

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of  
FRED L.G. KUEHM  
  
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(McDonnell & Co., Inc.)  
8-7300

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

July 16, 1973  
Washington, D.C.

Sidney L. Feiler  
Administrative Law Judge

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APPEARANCES: Andrew N. Grass, Jr., Esq. of Windels, Merritt & Ingraham  
40 Wall Street, New York, New York, for Fred L.G. Kuehm.

Dennis J. Block, Marc N. Epstein, Alan Rashes, Esqs., of  
the New York Regional Office of the Commission, for the  
Division of Enforcement.\*

BEFORE: Sidney L. Feiler, Administrative Law Judge\*\*

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\* This Division was formerly known as the Division of Trading and Markets and is so referred to in the record.

\*\* This is a title change. Record references to the undersigned in the record are as "Hearing Examiner."

## I. THE PROCEEDINGS

These proceedings were instituted by order of the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act") to determine whether certain allegations set forth in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.<sup>1/</sup>

The order for the proceedings sets forth allegations by the Division of Enforcement that during the period from about August 1968 to about July 1969 Fred L.G. Kuehm, office manager of the Park Avenue branch office of McDonnell & Co., Inc., a registered broker-dealer, willfully violated and willfully aided and abetted violations of the anti-fraud provisions of the Securities Acts in offering, selling, purchasing and effecting transactions in the common stock of Waltham Industries Corporation ("Waltham").<sup>2/</sup> It was also alleged that Kuehm failed reasonably to supervise persons under his supervision with a view to preventing violations by them of the Securities Acts and rules and regulations thereunder. It was also asserted and the undersigned finds that in the activities set forth in the order the respondent made use of the mails and means and instruments of transportation and communication in interstate commerce. The respondent filed an answer denying the material allegations of the order.

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<sup>1/</sup> The proceedings were originally brought against McDonnell & Co., Inc. and fifteen individuals. Prior orders of the Commission have disposed of the cases against all the respondents except Fred L.G. Kuehm. Only those portions of the order applicable to him are dealt with herein.

<sup>2/</sup> Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the offer or sale of any security by means of a device or scheme to defraud or untrue or misleading statements of a material fact, or any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon a customer or by means of any other manipulative or fraudulent device.

Pursuant to notice, a hearing was held in New York, New York. The parties were represented by counsel. Full opportunity to present evidence and to examine and cross-examine witnesses was afforded the parties. Proposed findings and supporting briefs were submitted by the parties.

On the basis of the entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

## II. FINDINGS OF FACT AND LAW

### A. The Respondent

Kuehm has had experience in the securities field since 1954 and became a registered representative in January 1955. In June 1967 Kuehm was employed by McDonnell and Co., Inc., at all relevant times herein a registered broker-dealer and a member of the New York Stock Exchange, with the understanding that he would become manager of a new office that the firm was planning to open at 400 Park Avenue, New York City. Kuehm met the professional requirements prescribed by the New York Stock Exchange and the National Association of Securities Dealers, Inc. ("NASD") and became manager of the Park Avenue branch on November 6, 1967. He also was made a vice-president of McDonnell as of January 1, 1968. He continued as vice-president of McDonnell and branch manager of the Park Avenue office of McDonnell until his voluntary resignation on December 8, 1969.

A nucleus of 23 registered representatives who had been working at the main office of McDonnell was transferred to the Park Avenue office when it was opened. Other additions were made both of registered

representatives and trainees as well as staff employees from time to time. At its peak there were approximately 45 or 46 registered representatives employed at the Park Avenue office and the total branch office complement fluctuated from 60 to 75. In addition to his managerial duties, Kuehm also acted as a registered representative for his own accounts. On this business he was compensated the same as any other representative. For his work as branch manager Kuehm received a management pool which could vary depending on the gross revenues of the branch office. From this pool Kuehm had to allocate money to compensate his assistant manager, Lou Gordon.

B. Management of the Park Avenue Office

Kuehm, assisted by Gordon, was in charge of the operations of the McDonnell Park Avenue office. Registered representatives, also known as account executives, after a period of training at the McDonnell main office, would be assigned to the Park Avenue Office with Kuehm's approval. Included in the training instruction was a review of applicable statutes, rules and regulations, and approved practices in the McDonnell organization. Each account executive received a manual which contained detailed instructions on his duties. When a new account was opened, an account executive would secure a completed New Account Card from the customer and Kuehm or Gordon would review it and initial it to indicate approval of the opening of the account (Tr. 1016). Kuehm further testified that trade tickets were reviewed by him and Gordon and discussions were held with individual account executives if there was any question about them. He also testified that he held meetings with individuals or groups for

discussion of methods of presentation to clients and that he also observed individual presentations. Kuehm also emphasized that he had made clear to the account executives that the question of suitability of certain investments for clients was very important and that matters might reach a point where an executive should decline an order from a given client if he felt that the security involved was not suitable for him (Tr. 1018 -1020).

Another office procedure that Kuehm followed was to conduct weekly staff meetings in his office with the registered representatives. During these meetings Kuehm would review operational procedures, discuss general economic conditions, review research ideas which had been prepared in the McDonnell organization and also recommendations of other advisory services. In addition, Kuehm from time to time discussed securities on which he had conducted his own review and analysis.

C. Activities of Kuehm in the Purchase and Sale of the Common Stock of Waltham Industries Corporation

Kuehm testified that he first became interested in the stock of Waltham, then known as Waltham Precision Instruments, Inc., when he read a newspaper article on August 23, 1968 stating that a firm of investment bankers was purchasing a majority interest in Waltham, 700,000 of Waltham's 1,208,000 outstanding shares (Resp. Ex. 8). Completion of the acquisition and the naming of a new management group of directors and officers was announced on September 6 (Resp. Ex. 19).

Kuehm testified that the investment bankers who had arranged for the acquisition of majority interest in Waltham had a reputation for having a "golden touch"; that they had interested themselves in at least one

other company of which Kuehm had knowledge where earnings had increased substantially while they were in control. He reasoned that there might be activities in Waltham designed to increase its business and earnings by the acquisition of other companies and turning it into a conglomerate enterprise.

Kuehm further testified that he examined and analyzed published information concerning Waltham as reported in the Standard and Poor's Stock Reports and determined that the company in his opinion had profitable operations, had a tax loss carry-forward of approximately \$2,000,000, a strong financial position, and stockholders equity of over \$3,000,000 (Resp. Ex. 16). Based upon this information Kuehm calculated that Waltham had a potential aggregate borrowing capacity of about \$4,000,000 which, together with an estimated \$1.5 million excess cash, could be used for an aggressive acquisition program (Tr. 831-832). Kuehm made further calculations concerning probable criteria for acquisitions, together with cash flows, potential earnings and profit capacity of the business to be acquired and determined that in his opinion that Waltham could earn, after taxes, in calendar year 1969, \$2 per share (Tr. 832, 884-898, Resp. Ex. 14, Tr. 1065-1068). Kuehm, according to his testimony, tried to have the research department of McDonnell obtain more information from the investment bankers who had obtained control of Waltham but was told that such information could not be obtained. Kuehm then determined to make investments in Waltham and to recommend its purchase to others after developing a research file of his own on Waltham.

On August 29, 1968, Kuehm made some purchases of Waltham stock in a family account and for the accounts of some of his clients.

At the end of that day there was a staff meeting at which Kuehm discussed Waltham with the assembled registered representatives. According to his version, he told the representatives that based on his knowledge of the investment bankers who had acquired control of Waltham, that Waltham would be used as a base company in an acquisition program where the bankers would apply their expertise. He stressed that the stock was highly speculative because there was no indication when the acquisition program would commence, what form it would take but that the balance sheet was a strong one. He stated that there were inherent risks in that to be successful the new management would have to make the right kind of acquisitions, the new management would have to have the talent and capabilities to control them, and that the company would be subject to conditions in the overall economy and the money market. He stressed that an investment in the stock would be highly speculative and aggressive (Tr. 833-836). He characterized a purchase of Waltham as a "businessman's risk" and for speculative accounts.

Kuehm further testified that as developments occurred in Waltham he brought them to the attention of the representatives at staff meetings. Much of that information also appeared as news items on news tapes at the office or in public relations releases which Kuehm and some of the representatives arranged to receive directly from a public relations company representing Waltham.

Developments in Waltham came thick and fast and were appropriately publicized. These were as follows:

September 9, 1968 - announcement of the acquisition of Johnson Bronze Company, including its subsidiary Ferralloy, Inc., for cash (Resp. Ex. 9).



September 12, 1968 - Announcement of agreement to purchase Stevens Corporation, for Waltham common stock and subordinated debentures (Resp. Ex. 22)

September 29, 1969 - Announcement of agreement for the purchase of Machining Technology Corp., for Waltham common stock (Resp. Ex. 25). This release also quoted the president of Waltham as stating "This third acquisition firmly establishes Waltham Precision's basic objective of building a major industrial organization devoted to manufacturing processes with definite technological superiority."

A report was issued to stockholders by the president of Waltham sometime before December 17, 1968 in which he reviewed developments since the new management had assumed control. In it, he stated, "A prime objective of your new management is to effect a dramatic growth in per-share earnings of the company's stock . . . your management plans to concentrate its resources and those of its subsidiaries and divisions on innovations and the profitable employment of unique or advanced technology." (Resp. Ex. 12)

December 10, 1968 - Notice of a special meeting of shareholders to be held on January 14, 1969 was issued. Among other matters to be considered was a merger into a subsidiary which would result in a changing of the name of Waltham to Waltham Industries Corporation and increasing the authorized common stock from 3 million to 10 million shares. (Resp. Ex. 20)

December 17, 1968 - Announcement was made of agreements for the acquisition of Underwater Electronics Corporation and Henry J. Burnett, Inc. for an undisclosed amount of stock. (Resp. Ex. 30)

December 19, 1968 - Announcement was made of the acquisition of Industrial Machinery Company, Inc. in exchange for common stock (Resp. Ex. 33).

The pace of rapid acquisition continued into 1969 as indicated by

the following announcements of acquisitions and other matters:

January 13, 1969 - Indar Division of P.R. Mallory and Co., Inc. - for cash (Resp. Ex. 34).

January 14, 1969 - Forgflo Corporation - for Waltham stock (Resp. Ex. 34).

February 10, 1969 - United Engine and Machine Co. - for a Waltham convertible note (Resp. Ex. 36).

February 18, 1969 - Grant Industries and Pacific Interchange Parts - for stock. (Resp. Ex. 37)

February 19, 1969 - Oppenheimer, Inc., and Opcalite, Inc. - for cash, stock and convertible subordinated debentures (Resp. Ex. 38).

February 20, 1969 - MIF Industries and Trident Industries - for stock (Resp. Ex. 39)

February 25, 1969 - Fostoria-Fannon, Inc., for stock.

In the press release announcing this acquisition it was noted that this acquisition would bring to 16 the number of companies comprising Waltham since the new management took control. It was further noted that there had been a 1/3 increase in the common shares outstanding and that Waltham's annual sales rate had increased to \$71,000,000 from the annual rate of \$4,000,000 that had existed 5 months previously, a 17-fold increase (Resp. Ex. 40).

April 21, 1969 - Waltham released its 1968 annual report noting per share earnings of 89¢ on a pooling of interest basis and including a special credit of 26¢, as against 76¢ in the prior year.

May 13, 1969 - First quarter earnings of 34¢ a per share amount as against 16¢ in the prior year was announced.

Around mid-1969 the financial fortunes of Waltham began to decline and it ended up with earnings of 3¢ a share for the calendar year 1969.

Kuehm testified that as Waltham acquisitions were announced he attempted to make an analysis of the companies being acquired and in instances where nonpublic companies were acquired he obtained Dun and Bradstreet business reports on those companies.

Kuehm also telephoned George Easter, Waltham's financial vice-president, on December 17, 1968, seeking more information on the Waltham acquisitions and its future plans. The pair also had a luncheon meeting on December 31, 1968; there was a detailed discussion at that meeting of the Waltham operations.

Kuehm later arranged for Easter to have a dinner meeting on January 28, 1969, with Gary Takessian, CFA, McDonnell's Senior Analyst and himself. After that meeting in a "Management Contact

Report" dealing with a number of companies, Takessian stated, "It is hard to estimate results with most of the acquisitions counted on 'purchase' basis." Earnings were estimated at \$2 per share on a fully taxed basis.

Easter testified that company policy was not to make earnings projections either in published material or in interviews with brokers or their representatives. Waltham's operations were changing rapidly because of the acquisitions and each one had an effect on any current earnings estimate, he stated, and he therefore refused to estimate probable earnings for callers. However, information on the current volume of business of Waltham and its acquired companies was available and Easter, if asked, would indicate current margins of profit. These could be used by others to estimate earnings, but Easter never issued any official estimate. He recalled that he did estimate volumes of the acquired companies and traditional profit margins in his meeting with Takessian and Kuehm. In the Spring of 1969 a confidential document was prepared by Waltham for submission to groups from whom it sought capital. (Resp. Ex. 10) This document contained an earnings estimate of \$2 per share for 1969, after taxes. According to Easter, this projection was made by the president of Waltham on his own determination. This document was shown to representatives of McDonnell in April or May 1969. Kuehm was present at the meeting. Easter further testified that in his opinion it would have been very difficult for an outsider in the Fall of 1968 to reasonably predict 1969 Waltham earnings of \$2 a share in view of the acquisition activity and Easter's knowledge of certain confidential information which was not available

to the public, but within his knowledge. (Tr. 681-682) His testimony as to his dealings with Kuehm, Takessian, and Waltham affairs, in general, is credited.

D. Activity in the Sale of Waltham Stock

Prior to the investment in Waltham by new management the market price for its common stock on the American Stock Exchange ranged between \$12 and \$14 per share, with a weekly volume approximated 20 to 30,000 shares. During the week prior to the first public announcement of new plans for Waltham in late August 1968 the price rose to 22 7/8 per share with a weekly volume of almost 230,000 shares (Resp. Ex. 3). Volume thereafter never reached the high activity reached in August and the beginning of September, but the price rose sharply to a high of 54 3/4 during the week ending December 27, 1968. A sharp decline commenced in April 1969 and by July the stock was down to 14.

Registered representatives at the McDonnell 400 Park Avenue Office took an active interest in the Waltham stock after Kuehm recommended its purchase. In the August 1968 through March 1969 period 62,421 shares of Waltham were purchased by that office, as follows:

August	1968	4,350	shares
September	1968	11,585	"
October	1968	5,340	"
November	1968	4,255	"
December	1968	10,970	"
January	1969	17,747	"
February	1969	5,054	"
March	1969	3,120	"

Sales for the period were 17,463 shares.

While McDonnell orders did not dominate the market in Waltham, it did participate in the market each trading day. Easter testified that

in the December 1968 period he determined through transfer sheet records that McDonnell was the fourth largest holder of Waltham shares among non-insiders (Tr. 405). Most of the McDonnell purchases were made through the 400 Park Avenue Office (Div. Ex. 3).<sup>3/</sup>

E. Fraud in the Sale of Waltham Stock

It is alleged in the order for these proceedings that certain named registered representatives of McDonnell willfully violated and willfully aided and abetted violations of the anti-fraud provisions of the Securities Acts in the offer and sale of the common stock of Waltham. These persons were named in the order for the proceedings, but are no longer parties since the commission has disposed of the cases against them by orders accepting offers of settlement. However, their activities are in issue here since Kuehm is also alleged to have willfully violated and willfully aided and abetted violations of the anti-fraud provisions aforementioned and the Division contends that Kuehm participated in the violations by the registered representatives.

Eleven customer witnesses who had purchased Waltham through registered representatives at 400 Park Avenue testified in these proceedings. Their testimony as to representations made to them was not specifically challenged and is credited as indicated.

Arthur Berla, a registered representative, sold Waltham stock to approximately fifteen customers. Four of them testified. A.S., a self-

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<sup>3/</sup> In the column headed "Reg. Rep. #/" in this exhibit, the numbers "22/" followed by a number identify the Park Avenue Office.

employed taxicab driver first heard of Waltham from Berla a short time before his initial purchase on January 13, 1969. Berla told him that Waltham was a hot issue, was really going to move, that the stock would earn \$4 a share for the coming year, and that they were going to be making some very important acquisitions, including one of \$65,000,000 (Tr. 17-19). Berla further told him that electronics stocks, and he included Waltham in this category, should sell at a multiple of at least 20 and that the stock should rise to 75 or 85 (it was then selling at around 40). S. was not given any information about operations of the company other than estimates of its earnings and details of its acquisitions. Berla also hinted that inside information was available about Waltham in the McDonnell office by telling him that he could not give him any details about the proposed \$65,000,000 acquisition because that was inside information (Tr. 39) and told him that Kuehm and some account executives had met with the president of Waltham (Tr. 34). S. <sup>b</sup> bought 100 shares of Waltham through Berla on January 14, and another 100 shares on January 17. About a month later, when A.S. discussed with Berla whether he should sell his Waltham shares, the latter dissuaded him, stressing the \$4 per share earnings estimate.

E.W., a retired woman, bought 100 shares of Waltham through Berla in November 1968 in two lots of 50 shares each. Berla told her that Waltham was terrific, they were making mergers, the stock was going up, and she should sell other stock she owned to buy Waltham. After she made her original purchase of 50 shares, Berla told her that the stock had gone up and that she was foolish not to have bought more originally. She then made a second purchase. He also told her that the stock should

go up to \$80 a share (it was then selling at about \$37).

Mrs. N.A. opened an account at McDonnell's 400 Park Avenue Branch in October 1968. She asked Berla, who was her representative, to recommend a stock that was not speculative or risky (Tr. 373). Berla recommended Waltham, stating that it had plenty of money, excellent management, was making acquisitions, was financed by a Swiss bank, was well diversified, had a very good future and should go up to about \$100 in about a year (Tr. 364-365) Mrs. A. bought 90 shares of Waltham through Berla between October 1968 and January 1969. She sold them in January 1969 but purchased an additional 30 shares in March 1969 and 20 more in August 1969. She made these purchases, she testified, when Berla told her that he still thought that the company was a good one and that the price would go to \$100 a share. Her purchases were paid for from bank savings. Her husband, who also dealt with Berla, bought 61 shares of Waltham.

Mrs. H.B.M., a widow and unemployed, was a friend of a secretary at the McDonnell Park Avenue office. Berla got to know her through her visits to the McDonnell office and urged her to invest in Waltham. Among other things, he told her that the stock would "Go to the Moon," that earnings were 80¢ a share, would be \$1.80 in 12 months, and \$4.40 the next year. He also told her that he had invested heavily in the stock and that she would be out of her mind not to buy, that the stock would be 100 in a year's time, that the officers of the company were personal friends of his, and that she might not be able to get any of the stock because of the demand for it. Mrs. M. agreed to make a purchase in Waltham and purchased shares for approximately \$60,000. She still

owned those shares at the time of the hearing.

Dr. F.B.C. bought 353 shares in February 1969 in three transactions through the Park Avenue Office; his account executive was Theodore Stagg. In late January 1969 Stagg suggested that he sell other stock that he had and buy Waltham. Stagg told Dr. C. that he had met with executives of Waltham and that he felt Waltham earnings would double within two years and that the stock should reach \$70 a share within the period because of increased earnings (the stock was then selling at about 50)(Tr. 174). He further told Dr. C. that Waltham had acquired a number of small technical companies and that Dr. C. should buy as much Waltham as he could. In reliance on this recommendation Dr. C. sold some stock in order to purchase the Waltham shares. He received no information from Stagg on the operations of Waltham other than a copy of the 1968 annual report, sent to him after his purchase. He eventually sold his shares in 1970 at a loss.

F.C.S. also dealt with Stagg. He purchased 100 shares of Waltham at \$48 per share in February 1969 and another 100 shares later at \$29 per share. In February 1969 he telephoned Stagg on the recommendation of a friend and discussed with Stagg the purchase of a security. Stagg recommended that he purchase Waltham instead. He stated that Waltham was a growth firm making acquisitions, a number of which would be announced in the next 6 months, that the stock was selling at 48 but had gone up 2 points while they were talking and that it was charted to reach 76 in perhaps 6 months (Tr. 510-511). When the stock dropped later, Stagg recommended a second purchase because, he said, the market was in a slump and that the stock would rise when the market came back and acquisition announcements were made. S. received a copy of the 1968 annual report from Stagg.



J.R. met Stagg at a nightclub where the former was employed as a waiter. R's income depended on tips he received. J.R. and a fellow employee spoke with Stagg and told him they were interested in increasing some capital they had which they planned to use to go into business together. Stagg recommended that J.R. purchase Waltham, stating that it would either reach \$200 a share or would give him a 200% return on his investment in about a year or 18 months, that many of his clients were buying Waltham and that he should sell everything to buy it. J.R. then gave Stagg an order for 100 shares which were bought for him at \$47 per share. A few days later the price of Waltham had risen to \$51 a share and on Stagg's recommendation J.R. withdrew money from his savings and purchased another 50 shares at \$51 3/4 per share. J.R. subsequently sold his shares at substantial losses.

Herbert R. Hartley was another registered representative at the Park Avenue Office who sold Waltham shares to customers. R.P.V. was introduced to Hartley by a fellow employee at Consolidated Edison. In a telephone conversation Hartley recommended the purchase of Waltham stock stating that it should go forward, the company had good management, that because of diversification and mergers that were pending the stock looked like it would go to at least 80 within the next year or so (Tr. 486-487). V. withdrew some bank savings and purchased 50 shares in September 1968 at \$29 3/8. In January 1969 Hartley telephoned V. and advised him that the stock was advancing, that it was acquiring additional companies and that it still looked like a good investment. He also repeated his claim that the stock would go to 80. V. bought an additional 50 shares of Waltham at that time at \$43 3/4. He still holds those shares.

M.S., a corporate executive, received a telephone call from Hartley in early October, 1968. Prior to this call, S. had not dealt with either Hartley or McDonnell. Hartley told S. that he had some interesting situations, one of which was Waltham. During the course of the conversation, Hartley told S. that Waltham was a growing company whose sales were currently between 4 and 5 million dollars annually, but were anticipated to increase to between 30 and 40 million dollars annually and earnings were expected to be \$1.80 a share before taxes and \$1.00 after tax. Hartley also stated that he expected that between November and December 1968 the price would increase to between 45 and 50 dollars per share. S. purchased 50 shares on October 11, 1968 at a price of \$30 3/8 per share.

On December 26, 1968, when the price of the Waltham shares had increased substantially, S. telephoned Hartley and asked him whether he should sell his shares Hartley recommended that S. should hold his shares and buy more because he expected the stock to go to about \$90 per share within the next 6 months and that there would be earnings of \$4 per share for 1969. He also mentioned that he had heard that there were negotiations for a merger acquisition.<sup>4/</sup>

Predictions of a substantial price increase of Waltham to about \$80 per share were made by another registered representative, Charles Redding, to H.W.W., an attorney. On his recommendation, W. made purchases of Waltham shares in October 1968 and January 1969. W. sold those shares at a profit. However, in late January, 1969,

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<sup>4/</sup> Hartley denied that he made any price predictions. However, the testimony of M.S. is mutually corroborative with that of R.P.V., another Hartley customer. S. also made notes of the conversation he had with Hartley on December 1968. These notes also contain a notation of a price prediction. The testimony of the two customers is credited.

Redding urged W. to buy more Waltham shares stating that Waltham was "Getting hot" and that its price was going to continue going up. W. then purchased an additional 100 shares of Waltham which he sold at a substantial loss. Some months after the original purchase, when the stock had declined sharply, Redding urged W. to double up and buy more stock but W. did not do so.

D.S. had had experience as a registered representative and was a friend of James Ivey, a McDonnell registered representative. In December 1968 Ivey recommended that S. purchase Waltham, stating that Waltham was growth oriented, would have substantial earnings in the next year of about \$2 per share through mergers or acquisitions of other companies, and that he and others in the office expected the stock to go upwards of 75 to 100 dollars a share in about 6 months.

D.S. knew that Ivey had not had much experience in the brokerage business and he questioned the latter as to his source of his information on Waltham. Ivey told S. that all his information about Waltham came from Kuehm and both he and another representative told M.S. that Kuehm had recommended stocks in the past which had done well. Based on this information, M.S. purchased 250 shares of Waltham in his own and in his wife's name. He sold these shares about 7 months later at a substantial loss.

Another representative, John Duffy, prepared a market letter on Waltham, had it typed and duplicated, at the Park Avenue office, and had it mailed to his customers and friends in January 1969. In it Duffy estimated earnings for Waltham in 1969 of \$4.50 to \$5.00 per share and \$7 to \$8 in 1970. The letter contained very little information on

Waltham other than recent acquisitions and was incomplete, false and misleading within the meaning of the Securities Acts.

It is evident that in their presentations to their customers, registered representatives at the McDonnell Park Avenue office violated the anti-fraud provisions of the Securities Acts in the offer and sale of Waltham stock. Representations of substantial short-term increase in the market price of Waltham shares were made, sharp increases of earnings were also predicted, and misrepresentations on acquisitions were made.<sup>5/</sup> At the same time very little information was furnished to customers on the actual operations of Waltham and its financial condition. At the time new management took over in the Fall of 1968, Waltham was primarily engaged in defense work and had an annual sales volume of approximately \$4,000,000. Prior to 1967 it had accumulated substantial deficits. It had earned 74 cents a share in 1967, but still had a substantial tax loss carry-forward in 1968. Earnings in 1968 for nine months were running behind the 1967 figures. While final figures for 1968 showed an increase of 13 cents a shares over 1967, these figures were computed on a pooling of interest basis and by use of a special credit of 26 cents and were first published in April 1969.

The above information on the financial history and operations of Waltham was not furnished customers in any detail by the registered representatives mentioned here. Instead they stressed sharp estimated increases in Waltham's business volume and earnings in the short term.

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<sup>5/</sup> Easter did testify that a large acquisition was under negotiation in the early part of 1969. Some McDonnell representatives obviously learned of this and used this information. Easter pointed out that these negotiations were not successfully completed. Representatives who spoke of a large acquisition spoke in positive terms about the acquisition and did not stress that it was in the negotiation stage.

None of the speculative aspects which might affect this earnings picture was even mentioned. While investment in Waltham was recognized in the Park Avenue office as a speculation, these representatives sold the stock to their customers without regard to its suitability to the investment needs of their customers. The record is replete with evidence that this stock which was characterized by Kuehm as a "businessman's risk" was sold to persons who by no stretch of imagination fitted into that category and who were hurt financially by their Waltham purchases. The risks involved in this speculative investment were never explained to them, so that they could make an informed choice.

The obligations of brokers and their salesmen to investors has been spelled out in many decisions by the Commission and the courts. A number of these have been analyzed and applied in the leading case of Hanley v. S.E.C., 415 F.2d 595, 596-597 (C.A. 2, 1969). It was pointed out in Hanley that securities salesmen are under a duty to investigate and their violation of that duty brings them within the term "willful" as used in the Exchange Act. A salesman occupies a special relationship to a buyer of securities in that by his position he impliedly represents he has an adequate basis for the opinion he renders, and he must disclose facts which he knows and those which are reasonably ascertainable.

Price and earnings predictions are governed by these general rules. The Commission has stated: "A prediction by a securities salesman or dealer to an investor that a stock is likely to go up implies that there is an adequate foundation for such prediction and that there are no known facts which made such a prediction dangerous and misleading" (Leonard Burton Corporation, 39 S.E.C. 211, 214 (1959)). Predictions of

substantial price increases within relatively short periods of time with respect to promotional and speculative securities have been held to be inherently fraudulent and cannot be justified.<sup>6/</sup> In the case of speculative securities a minimum requirement is that there be full disclosure of uncertainties that may affect predictions as to future earnings and price increases.<sup>7/</sup>

The record establishes that in the instances set forth previously, McDonnell representatives at the Park Avenue office did not conform to the requirements of the Securities Acts in their offer and sale of Waltham stock. Waltham, under its new management was to all intents and purposes a new company with different goals and methods of operation than had previously been in effect. No history of operations under these new plans had yet been developed. The new operations could result in success or failure. None of this background information was supplied to investors. Such conduct was willfully violative of the Securities Acts.<sup>8/</sup> The evidence adduced furnishes further detail to findings of such violations made by the Commission pursuant to offers of settlement.<sup>9/</sup>

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6/ Crow, Brouman & Chatkin, Inc., Sec. Exch. Act Rel. No 7839, p.6 (1966). See, to the same effect, Arnold Sec. Corp., Sec. Exch. Act Rel. No. 7813, p.3-4 (1966); Alexander Reid & Co., 40 S.E.C. 986, 991 (1962); Leonard Burton Corp., supra.

7/ Hanley v. S.E.C., supra; Gross v. S.E.C., 418 F.2d 103 (C.A. 2, 1969); James DeMammos, Sec. Exch. Act Rel. No. 8090, p.3 (1967).

8/ Tager v. S.E.C., 344 F. 2d 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord, Harry Marks, 25, S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. S.E.C., 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946).

9/ McDonnell & Co., Inc., Sec. Exch. Act Rel. No 8863, (1970); Clinton G. Hough, et al. (James Ivey and John D. Duffy), Sec. Exch. Act Rel. No. 9001 (1970); Arthur Berla, et al., Sec. Exch. Act Rel. No. 9097 (1971); Theodore Stagg, Sec. Exch. Act Rel No. 9229 (1971).

The Division, while not relying on any direct dealings between Kuehm and his customers, maintains that he also violated and aided and abetted violations of the Securities Acts by his conduct in recommending Waltham to the representatives in his office and supplying incomplete and misleading information on Waltham without disclosing or emphasizing negative factors affecting his statements and estimates. It is argued, on behalf of Kuehm, that he made no misleading statements about Waltham, made projections on the basis of his professional skill and judgment, expressed his opinions only to qualified registered representatives, and did not push or tout the stock.

Six registered representatives who were employed at the Park Avenue office during the relevant period testified in this proceeding. Their testimony establishes that they respected Kuehm's ability to make judgments on the value of securities and that he had a reputation among them to pick "winners". His recommendations were not lightly disregarded, although salesmen were not obligated to follow them.

Kuehm's version of his original recommendation of Waltham has been outlined previously (supra, p. 4-6). At that time there had only been a change of controlling stock interest in Waltham. Yet on that basis, his knowledge of the background of the investment bankers then in control of Waltham, and from his examination of the Waltham balance sheet as published in a commercial service early in 1968, Kuehm made his prediction of substantial increased earnings and business for Waltham in 1969. He predicted after-tax earnings of \$2 per share. He also estimated pre-tax earnings per share of \$4. Kuehm testified that he emphasized that there was a question as to the extent that the Waltham tax loss carry-forward

could be applied to current earnings.

The Division contends that Kuehm had no reasonable basis for his projections of Waltham's business and earnings at the time he made them. It is contended on behalf of the respondent that by education and training Kuehm was qualified to make the analysis and projections he did make and that he qualified his statements to his staff by pointing out the speculative nature of Waltham at the time and factors which might affect its future operations. Kuehm acknowledged the very substantial risk factors. An expert produced by the respondent testified about Kuehm's method of analyzing Waltham initially and its possible earnings that everything would have to "fall together pretty nicely" (Tr. 921). The right companies for acquisition would have to be selected, financing would have to be arranged, and the right kind of management would have to be installed to insure successful operation and supervision. (Tr. 938). These factors was not susceptible of any mathematical computation; at best Kuehm's projections represented an "educated guess" as to what might happen.

Kuehm never changed his estimates of sharply increased earnings for Waltham although there is some evidence that he may have lowered his estimate of \$2 a share after-tax earnings to \$1.50 sometime around the end of the first quarter in 1969. It is argued that Kuehm's estimates were the same as used by Easter, the McDonnell research staff, and Waltham management itself. However, Easter testified that in late 1968, he would have considered a \$2 earnings projection reasonable, but based only on information he knew and which was not made public. As a matter of policy he did not make earnings estimates to Kuehm or others who spoke with him. The later Takessian statement in a report on many companies was very brief and while it



also contained the \$2 per share earnings estimate it stressed that it was difficult to estimate results of Waltham. The later financial report of Waltham referred to, which contained a \$2 estimate of earnings, was not in a published report of Waltham, but was in a document being used to interest certain organizations in helping finance Waltham. Of course, Kuehm's estimates were made long before these reports were prepared.

The announcement of the change of control of Waltham was followed by substantially increased volume of trading in its shares and sharp increases in its price, which reached a peak in the first quarter of 1969. There was a steady succession of press releases announcing acquisitions and thereby increased business volume. It was a time when the caveats spoken by Kuehm originally should have been repeated, emphasized, and appropriate instructions given to the representatives. There is no evidence that this was done by Kuehm; he merely reported developments in Waltham which could only whet the interest of the representatives. There is evidence that advances in the price of Waltham were greeted with enthusiasm by the representatives and they urged their customers to buy Waltham shares by misrepresentations as to its prospects and earnings without giving any indication of negative considerations which could affect the success of the Waltham acquisition program. This did not occur in one or two isolated instances only; the proof reflects that these tactics were used by several of the representatives with a number of their customers. The proof does indicate that this was a regular practice among the representatives rather than the practice of making careful presentations of the speculative factors involved in a purchase of Waltham.

One representative testified that Kuehm never stopped recommending Waltham and repeated his estimate of 1969 earnings per share of \$4 pre-tax

and \$2 after-tax at least through the first quarter of 1969 (Tr. 79). He further testified that in January or February 1969 Kuehm indicated that a large acquisition for Waltham was being made -- larger than all the others put together. This, according to the witness, was not public information (Tr. 79-80). This testimony is credited. This statement undoubtedly was the source of similar representations passed on to customers by some representatives. Another representative testified that Kuehm indicated to him that he was close to someone in the Waltham management (Tr. 222). This testimony is also credited.

The undersigned concludes that while Kuehm may have pointed out some of the speculative aspects of an investment in Waltham at the time of his initial presentation to his registered representatives, these factors were not emphasized when Kuehm brought apparently favorable Waltham developments to their attention from time to time. His continued recommendation of the stock, coupled with the understanding of at least some of the representatives, that Kuehm did have access to some Waltham confidential information, all spurred these men on to make recklessly false and misleading statements to their customers about investments in Waltham. By his conduct, Kuehm aided and abetted these violations of the anti-fraud provisions of the Securities Acts. The violations were willful<sup>10/</sup>

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<sup>10/</sup> See authorities cited in footnote 8, page 20

The undersigned, in his findings as to Kuehm, has not relied on the letter sent out by one of the representatives, John Duffy. Testimony that procedures were in effect at Park Avenue for the initialing of correspondence to customers and that these procedures were followed is credited. Duffy testified he did not follow the procedures because he felt that a note he had placed in the letter indicated that the letter was his own work and not a McDonnell communication. As far as the evidence shows, this was an isolated instance.

F. Failure of Supervision

It is alleged in the order for these proceedings that Kuehm failed reasonably to supervise other persons under his supervision with a view to preventing violations of the Securities Acts and rules and regulations thereunder. Such conduct constitutes a violation of the Exchange Act pursuant to the provisions of Section 15(b)(<sup>5</sup>)(E) thereof.

However, it is further provided:

"For the purposes of this clause (E) no person shall be deemed to have failed reasonably to supervise any person, if--

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with."

The Division contends that Kuehm did not properly discharge his supervisory duties and responsibilities. It is argued on his behalf that established procedures did exist at McDonnell and its Park Avenue office, in particular, and Kuehm fully discharged his duties and responsibilities under these procedures and had no reasonable cause to believe that such procedures and systems were not being complied with.

Evidence was presented that McDonnell had a six-month training program for new registered representatives. The first half of the period was devoted to formal training sessions at the McDonnell main office. This was followed by a training period at a branch office where the representatives learned the functions of the different departments in a branch. Representatives were furnished copies of applicable statutes, rules and regulations, and also a manual containing prescribed procedures

for McDonnell representatives.

Evidence was also presented that at weekly staff meetings, in addition to discussion of investment and research ideas, on occasion there would be mention of office policies and procedures and compliance problems (Tr. 158). Representatives testified Kuehm would check their work, listen in on some of their phone conversations, and give them advice (Tr. 722, 545). He would pay special attention to new representatives.

Kuehm testified that new account cards were reviewed and initialed by him or his assistant, Lou Gordon. These cards noted the business of the customer (Tr. 1016; Resp. Ex. 40). Order tickets were reviewed and initialed by these supervisors (Tr. 107). Kuehm further stated that in addition to reviewing order tickets, he would hold individual conferences with brokers discussing how securities were to be presented to customers. He also would hold group meetings during and after office hours. He observed individual presentations personally. He heard "feedback" both from customers and Gordon (Tr. 1018). Weekly staff meetings were held. Kuehm also maintained that he stressed that stocks that were recommended must be suitable for a client and an unsolicited order might not be filled for a client in an appropriate case if it were unsuitable for his needs. (Tr. 1020).

The respondent has presented a picture of thorough supervisory procedures, carefully enforced at the Park Avenue branch. No contentions have been made that the McDonnell procedures and the system for applying these procedures were not reasonably to be expected to prevent and detect, insofar as practicable, violations of the Securities Acts by registered

representatives and other employees. However, the evidence establishes that Kuehm, as manager of the Park Avenue McDonnell branch, did not reasonably discharge his duties and obligations in connection with the offer and sale of Waltham stock at his office.

None of the supervisory procedures supposedly in force at the Park Avenue office were effectively applied in the case of Waltham transactions. There is no evidence that representatives were personally checked on their presentation of Waltham to customers nor were their presentations supervised in a way to uncover violations of general instructions. Instead, the record is replete with evidence that representatives made presentations to their customers and predictions on earnings and other developments in Waltham which violated the Securities Acts. None of this conduct was apparently observed by Kuehm or investigated in any way.

It is urged that the Waltham sales were a small part of the business at the Park Avenue office -- Kuehm estimated that it was about 1½ percent. However, Kuehm had evaluated Waltham as a speculative security and a "businessman's risk." Under these circumstances, Waltham sales activity certainly required more attention than activity in investment grade securities. It is also contended that Kuehm personally initialed only 4 order tickets of customers who testified here and that his assistant presumably took care of the others (Resp. Ex. 4). However, Kuehm did receive daily reports of transactions in stocks in the office. He therefore was aware of sales activity in Waltham. Yet there is no evidence that a single representative was reprimanded or censured in any way for his conduct in the offer and sale of Waltham stock. Kuehm, according to his own testimony, stressed to the representatives the importance of the

suitability of investments to a customer's needs. Here again, while there is plenty of evidence that Waltham was sold to customers who by no means fell into the "businessman's risk" category, none of this activity was discovered by Kuehm.

The Park Avenue office was a large one, employing almost fifty representatives. The Commission has stressed that in a large organization internal controls must not only be adequate, but effective.<sup>11/</sup> Especially close scrutiny is required where, as here, an office has not been established for a long period and there are new, inexperienced personnel on the staff.<sup>12/</sup>

The undersigned concludes that Kuehm did not reasonably discharge his supervisory duties and obligations and thereby failed to prevent violations of the Securities Acts and flagrant violations of procedures and instructions applicable to the McDonnell Park Avenue registered representatives who were subject to his supervision.

### III. CONCLUDING FINDINGS, PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, so far as it is material herein, may censure, suspend for a period not exceeding 12 months or bar any person from being associated with a broker or dealer if it finds that such action is in the public interest and that person has willfully violated any provision of the Securities Acts, or any rule or regulation thereunder, or has failed

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<sup>11/</sup> Reynolds & Co., 39 S.E.C. 902, 916 (1960); Sutro Bros. & Co., 41 S.E.C. 443, 463 (1963).

<sup>12/</sup> Richard J. Buck, Sec. Exch. Act Rel. No. 8482, p. 11 (1968).

reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, any person who commits such a violation, if such other person is subject to his supervision.

It has been found that Fred L.G. Kuehm willfully aided and abetted violations of the anti-fraud provisions of the Securities Act and applicable rules in the offer and sale of the common stock of Waltham Industries Corporation. It has also been found that Kuehm, as manager of the McDonnell Park Avenue branch office, did not reasonably discharge his supervisory duties and obligations and thereby failed to prevent violations of the Securities Acts by those subject to his supervision.

The Division urges that in view of the serious nature of the violations found and in view of the public interest involved by reason of the heavy losses of investors in Waltham at the Park Avenue office,<sup>13/</sup> Kuehm should be barred from further supervisory positions with any broker or dealer and should be suspended from any association with any broker or dealer for 12 months.

It is contended on Kuehm's behalf that Kuehm has never been the subject of any complaint or disciplinary proceeding and that during the relevant period there were a great deal of "back-office" problems at the McDonnell office, which imposed heavy burdens on Kuehm and that he had to work long hours on these and other problems at his office. It is also pointed

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<sup>13/</sup> Over \$2,500,000 was invested by these customers in Waltham. The company was in bankruptcy proceedings at the time of the hearing.

out that Kuehm lost a substantial investment in McDonnell and, while continuing in the securities business, has not been able to hold a supervisory position since this matter was under investigation.

There is no record of any adverse proceeding against Kuehm prior to this proceeding. No charges have been made against him with respect to his dealings with his own customers. His recommendation of Waltham was based on his own analysis of that stock and he attempted to obtain additional information from the company which might support his recommendation, although these efforts came several months after his initial recommendation of the stock to his representatives. The director of compliance at McDonnell during the relevant period testified that from his contacts with Kuehm he was of the opinion that Kuehm was a professional type manager, a man of high integrity and professional standards, and one of the best managers in the McDonnell organization (Tr. 701-702).

However, it must also be noted that the violations found were most serious and involve key regulatory provisions of the Securities Acts. In particular, Kuehm's failed to see to it that any reservations he had on Waltham were conveyed to investors and failed to detect serious fraudulent representations on the part of representatives in his office. While the office was a busy one and the evidence does establish that Kuehm did have heavy responsibilities, there is no shred of evidence that he detected any of the extensive violations going on about him.<sup>14/</sup>

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<sup>14/</sup> The Commission has pointed out, ". . . that the duty of adequate supervision cannot be avoided by adverting to the difficulties involved where facilities are expanding, personnel are inexperienced, or business pressures are increased. These factors only increase the necessity for vigorous effort." (Sutro Bros. & Co., supra, p. 463).



The undersigned further concludes from the record that while Kuehm failed to meet his obligations in connection with the offer and sale of Waltham stock, his record until that time was good and that he did not in the course of his employment exhibit such disregard for his duties and responsibilities as to warrant barring him from any supervisory positions in the future. However, a substantial period of suspension should be imposed in the public interest, to impress on Kuehm and others in similar positions the heavy responsibilities imposed on them by statutes and rules both as managers and representatives to be alert to meet those obligations. Accordingly,

IT IS ORDERED that Fred L.G. Kuehm is suspended from association with any broker or dealer for sixty days.

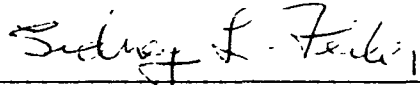
Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. This initial decision pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely

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(Footnote 14 continued)

The "back-office" problems Kuehm referred to did not become the deep problems they did reach until sometime in 1969, months after the Waltham activity started.

files a petition to review or the Commission takes action to review as to <sup>15</sup>  
a party, this initial decision shall not become final as to that party. <sup>16/</sup>



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Sidney L. Feiler  
Administrative Law Judge

Washington, D.C.  
July 16, 1973

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15/ All contentions and proposed findings and conclusions have been carefully considered. This initial decision incorporates those which have been accepted and found necessary for incorporation therein.