unsupported claims and statements which were clearly inadequate and misleading.

In any event, when the stock went below $2.00 Mr. H. G. sold all of his holdings through other brokers some time in late August, 1963 at prices ranging from 1-3/4 to 1-1/4, sustaining a loss in excess of $20,000.

Mr. G.T.A., a grade school teacher in Huntington, Long Island, testified that in September 1962, while Gladstone was still with Edwards and Hanly, he received a confirmation for the purchase of 300 shares of Sonics at 8-3/8 and that it came as a great surprise since he had not ordered the stock from Gladstone or anyone else at the Edwards and Hanly firm and in fact had never heard of it before. He immediately called Gladstone and asked what it was all about, whereupon Gladstone stated that the stock was "a winner" and would soon "double or triple" in value, and that

the company was already involved in merger negotiations with a big company in the electronics field. As a result of Gladstone's assurances to the effect that Sonics had a tremendous future in the electronics field which was enjoying a burgeoning popularity at the time; and that it should provide a good opportunity for him to recoup some of his losses on other investments, he ratified the purchase of the 300 shares above mentioned. Some time later after transfering his account to Buck & Co. and on February 28, 1963 Mr. G.T.A. received a confirmation for the purchase of 400 additional shares of Sonics at 7-5/8; and although he had not, as in the previous transaction, authorized the purchase, he testified that because of his confidence in Gladstone he ratified it.

Upon questioning by counsel for the Division Mr. G.T.A. stated that he requested Gladstone to furnish him with financial information about Sonics and was advised that none was immediately available but would be supplied. On failing to receive same, the witness complained to Gladstone who explained that difficulties the firm was having with the mail clerk were undoubtedly causing the delay. In any event no literature on Sonics of any kind was ever received by the witness and Gladstone later admitted in his own testimony that there had never been any mailing difficulties in the firm's office.

In addition to the foregoing it should be noted that this witness had retired from the United States Air Force on a 100%

disability pension in the amount of $10,000, which sum was also the approximate amount of his salary as a school teacher so that he had a total, more or less, fixed annual income of $20,000. He had become involved, however, in a real estate venture in Vermont which had put him in debt and therefore in what appears to have been a somewhat desperate effort to straighten out his finances, he engaged in speculative trading in securities. The latter had not been very successful at the time under review and had resulted in substantial losses in certain stocks. Mr. G.T.A. thereupon resorted to the dubious expedient of placing in his margin account, securities owned by his mother-in-law, a woman of fairly substantial means who will be referred to as Mrs. M.L.H. This action was taken without the knowledge of the latter who became highly incensed but took no further action.

Mrs. M.L.H. testified following her son-in-law, and stated that she received a confirmation from Buck & Co. - to which she had also transfered her account - for the purchase of 200 shares of Sonics at 7-3/8 on March 20, 1963 but that she had not ordered the same and had never previously heard of the company. Upon inquiry of Gladstone the latter stated that Sonics was in "the throes of a merger" and should be a good investment; also that it would make

the market performance of "Xerox look like a standstill" - a comparison without the slightest basis and what would be so recognized by anyone except a very inexperienced investor, as the witness stated she was, and which Gladstone, of course, well knew. Such comparisons when made to the unsophisticated, are a familiar technique of high pressure selling and, of course, are deliberately misleading. 1/ Mrs. M.L.H. furthur testified that since she had relied heavily upon the judgment of her son-in-law with regard to securities and had given him more or less carte blanche over her account, she took no adverse action.

1/ The Commission has held that comparisons of an unseasoned speculative stock with those of widely known well-established companies without disclosure of or reference to material differences are materially misleading. In Aircraft Dynamic International Corporation, et al, Exchange Act Release No. 7113 (August 8, 1963), the Commission commented, in part, at page 4 of its opinion:

> ". . . comparison of the issuer with two other companies to suggest the price at which issuer's shares might rise should have been accompanied by full disclosure of the facts necessary to make the comparison fair, including the identity and length of time in business of those companies."

Similarly, in American Republic Investors, Inc., 37 S.E.C. 287 (1956), at page 290, a stop order proceeding under Section 8(d) of the Securities Act based upon alleged false statements in a registration statement, the Commission held:

> "The registration statement included information concerning the growth and profits of 20 outstanding life insurance companies and a comparison between the capital gains and dividends paid on certain selected 'blue chip' industrial stocks and certain selected life insurance companies. These representations were extremely misleading. No reasonable conclusion as to the possible success of this newly formed enterprise could be drawn from the alleged facts about the growth of the well established companies mentioned."

This holding is also believed to be squarely in point here since it will hardly be contended that statements held to be false or misleading in a registration statement would not be equally so if made by a registered representative of a broker-dealer in the course of a sales solicitation. Cf. also The Whitehall Corporation 38 S.E.C. 259 (1958); C. A. Benson, S.E.A. Rel.7346 (June 15, 1967).

Mr. P.R., a department store manager at Beachhurst, Long Island, testified that during May 1963 he, as in the case of the previous two witnesses, received a confirmation for the purchase of 500 shares of Sonics at 5-1/4 without having placed an order for same and without any previous knowledge of the company, its business or financial condition. Upon asking Gladstone what the transaction was all about the latter said that Sonics should "go sky high" and that he should "get rich and retire on it."

Mr. N.E., another school teacher customer of Gladstone from Huntington, Long Island, stated that he told the latter that he had $1,000 to invest and that Gladstone immediately recommended Sonics stating that he, Gladstone, had "an inside track and that the stock should double in six months." This witness also asked for literature on Sonics which Gladstone readily promised but never supplied. He also said that Gladstone made no mention of Sonics' operating losses or deficits nor any specific information regarding the company's business except that contracts with various big companies were in the offing, suggesting it might be compared to IBM. As a result of these conversations Mr. N.E. purchased 100 shares at 7-7/8 which he said was the second securities transaction he had ever made.

When the stock declined in value he complained to Clasen at the main office of Buck & Co. and the latter referred him to William J. Fitzpatrick, general counsel to the firm. A conference at the Massapequa, Long Island office was subsequently held with

Fitzpatrick and Gladstone but no satisfactory result was reached and the matter was dropped.

Mr. W.G., a retired businessman, was a customer of one of the salesmen at Buck & Co. named Bernard Hoffman of whom he inquired about Sonics since he had heard the stock discussed in the office. Hoffman stated he did not know much about Sonics and referred him to Gladstone who stated that it was a great company and that it was producing a "gadget" in which American Motors was very much interested; also, that the company already had a contract to supply electronic components to General Instruments and likewise had obtained a verbal agreement with Texas Instruments of similar nature which it was expected would be finalized in the near future. Additionally, Gladstone stated that the company was doing well and should earn $1 per share by the end of 1963, although it was not currently earning that much. No information regarding the company's losses or other difficulties was mentioned. As a result of these conversations the witness purchased 200 shares on February 26 at 6-3/4; 200 more of Sonics on the same date at 7-1/2 and, subsequently, on May 16, 1963, another block of 200 shares at 4-3/8.

Mr. H.J.F., who had maintained a substantial trading account with Gladstone, testified that the latter called him in February 1963 and gave an enthusiastic sales talk on Sonics stating that it had an excellent potential and should have earnings of $1 per share within a year; also, that its financial backers were the same that sponsored Ilikon and that American Motors was interested

in some of its products. He further stated that the company was producing a ceramic filter for use in electronics and already had a contract to supply General Instruments with its products; also, that in another phase of its business Sonics had developed an alarm system for swimming pools which should have a very big market. As a result of these conversations the witness purchased 700 shares of Sonics on February 28, 1963 at 6-3/8 and was advised by Gladstone that the stock was being sold to him as "principal" for a net price which included no commission. The latter statement was of course misleading since it would have been improper to charge a commission in such a transaction. 1/

After making this purchase the witness testified that he received several brochures on Sonics through the mail during the month of March 1963 and that he had also been furnished with a copy of the "14-page report," but that none of the literature supplied contained financial statements or other information regarding the company's losses or other difficulties. When the stock declined the witness stated he became concerned and asked Gladstone if he had any explanation, whereupon the latter stated that the decline was due to the fact that the president of Sonics had become involved in marital troubles which resulted in his wife's selling a large block of her holdings which action, in turn, depressed the market in the stock. The witness further stated that he accepted this explanation and in June bought 400 additional shares at 4-1/8.

1/ See Leonard Burton Corp., 39 S.E.C. 211 at 213 (1959).

Additionally, it should be noted that a few weeks later, Mr. H.J.F., together with Gladstone, Fehr, Hanly and two or three other customers of Buck & Co., attended the analysts meeting on July 31, 1963, at which, as already mentioned, disclosure was made for the first time to Buck customers regarding unfavorable information about the company's operations, particularly its operating losses and large accumulated deficit. Despite these disclosures Gladstone continued to assure those who attended, that the company was still in good hands and was about to experience a "turn around" and that there was "nothing to worry about" due to the financial status of its wealthy backers. Additionally, the witness testified that Gladstone told him that the company had already received a check for $50,000 from a licensee in Argentina and that in his opinion the stock, being in short supply, should rise to about 12 within a week or two after announcement of a pending contract with General Instruments - to be made in due time.

In any event, due to the unfavorable disclosures at the analysts meeting the record shows that the stock continued its steady decline so that the witness discussed with Gladstone the advisability of selling his holdings whereupon Gladstone advised against it for the reason that such action would probably cause a further decline in the price of the stock; also, that Gladstone had assured him all along that he had personally investigated Sonics, that he was satisfied it was a good company and that the witness should stay with it. Finally, however, after the bankruptcy

of Sonics this witness, together with two other customers, brought a civil action for damages against Buck & Co. alleging that the stock had been sold on the basis of false and misleading representations and this suit was still pending at the time of the hearing.

Mr. H.R., another customer, referred to Gladstone by Hoffman in connection with Sonics, stated that Gladstone told him that Sonics would go up in price "sharply"; that it had signed a contract with General Instruments; that it had already earned over a dollar per share during the previous year and that its earnings should be greater for the next year. As a result of Gladstone's solicitation the witness purchased a total of 300 shares in February and May 1963 at prevailing prices.

Mr. H. R. further testified that he had never received any financial information about the company as he had requested, but that Gladstone said that he knew officials of Sonics who assured him there was nothing to worry about so far as the company's financial condition was concerned. However, he subsequently learned that the contract with General Instruments had not materialized but on inquiry was assured that a similar contract with Texas Instruments was being negotiated.

Mr. H.D., a refrigeration salesman who was also a customer of Hoffman, said that the latter told him he had a good stock that should go up 3 to 4 points on an in-and-out trade and make him some money; also that a merger was pending with General Instruments which would soon be

announced, adding that the earnings of the company were at least $1.00 a share. As a result of this conversation he purchased 100 shares of Sonics at 6-7/8 on February 26, 1963 and later purchased 100 shares each for his wife and son at 7-3/4.

When the stock declined to around 5 he asked Gladstone whether to sell and the latter recommended that he hold it; that the company was still in good shape and was about to be acquired by General Instruments. He also discussed the decline in the price of the stock with Gladstone who told him not to worry and that the decline was a temporary setback due to the marital troubles of the president of the company whose wife was dumping her stock on the market. At about the same time Gladstone also said that Buck & Co. would soon buy a large block of stock which would be "bound to cause the stock to go up." [1/] Finally, when the stock continued its decline to less than $1.00 per share the witness called Kolm directly and inquired about the proposed merger with General Instruments, whereupon Kolm stated that there were no such plans.

Mr. I.L.B., sales manager for a textile house, testified that he purchased 100 shares of Sonics at 4-1/2 on June 24, 1963 on the recommendation of the head of the textile firm by which he was employed. Later he saw Gladstone who told him that Sonics had important patents and a contract with Texas Instruments, also that papers for a merger with the latter were already being prepared for signature.

No literature or financial information was supplied by

1/ The record shows that registrant never at any time purchased Sonics stock for its own account.

Gladstone, who also made no inquiry as to the witness' own financial condition or investment objectives.

Mr. H.S., retired, testified that Gladstone in late April, 1963, asked him to come to the office, stating that he had a good stock which had been selling at a considerably higher price than at present, but that the decline had come about by reason of the fact that the wife of the president of the company had been dumping her stock on the market as a result of marital difficulties ending in divorce. He also said that the company had license contracts with large companies in Germany and Japan for production of the company's products and that negotiations were about to be completed for a similar contract in Argentina. Gladstone further stated that negotiations were also about to be completed for a domestic licensing contract with Texas Instruments; that the product was presently being tested by American Motors[1/] with a view to using it in automobile radios and that earnings of the company should be $1.00 per share for the current year. As a result of these conversations he purchased a total of 1000 shares of Sonics at prevailing prices.

This witness attended the analysts meeting on July 31 with Gladstone and Fehr, who told him that although the meeting was intended only for analysts, broker-dealers and their representatives, he would be allowed to attend "provided he asked no questions." It should also be noted that this same condition was imposed on other customers who attended the meeting.

1/ There is no evidence in the record to support the statement regarding American Motors.

Transactions by Paras

Mr. L.D., a schoolteacher, testified that Paras, while still at Edwards and Hanly, telephoned him in September, 1962 regarding Sonics, which he said he had investigated during a trip to Boston, and that the stock should double in three or four weeks because Western Electric or Western Union - he could not recall which - were buying a lot of its stock; also, that Texas Instruments was about to sign a contract involving Sonics' "patent on a radar device and when they do the stock would go." He further stated that Paras did not supply any financial statements or other literature about Sonics but that Paras told him he was "buying Sonics shares himself" and so he bought 100 shares a few days later at 8-1/2.

Mr. R.A.V. is in the meat business, and stated that Paras called him during the first week of March, 1963 and said that Sonics was a good growth stock and should "double in four to six months" due to the fact that Texas Instruments was about to take over the company, whereupon the witness purchased 100 shares at 8-1/4.

Mrs. T.S., retired and a widow, who had had an account with Paras for several years, stated that she trusted him fully and gave him an "open hand" regarding her account since she "did not know anything about stocks." In the early part of March Paras told her that he was very enthusiastic about a company called U. S. Sonics since it had developed a device that should make it a big success,

and that he had bought 300 shares himself = whereupon she purchased 100 shares at 8-5/8 on March 8, 1963.

Paras admitted that he never purchased any Sonics stock himself so that his statement that he had done so to both of the above witnesses was patently false. Moreover, the testimony shows that Mrs. T.S. is very unsophisticated in securities. In fact, she said she "did not know one stock from another"and followed Paras' advice at all times.

Mr. J.P.O., a retired builder of Baldwin, Long Island, testified that he was a customer of Paras and that about the first of March, 1963 he was surprised to receive a confirmation for the purchase of 200 shares of Sonics at 7-7/8. He immediately called Paras and said he had not authorized the purchase and asked him to cancel the transaction which Paras refused to do and assured him he had nothing to worry about; that Sonics was a good stock and should go up 10 or 15 points in no time and make him a lot of money. To allay his misgivings, Paras also assured him that he, himself, was buying the stock. When Paras testified in his own behalf he was asked on cross-examination whether he had made this statement to the witness and he freely admitted it but explained that he merely meant that he was buying the stock for other customers.

Inasmuch as this customer was an Italian immigrant with a third grade education such a statement by Paras was an obvious and cunning deceit. However, it should be pointed out that the

witness on cross examination displayed a crude and misguided craftiness in denying that he had signed an instrument shown him during the hearing giving Paras discretionary authority over his account; and, in fact, even denied signing signature cards for the bank's use in connection with his checking account, which of course is incredible. His testimony regarding the facts surrounding the transaction are therefore entitled to little weight, but Paras' own admission of telling this customer that he was buying the stock himself must stand as a stark and unmitigated come-on, made to an uneducated foreign born person quite unacquainted with the subtle nuances of our English tongue.

Transactions by Stutzmann

Mr. D.V.B., who operated a gas station, testified that Stutzmann called him on the phone early in July 1963 and said that he knew of a stock that was "as good as Ilikon" and though currently selling around 4 should go to 15 within a year.

Mr. W.F., a machinist, testified that Stutzmann told him that Sonics was receiving royalties from companies in Japan and West Germany on "transistors" developed by Sonics and that the stock should "double in six months"; also, that a big contract with Texas Instruments Company was about to be entered into.

Mr. J.E., a designer of mechanical equipment, testified that he opened an account with Edwards and Hanly and that Stutzmann was assigned to handle his transactions; that in the early part of May 1963, after his account had been transferred to Buck & Co., Stutzmann called on the phone and urged that he buy Sonics stating that it was managed by the same group as Ilikon on which the witness had previously made some money. As a result, and at Stutzmann's suggestion, he sold his holdings in Girard Industries, in which he had a small profit and purchased 200 shares of Sonics at 5-1/8 on May 22, 1963. He also testified that he never received any literature or financial information on Sonics.

Dr. D.J.P., an obstetrician, testified that he had become acquainted with Stutzmann several years prior to the hearing while both were working as lifeguards at Jones Beach, Long Island, and had maintained a close friendship ever since; that as a result he had maintained a trading account with Stutzmann, first at Edwards and Hanly and later at Buck & Co. after Stutzmann transferred to the latter.

Dr. D.J.P. further stated that by reason of his friendship with Stutzmann and confidence in his judgment he had allowed Stutzmann to make transactions in the account more or less at will, although he had not signed a written instrument giving him discretionary authority over the account. Thus in early May 1963 he received a confirmation for the purchase at 4-7/8 of 300 shares of Sonics of which he had never previously had knowledge. So he called

Stutzmann about it and the latter said it was a good deal; that he himself had switched his Ilikon into it and that since "there had been a drop in the stock . . .it was a good time to get some for me."

After stating that Stutzmann had never supplied him with any financial or other information about Sonics, the witness testified at R.302, 303 of the transcript as follows:

"Q Did he call you before he took you out of one stock and put you into another?

A Sometimes yes and sometimes no. There was no definite setup. It was mostly whatever he judged necessary to maintain the account. Whatever way he felt was in my best interest.

Q Did you ever sign a written authorization giving him discretion in your account?

A No, I never did actually.

Q Did there come a time when you made additional purchases of U.S. Sonics stock?

A Additional purchases were made.

Q How did those additional purchases come about?

A Truthfully, I don't know. Other stocks were changed.

Q Did you call Mr. Stutzmann and order them?

A No, we didn't order any stock at any time as far as this is concerned.

Q So you would receive a confirmation and that is how you knew you purchased this stock?

A What had been purchased and when."

Accordingly and as a result of Stutzmann's action and recommendation the following purchases of Sonics were made for the Doctor's account:

300 shares on May 16, 1963 at 4-7/8; 400 shares on June 24 at 3-7/8; 100 shares at 4 on the same date, 300 shares on July 3 at 4-1/8, and 100 at 4-1/2; 400 shares on August 14 at 1-3/4, making a total of 1600 shares.

When the price of Sonics underwent the precipitant decline heretofore indicated, followed by bankruptcy of the company, the witness and his wife, whose name was also on the account with Buck & Co., filed a complaint with the New York Stock Exchange charging misrepresentation and fraud in the handling of this account in violation of the Stock Exchange rules and requesting that arbitration proceedings be instituted pursuant to the rules of the Exchange to determine the nature ond extent of liability on the part of Stutzmann and Buck & Co., his employer.

After the taking of extensive testimony the claim against Buck & Co. was dismissed but upon review by the Department of Member Firms of the Exchange, of the testimony taken at the arbitration hearing said Department determined that Stutzmann had violated Rules 405 and 408, respectively, of the Exchange in that he had accepted third party orders and engaged in extensive trading on behalf of the complaining customers on a discretionary basis without having obtained written authorization from such customers as required. He was accordingly censured for such conduct on January 19, 1964 and required to retake the examination for registered representatives. He was further advised that he would have the

right to appeal the decision of the Department of Member Firms to the Board of Governors of the Exchange upon written notification within 30 days after such notice.

After consulting with his advisers, including his personal counsel, Stutzmann advised that no appeal would be taken from this decision. (See DX 40-A, DX 40-B and DX 40-C.)

Transactions by Hanly Jr.

Mrs. R.O., a housewife, testified that she had become acquainted with Hanly while he was with Edwards and Hanly and that when he moved over to Buck & Co. she contacted him there and advised that she and her husband wished to invest about $3,000 in securities -"preferably some good common stocks"- but wished to have a definite understanding in the event of a decline in market value of whatever securities might be purchased, that any resulting loss or losses be limited to $300. In other words, her intention in effect was to place with Hanly a stop-loss-order well in advance although no written instructions to that effect were given.

As a result of this conversation Hanly suggested that she buy Sonics which he said had a new invention that would "rock the world", as she put it, and that the stock was then selling at 8 but should go to from 12 to 15 within a few months. Mrs. R.O. further testified that she had much faith and confidence in Hanly as a representative of a member firm of the New York Stock Exchange and advised him that she would like to invest about $1,000 each in three

selected securities. Despite these instructions, however, she was surprised to receive a confirmation dated March 1, 1963 indicating the purchase of 300 shares of Sonics at 8-3/8 for a total of more than $2500.00, which transaction consumed practically the entire $3,000 she had stated she wished to divide among three stocks on a more or less equal basis. She therefore complained to Hanly about putting so large a portion of her investment in a single security contrary to her instructions, but let the matter stand upon Hanly's assurance that in any event any loss would be held to the agreed sum of $300 maximum.

When Sonics went down to about 4 the witness again complained to Hanly and asked why he had not sold the stock in accordance with her instructions before it had declined to that figure so that her loss would be limited to not more than $300 as he had agreed. For this Hanly was unable to give any explanation other than that the matter had slipped his mind. However, in order to satisfy the customer he immediately entered an order purchasing the stock from Mrs. R.O. at 5-1/4, thus making good his agreement. The transaction was back-dated on the books to June 26, 1963 whereas the transaction actually occurred on August 7 and was recorded in the firm error account where it still remained at the time of the hearing.

Finally, Hanly admitted when he took the stand that he had told Mrs. R.O. that Sonics would or should go to from $12 to $15 within a few months on the basis of current earnings of $1.00 per share and explained that he had based this prediction on information

obtained from Gladstone and Fehr who, he said, were his principal sources of information on Sonics and from whom he learned that Sonics' earnings would amount to $1 per share by the end of 1963.

It is obvious of course that the price rise and earnings predictions had no reasonable basis in light of the substantial operating loss and huge deficit shown in the financial statement for the 6-month period ending June 30, 1963 (DX-16), followed by bankruptcy six months later. Moreover, Hanly admitted he did not at any time furnish Mrs. R.O. with information about the financial condition of Sonics and, in fact, made no independent check on the claims about Sonics relayed to him by Gladstone and Fehr. Hanly's statements were therefore in reckless disregard of his obligation to deal fairly with his customer and violated the anti-fraud provisions cited. (See cases hereinabove referred to in the foot note on page 22, supra.)

Transactions by Fehr

Mr. W.R., employed as a cashier by Consolidated Edison, testified that he had dealt with Fehr for five or six years and that in early March 1963 Fehr told him about Sonics and stated that it had just negotiated a license agreement with Texas Instruments to market a device that should revolutionize the radio and TV industry and that the stock was due to go up in price, 3 or 4 points, as he understood it. Fehr also stated that he was basing his opinion on information which he had received from high officials of the company with whom he had personal contact. He did not, however, furnish the witness with financial statements nor any literature about the

operations of Sonics.

Because of his utmost confidence in Fehr the witness stated he purchased 200 shares at 8 on March 13, 1963; and later, on learning that the stock had gone down to the $4 level, he decided to "average down" by purchasing 200 additional shares at 4-3/8 on June 24. The witness further stated that he had not been told by Fehr of the large losses by Sonics which he subsequently learned had brought about the decline in the price of the stock. However, in spite of the unfortunate results of these transactions the witness still maintains an account with Fehr.

Although only one witness was produced regarding transactions with Fehr several investor-witnesses testified that they conferred with him regarding Sonics and that he boosted the stock at all times and without qualification. In fact, when testifying in his own behalf, Fehr admitted telling customers that the price of Sonics should soon reach the $12 to $15 level on the basis of projected earnings; and that he based these estimates on information obtained from Gladstone.

It is therefore clear that Fehr collaborated fully with Gladstone in promoting the stock and like the salesmen under his supervision failed to furnish customers with any factual information regarding the company's losses and large accumulated deficit. 1/

1/ In the above regard it should be noted, however, that customers were frequently told of a loss carry forward of over $1,000,000 covering operations for prior years; but this was always glossed over as an asset in reality in view of the large anticipated earnings against which the loss could be set off but which, of course, as the record shows, never materialized.

In fact, Fehr admitted in a letter to Byrne regarding the Donenfeld, Fein and Rabinowitz complaints that "the only information we did not have was as to the exact financial condition of the company." (Buck Exh. 31).[1/] [Underscore added.]

1/ Indeed, a very apt nutshell description of the Fehr-Gladstone compliance concept on Sonics may be seen in the following paragraphs appearing in another letter dated October 21, 1963 to Byrne on the same subject, in evidence as BX-33:

"Dear Pete:

* * *

1. Any information related to any of our clients originated from either Arthur or myself and subsequently passed on to our registered representatives.

* * *

3. Most of our representations to be supported will be touched upon in succeeding paragraphs. However, in answer to this question, I can only touch upon one in which documents might not be available. This is with reference to our projections as to possible earnings based on a successful domestic license arrangement. It is our understanding from management that the potential foreign unit volume of the filter could exceed 50 to 70 million units. We were also advised that a domestic licensee could contribute the same volume. Using a figure of 3% as a royalty payout to SONICS, and an average selling price for the unit of 25¢, we arrived at a figure of 100 to 125 million units with a gross sales volume of 20 to 25 million dollars, of which 3% would amount to royalty income of between $600,000 and $750,000 annually, once full promotional activities had been developed. In addition SONICS was also to receive additional sums of money in its sale of the ceramic itself. We were led to believe that these sales could be in the area of one to three cents per unit sold. If one were to make any projections from the above figures, it can easily be determined as to our interest in this company.

* * *

(Signed) Charles Fehr
BRANCH MANAGER"

Since there was no reasonable basis for a projection of earnings, Fehr's statements in this respect, together with his failure to furnish unfavorable financial information reflected in the company's financial statements, some of which he already had and which could easily have been brought up to date had he requested it, clearly violated the anti-fraud provisions of the securities laws hereinabove cited. In fact, Fehr admitted on cross examination that he had been supplied with a copy of Sonics' certified financial statements for the year 1962 from which he noted a serious operating loss and poor working capital position but kept these statements in his desk and did not make them generally available to salesmen. Instead, he exhibited them only on specific request which the evidence indicates rarely if ever occurred. He also stated that he had not consulted the Buck research department, which he admitted was highly competent, because he felt he already had sufficient information from officials of the company and Gladstone. Thus, he not only failed to make a full and fair disclosure of material facts, which he knew or should have known, to his own customers, but also failed to supervise adequately the activities of the salesmen under his jurisdiction, resulting in or contributing to the making of misleading statements and omissions of material facts in their solicitations of customers to purchase Sonics stock.

From the foregoing the undersigned is compelled to find that Fehr willfully violated and willfully aided and abetted violations of the anti-fraud provisions of Section 17(a) of the

Securities Act and Section 10(b) of the Exchange Act together with Rule 10b-5 thereunder as charged in the order for proceeding.

Finally, the record shows that each of the individual respondents testified in his own behalf and denied any wrongdoing intentional or otherwise as well as the specific statements of those who testified against them. However, in view of the uniformity of the statements attributed to respondents by investor witnesses regarding the financial condition of Sonics, its negotiations in respect of foreign and domestic licenses, the so-called turn around in earnings that should reach $1.00 to $1.25 per share at the current year-end plus price rises of from $10 to $15 per share forecasted for various periods, all tend to establish a pattern that mere denials are insufficient to overcome.

Moreover, most, if not all, of the complaining investors were unacquainted with each other and yet gave testimony of similar import and effect, and indeed in some cases testified to identical figures of price appreciation and the like, from which it would appear that such unplanned and unrehearsed uniformity is entitled to greater weight and credence than the self-serving unsupported explanations of those charged with wrongdoing. On the basis of the whole record the undersigned has therefore concluded that the charges in the order have been established by an ample preponderance of the evidence as the foregoing findings indicate.

Similarly the registrant introduced considerable testimony and documentary material through its various officials, the net effect of which was to show that it had instituted procedures designed to assure compliance with all regulatory laws, rules and

regulations. Such testimony did not, however, demonstrate that the measures used had been effective during the period under review as the foregoing findings of misrepresentation and omissions of material facts in the sale of Sonics stock by the respondent sales personnel clearly shows. Thus it is, for like reasons, concluded that the Division's charge of registrants' failure adequately to supervise the activities of its branch managers and registered representatives has been established by a fair preponderance of the evidence in willful violation of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act together with Rules 10b-5 and 15c1-2 thereunder; and the undersigned so finds. Indeed, on this issue the Commission's opinion in Reynolds & Co., et al., 39 S.E.C. 902 (1960) is deemed particularly apposite wherein it stated in pertinent part at pp. 916, 917 with controlling finality and force here:

> "We have repeatedly held that brokers and dealers are under a duty to supervise the actions of employees and that in large organizations it is especially imperative that the system of internal control be adequate and effective and that those in authority exercise the utmost vigilance whenever even a remote indication of irregularity reaches their attention. As the Court said in R.H.Johnson & Company v. S.E.C., 198 F. 2d 690 (C.A. 2, 1952), in affirming our action sustaining a decision of the NASD in a similar situation, a contrary rule 'would encourage ethical irresponsibility by those who should be primarily responsible.'"
>
> * * * * *
>
> "The existence of numerous and scattered branch offices complicates the problem of supervision and makes essential the installation of an adequate system of control."
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> * * * * *
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> "In the light of these considerations we are of the opinion that, where the failure of a securities firm and its responsible personnel to maintain and diligently enforce a proper system of supervision and internal control results in the perpetration of fraud upon customers or in other misconduct in willful violation of the Securities Act or the Exchange Act, for purposes of applying the sanctions provided under the securities laws such failure constitutes participation in such misconduct, and willful violations are committed not only by the person who performed the misconduct but also by those who did not properly perform their duty to prevent it." [Footnote omitted - underscore added.]
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> * * * * *

CONCLUSIONS

At the outset it should be noted that a certain amount of repetition and recapitulation of certain evidence and authorities already discussed will be necessary here to support and explain the rationale of the conclusions reached. Thus, to summarize the foregoing findings it is clear that registrant's branch managers together with the registered representatives named in the Commission's order have willfully violated the anti-fraud provisions of the Securities Act and Exchange Act as charged. Without exception the individual respondents referred to made predictions of price appreciation for Sonics stock without a reasonable basis therefor. The Commission has consistently held that statements by salesmen in the offer and sale of securities when made without a reasonable basis are fraudulent. Mac Robbins & Co., Inc., 41 S.E.C. 116 at 119 (1962) aff'd sub nom Berko v. S.E.C. 316 F.2d 173 (1963). It has also been held that when such statements include predictions of price appreciation to named figures for unseasoned speculative securities, they are to be condemned as a "hall mark of fraud." See Alexander Reid & Co., Inc., 40 S.E.C. 985 at 991 (1962).

Here the speculative nature of Sonics stock is not only undisputed but in fact its speculative possibilities for gain was one of the prime selling points used by all of the individual respondents in their efforts to induce purchases by their customers. Moreover, Sonics was not only highly speculative but unseasoned, within the meaning of that term as used in the securities industry. Indeed, none other than Richard J. Buck, Sr. himself, head of the

Buck firm, freely conceded that Sonics should be deemed an "unseasoned security." Additionally, both Gladstone and Fehr admitted that they had told certain of their clients, as indicated in the foregoing discussion, that the stock should rise to a level of from $12 to $15 per share, or even more in some instances, and even went to much pains to set forth the basis of their conclusion by computing the level at which the stock should sell, predicated on a formula of price-earnings ratios generally used in the industry - all on the assumption of earnings for Sonics in the neighborhood of $1.25 per share. [See excerpts from testimony in Appendices B, C, and D.]

Inasmuch as Sonics had never earned a profit since its first year of operation and had accumulated a deficit amounting to more than $2,030,600 at June 30, 1963 with a loss for that period alone of over $325,000, followed in short order by bankruptcy - any mention of earnings in any amount whatever during 1963, the company's final year of operation, certainly had no reasonable basis and could only mislead investors who, as the record shows, placed much faith and confidence in these respondents as representatives of a member firm of the New York Stock Exchange. In fact, the witnesses almost without exception mentioned their faith and trust in respondents' salesmen by reason of this much respected relationship.

As previously indicated Kolm testified that financial statements of Sonics covering any desired period through June 30, 1963 as well as other pertinent information would have been furnished to authorized representatives of the Buck firm had the same been requested, so that, the record establishes beyond any

serious question, that such information could have been obtained in exercise of due diligence.[1/] Indeed, the failure and neglect of Gladstone and Fehr to obtain adequate financial information is shown by their admission that they placed sole reliance in this area on the fact that Gladstone in particular had personal contact with Kolm and Scott, both of whom freely discussed the company's affairs and satisfied them that sufficient information regarding the company's operations and progress had been supplied. Indeed, both Fehr and Gladstone further admitted that they relied chiefly upon the tremendous potentialities of the license agreements rather than certified financial data as a basis for their enthusiastic predictions.

Thus, although these respondents were admittedly aware of the company's mounting deficit and continuing losses they deliberately shut their eyes to such sobering facts and relied instead upon the magic of the Dupont name and Josiah Scott's continuing interest and investment in the company - apparently taking no account of the fact that even the wealthy may, and often do, withdraw from a sinking enterprise. This, of course, is exactly what happened to Sonics - even though after the bankruptcy, Scott picked up the pieces and put them together in a new organization that the record indicates but alas too late, may now succeed where Sonics failed.

1/ It will be recalled that Fehr admitted he had a copy of the 1962 year-end statements in his desk - showing in round figures a loss of $671,000 and deficit of $1,700,000. (DX-15).

In addition to the unwarranted predictions of price appreciation described, the individual respondents placed equally unwarranted stress upon the great potentialities of the foreign and domestic license agreements which never materialized in any significant respect. Thus, of the three foreign licenses that were actually signed, only the German licensee paid anything more than the initial down payments; and while the latter commenced payment of royalties shortly prior to the bankruptcy, no evidence was introduced as to the amount thereof — from which it would seem to be a fair inference that if such royalties had been substantial or significant, more specific information would have been offered for the record. And, so far as domestic licenses are concerned, the record shows that Sonics experienced consistent frustration and failure in its efforts to effect a contract with either General Instruments or Texas Instruments — both having rejected the Sonics proposals for reasons already discussed. Automatic Radio likewise rejected Sonics' proposals but stated that it did so for reasons not related to the proficiency of the I-F filter or to its manufacturer and marketability, but rather to considerations stemming from its own plans of operations which it was alleged would not permit entering into the proposed license agreement within any reasonably foreseeable time. Delco on the other hand, flatly rejected the agreement for lack of feasibility and because of the high cost of manufacture and asserted dubious utility of the product.

In addition to the fabulous potential claimed for the various license agreements respondents also cited the imminence of mergers with various well-known companies. Kolm testified however that none of the proposed mergers ever got beyond the discussion stage - except with New England Transformer as to which a proposed merger was presented to a Sonics stockholders meeting in October 1963 - but without result. It is therefore clear that the salesmen's references to "mergers" with various named companies were without any sound basis and clearly misleading.[1/]

Besides the misrepresentations regarding Sonics the record shows that when the market on the stock continued its downward trend respondents, almost without exception, advised their customers

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1/ As the Commission so clearly held in Alexander Reid & Co., Inc., supra, at pp. 990, 991:

> "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." (Emphasis added.)

against selling and gave assurance that the decline in the price of the stock was due principally to Mrs. Kolm's dumping of her shares on the market rather than to the unfavorable reaction which actually resulted on disclosure at the stockholders meeting in April 1963 of the serious and continued losses experienced by the company. The purpose of these assurances was, of course, to lull investors into a false sense of security on the basis of a relatively minor and temporary setback that was supposedly more than offset by prospects of large royalties from license agreements and the magical backing of wealthy men as a guarantee of ultimate success.

Another factor worthy of note is that the testimony shows that, with the exception of Fein, Siegel, Donenfeld and Golden, nearly all of the customers who purchased Sonics were either without any substantial experience in securities or were quite unsophisticated. Indeed, several of respondents' customers were schoolteachers, such as Adams and Ellenberg; others were machinists, a gas station operator, several tradesmen, and the like, all of whom testified that they had had very little experience in securities. Some also were elderly widows who had inherited money from their deceased husbands and virtually all testified that the salesmen who sold them Sonics stock failed to make any inquiry as to their financial condition or investment objectives with the view of ascertaining the suitability of proffered investments.

In this area the Commission has held that the representatives of a broker-dealer are under obligation to deal fairly with

customers and to that end should ascertain the financial condition, resources, and investment objectives of prospective investors in order to determine the suitability of the securities to be offered to them. Boren & Co., 40 S.E.C., 217 at 222 (1960).[1/] By their failure to make the inquiries described on the question of suitability, the individual respondents clearly abdicated their responsibility in this respect.

Finally, although as previously noted, the violations of Buck & Co. stem from the activities of its branch managers and salesmen, the firm is, of course, nevertheless responsible for their conduct under the settled doctrine of respondeat superior. Moreover, in addition to this vicarious form of responsibility, the

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1/ See also C. Gilman Johnston, Exchange Act Release No. 7390 (August 14, 1964) and First Securities Corporation, et al, 40 S.E.C. 589, 591 (1961).

record shows that when Donenfeld complained to Clasen and the matter was referred to Peter Byrne (now deceased), a former Regional Administrator for this Commission who was then acting as supervisor of compliance for Buck & Co., the evidence shows that after an investigation, which included a written explanation of the circumstances from both Gladstone and Fehr, it was determined that no disciplinary action would be taken against either. Additionally, the record shows that neither Byrne nor Clasen took corrective or preventive action in the form of special instructions either to the two branch managers involved or by way of a general edict to all registered representatives. Moreover, when Siegel Rabinowitz and Fein brought suit against Buck & Co. charging Gladstone and others with fraud in connection with the transactions in Sonics and demanding substantial damages, Clasen again took no specific action toward prevention of a recurrence of the type of transactions which gave rise to the charges in the complaint - notwithstanding the fact that they involved solicitation of purchases by customers of a highly speculative and unseasoned security of low market value - activities which Clasen himself testified were contrary to firm policy.

Additionally, when William J. Fitzpatrick, general counsel of the firm who, as previously noted, had been on the staff of this Commission, took up the Ellenberg complaint which had been referred to him, he held a conference with Ellenberg and Gladstone at the newly opened Massapequa office for the purpose of adjusting the matter. After hearing Ellenberg, who was not represented by counsel, Fitzpatrick concluded that since the gravamen of his complaint merely boiled down to the fact that the stock had declined in price resulting in a potential loss which he could not afford, the complaint was without merit, and accordingly recommended that no action be taken in Ellenberg's behalf. Thus, from the way in which all of these complaints and lawsuits were handled, the inference seems inescapable that the individuals placed in charge of compliance acted in what might be described as a highly legalistic and technical manner despite their special training in the field of securities regulation. In any event, the selling methods employed by the branch managers and salesmen described demonstrate failure on the part of Buck & Co. to supervise adequately the sales activities of its branch offices and registered representatives.

On the other hand, it should be noted in partial mitigation that irrespective of the ineffectiveness of the measures taken to achieve compliance, the record establishes that Buck & Co. employed counsel and other individuals of long experience and specialized

training in securities regulation and placed them in full charge of compliance with the securities laws so that any lack of effectiveness in achieving the desired results in that area must be attributed to human frailty and error rather than to intent or design. Nevertheless, within the meaning of willfulness as that term has been consistently applied by the Commission and the Courts, a finding of willful violation and willful aiding and abetting such violation by others must be made against Buck & Co. as charged in the Commission's Order. 1/

1/ In Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329 (June 2, 1964), a relatively recent case, the Commission reaffirmed its long established interpretation of "willfulness" as applied under the Federal securities laws. In that case, on page 8 of its opinion, the Commission stated in pertinent part:

> "We have consistently held and it has been judicially established in broker-dealer proceedings that if a respondent acts intentionally in the sense that he knows what he is doing, his action is willful, and that there need not be in addition an intent to violate the law.11/ We have never considered a careless disregard of the law to be necessary for a finding of willfulness. That such a situation has been found to constitute willfulness or that, as in the Hughes case, the conduct of a respondent who deliberately chose to continue a method of operation in spite of repeated warnings that it was unlawful was found willful, does not mean that either situation is the minimum required for such filing. * * * * * The remedial purpose of Section 15(b) would be frustrated if we were required to interpret willfulness in the narrow manner urged by respondents." (Footnote 13 omitted.)

11/ See Thompson Ross Securities Co., 6 S.E.C. 1111, 1122-23 (1940); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); The Whitehall Corporation, 38 S.E.C. 259, 270 (1938); Hughes v. S.E.C., 174 F. 2d 969, 977 (C.A.D.C. 1949); Norris & Hirschberg, Inc., v. S.E.C., 177 F. 2d 228, 233 (C.A.D.C. 1949); Shuck v. S.E.C., 264 F. 2d 358, 363 (C.A.D.C. 1958).

Regarding the individual respondents, the record shows that Gladstone was the prime mover behind the offer and sale of Sonics and the source of much of the misleading information given to salesmen which in turn was relayed by them to customers. His violations were therefore particularly aggravated and extensive in this case, permeating as they did virtually all of the transactions in Sonics. Moreover, Gladstone, a college graduate with about ten years' experience in the securities business as a registered representative - having qualified as such under the rules of the New York and American stock exchanges as well as the NASD - was fully conversant with the duties and obligations of broker-dealers and their representatives in effecting securities transactions.

With this background he not only made misleading representations in sales to his own customers but omitted to disclose to them unfavorable information regarding Sonics' financial condition except by way of broad-brush references to losses and deficits which he hastened to gloss over and counterbalance with enthusiastic claims about the fabulous potential in the license agreements and the continued backing ~~of members~~ of well-known wealthy people.1/

In addition, it should be noted that neither Gladstone nor Fehr, Hanly nor any of the other individual respondents consulted the Buck Research Department which the testimony indicates was highly competent. When Gladstone was asked why he failed to consult the

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1/ That furnishing optimistic information to prospective investors without disclosure of unfavorable information known or reasonably ascertainable is fraudulent, see Van Alstyne Noel & Co., supra, footnote p. 22.

research department he gave the lame excuse that he was not personally acquainted with any of its personnel. Fehr stated he did not consult the research department because he believed he already had sufficient information from Sonics officials. As to the remaining respondents the testimony indicates that it never occurred to them to consult the research department or that for various reasons they thought it would not have more information than they already had from Gladstone and Fehr.

In any event William Sullivan, a member of the Buck research department, testified that he had never been consulted about Sonics and that his department had never researched the company since no request therefor had ever been made. Thus, the failure of Gladstone and Fehr as branch managers and their salesmen to make any attempt to use this acknowledged facility for evaluating the security, appears to indicate a deliberate and rash disregard of a source of information which due diligence would have sought. Indeed, such an omission serves to high-light the lack of any reasonable effort by such respondents to obtain information regarding Sonics from independent sources rather than to rely as they did, solely upon the more or less self-serving statements of officials of the company. The Commission has repeatedly and consistently held that securities salesmen are not justified in relying solely upon information obtained from officials of a company whose securities are being

offered, but are required to use all reasonably available means to assure that information supplied to prospective investors is adequate and accurate. 1/

Additionally, it should be pointed out that the record shows that about 90% of the securities transactions of Buck & Co. were on national securities exchanges on an agency basis, and that the company's gross revenues amounted to in excess of $3,000,000 annually derived from some twelve to fifteen offices. With such facilities at their disposal and with the vast number and variety of securities to choose from, the concentration by these respondents in the promotion of Sonics as shown by the testimony could hardly have taken place except by concerted action as charged in the order for proceedings - and the undersigned so finds. In any event, in view of Gladstone's leading role in the offer and sale of Sonics to the public under the circumstances established by this record, it is believed that the public interest requires that he be barred from association with any broker or dealer in securities subject only to his right to re-apply for such association upon an appropriate showing in accordance with the Commission's usual practice and procedure in this area.

Regarding Fehr, the testimony shows that he also received a college education including a law degree, although he was not a member of the Bar. In addition, he has had about 20 years' experience in the securities business as an employee of a number of

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1/ See recent opinion of this Commission in A. T. Brod & Company, Securities Exchange Act Rel. No. 8060, dated April 26, 1967 and cases there cited.

substantial broker-dealer firms working in various capacities including the so-called back-office[1]; and, finally, as a registered representative and branch manager for Edwards and Hanly prior to becoming co-manager with Gladstone of the Forest Hills branch of the registrant.

The testimony also shows, as previously noted, that Fehr sold Sonics to a number of his own customers and made misrepresentations regarding the operations and financial condition of the company by parroting many of the statements made by Gladstone. In fact, Fehr admitted that he looked to Gladstone as a principal source of information on Sonics and accepted it without any independent investigation. Thus, he attended the meeting with Gerber, Kolm, Roach and Gladstone in February 1963 at which the 14-page report was discussed, containing a number of misleading statements and omissions, particularly of financial statements, the absence of which does not appear to have even been questioned. Additionally, he also attended the analysts meeting on July 31, 1963 with Gladstone, Siegel and Fein, at which disclosure was made of the unfavorable results shown in the 1962 year-end report supplemented with the report for the 6-month period ending June 30, 1963; and notwithstanding the large losses and accumulated deficit

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1/ In the securities industry the bookkeeping and cashier departments of broker-dealer firms are referred to as the "back-office."

reflected in those statements, Fehr continued to boost the stock and failed to give any particular attention to continued solicitation and sales of Sonics by the salesmen working under him. Additionally, to allay the growing dissatisfaction of customers who had already purchased Sonics, Fehr like Gladstone continued to refer to income expected to come in as royalties from the foreign license agreements plus the imminence of domestic licenses or mergers with the big companies already discussed, all of which would vastly increase the company's resources and income.

In any event, the testimony demonstrates that Fehr was in full accord with Gladstone in promoting Sonics although his individual sales were less in both number and amount, and his sales solicitations were somewhat less aggressive. Under all the circumstances related and since his previous record covering more than 20 years in the industry appears to have been good it is believed that the public interest would be served by suspension of Fehr from the securities business for a period of five months from the effective date of this order, as hereinafter provided.

Regarding Hanly Jr., the record shows that he has been in the securities business about 15 years, the early part of which was spent as a registered representative in the commodity department of the well-known firm of Merrill Lynch, Pierce, Fenner & Smith. And although Hanly does not appear to have had a college education he had received a thorough indoctrination in the practices and pro-

cedures in the securities industry and the requirements of state and federal securities laws.

However, as the foregoing shows, Hanly parroted virtually the same misrepresentations and made the same omissions referred to in the discussion of the activities of Gladstone and Fehr whom he also relied upon as the chief source of information about Sonics - so that in this sense he clearly acted in concert with them and sold a substantial number of shares of Sonics to some of his own customers. In addition, both Paras and Stutzmann worked under his direction and in view of the aggravated and repeated violations by those respondents hereinabove described, it is obvious that Hanly's supervision of their activities was far from adequate. On the other hand, the fact that Hanly made good his commitment to the Oberfields to hold their loss to no more than $300 and at a personal loss to himself, would seem to be a mitigating factor even though his dealings with certain other customers would not appear to fully measure up to the requirements of fair dealing. Under all the circumstances, however, and having in mind that Hanly's record has been good, it is believed that a suspension from the securities business for a period of four months would serve the public interest.

Regarding Paras, the record shows that prior to entering the securities business he had been engaged in the dry cleaning business for about five years. Shortly after disposing of the dry cleaning business he answered a newspaper advertisement of Edwards

and Hanly for trainee salesmen, for which position he was hired. After spending some months as a trainee and after having passed the examination of the New York Stock Exchange for registered representatives he became a full-time salesman for the Edwards and Hanly firm and worked as such for several years prior to the period under review.

Upon joining Buck & Co. in February 1963 and after briefing by Gladstone and Hanly on Sonics he decided to offer the stock to his customers to whom he sold a total of 7,000 shares. The representations and omissions made in these transactions have already been pointed out and of course need not be repeated. Suffice it to say here that his deception of the witness Orzano as well as other customers is a highly reprehensible example of over-reaching, and demonstrates an aggressive self-interest which most certainly does not comport with those standards of fair dealing that the industry and the tenets of securities regulation laid down by this Commission and the Courts, require. Accordingly, it is believed that the public interest and protection of investors requires that Paras be suspended from association with a broker or dealer in securities for a period of five months and that his reinstatement be conditioned upon a showing of adequate supervision in accordance with the Commission's usual practice in this regard.

Regarding Stutzmann, the record shows that he is about 35 years of age, has had a college education and appears to have

started in the securities business as a trainee with Edwards and Hanly, by whom he had been employed approximately ten years prior to joining the Buck firm. The violations of Stutzmann have already been discussed and likewise of course need not be repeated in detail here except to say that his handling of the account of one of his best friends, namely, Dr. D.J.P., seems to reflect an overreaching and aggressive self-interest similar to that shown by Paras; and which also does not comport with the principles of fair dealing required of registered representatives already referred to. Moreover, the fact that he was censured by the New York Stock Exchange for his conduct in handling the above-mentioned account, from which action and decision he did not see fit to exercise his right to appeal; and no impediment to exercising that right having been asserted, the inference appears justified that the findings of the Stock Exchange Department of Member Firms were supported by the evidence.

On the other hand, the evidence also shows that because of the censure of the Stock Exchange which was given due publicity, and the further fact that these proceedings, although private, had become known to the individuals concerned, had the effect of depriving him of the acquisition of a seat on the American Stock Exchange as a partner of a member firm, so that he thereby suffered a severe setback in his career — a factor which, it is believed, should be taken into consideration as a matter of fairness in determining what sanction would be appropriate in the public interest.

Under all of the circumstances it is accordingly believed

that a like suspension for a period of five months would be adequate in Stutzmann's case. However, by reason of the number and nature of the violations by Stutzmann it would further appear that his reinstatement should be conditioned upon a clear showing of adequate supervision.

Regarding the registrant's failure adequately to supervise the sales activities of the respondent employees resulting in willful violation of the Federal securities laws as set forth in the foregoing discussion, the next question to be determined is what sanction would be appropriate in the public interest and for the protection of investors. On this issue it is believed the following factors should be considered; firstly, that registrant employed on a regular basis for purposes of compliance with the securities laws, counsel and others of acknowledged expertise in securities regulation, notably Peter Byrne who for many years had been Regional Administrator in the Commission's New York Office, William J. Fitzpatrick, a former S.E.C. attorney and Joseph Clasen, a partner of registrant who had had at least 25 years "back-office" experience with several large securities firms. Complete authority for the adoption, promulgation and execution of measures deemed necessary in their judgment to effect compliance with the securities laws was accorded these individuals. Under such circumstances it is difficult to see what more a large organization, having many branches in several states, could have done

to assure that the securities laws would be complied with subject, as always, of course, to the exigencies of human error and failure in execution such as occurred here.

And although in Reynolds, supra, and other cases the Commission has consistently held that large broker-dealer firms are under obligation to use the utmost vigilance in supervising branch offices; and where violations occur, are not excused by the exigencies of management attributable to distance, volume of transactions and the like - nevertheless, in applying this principle and in a realistic appraisal of human conduct, it would seem that some account should in mitigation be taken of the customs and attitudes of every day life, such as for example, that one does not ordinarily question the knowledge or competence of his doctor, lawyer or accountant except for some compelling reason in the form of possible malpractice or professional failure. Here, there is no evidence that any of the transactions in Sonics by the respondent salesmen were brought to the attention of any of the partners of the firm except Clasen, who was himself involved, at least to some extent, in the laxity that contributed to the persistence and aggravation of the violations that took place. Thus, the fact that the violations occurred at the very doorstep of the main office rather than in some remote region seems to place the blame chiefly if not entirely upon the "experts" in charge of regulatory compliance.[1/] In fact, the record shows that no

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1/ There is no evidence that the Sonics transactions or complaints were ever reported to Richard J. Buck, Sr., the senior partner of the firm who denied knowledge thereof until the S.E.C. investigation commenced.

specific action was taken by any of the individuals in charge of compliance by way of issuance of cautionary instructions or restriction of activities in relation to Sonics even after several serious complaints came to their attention. Nor were any re-inspections made of the blotters nor other action taken to check on the activity in this speculative low-priced stock even after they had been put on notice by such complaints. 1/

In any event, the record shows that a few weeks following the close of the evidentiary hearings and on September 1, 1966 Buck & Co. ceased doing business as a broker-dealer and sold all of its business and assets to Bache & Co., Inc., a large broker-dealer firm of New York City with nation-wide branch offices. Upon completion of these arrangements

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1/ However, in the above connection it should be noted that following the Division's preliminary investigation of this case and after institution of these proceedings, Buck & Co. adopted and put into effect a number of more stringent rules designed to prevent recurrence of the type of violations found here and to assure avoidance of others. Indeed, the record shows that these rules and procedures are detailed and purvasive and demonstrate a determined although belated effort by the registrant to stamp out the abuses by its sales personnel that formed the genesis of these proceedings. See BX-42, 43, 44, 45, 48, 49, and 50 inclusive. And while this is a mitigating factor on the question of good faith it can be given little weight otherwise.

Richard J. Buck, Sr. became a vice president of that firm which took over all of the branch offices of Buck & Co. and still operates the same including those involved in these proceedings. It further appears that virtually all personnel of Buck & Co. including the individual respondents named herein except Gladstone, have been employed by Bache & Co. in the same positions in which they functioned at the time of the hearing in this case. [See supplementary stipulation filed in these proceedings on March 29, 1967 after submission of proposed findings and briefs by all parties.][1/]

Under the circumstances related it appears that the sanctions provided under the Exchange Act if imposed on registrant—taking the form either of censure, revocation of registration, or expulsion or suspension from membership in the NASD or from national securities exchanges—might not now be fully effective since registrant is already out of business. These developments would thus

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1/ Additionally, it should be noted that on September 19, 1966 and after the close of the record on July 20, 1966 Buck & Co. filed a notice of withdrawal of its broker-dealer registration with the Commission, which withdrawal of course has not become effective since under Rule 15b6-1 of the Commission's Rules and Regulations under the Exchange Act such notice is stayed in the event of the filing or pendency of disciplinary proceedings and may become effective only at such time and upon such terms as the Commission deems necessary in the public interest or for the protection of investors.

seem to have the effect of virtually insulating the registrant and certain of its principals, in a pragmatic sense, from the full intent and purpose of the sanctions provided under the Exchange Act referred to above. And, although registrant's disposing of its business through the action of its principals would seem to be a natural human reaction to the circumstances in which the registrant found itself, it, nevertheless, raises a serious question whether such an expedient, undertaken for the apparent purpose of minimizing in advance the effect of the sanctions provided under said Act, does not of itself militate strongly against according such lenience as might otherwise be deemed appropriate.

In any event, as previously noted, registrant's involvement appears to be a vicarious one, stemming as it does from the violations of its employees in only two of its many branches. It further appears that neither the registrant nor any of its partners have ever been involved in disciplinary proceedings by this Commission or any other regulatory agency. Indeed, registrant's broker-dealer business appears to have been conducted on a highly ethical basis and almost exclusively on national securities exchanges. Thus, the violations found here stand as a first offense so far as the registrant and its

principals are concerned and in a relatively miniscule segment[1/] of its operations.

Thus, by reason of the good record of the registrant and its principals and the high ethical standards adhered to over a long period of operation in a sensitive and technical field, the undersigned is of the view that, were it not for the fact that registrant appears to have attempted to insulate itself in the manner described above, from the impact of whatever sanction the Commission might apply in exercise of its discretion as an expert body - administration of a censure of registrant rather than a more severe sanction might adequately serve the public interest in this case. On the other hand, the undersigned is further of the view that those charged with violations of the Federal securities laws should not with impunity even attempt to emasculate or stultify the disciplinary powers of this Commission by taking deliberate action in advance to insulate themselves as far as possible from the effectiveness thereof. Indeed, the circumstances described would seem to suggest that imposition of a suitable fine [such as has long been imposed by the NASD for

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1/ The total volume of Sonics shares sold by all respondents amounted to only about 39,000 shares. (DX-3).

violation of its Rules of Fair Practice] with power in the Commission to apply to a Court for enforcement procedures might well be an effective deterrent to such action.[1/] But since the Congress has not yet provided the Commission with that power there would appear to be no alternative in the public interest and for the protection of investors but to impose upon the registrant a more severe sanction than censure here,[2/] having in mind the possibility of ultimate release or publication of these or the Commission's findings as the case may be. Accordingly,

IT IS ORDERED that the registrant be suspended from the National Association of Securities Dealers, Inc. for a period

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1/ In the above connection it might be observed that in proceedings for review of NASD disciplinary action the Commission consistently passes on the propriety of the fines or penalties imposed and frequently reduces them, but apparently has no power to increase them even in cases where the latter may be warranted. This would seem to pose a rather anomolous situation.

2/ It may well be, of course, that under Section 15(b)(7) of the Exchange Act imposition of sanctions for willful violations may prevent those affected, from employment by a broker or dealer in securities, except upon S.E.C. approval and/or terms. However, the registrant here and its principals have, during the pendency of this proceeding, already secured the benefit of a sale of its business and all of its assets including good will which presumably had not yet been adversely affected, since these proceedings are not public but confidential and private. It is, therefore, believed that the remedial purposes of the Exchange Act have been thwarted at least to this extent. On the other hand, some account should also be taken of the fact that registrant's principals have now forsaken the cherished edifice of a lifetime, built in a chosen field, and have suffered accordingly in addition to the travail of these proceedings. So there are, indeed, many facets to the problem here that must be considered in the effort of reaching a fair and just solution.

of forty-five days pursuant to the provisions of Section 15A(1)(2) of the Exchange Act; and that pursuant to the provisions of Section 19(a)(3) of said Act it be suspended from the American Stock Exchange and the New York Stock Exchange each for a period of ten days from the effective date hereof.

In view of the sanctions imposed on registrant it would appear that registrant's notice of withdrawal of registration should be permitted to become effective upon expiration of the maximum period of suspension hereinabove provided, and

IT IS SO ORDERED. 1/

The undersigned further concludes that pursuant to the provisions of Section 15(b)(7) of the Exchange Act and on the basis of the foregoing findings the public interest requires that Arthur Gladstone be barred from association with a broker or dealer in securities; that Charles Arthur Fehr be suspended from association with a broker or dealer in securities for a period of five months; that Mortimer W. Hanly be suspended from association with a broker or dealer in securities for a period of four months; that Frederick C. Stutzmann, Jr. and Steve Charles Paras each be suspended from association with a broker-dealer for a period of five months with the proviso that upon expiration of said five months' suspension, the reinstatement of Stutzmann and Paras, aforesaid, be conditioned upon a showing of adequate supervision in accordance with the Commission's usual

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1/ It should perhaps be noted here that the Division has not advocated maximum sanctions against any of the respondents except Gladstone.

practice in this regard,[1] and

IT IS SO ORDERED.

This initial decision and order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice. Pursuant to said Rule this initial decision shall also become the final decision of the Commission as to each party who has not within fifteen days after service thereof upon him, filed a petition for review pursuant to Rule 17(b) of said Rules of Practice or unless the Commission pursuant to Rule 17(c) thereof determines on its own initiative to review this initial decision as to any party or parties. If any party timely files a petition for review or the Commission takes action to review as to any party this initial decision shall not become final as to such party or parties.

James G. Ewell.

James G. Ewell
Hearing Examiner

Washington, D. C.
June 26, 1967

1/ The proposed findings and conclusions of law submitted by the parties are affirmed insofar as they are consistent with the foregoing and are otherwise denied.

ADMINISTRATIVE PROCEEDING
File No. 3-

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

DEC 3 1965

In the Matter of RICHARD J. BUCK & CO. (8-4276) ARTHUR GLADSTONE CHARLES ARTHUR FEHR MORTIMER W. HANLY FREDERICK C. STUTZMANN, JR. STEVE CHARLES PARAS	ORDER FOR PRIVATE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTIONS 15(b), 15A AND 19(a)(3) OF THE SECURITIES EXCHANGE ACT OF 1934

I

The Commission's public official files disclose that:

A. Richard J. Buck & Co. (Registrant), a partnership, having its principal place of business at 4 Albany Street, New York, New York, has been registered as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act) since February 2, 1950 and is still so registered.

B. Registrant is a member of the National Association of Securities Dealers Inc. (NASD), a national association registered pursuant to Section 15A of the Exchange Act.

C. Registrant is a member, within the meaning of Section 3(a)(3) of the Exchange Act, of the New York Stock Exchange, the American Stock Exchange, national securities exchanges and other exchanges registered pursuant to Section 6(a) of the Exchange Act.

II

As a result of an investigation, the Division of Trading and Markets has obtained information which tends to show and it alleges that:

A. During the period from January 1963 through December 1963 Arthur Gladstone and Charles A. Fehr were employed as company managers of registrant's Forest Hills, New York office, Mortimer W. Hanly was employed as branch manager of registrant's Hempstead, New York office and Frederick C. Stutzmann, Jr. and Steve Charles Paras as registered representatives with registrant in its Hempstead office.

B. During the period from about September 1, 1962, to about December 31, 1963, Arthur Gladstone, Charles Arthur Fehr, Mortimer W. Hanly, Frederick C. Stutzmann, Jr. and Steve Charles Paras hereinafter sometimes collectively referred to as respondents, singly and in concert wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that these respondents, by use of the means and instruments of transportation and communication in interstate commerce and of the means and instrumentalities of interstate commerce and the mails in the offering and selling of and in effecting transactions in the common stock of U.S. Sonics Corp. (U.S. Sonics) otherwise than on a national securities exchange, directly and indirectly, employed devices, schemes, and artifices to defraud, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in transactions, acts, practices and a course of business which would and did operate as a fraud and deceipt upon purchasers and prospective purchasers of said securities. As a part of the aforesaid conduct and activities, respondents among other things would and did:

(1) offer and sell such securities which were speculative and unseasoned and in connection therewith fail to make reasonable and diligent inquiry as to the nature and worth of such securities, although on notice of facts which made such inquiry essential and which inquiry if made would have revealed the true background of the issuer and its history as to its operations, earnings, dividends, prospects, current general condition and other similar matters;

(2) endeavor by use of high-pressure selling efforts to place customers in a position where they were asked to make hasty decisions to buy such securities upon the basis of deceptive, incomplete, untrue and unsubstantiated representations, without having disclosed to them material facts concerning the true nature and worth of such securities;

(3) send and cause to have sent confirmations of sales of such securities to customers who had not ordered or agreed to purchase such securities;

(4) make false and misleading statements of material facts and omit to state material facts necessary to make the statements made in light of the circumstances under which they were made, not misleading with regard to the above named security, concerning, among other things:

(a) a rise in the price of U.S. Sonics stock;

(b) the earnings and financial condition of U.S. Sonics Corporation;

(c) U.S. Sonics' prospects for growth and financial success;

(d) the operations in which the issuer was engaged or in which it intended to engage;

(e) acquisitions and mergers involving U. S. Sonics;

(f) ownership of U.S. Sonics stock by one or more of the respondents;

(g) the activities described in paragraphs (1) through (3) above; and

(h) other statements, representations and omissions of similar object and purport.

C. Registrant wilfully violated and wilfully aided and abetted violations of Section 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 in that during the period from January 1963 through December 1963 in connection with the activities described in Paragraphs A and B of this section registrant failed reasonably to supervise the conduct and activities of its employees.

III

In view of the allegations made by the Division of Trading and Markets the Commission deems it necessary that private proceedings be instituted to determine:

(a) whether the allegations set forth in Section II hereof are true and in connection therewith to afford respondents an opportunity to establish any defenses to such allegations;

(b) what, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act.

IV

IT IS HEREBY ORDERED that a private hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held at a time and place to be fixed and before a hearing examiner to be designated by further order as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that each party file an answer to the allegations contained in the order for preceedings within 15 days after service upon him of said order as provided by Rule 7 of the Commission's Rules of Practice.

If any party fails to file the directed answer or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceedings may be determined against such party upon consideration of the order for proceedings, the allegations of which may be deemed true.

This order shall be served upon Richard J. Buck & Co., Arthur Gladstone, Charles Arthur Fehr, Mortimer W. Hanly, Frederick C. Stutzmann, Jr., and Steve Charles Paras, personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted

to participate or advise in the decision upon this matter, except as a witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that section delaying the effective date of any final Commission action.

By the Commission.

Orval L. DuBois
Secretary

SERVICE LIST

Rule 23 of the Commission's Rules of Practice provides that all amendments to moving papers, all answers, all motions or applications made in the course of a proceeding (unless made orally during a hearing), all proposed findings and conclusions, all petitions for review of any initial decision, and all briefs shall be filed with the Commission and shall be served upon all other parties to the proceeding including the interested Division of the Commission.

The attached Order for Proceedings has been sent to the following parties:

Securities and Exchange Commission
Division of Trading and Markets
425 Second Street, N. W.
Washington, D. C. 20549

Llewellyn P. Young, Administrator
New York Regional Office
225 Broadway, 23rd Floor
New York, N. Y. 10007

Richard J. Buck & Co.
4 Albany Street
New York, N. Y.

Arthur Gladstone
RFD #2 West Hills Road
Huntington, Long Island, N. Y.

Charles Arthur Fehr
2679 Covered Bridge Rd.
Merrick, Long Island, N. Y.

Mortimer Wyatte Hanly
2 Patience Lane
Westbury, Long Island, N. Y.

Frederick C. Stutzmann, Jr.
18 Adar Lane
East Northport, Long Island, N. Y.

Steve Charles Paras
64 Irving Avenue
Freeport, Long Island, N. Y.

APPENDIX "B"

Testimony of Gladstone taken on May 12, 1964 during preliminary investigation prior to institution of these proceedings in evidence as DX-33 (See pp. 23, 24, and 25 id. Material in parentheses added.)

Q What, if anything, did you tell your customers with respect to the accumulated losses and deficit of U. S. Sonics?

A I explained to them that the company had never really made any money, but if this product went through and became a commercial item with the plans that the company had, it conceivably could earn a dollar to a dollar and a half a share through the first year of production.

Q Now, were these your figures, the dollar and dollar and a half a share to --

A No. These were the figures that were projected by Mr. Comm, sic(Kolm which we, in turn, took a pencil and paper and figured out.

Q Then you were parodying (sic) parroting what Mr. Comm (Kohm) told to your customers?

A No, not exactly.

Q How did you come to compute the projected earnings of a dollar to a dollar and a half?

A He gave us figures as to what they could do with the Japanese licenses and the German licensee and the American licensee. The other two were already signed. The American licensee was not signed yet.

Q The American licensee to whom you are referring was Texas Industries?

A They were trying to license Texas Instrument and General Instrument. There were other companies in there back and forth, too, from what I understand, but these were the ones they would have liked to license.

Q What, if anything, did you say with respect to the price of the stock of U. S. Sonics?

A Nothing specifically, except that if this worked out, and they did earn between a dollar and a dollar and a half a share, it is conceivable that this type of a company, the street would discount it upto a certain point on earnings, and then eventually, if they did earn the dollar and a half, the stock would be selling between $15 and $20 a share.

Q Now, upon what did you base -- what else did you base this projection of $15 to $20 a share on, other than what you have already told us about?

A Just plain, ordinary stock market price earnings ratios.

Q Well, based upon the facts as we know them, that the company didn't have any earnings, what did you use to base your predictions on?

A That if this product went over, they conceivably could earn a dollar to a dollar and a half through the first year of productionm and if they did this, then the street would discount the stock up to $15 or $20 a share because it would not be the full potential of this product.

Q Did you attempt to verify in any way the prospects for the products going over? Did you inquire of any of the potential users as to how they viewed the product of the company?

A Not directly. Only through the company itself.

Q So that you were relying then only entirely upon what the company told you with respect to their product and with respect to their projections?

A Right; which is in most cases normal.

APPENDIX "C"

Excerpts from testimony of Gladstone during hearing

at pp. 2794, 2795 and 2955 of transcript.

Q Did you speak to anybody technically in the last six months of '62?

A No.

Q Even though you were selling the stock to clients?

A Correct.

Q And even though you didn't know the financial condition of the company then?

A I knew the financial condition. I knew they didn't earn money.

Q Did you know the specific financial condition in '62?

A What specifics?

Q Figures?

A No.

Q How much didn't they earn?

A What?

Q How much did they lose?

A I knew they were going to lose money at that particular point. I didn't know how much. I knew the company had a tax carry-forward of at least one million dollars in '62, without the year end statement of '62.

Q Did you think specifics of the financial condition were material when you were selling the stock in '62?

A No, not specifics at that time.

* * * * *

Q You also felt, with the proper set of circumstances, this stock could go between $12.00 and $13.00 a share, is that correct?

A Right.

Q This is doubling from around the 6 area where you were selling it in February and March?

A Yes.

Q Is it possible you may have said to investors that the stock may double or triple?

A No, I think I used that precise figure of $12.00 to $13.00 a share, on a price earnings ratio basis.

Q Right. So you didn't say the stock may double? You said it may go to $12.00, $13.00 a share; is that correct?

A Correct.

Q You may have said this to some of your investors?

A I am sure I did.

APPENDIX "D"

Excerpt from prehearing testimony of Fehr in evidence as DX-48A at pp. 47, 50 and 51:

Q What did you tell them with respect to the price? Did you tell them in your view it would go up?

A In my view it would go up, certainly. With no time limit.

* * * * *

Q In your opinion, would there have been any basis in July, 1963 for a prediction that the price of U. S. Sonics would go to $10.00 or $20.00 in a six months' period of time?

* * * * *

A I would qualify to this respect, that would there have been a reason to say, knowing only what I knew until that time, yes.

Q Well, I asked for your opinion. Obviously, others may take a different view than you.

A Yes. But I mean, I am not saying that I did say it. I would say that at that time knowing that if this product was brought around, I would say yes, there was every reason to believe that the stock would have a substantial rise.

Letter from Texas Instruments APPENDIX "E"

July 29, 1963

Dear Mr. Kolm:

It is the desire of Texas Instruments Incorporated to terminate negotiations with U. S. Sonics for the licensing of Texas Instruments to manufacture piezoelectric ceramic IF filters by the U. S. Sonics process.

This decision is based on two major negative factors:

1) It is the opinion of our legal staff that production of ceramic filters by your process would result in possible infringement liability with respect to patents of others, primarily Clevite. Also, the protection which you will probably acquire as a result of your patent applications would not appear to keep closely competitive products off the market.

2) Close scrutiny of competitive filters in this market indicates that the proposed process would not be technically competitive enough to command the portion of the market necessary to make the venture profitable.

The patent applications supplied to us on our last visit by Blair & Buckles are being returned to them under separate cover.

Your cooperation and help to us was sincerely appreciated, and we are sorry that our evaluation of this program was not affirmative.

Yours very truly,

Robert W. Bronson, Manager
Hermetic Seals Department

RWB:ba

Division Ex 46