ADMINISTRATIVE PROCEEDING
FILE NO. 3-133

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

LAIRD, BISSELL AND MEEDS (8-18)
LOUIS J. SNEED
HANNS E. KUEHNER
EDGAR F. ISAACS
HAROLD J. RAU

CORTLANDT INVESTING CORPORATION (8-5630)
MELVIN CANTOR
SAMUEL E. STONE
MAX REITER
MICHAEL KRAMER

INITIAL DECISION

(Private Proceeding)

APPEARANCES: Joseph C. Daley, Esq., Lawrence M. Levy, Esq., Jack Becker, Esq. and Judith S. Shepherd, Esq. on behalf of the Division of Trading and Markets, Securities and Exchange Commission.

Shearman & Sterling, Robert H. Knight, Esq., John E. Hoffman, Esq., Werner L. Pollak, Esq. for Respondents Laird Bissell and Meeds.

Robert Trescher, Esq. of Montgomery, McCracken, Walker & Rhoades, 1421 Chestnut Street, Philadelphia, Pennsylvania for Respondent Louis J. Sneed.

Irving Bick, Attorney for Respondent Max Reiter, 150 Broadway, New York, New York.

Meyer, Kissel, Matz & Seward, Attorneys for Respondents Hanns E. Kuehner, Edgar R. Isaacs and Harold J. Rau, 25 Broad Street, New York, New York.

Cortlandt Investing Corporation, c/o Melvin Cantor, 226 East 68th Street, New York, New York.

Melvin Cantor,*/ pro se 226 East 68th Street,
New York, New York.

Dubow, Frank & Dubow, Attorneys for
Respondent Michael Kramer, 350 Broadway
New York, New York.

Samuel E. Stone, 5360 Sheridan Road, Chicago,
Illinois.

BEFORE: Samuel Binder, Hearing Examiner

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*/ Melvin Cantor and Cortlandt Investing Corporation were represented by counsel during part of these proceedings but such counsel withdrew and Cantor represented himself and Cortlandt Investing Corporation thereafter.

These are private proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine what, if any, remedial action should be taken with respect to Laird, Bissell and Meeds, Inc., 1/ ("Laird Bissell"), Louis J. Sneed ("Sneed"), Hanns E. Kuehner ("Kuehner"), Edgar F. Isaacs ("Isaacs"), Harold J. Rau ("Rau"), Cortlandt Investing Corporation ("Cortlandt"), Melvin Cantor ("Cantor"), Samuel E. Stone ("Stone"), Max Reiter ("Reiter") and Michael Kramer ("Kramer"). The order instituting this consolidated proceeding was issued by the Commission on May 5, 1965 and alleged, among other things, that during the period from approximately April 1961 through September 1963, respondents singly and in concert wilfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15cl-2 thereunder in connection with the offer and sale of the common stock and 6% convertible subordinated debentures of Old Empire, Inc. ("Old Empire" or "OE"). During the proceedings the Commission's order was amended to allege that on February 4, 1966 the United States District Court for the

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1/ Laird, Bissell and Meeds, a general partnership, was registered as a broker-dealer with the Commission on January 1, 1936 pursuant to Section 15(b) of the Exchange Act. On February 18, 1948 it became a limited partnership and was registered as such. Laird, Bissell and Meeds, Inc., a Delaware company, incorporated on October 1, 1965 was registered with the Commission as a broker dealer on November 28, 1965 and is a successor to the partnership of the same name. In a stipulation dated November 23, 1965 entered into by the Division of Trading and Markets ("Division") Laird, Bissell and Meeds, the partnership against which this proceeding had been instituted and Laird, Bissell and Meeds, Inc., the successor corporation, this proceeding was made applicable for all purposes to the successor corporation.

Southern District of New York issued an order in Securities and Exchange Commission v. Cortlandt Investing Corporation and Melvin Cantor, 66 Civil Action File No. 361 permanently enjoining Cortlandt and its president, Melvin Cantor from further violating Sections 15(c)(1), 15(c)(2) and 15(c)(3) of the Exchange Act and Rules 15c1-2, 15c2-1 and 15c3-1 thereunder and appointing a receiver for Cortlandt. 2/ The injunctive proceedings involved violations of the Commission's net capital rule, failure to disclose material facts concerning the net capital deficit of Cortlandt, and the hypothecation of securities carried for the account of customers.

The facts pertaining to this injunction were not disclosed in Cortlandt's Form B/D or in any amendment thereto. 3/

All parties to the proceeding filed answers denying the allegations contained in the Commission's order. All parties except Stone were represented and participated in the formal hearing held in these proceedings. Counsel for Cortlandt and Cantor withdrew during

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2/ As the Commission pointed out in Kimball Securities, Inc., 39 S.E.C. 921 (1923):

> "The proof of the entry of such an injunction, whether based on the defendant's consent or otherwise, and whether the defendant has denied the allegations of the complaint or not, may in itself form a sufficient basis for a finding that revocation is in the public interest."

3/ In Sterling Securities Company, 39 S.E.C. 487, the Commission held that where registrant

> ". . . knew that it had not filed [an] amendment . . . its failure to file an amendment was a willful violation of Rule 15b-2 prescribed under Section 15(b) of the Exchange Act. . . ." As president of the registrant, Cantor was under a duty to determine whether the filing had been consummated, and his failure to do so constituted such negligence as to amount to wilfulness.

the course of the hearing and Cantor represented Cortlandt and himself thereafter.

Proposed Findings of Fact, Conclusions of Law and briefs were filed on behalf of Laird,Bissell and Meeds, Louis J. Sneed, Hanns E. Kuehner, Edgar F. Isaacs, Harold J. Rau, Max Reiter and Michael Kramer. 4/ Melvin Cantor filed Proposed Findings of Fact and Conclusions of Law and a brief on his own behalf and a brief on behalf of Cortlandt Investing Corporation. Samuel Stone did not appear at the hearing and did not file any Proposed Findings of Fact and Conclusions of Law or a brief.

The Findings, Conclusions and Initial Decision made herein are based upon the entire record including the Proposed Findings, Conclusions and briefs filed by the parties and upon observation of the witnesses at the hearing.

Laird Bissell's principal office is in Wilmington, Delaware and it has branch offices in New York City, Philadelphia, New Haven, and Dover, Delaware. Laird Bissell also has a wholly owned subsidiary Swiss corporation, Laird, Bissell & Meeds, A.G., engaged in the stock brokerage business in Zurich, Switzerland which was employed in furtherance of its parent's allegedly fraudulent transactions in the securities of

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4/ The proposed findings of fact, conclusions of law and briefs filed by Laird, Bissell and Meeds were adopted *in toto* by Louis J. Sneed. Laird Bissell adopted the proposed findings of fact and conclusions of law filed by respondents Kuehner, Isaacs and Rau. Respondents Kuehner, Isaacs and Rau joined in the proposed findings of fact, conclusions of law and brief of respondents Laird, Bissell and Meeds, Laird, Bissell and Meeds, Inc. and Louis J. Sneed.

Old Empire.

Laird Bissell is a member of the New York and American Stock Exchanges and of other principal stock and commodity exchanges in the United States and of the National Association of Securities Dealers ("NASD").

Sneed was managing partner of Laird Bissell, the partnership, from 1948 to 1965 when he became a vice president and director of the successor corporation and served as such until his retirement on March 31, 1967. When Laird Bissell was incorporated in October 1965, Sneed became one of 20 vice presidents, and a member of the board of directors but was not on Laird Bissell's executive committee.

Kuehner had been employed as a registered representative in Laird Bissell's New York office from January 1959 to the time of his retirement on March 31, 1967. He has been in the securities business since 1929. Laird Bissell had also employed Kuehner to write economic letters and research reports, for which he received additional compensation. Kuehner majored in economics at the Universities of Hamburg and Munich, has had training in accounting, taken courses in securities analysis and investment account management at the New York Institute of Finance, and is a member of the New York Society of Security Analysts.

On March 31, 1967 Sneed, Kuehner, and Laird, Bissell and Meeds entered into agreements whereby Sneed and Kuehner were retired from the firm and on July 24, 1967 an order was issued granting a motion to make such agreements part of the record in this proceeding.

Isaacs is and has been employed as a registered representative in Laird Bissell's Dover office since 1957. During the period involved in this proceeding Isaacs was co-manager of the Dover office. Prior to 1957 Isaacs was employed by the Delaware State Police.

Rau is and has been employed as a registered representative by Laird Bissell since 1960. During the period involved in this proceeding he was co-manager of Laird Bissell's Dover office. Rau had had no experience in the securities business prior to his employment by Laird Bissell.

Cortlandt, a member of the NASD 5/, has been registered with the Commission as a broker-dealer since March 14, 1957 6/ with offices located in New York City. Sometime after the issuance of the permanent injunction of February 4, 1966, Cortlandt's business office was closed. The record in this proceeding does not reflect

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5/ Cortlandt was expelled from membership in the NASD by a decision of the Board of Governors dated June 11, 1964. Cantor was found to be a cause of the expulsion of Cortlandt from the NASD. The Commission on review on August 24, 1965 ordered the expulsion reduced to suspension for 30 days. The case involved violations of: Sections 1 and 4 of Article III of the Rules of Fair Practice of the NASD; Regulation T of the Federal Reserve Board; and Rules 15c3-1 and 15c2-1 under the Exchange Act (Official File No. A-10-2, Vol. 1.)

6/ Cortlandt was originally incorporated under the name of Berg, Cantor & Co., Inc. and became registered with the Commission as a broker-dealer on February 13, 1957. On March 14, 1957 an amendment was filed changing the name of the registrant to Cortlandt Investing Corporation.

that Cortlandt has engaged in business since its office was closed.

Cantor is president, treasurer, secretary, director and sole shareholder of Cortlandt. He did all the hiring for the firm and took full charge of all of Cortlandt's activities. Cantor has been in the securities business since 1950 and had been associated with five broker-dealers prior to the organization and registration of Cortlandt.

Stone was employed by Cortlandt during the entire period involved in this proceeding and had become a registered representative in March 1956. He had been previously employed by Cortlandt in 1957 and again in 1960. During the period from March 1956 to December 1961, Stone held twelve different jobs as a registered representative with eight different brokers. Stone was the president and controlling stockholder of S.A.E. Corporation whose registration as a broker-dealer was denied by the Commission on November 28, 1962. The grounds for the denial were the filing of false financial statements of the corporation and false information as to Stone's prior employment experience on Form B/D, in violation of Section 15(b) of the Exchange Act and the rules thereunder. Stone was found to have aided and abetted such violations.[7/]

Reiter was employed by Cortlandt beginning in May 1962 and throughout the balance of the period involved in this proceeding. Reiter was employed as a registered representative of M.J. Reiter & Co.

7/ Securities Exchange Act Release No. 6956; Official File No. 8-9529.

from January 1959 to April 1962, and during part of April 1962 at S.P. Levine & Co., Inc.

Kramer was employed as a registered representative by Cortlandt from October 1962 and throughout the balance of the period involved in this proceeding. Kramer entered the securities business in 1953 and between that time and 1962 was employed by sixteen different broker-dealers.

Old Empire succeeded to a business which was founded in 1939 by the DeElorza family and had its plant in Newark, New Jersey. In 1954 Old Empire was incorporated under the laws of New Jersey. In March 1964, Old Empire filed in the United States District Court for the District of New Jersey a petition for an arrangement under Chapter XI of the Bankruptcy Act and stated that the company was bankrupt.

From 1939 to 1960 Old Empire had been primarily engaged in making and distributing proprietary and standard toiletries, cosmetics and household specialties as a contract manufacturer and packager for others including distributors of some well-known and highly advertised toiletries and it also engaged in aerosal packaging.[8/]

John DeElorza was president, a director and owner of approximately 12% of the stock of Old Empire after it went public.

Herbert Garde, a registered pharmacist, was president, treasurer and principal stockholder of Garde Drug holding approximately 80% of its stock. After Garde Drug was acquired by Old Empire, Garde became

8/ Old Empire had manufactured some pharmaceuticals. Old Empire had also manufactured and distributed its own brand name items which accounted for approximately 30% of its total sales. After 1960, Old Empire expanded into the pharmaceutical field through acquisitions and manufactured and distributed primarily for its own account.

vice president of Old Empire and was elected to its Board of Directors and became president of Physicians' Drug and Supply, another subsidiary of Old Empire, secretary of Welton Company, also a subsidiary of Old Empire, and a director of both.

John Horn was a director of Old Empire, Garde Drug, and Welton Company and controlled a corporation which owned approximately 12% of the stock of Old Empire. He participated with DeElorza in many aspects of management of Old Empire and was particularly active in the acquisitions of Old Empire.

Hanns Maucher was a vice president of Old Empire and a member of its Board of Directors. He was the sales manager in charge of the Contract Packaging Division.

DeElorza, Garde, and Maucher were witnesses in this proceeding.

The principal charges made by the Division were that the respondents singly and in concert had violated the anti-fraud provisions of the Securities Acts between April 1961 and September 1963 in that the respondent Laird, Bissell and Meeds by its managing partner Sneed and by its registered representative Kuehner prepared two materially false and misleading market letters, the first dated February, 1962 and the second dated August, 1962 containing, among other things, false and misleading statements concerning Old Empire's sales and earnings, its vitamin and generic drug programs and other aspects of its business, and containing unwarrantedly optimistic statements concerning future sales and earnings and that such documents were widely distributed through the mails by all the respondents and at the same time all the respondents made numerous materially false and misleading representations, principally over the telephone, to members of the investing public in connection with the purchase and sale of such securities.

Prior to August, 1962 Cortlandt, Cantor, its president, and its registered representatives had employed the February 1962 market letter in offering and selling the securities of Old Empire.

The alleged false and misleading statements in the August 1962 market letters were identical in most respects to those appearing in the February market letter, but were more misleading in that the August market letter omitted to state that the financial condition of Old Empire had deteriorated substantially in the period between the writing and distribution of the February market letter and the writing and distribution of the August market letter.

The preparation and distribution of the August market letter resulted from a request by Cantor of Kuehner for additional copies of the February market letter. Kuehner requested authorization from Sneed, his superior at Laird, Bissell and Meeds, to furnish Cortlandt with additional copies of the February market letter. Sneed instructed Kuehner in August, 1962 to update the February letter and to furnish copies of such updated letter to Cortlandt. Sneed in a telephone conversation initiated by Cantor informed him that the February market letter was being updated and that he would be furnished with copies of the updated letter. Sneed was the principal writer of the February, 1962 market letter. Kuehner updated and revised the February market letter in August, 1962.

Despite Sneed's instructions to Kuehner to update the February market letter, Laird Bissell as well as Sneed claimed ignorance concerning the giving of any order by them to the printer to print and deliver the August market letter to Cortlandt. However, the evidence reflected that the same printer who printed the February letter for Laird Bissell printed 1,500 copies of the August market letter. Both the February and the August market letters were on the letterhead of Laird Bissell. One thousand copies of the August market letter were delivered to Cortlandt. They were sent back to the printer to have blue covers placed on such market letters. Cortlandt thereafter sent a check to Laird Bissell for the delivery to it of the August market letter with blue covers. The remaining 500 copies of the August market letters were kept in Laird Bissell's New York branch office and apparently were never used by Laird Bissell. The charge for placing blue covers on the August market letters according to a bill addressed to Laird Bissell by the printer, which was received in evidence, was $150. Laird Bissell received a check from Cortlandt for $150 which they credited to advertising and literature.

Laird Bissell claimed that Kuehner had made an oral request of Cantor pursuant to a direction by Kuehner's superior in its New York branch office to return to Laird Bissell the copies of the market letter which had been delivered to Cortlandt by the printer and in this connection they presented the testimony of Kuehner's superior in its New York branch office to the effect that he had told Kuehner to obtain the return of the August market letter from Cortlandt.

The hearing examiner credits the testimony of Kuehner's superior to the effect that he had objected to the use of the August market letter by Cortlandt and his further testimony that he had asked Kuehner to obtain the return of the August, 1962 market letter. Kuehner testified that he had asked Cantor to return the August market letter. Cantor denied that he had received any telephonic or oral request from Kuehner or anyone at Laird Bissell for the return of the August market letters which had been delivered to him. Laird Bissell never wrote to Cortlandt demanding the return of the August market letter or offering to return the $150 paid by the company, nor did it take any other steps to recover the August market letter from Cortlandt or prevent its use by Cortlandt and its registered representatives.

The hearing examiner heard and observed the witnesses and credits Cantor's testimony that no demand was made upon him by Laird Bissell, or Kuehner, or any other person for the return of any copies of the August, 1962 market letter received by him. Cortlandt used the August, 1962 market letters extensively in making sales of OE stock, mailing it to numerous persons.

As a concomitant to the distribution of the market letters, all the respondents, except Sneed, made numerous telephone calls to investors to sell them Old Empire securities. In this connection all the individual respondents, except Sneed, made grossly false and misleading statements to investors to persuade them to purchase Old Empire securities and in some cases not to sell Old Empire securities which they had purchased. Not only the market letters but the telephone solicitations as well had an important effect in increasing the sale by respondents of Old Empire securities.

After the printing and distribution of the February market letter there was a marked increase in the sale of Old Empire stock. For example, for the three months from November 1961 to January 1962 Laird Bissell bought 10,202 shares of Old Empire but sold only 3,755, thus increasing its long position from 21,960 shares to 28,407 shares. During the months of February and March 1962, Laird Bissell bought 14,068 shares of Old Empire and sold 33,295. Thus, in these two months Laird Bissell's net sales of 19,227 shares reduced its long position from 28,407 shares to 9,180 shares.

In June 1962 Cortlandt had a long position of 7 shares of Old Empire. In July 1962 Cortlandt bought 2,700 shares but sold 8,600 shares, i.e., Cortlandt was in a short position by 5,893 shares at the same time that it was using the February market letter and engaging in telephone solicitations to drum up sales of Old Empire stock.

Both the February and the August market letters when viewed as entities gave a glowing picture of a seasoned, expanding and successful company free of serious financial problems, which was enjoying substantially increased profits in fiscal year ended January 31, 1962 and both letters contained predictions of substantially increased profits for Old Empire for fiscal year 1963. The letters pictured a company which was on the road to substantially greater profits in the immediate future than it had enjoyed in the past. The market letters made predictions of greatly increased earnings without reasonable basis and contained optimistic predictions without reasonable support. Further the letters presented false and misleading claims of completely successful programs which had been instituted by Old Empire relating to the sale of vitamins and made unwarrantedly optimistic representations concerning its generic drug program. The August letter gave the impression that earnings had gone up over 800% between fiscal year 1961 and fiscal year 1962 and both letters predicted that earnings in fiscal year 1963 would be 250% higher than they had been in fiscal year 1962.

There was nothing in the market letters describing the highly speculative aspects of Old Empire as a security or indicating the possibility of failure or informing the readers of the precariously tight cash and working capital position of Old Empire from which it had suffered throughout the period involved in this proceeding and which was particularly acute during fiscal year ended January 31, 1962 when it started making large expenditures in the production of an inventory of vitamins and generic drugs. Nor did the market letters refer to the serious production and delivery problems of the company in 1961 and 1962 in connection with the manufacture and distribution of its vitamin and generic drug products.

The market letters were not only misleading when read as a whole but contained specific statements which were of themselves highly misleading, particularly concerning the company's sales and earnings, with regard to its programs concerning sales of vitamins and generic drugs, and with regard to its personnel and its plant and facilities.

In addition, the market letters contained omissions of fact which were material to an understanding of Old Empire's highly speculative and hazardous financial condition during the substantial period of time when the market letters were being used to sell Old Empire securities. Specifically, when describing the company's past earnings history the market letters failed to set forth the facts concerning the company's fluctuating history of earnings, or to state that its working capital was always insufficient during the period when the letters were employed; that its cash position was precariously low at all times; that substantial amounts of accounts receivables were of doubtful collectability, and that inventory became precariously high and could not be converted into cash within a reasonable period; and that interest charges and factoring charges thereafter became extremely costly to the company and became a serious drain on its already thin working capital.

Old Empire's first offering of securities to the public was made in December 1955. This was an offering of 300,000 shares of common stock at $1.00 per share. However, only 20,490 shares were sold.

In the late spring of 1959, Kuehner, at Sneed's request inspected Old Empire's plant in Newark and talked with DeElorza and Horn in connection with a proposed Regulation A offering of its common stock. Kuehner thereafter reported to Sneed concerning the results of his inspection and discussions. Sneed, Kuehner, DeElorza and Horn had several meetings thereafter and Laird Bissell then entered into an underwriting agreement with Old Empire on November 30, 1959 in connection with a Regulation A offering of 240,000 shares of Old Empire common stock at a price of $1.25 per share. Laird Bissell as part of the underwriting agreement was given the right to designate one person as a director of Old Empire. Laird Bissell also received, at a cost of 10 cents per share, an option to purchase 30,000 shares of Old Empire at $1.40 per share which was not to be exercised until thirteen months after the effective date of the Regulation A offering and was to continue thereafter for twenty-three months. The Regulation A offering was completed on January 14, 1960.

In February, 1960, in accordance with the underwriting agreement Kuehner was elected to Old Empire's Board of Directors as the designee of Laird Bissell.

The selling circular dated December 29, 1959 employed in connection with the Regulation A offering provided in pertinent part that:

> "After payment of the underwriter's commissions, the net proceeds to the Corporation will be $264,000 and will be applied as follows:

Underwriter's Expense Allowance	$ 5,000
Estimated Expense of Issue.	10,000
Acquisition of New Subsidiary or Development of Sales Force	100,000

On Account of Retirement of Current Liabilities.	$ 50,000
Purchase of New Equipment	15,000
Inventory Purchase	30,000
Working Capital for General Corporate Purposes	34,000
Total	$ 264,000

On February 26, 1960, Old Empire entered into agreements with Welton Laboratories, Inc. (Welton Labs) 9/ and its stockholders which provided in pertinent part (1) for loans by Old Empire to Welton of up to $75,000, (2) an option to the company to acquire all of the outstanding stock of Welton for $100, and (3) in the event of the exercise of the option the closing would take place as of January 16, 1960.

As of January 16, 1960, Welton had a net deficit of $169,994. As a result of the exercise of the option, Welton Labs became a wholly owned subsidiary of Old Empire and a loan in the amount of $65,000 made by Old Empire became an investment by the company in Welton Labs, the transaction being reflected on the company's books in the amount of $48,070 representing good will of Welton Labs.

In a report pursuant to Rule 260 of Regulation A filed by Old Empire on August 9, 1960, the company reported that the offering had been completed on January 14, 1960 and that the net proceeds received from the regulation A offering were $248,649 and that

9/ Welton Laboratories, Inc. had been engaged in the distribution of drugs manufactured by Standard Drug Company, and had been operated as a division of the latter company.

these proceeds had been employed as follows:

For the purchase and installion of machinery and equipment	$ 28,088
For the purchase of raw materials, inventories, supplies, etc.	81,105
To repay a bank loan	40,000
To repay equipment loans.	10,785
For acquisition of subsidiary	88,671
	$ 248,649

While the net proceeds from the Regulation A offering were less than the amount set forth in the selling circular and were used differently in certain respects from the representations as to the "use of proceeds" made in the offering circular employed in the Regulation A offering, it is clear that no part of the proceeds became available to Old Empire as a result of the Regulation A offering for "Working Capital for General Corporate Purposes", and Old Empire's working capital and cash position was not improved by the Regulation A offering.

On December 2, 1960 Old Empire acquired all of the assets of Garde Drug (Garde Drug) subject to its liabilities, obligations and debts. Garde Drug at that time had a net worth of $173,275. The consideration paid by Old Empire was the issuance of 110,000 shares of its common stock, the aggregate value of which was $323,400 based upon $2.94 per share, the mean between the bid and asked prices on Old Empire's stock on or about that date. Garde Drug was thereupon dissolved and the 110,000 shares were distributed to its stockholders.

Old Empire had used some of the proceeds of the Regulation A offering to acquire Welton, and while it had also acquired Garde Drug towards the end of 1960 little cash was involved and Old Empire's working capital position was still tight.

Accordingly in late 1960 or about a year after the Regulation A offering, DeElorza approached Laird Bissell and discussed an additional public offering of Old Empire with Sneed and Kuehner. In May 1961 Old Empire filed a registration statement to cover an offering of $950,000 6% convertible debentures.

However, prior to such filing and on April 10, 1961 pursuant to an agreement entered into on January 31, 1961 with the stockholders of Physicians' Drug and Supply Company, Drug Laboratories, Inc. and John H. Wood, (PD&S) Old Empire acquired all of the issued and outstanding stock of the aforesaid three companies. The purchase price was $348,954 computed upon $252,954 which was approximately the combined net worths of said three companies as at January 31, 1961 plus $96,000.

In order to make this acquisition the company borrowed $500,000 from the First Pennsylvania Banking & Trust Company and paid the purchase price in cash and an indebtedness of PD&S to one of its principal stockholders amounting to $72,849.95. The loan of $500,000 bearing interest at the rate of 5% was paid in full thereafter from the proceeds of a registered public offering of $950,000 6% convertible subordinated debentures which Old Empire made in December, 1961.

The prospectus covering the $950,000 6% convertible subordinated debentures was dated December 26, 1961 and disclosed that Old Empire was going to use the net proceeds of the offering estimated at $837,000 as follows: $500,000 was to be employed to repay the bank loan used to acquire PD&S; $75,000 to improve and modernize OE's Newark plant; and $175,000 was to be used to repay an advance made by the underwriters to Old Empire shortly before the effective date of the registration statement covering the debentures. A balance estimated at only $87,000 in cash was to be left to Old Empire as a result of the offering.

Old Empire was still suffering from a very tight working capital position in the spring of 1961. Accordingly on April 4, 1961, prior to the date when the registration statement covering the debentures was filed DeElorza wrote a letter to Sneed pointing out that Old Empire need $200,000 urgently in additional working capital in order to be able to move the new subsidiaries from Philadelphia to Newark and to build up an inventory of vitamins for sale in the fall of 1961 and DeElorza in his letter stressed the importance also of having such inventory available on time to meet seasonal demand. With this letter DeElorza enclosed a number of charts including an "Estimated Cash Flow Projection". DeElorza's letter stated, among other things, that Old Empire's

> ". . . heaviest need for cash will occur in August, September and October and November. However, cash will start to reach a danger point in late May and early June with balances being virtually eliminated at the end of June.
>
> "It is our strong opinion that we should not delay either our moving expenses or our vitamin program because we have seasonal peaks and valleys to take into consideration. Any delay would mean, perhaps, postponement for another year. This means lost revenues and perhaps the loss of timely marketing opportunities."

The charts enclosed with DeElorza's letter included projections for the period from April, 1961 through January, 1962 inclusive and were prepared on the assumption that Old Empire would move PD&S, Garde

Drug, and Welton from Philadelphia to Newark in May, June and July of 1961 and would, in this connection, incur estimated moving expenses of $92,000.[10/] The cash flow chart enclosed with DeElorza's letter attempted "to project the cost of these moves plus some additional investments in a 'low cost vitamin project' which we are planning for early summer or late spring launching." The purpose in moving the subsidiaries to Newark according to DeElorza was to save an estimated $13,000 to $23,000 a month and to have the manufacturing subsidiaries under "one roof" to achieve a consolidated and integrated operation.

DeElorza's letter requesting an additional amount of $200,000 contemplated the removal of Old Empire's acquired manufacturing subsidiaries beginning in May, 1961, i.e., one month after his letter of April 4, 1961 requesting the additional $200,000 in working capital. It was in this context that DeElorza's cash flow chart projected the cash balance of Old Empire as being $80,000 at the beginning of the month of April 1961 and $61,833 at the end of the month. It further projected that Old Empire's cash balance at the end of May, 1961 would go down to $50,066 and be reduced to $5,149 by the end of June 1961. Beginning with July, 1961 through the end of the year there were projected deficits in Old Empire's cash balances during the remainder of 1961 as follows:

$ 97,018	-	for July
145,785	-	for August
175,502	-	for September
153,469	-	for October
106,436	-	for November
47,153	-	for December

10/ The moving expenses, which were not incurred until the fall and winter of the year, were underestimated by DeElorza and actually came to $175,000.

Furthermore as DeElorza's April 4, 1961 letter pointed out on receiving the $200,000 in working capital from Laird Bissell, Old Empire planned to go forward immediately with its program to move its subsidiaries and with its plan to make expenditures to build up an inventory of low cost vitamins. In this connection, DeElorza's letter to Sneed emphasized that he was of the "strong opinion that we should not delay either our moving plans or our vitamin program because we have seasonal peaks and valleys to take into consideration."

The evidence in the record supported DeElorza's observations in regard to the seasonal character of the vitamin business. The vitamin business peak demand occurs during the fall and early winter months, and this was the reason for the urgency expressed by DeElorza that Old Empire be afforded additional working capital promptly so that the manufacturing subsidiaries could be moved from Philadelphia to Newark and production of vitamins started promptly in May of 1961. Manufacture of an inventory of vitamins promptly was important so that such products would be available for sale and delivery to wholesalers for peak demand at the retail drug level which was in the fall of the year.

DeElorza's request in April, 1961 for $200,000 immediately in working capital was made because the company had a thin working capital position and because DeElorza wanted to assure the prompt removal of the manufacturing facilities of PD&S, Garde Drug and Welton from Philadelphia to Newark and the prompt buildup of an inventory of vitamins in time to meet anticipated peak demand in the fall of 1961 for the product and its delivery to the trade.

PD&S was the basic instrument of Old Empire for the production of vitamins.

Old Empire planned an expenditure in this connection of approximately $230,000 to build up its inventory of vitamins in time to meet the anticipated seasonal demand for the product. In addition the company decided that at the same time it was making heavy expenditures to build up an inventory of vitamins it would also manufacture a large inventory of generic drugs involving a planned expenditure of approximately $400,000 to meet anticipated demand for these products. Some of the same machinery used to produce vitamins was used to produce generic drug products. Furthermore, as DeElorza had pointed out in his letter to Sneed, the company had planned in the same fiscal period to expend $92,000 to move the manufacturing plants of the subsidiaries from Philadelphia to Newark to be able to manufacture its products in time to meet the anticipated demand for the vitamin season. However, Old Empire was unsuccessful in its effort to obtain the additional $200,000 in working capital from Laird Bissell, a sum which DeElorza had informed Sneed was "essential. . . before the end of the month" to carry out the program described in his letter. DeElorza had also pointed out in his letter that "without the assurance that these funds will be available, we cannot implement plans which require numerous steps to complete before we reach our peak production period. In other words, unless we start now we must wait until next year."

PD&S was not moved in the spring or summer of 1961 and its move to Newark was delayed until September or October 1961 and was not fully completed until January, 1962. The move of PD&S to Newark was begun at the start of the peak demand season for the vitamin business. Garde Drug was not moved until April, 1962.

Although the company was well aware that its request for $200,000 in additional working capital had been rejected, and although the company had advised Laird Bissell that it could not implement these plans without the additional working capital it was seeking, Old Empire took the grave business risk of going ahead with this program despite its acknowledged lack of adequate working capital. The management of Old Empire decided it would take the calculated risk of manufacturing a large inventory of vitamins and generic drugs and attempt to sell and deliver these products and to collect on its receivables in time to pay its creditors. Without the necessary working capital this was a highly speculative undertaking for Old Empire to undertake.

Old Empire was, of course, entitled to take any business risk it chose to take. However, when securities of a company taking such grave risks are the subject of a market letter recommending their purchase, a broker-dealer, who is put on full notice of the gravity of this risk (as Laird Bissell was here), cannot lawfully under the Securities Acts direct attention in such market letter only to the favorable financial aspects of the securities and the company and make rosy predictions of large increases in the earnings of such enterprise and at the same time omit to make disclosure of material facts pertaining to the speculative aspects of the company and the securities which he is recommending.

Sales for the company's vitamins products were initiated in April, 1961 before the manufacturing facilities had begun to move to Newark.

When Garde Drug and PD&S were moved to Newark they lost most of their key technical manufacturing personnel and this loss of personnel severely hindered and disrupted manufacturing of both the vitamins and the generic drugs.

In this connection both market letters stated that:

> "Each acquisition has brought valuable management talent into the company in technical production and sales fields."

Contrary to this representation, none of the Garde Drug managerial personnel, other than Garde himself, moved to Newark and nine persons of supervisory capacity at PD&S refused to move to Newark.

Sales of vitamins up to October, 1961 were comparatively high totalling somewhere between $300,000 and $450,000, but the manufacture of the necessary inventory to meet these sales had been disrupted by the removal of PD&S and Garde Drug to Newark and by the loss of key personnel. Further, by reason of its tight working capital position and meager cash position the company was unable to pay its bills for raw materials promptly and some of the suppliers refused to make delivery unless payment were guaranteed or made in advance. Adequate inventory to deliver the products related to the sales had not been built up prior to the move.

At the beginning of the vitamin season, PD&S began its move from Philadelphia to Newark.

While PD&S had built up some inventory of vitamins prior to the move from Philadelphia to Newark, the sales of vitamins made by Old Empire from July, 1961 to October, 1961 had diminished such inventory and by August and September, 1961 Old Empire could not make deliveries to its customers on time to meet the orders it had obtained.

Since the company could not manufacture sufficient vitamins to meet its orders and could not make deliveries on time after the removal of the subsidiaries from Philadelphia, Old Empire stopped taking orders for vitamin products at the end of 1961, and vitamin sales for the first few months amounted to between $300,000 and $450,000 and sales for the first twelve months of the vitamin program were no more than $400,000 to $450,000. Furthermore, by January, 1962, Old Empire's vitamin program was in a chaotic state due to the disruption in production which had occurred during the period when orders had to be filled.

The February 1962 market letter contains language repeated in the August 1962 market letter referring to the decision of Old Empire early in 1961 "that important economies could be effected and better management control attained by consolidating all operations at the company's main plant in Newark, New Jersey."

The employment of this language in the August, 1962 letter without reference to the operating results following the removal of the acquired companies to Newark was highly misleading.

A large volume of vitamins finally delivered to customers by Old Empire in the winter of 1961 was returned in the spring and accounts receivable of approximately $250,000 for this merchandise became uncollectable. These events had devastating financial effects on Old Empire and resulted in substantial losses for fiscal year 1962. Old Empire sustained losses for the fiscal year which amounted to five cents per share after adjustment for its uncollectable accounts receivable. In this connection it is noted that Old Empire filed an annual report with the Commission on Form 10-K on July 5, 1962 covering the fiscal year ended January 31, 1962, and filed an amended Form 10-K for fiscal year ended January 31, 1962 on August 23, 1963.

The balance sheet of the annual report filed on Form 10-K on July 5, 1962 reflected accounts receivable for the fiscal year ended January 31, 1962 in the amount of $1,119,063. The balance sheet did not reflect that there was any doubt as to the collectability of any of OE's accounts receivable. This report also showed that as of January 31, 1962 Welton Labs had assigned receivables in the amount of $248,663 to secure a loan balance of $157,390 and that Continental Brands Corporation another Old Empire subsidiary had assigned receivables of $77,401 to secure its debt to the bank of $40,823. Current liabilities were set forth at $1,300,261 and long-term liabilities were set forth as $1,108,028, leaving stockholder equity of $1,249,825. The total assets were stated as $3,658,114. Net income was shown of $160,297. The company's financial statement reflected earnings in the order of 17 cents per share.

On August 22, 1963, Old Empire filed an amended annual report on Form 10-K for fiscal year ended January 31, 1962. This report reflected accounts receivable in the amount of $821,371 as compared to $1,119,063 as originally reported. Total assets were $3,399,899, current liabilities were shown as $1,250,087, long-term liabilities were shown as $1,108,028 and stockholder equity was shown as $1,041,784 as compared to $1,249,835 as originally reported.

The notes to the financial statements in the amended Form 10-K report reflected a reduction of "sales" and "accounts receivables" in the amount of $250,000. The notes to the financial statements pointed out that after the close of fiscal year January 31, 1962 several accounts receivables of significant size were determined to be uncollectable. In addition, a reserve for bad debts of $47,692 was provided for doubtful accounts and with the accounts receivable which were written off during the year resulted in a total bad debt expense of $76,907.

As has been pointed out hereinabove, Old Empire was unable to manufacture vitamins and to deliver such merchandise to customers in time to meet seasonal demand for the fiscal year ended January 31, 1962 and merchandise which had been sold was returned to the company because it was delivered too late for seasonal use by the customers. As a result the company's original report as to sales and accounts receivable was thereafter corrected by a reduction which has been recounted hereinabove.

The corporate statement of income and expenses for the year ended January 31, 1962 as reported in the initial Form 10-K filed by the company reflected net income of $160,297 or earnings of approximately 17 cents per share. However, by reason of the adjustment in the financial statements as required by the actual business experience of the company for the fiscal period involved the company showed a net loss of $47,744 or a loss of approximately 5 cents per share.

Both market letters stated that "Old Empire, Inc. is a rapidly growing dynamic company with young aggressive and able management. It has successfully demonstrated its ability to successfully broaden its scope."

The statement conveyed the idea that Old Empire was successful in its operations when in fact the contrary was the truth. By the end of 1961, it had stopped delivering vitamins and its production activities were in a chaotic state, its working capital condition was tight, and it had little cash and large obligations.

The statement was misleading and there was no justification for making it without qualification reflecting the lack of success attendant upon the enterprise at the time the February letter was written and distributed.

For the fiscal year ended January 31, 1963 Old Empire sustained a loss of $955,727 representing a loss of 97 cents per share.

In its proposed findings the Division referred to the large expenditures made by Old Empire in the acquisitions of subsidiaries in the latter part of 1961 and early 1962 and to the large expenditures made by Old Empire in connection with its promotional programs. These expenditures included an outlay of $175,000 to move Welton Labs, PD&S and Garde Drug from Philadelphia to Newark instead of $92,000 as estimated by DeElorza.

Both market letters contained the following statements concerning Old Empire's assaying facilities:

> "The company's enlarged Assay Laboratory tests, assays and approves all tablet and liquid pharmaceuticals before they are released for shipment. Emphasis is placed on quality control and each product is subjected to exhaustive tests in the Quality Control Laboratory to determine chemical compatibilities and the effect upon the product of heat, cold, shelf life, etc."

Contrary to the representations in the market letters the fact was that Old Empire did not assay or approve all tablet and liquid pharmaceuticals before they were released for shipment. It did not assay all raw materials nor did it assay intermediate products and it did not run complete assays on all multi-ingredient products. In fact, Old Empire did not have the facilities to do all assaying and sent some products to outside laboratories. Furthermore, Old Empire did not monitor its inventory for removing aged and outdated products, nor did it subject each product to exhaustive quality control tests.

In its proposed findings Laird Bissell conceded that Old Empire did not perform all the functions concerning assaying facilities that it claimed it performed in the market letters, but asserted that when Old Empire's chemists were faced with a surge of business which they could not handle, they sent the extra work to an outside laboratory. Laird Bissell also claimed that OE sent work to an outside laboratory to check on its own work.

If this, in fact, was the situation, the language in the market letters should have been qualified. However, the language employed was not qualified and gave the reader the impression that the assaying facilities were adequate for all purposes when in fact they were not. Although Kuehner updated the February letter in August 1961, there was no modification of the claims made on this score in the February letter. Both market letters tended to exaggerate the facts.

The Division attributed an expenditure by Old Empire in the Welton Vitamin Program of $180,000 and in the Wrigley vitamin program of $50,000.[11/]

The respondents Laird Bissell did not deny that $180,000 was expended in the Welton Vitamin Program by Old Empire. Instead the respondents Laird Bissell in their proposed findings requested the hearing examiner to find that "Old Empire contributed $80,000 to the Welton Vitamin Program. The balance of $100,000 of the program's cost was obtained through outside financing."[12/] They also requested the hearing

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11/ The Wrigley label was to be used for vitamins to be sold to supermarkets.

12/ Laird, Bissell and Meeds' Proposed Finding 201.

examiner to find, among other things, that ". . . The cost of the Wrigley program was probably included in the anticipated cost for the Welton Vitamin Program. However, even if it were not, the cost of the program was less than $50,000 because approximately one-third of the "Wrigley vitamins were relabeled and sold as Welton vitamins." 13/

An examination of the exhibit relied upon by Laird Bissell does not in fact support the findings proposed by respondents.

The exhibit consists of minutes of a special meeting of the board of directors of Old Empire held on August 16, 1961 in which DeElorza stated ". . . that the Welton vitamin program would cost approximately $180,000 to finance 300,000 vitamin deals and that $80,000 could be financed by the company."

There was no reference in the minutes as to where the balance of $100,000 needed to finance the program would be obtained. However, the minutes contained a resolution authorizing the "management to increase the amount of convertible debentures from $700,000. to a maximum of $1,000,000 . . . ."

The amount of convertible debentures actually offered was $950,000. An examination of the "Application of Proceeds" section of the prospectus dated December 26, 1961 covering the debentures reflects that no part of the proceeds of this offering were to be used to implement the Welton Vitamin Program.

There is no ground for coming to the conclusion that the remaining $100,000 referred to in Laird Bissell's proposed findings came from "outside financing".

13/ Laird, Bissell and Meeds' Proposed Finding 203.

The Division proposed a finding to the effect that the Wrigley vitamin program involved an expenditure by Old Empire of $50,000. According to the testimony of Garde who was in charge of the program of manufacturing vitamins for Old Empire, approximately $50,000 was used in connection with the production of vitamins for Wrigley but Old Empire took about $15,000 of this $50,000 in vitamins and relabeled it and about $35,000 of the Wrigley vitamins sat on the shelf and none of it was sold. Apparently $15,000 of the $50,000 in Wrigley vitamin products were relabeled to carry the name of Welton but $35,000 in vitamin products made under the Wrigley label were kept under that name.

The Division proposed that the hearing examiner find that Old Empire had expended $400,000 to build up an inventory for its generic drug program. The respondents Laird Bissell, and Sneed proposed that the examiner find that "the $400,000 anticipated as the cost for the complete generic drug program was never spent because only approximately 40% of the complete line was manufactured. By May 1962 less than $200,000 had been spent on inventory." 14/

Garde testified that the inventory for the generic drug program ". . . in dollars and cents was extremely high and very unbalanced." He explained that what he meant was that there was "a lot of dollars and few products, instead of a lot of products and a lot of dollars." By April, 1962, according to Garde the company had expended between $250,000 to $300,000 on the generic drug inventory.

14/ Laird, Bissell and Meeds Proposed Finding 202.

The hearing examiner credits Garde's testimony and finds that as of April, 1962 the company had expended between $250,000 and $300,000 on the generic drug program.

The Division requested the examiner to find that Old Empire had expended $50,000 on a program involving the sale of vitamins to housewives through a company called Golden Valley Laborities, Inc. ("Golden Valley"). In this connection the Division cited corporate minutes of a meeting of the board of directors of Old Empire on August 16, 1961 to support its claim.

Old Empire had agreed, among other things, to provide advertising credits to Golden Valley up to $50,000. However, the total amount of advertising credit used by Golden Valley up to March 27, 1962 was only $3,705 and the examiner finds in accordance with the findings proposed by Laird Bissell that the latter amount is the amount expended by Old Empire in the Golden Valley project.

The Division requested the hearing examiner to find that Old Empire had expended $75,000 in acquiring an interest in Chef Pet Foods, Inc. in February, 1962. The minutes of the special meeting of the board of directors of Old Empire held on February 2, 1962 reflects that the board had for consideration before it a proposal to purchase a one quarter interest in that company for $75,000.

Note 6 of the notes to the financial statements contained in Old Empire's annual report for the year ended January 31, 1963 states that "during the year ended January 31, 1963 the company purchased a minority interest in Chef Pet Foods, Inc. for $18,750. As of January

31, 1963 the subsidiaries had been operating at a loss with no immediate prospect of improvement. In view of this the carrying value of the investment has been written down to the nominal sum of $1 and is included under the caption "Other Deductions".

The examiner finds that Old Empire expended $18,750 with regard to Chef Pet Foods, Inc.

The Division requested that the hearing examiner find that **Old Empire had expended $100,000 in the acquisition of Goyescas Corporation ("Goyescas").**

The pertinent facts regarding Goyescas were as follows:

In February, 1962, Old Empire acquired Goyescas Corporation, a subsidiary of Humphrey's Medicine Company, engaged in wholesaler servicing of **toiletries** for Spanish speaking retailers.

Goyescas' financial statements for the year ending December 31, 1960 had shown a net loss of $22,471, and for the year ending December 31, 1961 had shown a net loss of $11,075, and for **the six months ending June 30, 1962 had shown a net profit of only $876.**

The Division relied upon a report written by John DeElorza to support its proposed finding. However, in a Form 8-K filed by Old Empire on July 5, 1962 for the six-month period ending June 30, 1962 Old Empire reported that on April 30, 1962 but as of February 6, 1962 Old Empire had acquired by purchase from Humphreys Medicine Company, Inc. all the outstanding "common stock of Goyescas Corporation ("Goyescas") for a consideration of $95,000 cash, of which $39,000 cash and $12,000 by the issuance of **4,000 shares of Registrant's** stock was paid on April 30, 1962. The balance of $44,000 is payable in quarterly installments of $2,750 commencing with February 1, 1963. In addition Goyescas agreed to liquidate a liability due Humphreys of $27,650 by monthly payments of $1,382.50 commencing with October 15, 1962."

The hearing examiner finds that Old Empire expended $39,000 in cash in February, 1962 to acquire Goyescas and incurred the above described obligations at that time but is unable to find anything in the record to reflect the payment of any amount in cash in connection with the acquisition of Goyescas beyond $39,000 for the period encompassed in this proceeding.

Accordingly the hearing examiner finds that during Old Empire's critical financial period between the latter part of 1961 and early 1962 when it was suffering from a tight working capital position and had little cash, Old Empire embarked upon acquisitions and promotional programs which required almost three quarters of a million dollars in working capital and that the financial condition of Old Empire at the time these programs were initiated, when combined with the loss of personnel and the attendent disruption of production, made the attainment of its business objectives extremely hazardous and that the management of Old Empire knew that the achievement of these objectives was highly speculative and that the respondents Kuehner and Sneed were fully aware and through them Laird Bissell was fully aware of the extreme hazards of Old Empire's ventures long before they wrote their February, 1962 and August, 1962 market letters.

Old Empire was always in a tight working capital position and continued throughout 1962 and 1963 to seek additional capital. It looked into the possibility of factoring and found it was very costly.

In September 1962, however, the company concluded an agreement with the First Connecticut Small Business Investment Company to borrow $282,000 at 8% interest. The loan was secured by real estate mortgages and chattels on equipment. In addition in order to obtain the loan Old Empire had to issue **stock purchase warrants covering 100,000 shares of its common stock.**

Kuehner was well aware of the continuing need of the company for capital and according to DeElorza, Kuehner "checked out at least one possible source of equity capital and found that the individual was not interested in our particular industry because of his long background in another field."

In May 1963 Old Empire's need for capital was so pressing that it negotiated a factoring loan with Concord Financial Corporation of fluctuating amounts up to $1,200,000 at 12 1/2% interest. The loan provided for the repayment of all prior outstanding secured loans so that the loan for the Concord Financial Corporation was senior to all other indebtedness and was secured by substantially all of the real and personal tangible and intangible property of Old Empire and its subsidiaries. The terms of this agreement included a clause whereby Concord Financial could put its own supervisory personnel in control of Old Empire's finances.

The continuing financial difficulties of Old Empire were known or should have been known to Kuehner from the time he was elected to membership on the board of directors of Old Empire. He was the designee of Laird Bissell and was placed on the board so that Laird Bissell would know the material facts concerning the company.

In November 1962 about three months after Cortlandt first received the August market letter Sneed, who was Kuehner's superior at Laird Bissell and the person to whom Kuehner reported told Cantor that he was aware of the company's problems with personnel and production and expressed the opinion that the situation at Old Empire could go either way.

In December, 1962 DeElorza and Horn told Sneed that the company was in serious financial difficulty and that the best course of action was to try to merge into another drug manufacturer. DeElorza also told Sneed at that at that time Old Empire "had a very desperate emergency, they had failed to pay the withholding taxes and that the Internal Revenue Service was about to padlock them which would not be conducive to any merger."

The company's financial situation was so obviously desperate at least a year before the petition in bankruptcy was filed and during a period when the August market letter was being used by Cortlandt to sell Old Empire's securities that Sneed and the management of Old Empire were of the opinion that the only way left open to the company was to seek a merger. Sneed decided "that in order to buy time and in what I thought was in the best interest of the stockholders and bondholders, to keep the situation afloat, until some solution could be worked out -- I authorized payment at that time of $25,000 of Laird Bissell and Meed's money to Old Empire."

Sneed loaned Old Empire a total of $112,000 during the period from December 1962 to March or April of 1963. In February 1963 Sneed acted as a guarantor to Vita-Mix Corporation which refused to manufacture pharmaceuticals for Old Empire without a guarantee of payment. Sneed admitted that the purpose of the loans and the Vita-Mix guarantee were primarily to keep Old Empire going until either financing or a merger could be negotiated. Notwithstanding Sneed's advances, Old Empire was forced in its efforts to obtain additional working capital to enter into negotiations with Concord Financial to avoid bankruptcy. Finally in March 1964 the Company filed a petition in bankruptcy under Chapter XI of the Bankruptcy Act.

Insofar as this case is concerned, Sneed, Kuehner, and Laird Bissell well knew that Old Empire had very little cash and had a very tight working capital position both before the debenture offering and thereafter. There was no information in the prospectus covering the debentures stating that Old Empire was about to embark upon extremely large expenditures considering the size of the Company, for the build up of a large inventory of vitamins and generic drugs. By February, 1962, however, it was apparent that Old Empire had expended large sums of money to build up such inventory and had done so at a time when the company was suffering from lack of cash and working capital. Further, it was clear to the management of Old Empire by February, 1962 that the figures put out in the company's Form 10-K report filed with the Commission on July 5, 1962 concerning its sales and accounts receivable were misleading since it knew before February 1962 that Old Empire had been unable to deliver merchandise in time to meet the orders which it had received, and it had stopped taking orders for vitamins.

Sneed was under an obligation to ascertain the facts regarding the company's financial condition of the company before writing any such rosy document as was put out in February, 1962 by Laird Bissell and he knew or should have known the financial facts relating to the company's operations and its financial condition at the time he wrote the January, 1962 market letter.

Contrary to the respondents' contentions, the Division's allegations against them were not based on mere "hindsight" developments such as the subsequent filings of OE's 10-K report and its amended 10-K report for 1962 and the filing of Old Empire's petition in bankruptcy but were based on evidence showing that prior to such filings respondents Laird Bissell, Kuehner, and Sneed knew or should have known in February 1962 and in August 1962 when they wrote the letters that the representations contained in such letters particularly concerning OE's sales and earnings, the most important aspects of the letters, were false and misleading and that there was no reasonable support for the representations and the predictions made in such letters. In addition, in August, 1962 when the second market letter was written and thereafter when such letter was being used by Cortlandt, the facts concerning

Old Empire's financial and operating conditions had worsened and these facts were known or should have been known to Sneed and Kuehner. In this connection the Division points to facts showing the attendance of Kuehner, Laird Bissell's designee, at meetings of OE's board of directors, the frequent communication between the management of Old Empire and the designee of Laird Bissell on the board, and also points out that he knew or should have known the facts concerning Old Empire's operations and financial condition. Sneed consulted Kuehner before releasing the February 1962 market letter, and Kuehner approved of Laird Bissell's printing and distributing the letter to the investing public.

The emphasis of the market letters on tremendously increased earnings and the omission in such letters of the seriously adverse facts concerning the operations of the company, made the letters when considered as a whole and at the time they were written false and misleading. In view of the highly optimistic representations in the letters, the omission from such letters of important adverse financial and operating facts concerning Old Empire was highly misleading and was a serious impediment to the exercise of an informed judgment by any person to whom the market letters were sent. In this connection it should be noted, that under the Securities Acts once the investors are given correct information in a market letter or other selling literature, rather than half truths, the determination whether to purchase a speculative security is left entirely up to the judgment of the investor. However, when in writing a market letter, a broker-dealer embarks upon a description of a highly speculative security including the past business and financial history, and earnings of the issuer and when the broker-dealer makes highly optimistic predictions of future earnings, 15/ fair dealing requires him to make such disclosure of the speculative uncertainties as will enable the investor to measure the company's resources and past performance against the speculative appetite the issuer is attempting to satisfy. In such a context it is not enough to inform a customer orally or otherwise that a security is speculative. The customer is entitled in these circumstances to an honest statement of the hazards he faces in purchasing the security which the broker-dealer has recommended in the market letter.

It was not hindsight but the failure to comply with these standards which impelled the Division to make the allegations contained in the Commission's order initiating these proceedings.

Both letters speak principally in terms of Old Empire's sales and earnings for the fiscal periods ended January 31, 1962 and January 31, 1963.

"The February market letter in pertinent part stated:

> The company's sales have expanded from $1.2 million in 1959, to $1.8 million in 1960, to an estimated $3.6 million in 1961, or by 200%. Sales for 1962 are projected at between $5 million and $6 million. In spite of the difficulties of reorganizing, consolidating and centralizing the new acquisitions the company estimates earnings of $0.15 to $0.20 per share for the fiscal year ended January 31, 1962. A conservative estimate for the

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15/ The Commission in the Matter of James De Mammos, et al, Securities Exchange Act Release No. 8090 (June 2, 1967), held that, "It is also inherently misleading to predict a sharp increase in earnings with respect to a speculative stock without disclosure of the uncertainties as well as the known facts upon which a prediction rests."

current year is $0.40 to $0.45 per share which could well be improved upon if the generic drug program meets with more than the minimum projected success.

The August market letter in pertinent part stated:

> The company's sales have expanded from $1.2 million in 1959, to $1.8 million in 1960, to an estimated $3.8 million in 1961, or by about 220%. Sales for 1962 are projected at between $5.5 million and $6 million. In spite of the difficulties of reorganizing, consolidating and centralizing the new acquisitions the company earned $0.17 per share for the fiscal year ended January 31, 1962, versus $0.02 in the preceding fiscal year. Since approximately $0.10 per share was written off on non-recurring plant moving expenses and an additional $0.03 per share on amortization of good will, it would appear that actual earning power for fiscal 1961/2 came to about $0.30 a share. A conservative estimate for the current year is $0.40 to $0.45 per share which could well be improved upon if the generic drug program meets with more than the minimum projected success."

Old Empire's earnings for fiscal year ended January 31, 1961 were two cents a share. Both letters reflect earnings of 17 cents per share or earnings in the order of more than 800% higher for fiscal year 1962 than earnings of the company for fiscal year 1961, and both letters present a "conservative estimate" of earnings for fiscal year ended January 31, 1963 of between 40 to 45 cents per share or approximately 250% higher than the earnings for fiscal year ended January 31, 1962.

In fact, instead of earning 17 cents per share for fiscal year ended January 31, 1962, Old Empire lost 5 cents per share for such period and instead of earning between 40 cents and 45 cents per share for fiscal year 1963 as predicted the company lost 97 cents per share for such fiscal period.

As had been pointed out hereinabove, one of the principal reasons for the company's losses in fiscal 1962 and fiscal 1963 is that it expended approximately three quarters of a million dollars to move acquired plants from Philadelphia to Newark and to build up a large inventory of vitamins and generic drugs for the fall of 1961 at a time when it was very short of working capital and had little cash and took the high business risk (which turned out to be unsuccessful) that it could produce vitamins in time to meet the oncoming season in this product, sell and deliver such products on time to meet seasonal demand, collect on its receivables and pay its creditors promptly enough to assure the delivery of additional raw materials in time to continue the manufacture of its products.

It became clear to the management, however, by the end of 1961 that its business speculation was unsuccessful when it had to stop taking orders for vitamins.

In connection with the operations of the company during the period discussed in such glowing terms in the market letters the testimony of Garde, a vice president of Old Empire, was enlightening. He testified, among other things, that in the latter part of 1961 and at the beginning of 1962, Old Empire's problems became financial problems. "Goods were delayed coming in because suppliers wanted to get paid. Packaging material was delayed because of the same reason. Therefore, no matter how I screamed on rescheduling, we started to fall behind greater and greater." He further explained that the "production problem became a financial problem" because "we couldn't get goods". These financial problems arose in late 1961 and early 1962 and were attributable in major part to the company's tight working capital position and because it had little cash with which to operate. The lack of cash flow which stemmed from the failure to make deliveries, and the wave of cancellations which also stemmed from the failure to make deliveries aggravated the company's initial tight working capital position and meager cash position and placed the company in a precarious financial situation. These conditions were well known to the management of OE and they were the subject of considerable heat between DeElorza and Garde who were in attendance at board meetings with Kuehner. Laird Bissell, Sneed and Kuehner knew or should have known of these conditions, or at the very least should have ascertained these facts before the February letter was written. It was insufficient merely to take management's optimistic oral representations as to the company's operations as Sneed and Kuehner claimed to have done and to pass such representations on to the public in the form of market letters carrying the letterhead of Laird Bissell.[16/]

The company's problems became even more aggravated prior to the writing of the August market letter. Nevertheless there was no word of the company's financial or production predicament in either letter. Instead both letters contained extravagant claims of enormously increasing earnings and omitted giving any information to the readers concerning the high risks of buying stock in the enterprise.

Apparently the excuse for making these statements and predictions were that Kuehner who was Laird Bissell's designee on Old Empire's board

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16/ Equity General Investment Corp., Securities Exchange Act Release No. 7388 (August 13, 1964).

of directors and Sneed were not aware of these important and damaging facts, accepted the management's representations regarding past earnings and its predictions regarding future earnings without any independent investigation and passed the management's optimistic but unfounded representations as to the success of the enterprise on to the investing public.

Sneed and Kuehner claimed, among other things, that they relied on DeElorza's representations and his predictions as to substantially increased sales and repeated these representations and predictions in material part in the market letters.[17/] Laird Bissell pointed out in its proposed findings that Sneed relied upon some fourteen documents in preparing the February 1962 market letter. In this connection it should be noted that the data relied upon by Sneed was either self-

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17/ In Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (Nov. 12, 1965), a case where a member firm relied on information supplied by management the Commission held that "Whatever such practice may be in the ordinary situation, where a director is engaged in the business of selling securities his duty to deal fairly with customers requires that recommendations and representations made to them be based on facts, not self-serving statements by management unaccompanied or unsupported by financial statements." When the February market letter was written it was unsupported by financial statements and when financial statements were filed they were misleading. In Hayden Lynch & Co., Inc., Securities Exchange Act Release No. 7935 (August 10, 1966) the Commission stated that "We reject Leason's defense that he was justified in relying upon the information in the sales literature to the extent that it was supplied by management to him or the salesman who initially drafted the brochures. In the absence of complete financial and factual data, such reliance was misplaced and, at the very least, optimistic representations should have been withheld and prospective investors cautioned as to the risks involved in purchasing the stock without such data. In any event, having become a director on December 9, 1959, Leason had access to information which belied the glowing representations in the sales literature, yet he continued to use such literature in the sale of the stock."

serving or outdated and included only one financial statement of Old Empire which was contained in the company's Annual Report for the fiscal year ending January 31, 1960. 18/

Old Empire's predictions of large increases in sales and earnings related to and were dependent upon orders for vitamins obtained by the company beginning in April, 1961. These orders as to increased sales could be meaningful in a business or financial sense only on the assumption that Old Empire had the capacity to manufacture the vitamins and deliver such merchandise in time to meet the vitamin season and collect on its accounts receivable in time to pay its suppliers for raw materials. However, the fact is that DeElorza had made it clear to Sneed in April, 1961 that Old Empire could not accomplish these objectives without more working capital than it had available when it embarked on its vitamin and generic drug programs. Sneed knew that Old Empire did not have such working capital available when it embarked on its vitamin and generic

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18/ Sneed claimed that in writing the February market letter he relied on DeElorza's letter of April 4, 1961; Old Empire's Annual Report for year ending January 31, 1960; an analysis of Old Empire prepared in 1959 in connection with a proposed Regulation A offering; Garde catalogue of items for 1961; a news release on Goyescas; a memorandum prepared in December, 1960 on behalf of Lehman Brothers; a clipping from Aerosol Age dated May, 1960; News 'n Ideas dated November 1960, a house organ of Old Empire; A news release of Old Empire announcing the acquisition of Goyescas; a Revised Summary of results dated December 4, 1961 covering 9 retail routes in a test program concerning vitamin sales through milkmen together with a note from John Horn advising Sneed that "We go into an expanded test program after January 1st"; a reprint of an article in American Milk Review dated December, 1960 discussing Golden Valley; Dun & Bradstreet reports on Garde Drug dated June 9, 1960, on PD&S dated December 7, 1961 and on Welton Co. dated December 21, 1961; a list of distributors and retail accounts of Welton; a news release of Old Empire announcing the acquisition of PD&S; a report for fiscal year ended January 31, 1961 from DeElorza pointing out, among other things that "your management is now devoting itself to the task of consolidating its operations for maintaining operating efficiency. Involved in this project will be the moving of two of our plants and refurbishing our main plant for the manufacture of ethical drugs and tablets."

drug programs and, in fact, rejected the company's request for $200,000 in additional capital. Despite the fact that Laird Bissell, Sneed and Kuehner were undoubtedly aware of Old Empire's tight working capital position and its weak cash position, both before and after Old Empire's offering of debentures, and had been warned that Old Empire could not achieve its purposes without additional working capital which it couldn't obtain they accepted without question the management's statements to them of higher sales and higher earnings attributable to Old Empire's sales and its predictions of increased earnings in the immediate future and embellished them in market letters without reference to the highly speculative aspects of Old Empire's venture into the vitamin and generic drug business.

The February 1962 market letter stated in regard to the vitamin program that:

> "Acceptance of the vitamins exceeded expectations and nearly five months production was constantly oversold . . . . While vitamin sales are not expected to continue at the initial rate a conservative estimate indicates sales of $1.2 million to $1.5 million per year.
>
> The vitamin program was well-planned and promptly successful."

Since Old Empire had stopped taking orders for vitamin products by the end of 1961 because they could not make deliveries due to the disruption of production which occurred in the middle of the period when orders had to be filled and since sales for the first few months of the Welton Vitamin Program totalled somewhere between $300,000 and $450,000 and total sales for the first twelve months of the Welton Vitamin Program were no more than $400,000 to $500,000, there was no basis for the representations made in the market letter and they were false and misleading. Furthermore, the August, 1962 market letter was additionally misleading in that it omitted to state that Old Empire had a large volume of vitamins returned to it from its customers in late spring and early summer of 1962.

The February and August market letters contained the following statements concerning the generic drug program:

> "As a pioneer in the field Old Empire's management feels that this program will add a minimum of $1.5 million to their gross sales and return a very satisfactory profit margin.
>
> The vitamin program was well-planned and promptly successful. The generic drug program shows every indication of being as much or more of a hit."

Neither Old Empire nor its management (other than Garde) was a pioneer in the generic drug field. Moreover, in February 1962 sales of generic drugs had not even begun. When such sales began in April 1962 its generic drug inventory was expensive but unbalanced and Old Empire was never able to deliver more than between 35% to 40% of the items under the generic drug program. Furthermore, any reasonable calculation as to the size of the market in generic drugs and the profits to be made therein by Old Empire would not only have to take into account the particular difficulties which Old Empire was having with its generic drug program but also the minor position of Old Empire in the drug industry.

The representations concerning Old Empire's generic drug program were false and misleading.

Both market letters contained the following statements concerning Golden Valley Laboratories, Inc.:

> "An interesting development in connection with vitamin sales is a joint project between Old Empire and Golden Valley Laboratories, Inc. This idea, whereby the milkman sells and delivers vitamins to housewives in conjunction with regular deliveries of milk, has proved extremely successful in the two Pennsylvania cities where it has been test marketed."

Golden Valley conducted a series of marketing tests of this idea. Its testing ended in 1959 with a total loss of Golden Valley's investment of approximately $85,000.

Golden Valley and Old Empire entered into an arrangement for another test series which was scheduled for the fall of 1961 but which did not begin until January 1962. The test was a failure and Golden Valley conducted no further tests either in conjunction with Old Empire or separately. After April 30, 1962 Golden Valley ceased all operations.

Golden Valley never earned any money, had a substantial retained earnings deficit, and had never been able to sell vitamins through milk routes successfully.

The August market letter further omitted to state that Golden Valley became almost totally inactive in March, 1962 and had ceased all operations by April, 1962.

The representations concerning Golden Valley were false and misleading.

Both market letters contained the following statements concerning Old Empire's sale of proprietary toiletries and cosmetics:

> "Old Empire, Inc. over 23 years has developed a national reputation as a manufacturer and distributor of proprietary and standard toiletries, cosmetics and household specialties. . . .
>
> "While Old Empire had made the rapid move into the pharmaceutical industry the management has every intention . . . to continue its franchise direct to consumer door-to-door selling."

Old Empire's efforts to establish a proprietary line of household specialties ended prior to 1953. Between 1956 and 1960, Old Empire engaged in limited manufacturing and distribution of proprietary and standard toiletries and cosmetics and attempted to initiate a door-to-door sales campaign. By 1962, none of the efforts in the proprietary field had been successful, and such operations as Old Empire continued to carry on in this area were conducted on a very limited basis. Old Empire never established a national reputation as a manufacturer and distributor of proprietary and standard toiletries, cosmetics and household specialties.

Maucher a vice president and a member of the board of directors of Old Empire who was with Old Empire from 1953 to 1962 and acted as sales manager from 1957 to 1962, testified that the company was strictly a contract manufacturer doing business on a bid-by-bid basis with no firm commitments from any customer.

Laird Bissell's prior experience with the management of Old Empire before the writing of the February market letter indicated that the company's predictions as to future earnings were very unreliable.

For example, on December 14, 1960 DeElorza and Horn wrote a memorandum to Sneed and Kuehner in which they made the following projections for Old Empire for the year ended January 31, 1961: Sales of $2,600,000; net income $118,000; and earnings per share of 19 cents. The actual figures for the year ending January 31, 1961 were: Sales -- $1,788,693; net income -- $17,359; earnings per share -- two cents.

The January 31, 1961 annual report for Old Empire came to Kuehner's attention in about June 1961 and he noted that the company had reported only 2 cents per share in earnings instead of 19 cents per share as predicted in DeElorza's and Horn's memorandum of December 14, 1960.

Kuehner thereupon held a meeting with DeElorza and Horn and "asked them for the reasons for the difference between the actual results shown in the statements of two cents a share and their prediction of 17 to 19 cents they made before." Kuehner testified concerning the statements made to him at this meeting as follows:

> "Mr. Horn, to the best of my recollection, said that difference was in the following figures, that, first of all, there was a three cents per share write-off on account of Welton good will and then extra-ordinary acquisition expenses connected with Physician's

Drug and Supply which accounted for five cents per share.

Then he explained further that the earnings for Garde Drug Company, which they originally took in in their estimate, from the date of the pooling of interests, which was, as I recall, the end of July or August 1, 1960, had to be eliminated and the actual Garde earnings were only taken in for the last -- since the first week in December, 1960, and that would account for five cents.

These three items would bring the earnings up to approximately fifteen cents, and I considered that within shooting distance of their previous projection."

The prospectus covering the debentures states that "On April 10, 1961, pursuant to an agreement entered into on January 31, 1961 with the stockholders of Physicians Drug and Supply Company, Drug Laboratories, Inc. and John H. Wood Company, the Company [Old Empire] acquired all the issued and outstanding stock of the aforesaid three companies." The agreement itself was entered into on January 31, 1961 to effect an acquisition on April 10, 1961.

There was no justification shown in this record for attributing five cents per share for extraordinary acquisition expenses for fiscal year ended January 31, 1961 related to PD&S. Five cents per share would have amounted to over $40,000 based on outstanding shares as of January 31, 1961.

In this connection it may be observed that there was no "pooling of interests" in regard to Garde Drug but simply a purchase and further that 5 cents in reduction of the earnings below the estimate was attributable to a mistake in calculating Garde Drug's earnings attributable to Old Empire for the accounting period involved. In any event, the difference between the predicted earnings in fiscal year 1961 was the difference between 19 cents predicted and 2 cents earned, surely a wide enough difference to put Kuehner on his guard with regard to any future management predictions of earnings.

In February 1961, DeElorza drafted a memorandum discussing Goyescas, a small wholesaling firm that Old Empire wished to acquire. In this memorandum DeElorza again made predictions as to future earnings and stated that Goyescas would earn, after taxes $25,000 to $30,000 for the year ended December 1961.

Kuehner read the February 1961 memorandum concerning Goyescas shortly after it was written. The financial figures on Goyescas for the period of January 1960 to December 1960 became available to Kuehner by April 1961. These figures showed that Goyescas had a net loss of $22,471.06.

Long before the February 1962 market letter was written there was good ground for Laird Bissell, Sneed, and Kuehner to be very wary of predictions of the principal officers of Old Empire with regard to sales and earnings. At some time prior to March, 1962, information became available to Kuehner that Goyescas had a net loss of $11,075.59 for the period from January 1961 to December 1961. This also should have served to warn Laird Bissell against accepting Old Empire's management representations as to earnings but Laird Bissell again accepted Old Empire's statements and predictions when it put out its August 1962 market letter.

Furthermore, at the same time that DeElorza was making highly optimistic predictions as to Old Empire's future earnings, he was appealing to Sneed for additional working capital and pointing out the necessity for obtaining such additional working capital in order to achieve Old Empire's objectives. Sneed was aware of course, that Laird Bissell had rejected DeElorza's request for $200,000 in additional working capital and was aware, of course, from the representations in the prospectus that the proceeds of the debenture issue would not yield Old Empire additional working capital.

In connection with the earnings attributable to Old Empire for fiscal year ended January 31, 1961 Laird Bissell proposed the making of the following finding:

> "102. While sales generally increased earnings and earnings per share declined during one of the years the fiscal year ending January 31, 1961. This decline was due to costs incurred in the acquisitions and integration of Welton Co., Garde Drug and PD&S."

Earnings per share for fiscal year ended January 31, 1960 were nine cents per share and for fiscal year ended January 31, 1961 earnings were two cents per share.

PD&S was the subject of an agreement on January 31, 1961 to acquire PD&S on April 10, 1961, i.e., during fiscal year ended January 31, 1962.

There is no evidence in the record to justify the claim that earnings decreased from nine cents per share to two cents per share as a result of acquisition and integration expenses.

It will also be observed that while the estimate of earnings of 15 cents to 20 cents per share contained in the February 1962 letter was updated in the August, 1962 market letter by a definitive statement that the earnings for fiscal year 1962 were in fact $0.17 per share, both letters implied that the earnings would have been higher in fiscal 1962 were it not for the non-recurring expenses attributable to the acquisition of Welton, Garde Drug and PD&S.[19/]

These implications in the February 1962 market letter were made explicit in the August, 1962 market letter. The August market letter in discussing the per share earnings for fiscal year January 31, 1962 stated, in pertinent part, that ". . . it would appear that actual earning power for fiscal 1961/2 came to about 30 cents per share."

There was, of course, no such thing as fiscal 1961/2 for Old Empire. The company's fiscal year ended January 31.

The earnings for fiscal year ended January 31, 1961 were stated to be two cents per share. The earnings for fiscal year ended January 1962 were stated to be 17 cents per share.

The way in which the 30 cents in "earning power" for the period was reached was by adding 13 cents per share representing "non-recurring plant moving expenses" and "amortization of good will" to the 17 cents claimed to have been earned in fiscal year ended

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19/ It may be noted that the respondents were claiming that the same non-recurring costs were referrable not only to fiscal year ended January 31, 1961 (See Laird Bissell's Proposed Finding 102) and fiscal year ended January 31, 1962.

January 31, 1962. According to the August market letter the 13 cents was reached by attributing a "write-off" of 10 cents per share to "non-recurring plant moving expenses" and an additional 3 cents per share to "amortization of good will."

The 17 cents per share as reported by Old Empire was a result of taking into consideration both the expenses and the substantial earnings of the newly acquired subsidiaries.[20/]

The explanation of the 30 cent figure employed in the market letter blurs the financial facts and creates an unwarrantedly optimistic impression as to the earnings of Old Empire for the period considered in the letter. There was no justification for presenting 30 cents as the "actual earning power for fiscal 1961/2" since the earnings for fiscal year ended January 31, 1961 were 2 cents per share and for fiscal year ended January 31, 1962 were 17 cents per share and these results took into account both the earnings of the new acquisitions as well as the expenses related thereto for both periods. Had these acquisitions not taken place there would have been no 17 cent figure and certainly there was no basis for a 30 cent earning power figure for the non-existent period referred to in the letters. The use of the 30 cent figure in the context in which it was employed was misleading.

The "good will" related to the acquisition of Welton Labs, an acquisition which occurred in fiscal 1961, and was written off for such period. The 3 cents in good will did not enter into the 17 cents per share claimed to have been earned for fiscal year ended January 31, 1962. It was recognized as a non-recurring expense for the fiscal year ended January 31, 1961, was unrelated to the

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20/ See prospectus covering the debenture issue showing that the earnings of newly acquired companies were more than double those of Old Empire.

17 cents per share earned for fiscal year January 31, 1962 and could not correctly be attributable to fiscal year ended January 31, 1962.

The 10 cents per share for plant moving expenses attributed to fiscal year 1962 referred in principal part to moving expenses. No support for the specific amount of 10 cents as applicable to fiscal 1962 was shown by the respondents.

In connection with the claim that Old Empire had shown "earning power" of 30 cents, it should be observed that this claim was not related to a situation where Old Empire owned and operated a going plant in Philadelphia and moved it to Newark. Here, the situation was quite different. Old Empire had acquired three new companies located in Philadelphia, namely, Welton Labs, Garde Drug and PD&S which had their own management, personnel, and earnings. Welton of Welton Labs' experience was in sales and there is no doubt that his skills were acquired by Old Empire when they acquired such company. Welton Labs, however, had no earnings when it was acquired, Garde Drug and PD&S,on the other hand, had earnings and skilled technical personnel in the manufacture of drugs. With the exception of Herbert Garde of Garde Drug and Welton of Welton Labs, Old Empire did not acquire the management and the technical personnel of the acquired companies whose skills had contributed towards the earning power of the acquired companies. Such technically skilled personnel were an important factor to Garde Drug and PD&S and the loss of such personnel was detrimental to Old Empire.

The representations in the market letters called particular attention to the claim that Old Empire had acquired the skilled technical personnel of these companies but these representations were, in fact, misleading[21/] in that with the exception of Garde and Welton, Old Empire had

21/ The prospectus covering the debentures (p. 8) shows in a pro forma statement for the year ended January 31, 1961 that earnings attributable to Old Empire were only $17,359 while earnings attributable to PD&S, et al. were $48,710.

not, in fact, obtained the technically skilled personnel as a result of the acquisitions but had lost them. The discussion in the market letters of "earning power" of Old Empire which was attributable in part to the acquisition of the acquired companies with such personnel was, therefore, misleading.

Both market letters predicted earnings of 40 to 45 cents per share for fiscal year ended January 31, 1963.

The February letter prepared by Sneed based its predictions of earnings principally on representations made by DeElorza to Sneed in telephone conversations.

Kuehner's testimony concerning the basis on which he predicted earnings of 40 to 45 cents per share for fiscal year ended January 31, 1963 was summarized in his proposed findings, and reads in pertinent part, as follows:

> "Using as a base the 17¢ per share earned by Old Empire in 1961, he added 3¢ for the completion of 1961 of the write-off of Welton Labs good will, 10¢ for extraordinary non-recurring moving costs, 5¢ for profits on a vitamin volume of $1 million, 3¢ for expected profits from Goyescas, 2¢ for the upgrading of contract packaging and a possible 5¢ representing the potential of the generic program."

The summary speaks in calendar years but the operations of Old Empire were based on a fiscal year ended January 31.

In connection with the addition of "3¢ for the completion in 1961 of the write-off of Welton Labs' good will", it may be noted that Kuehner accepted an explanation from Old Empire's management which attributed the 3 cent write-off to the period ended January 31, 1961 when the management explained to him why the earnings were only 2 cents per share for that period.[22/] The 17 cents per share was reported for fiscal year ended January 31, 1962. It would be inappropriate to add 3 cents that was written off in fiscal year ended January 31, 1961 to the 17 cents per share earned in fiscal year ended

22/ Old Empire's Annual Report for the year ended January 31, 1962 reflected that the good will applicable to Welton Labs was completely written off as of January 31, 1961, i.e., for fiscal year ended 1961.

January 31, 1962. The lumping together of expenses of acquisition for two different fiscal periods such as the write-off of Welton's good will in 1961 and extraordinary non-recurring moving expenses occuring at a later fiscal period was not justified in reaching the earnings predicted for fiscal year 1963 and was misleading.

Kuehner using the 17 cents base earned in fiscal 1962 to project earnings for fiscal 1963 added 10 cents per share "for extraordinary non-recurring moving costs."

These costs were attributed to moving the newly acquired subsidiaries from Philadelphia to Newark.

Welton Labs and PD&S were moved in fiscal year ended January 31, 1962. Garde Drug did not move until April 1962, i.e., in fiscal year ended January 31, 1963.

While moving costs for all the subsidiaries were determined during the hearing to be $175,000, there was no breakdown in the company's financial statements of the amount of these costs as between fiscal year 1962 and fiscal 1963 or as between Welton Labs and PD&S on the one hand and Garde Drug on the other.[23/] The use of a specific figure of 10 cents to add on to the earning power attributable to fiscal year ended January 31, 1962 in Kuehner's explanation was not explained, justified or substantiated.

One of the important misleading aspects of both market letters is that it emphasizes the expenses related to the acquisitions and deemphasizes the earnings attributable to the acquired companies. For example, the letter states that "In spite of the difficulties of reorganizing, consolidating and centralizing the new acquisitions the company earned $0.17 per share for the fiscal year ended January 31, 1962 versus $0.02 in the preceding fiscal year. . . ." The comparison in this sentence appears to downgrade the new

23/ A flow chart prepared by DeElorza in April 1961 estimated that the moving expenses would be $92,000 of which $64,000 was attributed to PD&S, $3,000 to move Welton Labs and $25,000 to move Garde Drug but these estimates were less than was actually expended.

acquisitions by emphasizing the costs of acquisition without referring to the earnings contributed by such acquired companies to Old Empire's total earnings. In particular the comparison does not make clear the degree to which the newly acquired companies may have contributed to the reported 850% betterment of 1962 earnings over 1961 earnings.

In this connection the prospectus covering the debentures (p. 8) shows in a pro forma statement for the year ended January 31, 1961 that earnings attributable to Old Empire were only $17,359 while earnings attributable to PD&S, et al. were $48,710.

The comparison of two cents per share in earnings for the fiscal year ended January 31, 1961 as compared to 17 cents "In spite" of such costs related to acquisition rather than because the acquired companies contributed to earnings for fiscal year ended January 31, 1962 was not justified and was misleading.

For reasons already detailed at length hereinabove, there was no basis for predicting 5 cents per share earnings with regard to vitamin sales.

Kuehner claimed that in calculating the 40 to 45 cents per share he attributed 5 cents per share to potential sales of generic drugs. Among other things, he claimed to have reached this estimate by using Standard & Poor's Industrial Survey available to him in August, 1962. However the figures used by Kuehner did not appear in any volume of Standard & Poor's Industrial Survey prior to March 31, 1966.

As to "3¢ for expected profits from Goyescas" the facts may be summarized as follows:

In February, 1961 DeElorza drafted a memorandum discussing Goyescas, a company which Old Empire wanted to acquire and predicted that Goyescas would earn after taxes $25,000 for the year ended December 1961. Kuehner saw this memorandum shortly after it was written.

The facts in connection with Old Empire's acquisition of Goyescas were as follows:

Old Empire acquired Goyescas in February, 1962. Goyescas' financial statements for the year ended December 31, 1960 had shown a net loss of $22,471;[24/] for the year ended December 31, 1961 Goyescas had shown a net loss of $11,075 and for the six months ended June 30, 1962 Goyescas showed profits of only $876.

In order to earn 3 cents per share in profits, Goyescas would have had to increase its earnings to approximately $29,000 for the balance of the fiscal year ended January 31, 1963. Based upon its past history there was no justification for estimating that Goyescas would add 3 cents per share in profits to Old Empire.

Old Empire's earnings per share declined from 11 cents in fiscal 1958 to 2 cents in fiscal 1961. Old Empire reported, however, in its December 26, 1961 prospectus for its 6% convertible subordinated debentures for the 9 months ended October 31, 1961 earnings of 7 cents per share.

The company, however, was suffering in 1961 because it lacked working capital. Nevertheless, it decided to shift its business emphasis from that of contract packaging to the pharmaceutical business, and in such connection to expend large sums of money to acquire pharmaceutical subsidiaries and to

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24/ Although Kuehner claimed that he had no recollection of seeing the financial statements of Goyescas covering calendar year 1960, the evidence in this case reflects that a statement of financial condition of Goyescas for that period was addressed to the stockholders of that company dated April 7, 1961 and as a director of Old Empire it was undoubtedly available to Kuehner.

build up large inventories. Its manufacturing facilities were fully employed in fiscal year 1962 in an effort to build up a vitamin and generic drug inventory and to manufacture enough merchandise to make deliveries on sales. In fact, Old Empire could not meet these demands on its facilities and the company was considering farming out some of its contract packaging business. There was no justification for adding 2 cents to the 1962 earnings of Old Empire for the upgrading of contract packaging.

The prediction of earnings of 40 to 45 cents per share for fiscal year ended January 31, 1963 was unjustified. Moreover, based on the demeanor of Kuehner while on the witness stand and based on the substantive aspects of his testimony the hearing examiner has concluded that his explanation of the reasons why he made a prediction of 40 to 45 cents in earnings in the market letter was contrived and was unbelievable. His testimony is not credited.

Old Empire borrowed enough money to acquire the subsidiaries and paid for the acquisitions with the money obtained through the sale of the debentures but the proceeds from this offering did not provide enough capital to build up the large inventories which it considered necessary to engage in the vitamin and generic drug manufacturing business. The large expenditures made in building up a large inventory of vitamins and generic drugs placed a burden on the business which it could not carry and resulted in its collapse.

Nothing was said in the prospectus about the chaotic production and financial problems of Old Empire which were besetting the company and which came to a head in December 1961 and which lead the company to stop taking orders for vitamins by the end of that month. More important, infofar as this proceeding is concerned, is the fact that this material information concerning Old Empire was omitted from the market letters which were distributed to the public by Laird Bissell and by Cortlandt and their registered representatives.

The evidence in this record demonstrates that throughout the period involved in this proceeding, Old Empire's working capital position and cash position was low in relation to its business operations and became lower, its accounts receivables which were always high in relation to cash increased, its inventory was high and unbalanced, and credit control was poor.

Old Empire's rapid acquisition program although aided by the proceeds of the debentures offering did not improve its working capital or cash position. The implementation of its manufacturing and sales program including particularly the vitamin and generic drug programs, together with the expenditures involved in moving the acquired companies from Philadelphia to Newark, drained the company of its already inadequate working capital and brought about its financial collapse.

In an effort to explain the basis of Laird Bissell's representations in its market letters, Laird Bissell in its proposed findings referred, among other things, to Old Empire's profit and loss statements and referred particularly to Sneed's reliance on figures contained in the company's December 26, 1961 prospectus covering the debentures. These data showed sharply increased sales figures between fiscal year ended January 31, 1959 and the nine months ended October 31, 1961,[25/] (the latter figures being unaudited). Laird Bissell also pointed out that there had been an increase in

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25/ In this connection it should be noted that the unaudited figures included substantial sales attributable to PD&S.

the number of Old Empire's outstanding shares which rose from 334,580 shares outstanding for fiscal year ended January 31, 1959 to 966,040 shares outstanding at the end of the unaudited nine-month period ended October 31, 1961 as being the reason for the drop in earnings from 11 cents per share for the year ended January 31, 1959 to 2 cents per share for the year ended January 31, 1961 which "then increased to 7 cents for the nine months ended October 31, 1961."

No reference was made, however, to a more cogent reason for the decline in earnings per share for the period. The reason is set forth graphically in the prospectus covering the debentures, namely, that in fiscal year ended January 31, 1959, Old Empire's net earnings were $36,381 while in fiscal year ended January 31, 1961 the net earnings had declined to $17,359.[26/]

The following chart depicts the cash, accounts receivable, and inventory for the fiscal years ended January 31, 1959 through January 31, 1963 including the revised figures for 1962:

January 31	Cash	Accounts Receivable	Inventory
1959	$111,722	$ 224,227	$ 234,605
1960	183,786	400,609	369,573
1961	99,560	506,328	653,727
1962	74,913	1,119,063	1,242,833
1962 (revised)	74,913	821,371	1,242,833
1963	15,252	450,695	1,440,896

26/ In this connection it should be noted that included in the earnings for fiscal year ended January 31, 1961 were earnings obtained by Old Empire through its acquisition of Garde Drug and Welton Labs. For Welton Labs this would encompass the entire year and for Garde Drug approximately two months.

In the revised annual report for fiscal year 1962, $250,000 in accounts receivable were written off because they were uncollectable, merchandise having been returned to Old Empire because it was delivered too late to meet seasonal requirements.

Garde had told DeElorza that Old Empire's inventories and accounts receivable should be lowered in 1960 so as to give the company a better cash position. DeElorza agreed to attempt to do so. Inventories and accounts receivable were not reduced, and Old Empire's cash position declined steadily from fiscal 1960 to fiscal 1963.

Although Old Empire filed a petition in bankruptcy in March 1964, and lost 97 cents per share for fiscal 1963, it would appear from Laird Bissell's Proposed Findings that they contend that Old Empire's financial position in 1963 was better than it was in 1959. The ratios of accounts receivable to sales presented by Laird Bissell in its proposed findings tend to reflect that Old Empire's accounts receivable were being converted into cash more quickly in fiscal 1963 than in fiscal 1959.[27]

The reason that the ratio "improved" as of fiscal year ended January 31, 1963 was not because accounts receivable were being converted into cash more quickly at the latter due but because approximately $250,000 in accounts receivable were written off as uncollectable and not realized in cash.

27/ See Laird Bissell's Proposed Finding No. 192 reading in pertinent part that "The ratio of accounts receivable to sales increased from approximately 1 to 5.5 in 1959 to 1 to 7.5 in 1963."

Laird Bissell's claim that the ratio of accounts receivable to sales improved between 1959 to 1963 fails to take into account material factors which rendered the impression of an improving ratio more apparent than real. Instead of an improving ratio of accounts receivable to sales, the information which Sneed claimed to have available when he wrote his January, 1962 letter, reflected a declining ratio of accounts receivable to sales.[28/]

The Division in its proposed findings pointed out and the respondents conceded that "From January 1960 to January 1963 the cash position of Old Empire declined and its inventories increased."

Net sales, net income and earnings per share for Old Empire for the fiscal years ending 1958, 1959, 1960, 1961 and for the nine months period ended October 31, 1961 are summarized as follows:

	For the years ended Jan. 31 (unaudited)				Nine months ended Oct. 31 (unaudited)
	1958	1959	1960	1961	1961
Net Sales	1,071,979	1,252,187	1,189,270	1,788,698	2,605,425
Net Income	36,245	36,831	41,604	17,359	63,876
Earnings Per Share	.11	.11	.09	.02	.07

28/ According to Sneed the last figures available to him were those of July 31, 1961 (see table above).

All of this information was available prior to February 1962, as it appeared in the December 26, 1961 prospectus for Old Empire's 6% convertible debentures.

The letters under attack by the Division were written in February and August 1962.

Laird Bissell in its proposed findings (192) states that "The accounts receivable position of Old Empire improved from 1959 to 1963" and that "The ratio of accounts receivable to sales increased from approximately 1 to 5.5 in 1959 to 1 to 7.5 in 1963.

The ratio of accounts receivable to sales between fiscal year 1959 and fiscal year 1963 were as follows:

For the fiscal year ended January 31, 1959	-	1 to 5.5	
For the fiscal year ended January 31, 1960	-	1 to 2.9	
For the fiscal year ended January 31, 1961	-	1 to 3.5	
For the 6 months period ended July 31, 1961	-	1 to 2.7	
For the fiscal year ended January 31, 1962	-	1 to 3.3	
For the fiscal year ended January 31, 1962	-	1 to 4.3	(revised)
For the fiscal year ended January 31, 1963	-	1 to 7.5	

In explaining the reasons for the declining cash position and the increasing inventory position Laird Bissell stated that between January 1960 and January 1963 "Old Empire acquired four companies and embarked upon two major programs which converted cash into other forms of working capital. It engaged in a business which necessitated the manufacture of many items and a large inventory."

These comments reflect agreement with the Division that Old Empire's liquid financial condition was deteriorating. Laird Bissell's explanation, however, obscures the fact that when Old Empire embarked on its program to expend funds for the manufacture of a large inventory of vitamins and generic drugs, the high inventories of the company were being converted into cash at a decelerating rate. Nor does this proposed finding serve to explain why these important financial facts and their impact on the financial position of Old Empire were not described in the market letters at the same time that such letters were depicting Old Empire's operations in highly optimistic terms. In this connection, it is noted that the number of times inventory turned over for the year ended January 31, 1961 was 3.93. (See prospectus covering debentures.) The inventory turns for the year ended January 31, 1962 was 2.67.[29/] The inventory turns for the year ended ended January 31, 1963 computed from the company's annual report on Form 10-K filed with the Commission were 2.28.

It will be noted that the inventory turns amounting to 3.93 for the fiscal year ended January 31, 1961 were reduced to 2.67 for fiscal year January 31, 1962 and remained in that range thereafter. The reduction in inventory turnover between fiscal year 1961 and fiscal year 1962 amounted to more than one full turn, indicating that Old Empire was not converting its inventories into sales in

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29/ Furthermore, Old Empire amended its 10-K report for calendar year 1962 and as a result the inventory turns were reduced from 2.67 to 2.61 as reflected in original 10-K filing.

fiscal year 1962 as rapidly as it was in fiscal year 1961. Despite the respondents' explanations relating to Old Empire converting cash into other forms of working capital, the conversion of cash into other forms of working capital such as inventory could not in this context be considered advantageous to the company. This was pointed out to DeElorza by Garde and DeElorza promised to try to improve this situation.

Laird Bissell in its Proposed Findings and Conclusions of Law (198) stated that:

> "The working capital position of Old Empire greatly improved from 1959 to 1962. Working capital increased from $528,752 to $1,295,895 during the fiscal year ending January 31, 1962. The current ratio increased during that year from 1.62 to 1 to 2 to 1. Current assets almost doubled while current liabilities increased only a little over 50%."

The background facts concerning the working capital position of Old Empire may be stated as follows: The prospectus covering the 6% convertible subordinated debentures shows that as at July 31, 1961 the current liabilities were $1,446,853 and current assets were $1,904,981, i.e. the working capital ratio was 1.3 to 1. The working capital ratio had declined from 1.62 to 1 as of January 31, 1961 to 1.3 to 1 as of July 31, 1961.

The prospectus covering the debentures shows that as of July 31, 1961 the current liabilities of Old Empire were $1,446,853 and the company's annual report to stockholders for fiscal year ended January 31, 1962 shows that the current liabilities were reduced.

to $1,300,026. In substance the offering of debentures maintained current liabilities at approximately the same level between July 31, 1961 prior to the offering and January 31, 1962 shortly after the offering of debentures with practically no increase in cash. The company realized only $837,000 to pay its current liabilities to the bank in the amount of $500,000 and $175,000 to pay its current liabilities to Laird Bissell.

As of January 31, 1962, Old Empire only had $74,913 in cash to meet current liabilities of $1,300,261 even though the current ratio at this point was 2 to 1.

At January 31, 1962 Old Empire was having difficulties meeting deliveries for orders previously taken for vitamins and generic drugs and the company was unable to pay promptly for raw materials being delivered to it.

Since the working capital ratio consists of the ratio of current assets to current liabilities it is important to be sure when employing such a ratio that the dollar figures representing the current assets and the current liabilities are reliable. If the figures representing current assets and current liabilities are not dependable the working capital ratio derived therefrom will not be dependable and could be delusory.

The working capital ratio has long served as a credit test and often as a measure of debt paying ability. In attempting to apply such a test, however, it should be recognized that other factors equally and frequently more important remain to be considered before the meaning of the working capital ratio in any given situation can be correctly understood and relied upon.

The assumption when the working capital ratio is employed is that non-cash current items such as receivables and inventory will be returned to cash within the current accounting period which is normally one year.

In the case of Old Empire, particularly in view of its serious production and delivery problems and its tight cash and working capital problems, it was apparent in February 1962 as well as in August 1962 that any assumption as to the dependability of the company's current assets, particularly insofar as the reliability of the accounts receivables were concerned, would be extremely hazardous. As we have noted Old Empire's cash and working capital position had not been substantially improved by the sale of the debentures. The company had not only expended substantial amounts in repayment of its current liabilities to the bank and to Laird Bissell, it had expended thereafter approximately three quarters of a million dollars for the building up of its inventory of vitamins and generic drugs and was unable to make deliveries of merchandise on time to meet the orders which it had received, its cash flow was affected, and it could not pay creditors and get raw materials. As a result there was a wave of cancellations of orders and Old Empire could not collect on large amounts of accounts receivable.

In Old Empire's amended report on Form 10-K the company in Note 2 to its financial statements reported that for the year ended January 31, 1962 "several accounts receivables of significant size were determined to be uncollectable." The amount involved in the reduction of accounts receivable was $250,000. In addition the company set up a reserve for bad debts of $47,629 and provided a total bad debt expense of $76,907.

The figures presented in the initial report on Form 10-K were figures which were not reliable since they were dependent on the speculation that Old Empire had the capacity to produce vitamin and generic drug products to meet the orders which it had received in time to deliver them to the customers for the fall vitamin season. It was apparent in December 1961 when its production and delivery schedules were in a chaotic condition and when Old Empire had stopped taking orders that it could not make deliveries on the orders received on time. Consequently, it was inappropriate to use a figure of $1,295,895 (which included large amounts of accounts receivable) as a basis to come to a conclusion as to the current working capital ratio of Old Empire for the fiscal year ended January 31, 1962.

Furthermore in its initial filing on Form 10-K for fiscal 1962, the company had provided no reserve for bad debts relating to accounts receivable.

When the working capital ratio is considered on the basis of the amended annual 10-K report the current assets appear as $2,298,464 and current liabilities appear as $1,250,087, the current ratio would then appear as 1.84 to 1. However, further analysis shows that the company as of January 31, 1962 had less than $72,000 in cash and approximately $821,000 in accounts receivable so that its total quick assets were less than $900,000 as against total current liabilities of $1,250,087. In connection with the remainder of the current assets available to Old Empire, it will be noted that $1,242,833 represented inventory and the balance of current assets related to such matters as prepaid expense, loans to employees and tax advances for alchohol used in the manufacture of the company's products.

Current assets include accounts receivable and inventory. Since such current assets are far from being equivalent to cash, particularly where the accounts receivable are of questionable collectability and where inventory is of doubtful saleability, a company may show a favorable ratio of current assets to current liabilities and still be in a poor position if these current assets bulk large in the total.

As we have noted inventories of Old Empire were being converted into cash at this period at a decelerating rate and the company was having production and delivery difficulties. Vitamin orders had been cancelled and large amounts of inventory had been returned.

Using an acid test ratio figure which would be appropriate in this context the acid test ratio[30] amounted to .72 to 1 based on the revised figures as at January 31, 1962. Even before the write-off due to cancellations of orders the acid test ratio amounted to .92 to 1 on the basis of the initial Form 10-K filing of Old Empire. Reliance upon the so-called improvement in the ratio for Old Empire for fiscal year ended January 31, 1962 would not be warranted. In fact, it would appear that contrary to Laird Bissell's proposed findings the financial position of Old Empire had not improved between 1961 and 1962.

Laird Bissell sold Old Empire stock not only in the United States but also through Laird,Bissell & Meeds, A.G. ("LB&SM, A.G."), a wholly owned Swiss subsidiary located in Zurich, Switzerland.

Markus Meier ("Meier"), an assistant manager of Bank Rohner & Co., Ltd., St. Gall, Switzerland ("Bank Rohner"), a Swiss bank which engaged in the stock brokerage business testified that he was in charge of Bank Rohner's brokerage business and that Bank Rohner started doing business with Laird Bissell's Zurich office after a visit from Dr. George Weil ("Weil"), manager of Laird Bissell's Zurich office.

Bank Rohner purchased from Laird Bissell on behalf of its customers 6,050 shares of Old Empire between March, 1962 and December,

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30/ The acid test ratio is the determination of the ratio of the dollar of cash, trade receivables and marketable securities of a business concern to its current liabilities, and is a test frequently employed in making analyses of business enterprises.

1962. Some of Laird Bissell's sales were made as agent and some as principal. All confirmations representing Bank Rohner's purchases were confirmed by and mailed from Laird Bissell's New York office to Bank Rohner in Switzerland.

Meier received a telephone call on March 18, 1962 from Loan R. Affolter ("Affolter"),a registered representative in Bissell's Zurich office recommending that Bank Rohner purchase Old Empire securities. This was the first time Meier had ever heard of Old Empire.

Affolter told Meier that he would send him an expose on Old Empire; that Kuehner who worked for Laird Bissell was a director of Old Empire and therefore, Laird Bissell was very well-informed as to the company's business and its operations.

Bank Rohner on March 19, 1962 purchased through Laird Bissell as its agent 100 shares of Old Empire at 5 3/8 for a total of $543.73.

On March 19, 1962, the day after Affolter's telephone call, Bank Rohner received in the mail from Laird Bissell's Zurich office a market letter dated "mid-March 1962" typed on the letterhead of LB&M, A.G. bearing Sneed's initials which was substantially similar to the February market letter prepared by Sneed and Kuehner.

On March 20, 1962 after a discussion with Affolter and Weil and after having read the market letter Bank Rohner bought 500 shares from Laird Bissell at 5 1/8 for a total of $2,562.50.

Bank Rohner received in the mail on March 20, 1962 a one-paragraph document bearing the typed name of Hanns E. Kuehner and the initials HEK:md stating that the market for Old Empire was "4 bid . . . offered at 5½". The document, in pertinent part, stated Kuehner's belief that once a block of stock is sold for the account of one of the registrants under the last prospectus "a market level of between 6 and 7 can be reasonably expected. I am looking forward to a price range of 10 or better over the long-term based upon what management plans to do and my confidence in its ability to carry it out. Of course, you know I am a director of the company . . . . I should like to hear from you promptly on this." 31/

After having read the Kuehner memorandum, Bank Rohner made two purchases of 500 shares each of Old Empire from Laird Bissell as principal at 5¼ for $5,250.

During the four-day period between the time Affolter first recommended Old Empire stock and forwarded the Kuehner note, Bank Rohner purchased 1,600 shares of Old Empire from Laird Bissell in its own name on behalf of twenty of its private customers. 32/

Contrary to Laird Bissell's proposed findings (Proposed Finding 236) the confirmations covering these sales were issued by Laird Bissell New York, not Laird Bissell & Meeds, A.G.

31/ The respondents produced a carbon copy of a document showing that the document sent to Bank Rohner was part of a memorandum addressed to Dr. George Weil by Kuehner.

32/ Swiss law prohibits Bank Rohner from revealing the names of its customers to anyone including a broker-dealer.

Between March 1962 and the end of May 1962, Meier had numerous conversations with Affolter and Weil in which the latter assured Meier that the price of Old Empire would go up to $8 per share, that Kuehner as a director knew Old Empire well, and that the information was reliable.

In July 1962, Laird Bissell's Zurich office mailed Bank Rohner a copy of a memorandum from Kuehner to Weil in which the following statements were made as to future sales and earnings for Old Empire:

> "Although, I would not wish to be quoted, nor in fact, should I be quoted, I will venture my personal opinion to you that we should reach a volume of $5.5 to $6 million for the current fiscal year, generated entirely from our present lines and without considering any additional acquisitions. Based on such a volume, I would deem a per share result of between 40¢ and 45¢ attainable. However, I must caution you that there is still a certain amount of moving expenses to be charged off during the current fiscal year."

Old Empire was a highly speculative stock and was entering into speculative operations in the manufacture of vitamins and generic drugs in which it had not engaged before and in which it had no experience.

Kuehner's communications were mailed to Laird Bissell's Zurich office and transmitted to Bank Rohner. It is of no importance from a jurisdictional standpoint that the mailings were made to the Zurich office from the United States and transmitted by the latter to Bank Rohner rather than having been mailed directly by Kuehner to Bank Rohner.

The market letter dated mid-March 1962 and Kuehner's statements transmitted by Laird Bissell & Meeds, A.G. to Bank Rohner were predictions made without reasonable basis. The communications were sent through the mails and they were communications of Laird Bissell's registered representatives and they were inherently fraudulent.[33/]

On December 10, 1962 Bank Rohner wrote to Laird Bissell's New York office asking, among other things, whether there had "been a fundamental change in the business prospects for Old Empire since your recommendation", and also asking Laird Bissell's opinion as to the "reason for the sharp decline and the inability of the stock to recover since the general market turned the corner".

On December 19, 1962 Sneed replied that Laird Bissell "did not believe there [had] been any fundamental change in the business prospects of the company" and that the past problems of Old Empire could be attributed to difficulties with production which management felt had been overcome.

33/ Cf. Leonard Lazaroff, Securities Exchange Act Release No. 7940, p. 3 (August 22, 1966); Shearson Hammill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965); R.A. Holman, Inc. v. S.E.C., 366 F.2d 456 (1966); e.g. Mac Robbins & Co., Securities Exchange Act Release No. 6846 (July 11, 1962); Aircraft Dynamics International Corp., Securities Exchange Act Release No. 7113 (August 8, 1963); E.G. Barnett & Co., 40 S.E.C. 521 (1961); Alexander Reit & Co., Securities Exchange Act Release No. 6727 (February 8, 1962); See Securities Exchange Act Release No. 6721 at p. 3 (February 2, 1962) (statement of policy); Cf. Standard Bond & Share Co., 34 S.E.C. 208 (1952); e.g. Ross Securities, Securities Exchange Act Release No. 7069 at p. 5 (April 30, 1963); Heft, Kahn & Infante, Securities Exchange Act Release No. 7020, and B. Fennekohl & Co., Securities Exchange Act Release No. 6898.

In view of the fact that Kuehner, some time prior to September 19, 1962 had received a memorandum on financing prepared by DeElorza bearing upon the company's serious financial difficulties, and in view of Old Empire's serious operational problems and of the further fact that in December 1962, DeElorza and Horn the principal officers of Old Empire had told Sneed that Old Empire did not have the money to pay its taxes,and that unless Old Empire could obtain money for taxes, its plant would be padlocked, Sneed's letter to Bank Rohner was seriously misleading. Furthermore if Sneed's letter of December 19, 1962 were mailed prior to the time of his meeting that month with DeElorza and Horn when they reported to Sneed concerning the company's serious financial situation his duty to deal fairly with Laird Bissell's customers should have prompted him to correct the representations made in his December letter to Bank Rohner stating that he did not believe that there had been any fundamental change in the business prospects of the company. This he did not do.

After receiving Sneed's letter Bank Rohner purchased 100 additional shares of Old Empire in order to "average down".

Affolter telephoned Meier that he was sending a memorandum dated May 13, 1963. This memorandum was mailed to Bank Rohner and bore Sneed's name typed thereon. The opening sentence of this memorandum read "From this morning's cable advice you will have seen that the Old Empire financing deal has been consummated. The contract with a large factoring organization was signed late Friday, May 10."

This memorandum went on to express Sneed's opinion that the company's fortunes had "turned the corner" (the underscoring appears on the memorandum) and also stated that Old Empire had "consummated" a "financial" deal exceeding $1 million and after paying certain obligations there would remain $250,000 for additional working capital for Old Empire. In fact, however, the transaction to which Sneed referred was a factoring arrangement at very high interest, and there was no assurance that Old Empire would receive any additional working capital. Furthermore, Sneed had made a series of loans through April 1963 to Old Empire which totalled $112,000 to keep the company going until a merger or some other solution for its problems could be found. The factoring arrangement was not a solution of the company's problems and was never considered to be such solution. These facts should have been disclosed at that time in any communication addressed to a customer who had purchased Old Empire stock from Laird Bissell and was seeking information concerning the company as well as the important facts regarding the cancellations of Old Empire's vitamin orders and the serious financial and business straits in which Old Empire found itself in 1963.

Laird Bissell's proposed findings assert, in pertinent part, that "The memorandum was not prepared by Sneed and Meier doesn't know who prepared it. The handwritten Arabic numerals [34/] and typed

34/ The Arabic numerals referred to were "3/4 - 1 3/4" inserted at top of the memorandum. This was the only handwriting on the letter.

dollar figures contained in this letter were printed in the European style, i.e., $1.000.000, instead of $1,000,000 and Sneed did not use LB&M, A.G. letterhead." (Proposed Finding No. 252).

The fact was, however, that Affolter had informed Meier that he had received a memorandum from Sneed and had sent him a document or a copy of a document he had received from Sneed. Bank Rohner received this document in the mail on the letterhead of LB&M, A.G., Laird Bissell's wholly owned subsidiary. There was no claim that such document had not been sent by LB&M, A.G., to Bank Rohner. Sneed did not resume the witness stand after this memorandum was received in evidence to disown it, although he had been a witness on his own behalf in this proceeding.

Meier was a very impressive witness and his testimony is fully credited.

Harry Bedsworth, a Master Sergeant in the U.S. Air Force, with some eighteen years service testified, among other things, that during a conversation he had with Rau some time between June and September 1961 he discussed with Rau a letter which Sneed had sent to the latter stating that Old Empire had some difficulties with production but that everything was going to be all right.[35/]

Towards the end of 1961 or at the beginning of 1962 Sergeant Bedsworth wrote to Laird Bissell asking for further information on Old Empire. His inquiry was answered by a letter dated June 26, 1962 signed by Sneed. Sneed, among other things, advised Bedsworth that

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35/ Rau had a number of transactions with Bedsworth in Old Empire stock and they will be discussed hereinafter. At this point, however, the discussion will deal primarily with documentary evidence.

he had attended the annual meeting of Old Empire on June 25, 1962 and had learned from the "President's report that the business and operation has been just about in line with our brochure published in February.

Integration of the sundry acquisitions has been completed and seems to be operating efficiently. The generic drug program went into full operation a week or so ago and primary indications appear successful".

With his letter Sneed enclosed a copy of the February 1962 market letter, Old Empire's 1961 balance sheet and earnings statement and some product advertising of Old Empire.

Sneed omitted to tell Bedsworth any of the material facts concerning Old Empire's problems with working capital, with production, the failure of scientific and technical personnel to move with the subsidiaries, and the difficulties with the various promotional programs described in Laird Bissell's February market letter and omitted to tell him that the company had stopped taking orders for vitamins by the end of 1961 that there had been a wave of cancellations of orders thereafter.

Sneed had periodic general discussions with Isaacs and Rau concerning the status of Old Empire and kept them generally informed concerning the condition of the company and both Isaacs and Rau wrote some letters to investors concerning Old Empire.

Some of these letters were received in evidence and these documents will be considered prior to a discussion of the evidence relating to oral representations made by the respondents associated with Laird Bissell.

There was an exchange of correspondence between Sergeant Bedsworth and Rau throughout 1961, 1962 and 1963. Bedsworth attempted to get some information about Old Empire from Merrill Lynch but was unable to do so. He wrote to Rau on January 30, 1963 asking what had happened to Old Empire, and asking Rau to advise him whether he should sell his shares as Old Empire was steadily decreasing in value.

On January 31, 1963 Rau replied stating, in part, that Old Empire's "basic error in the past year was to expand their sales force and the customer accounts faster than they expanded their productive capacity. As a result of this error in management, they had cancellations of over $1,000,000 worth of business because they could not fill their customers' orders promptly and keep their display boards supplied with products they had advertized".

Rau recommended, however, that Bedsworth keep his Old Empire stock for which he had paid $7 per share and which was selling at $1 per share. In this connection Rau told Bedsworth that he also held 1,100 shares of Old Empire stock and was going to continue to hold it. Rau omitted, however, to inform Bedsworth that the Old Empire stock which he was holding had been purchased in January 1963 at $1 per share as compared to the $7 per share paid by Bedsworth for his stock. In this connection Rau wrote, "I still own 1,100 shares and I am going to hold it in the hope that I may some day recover something from it." The implication was that Rau had paid more than one dollar for his Old Empire stock and had suffered a loss just like Bedsworth, when in fact Rau had only paid one dollar a share and the bid and ask price at the time did not reflect any paper loss to him.

Bedsworth after receiving Rau's letter held on to his Old Empire stock.

In March 1963 Rau mailed Bedworth another letter advising him that on January 14, 1963 he had "found out that Old Empire had encountered production difficulties during the last quarter of 1962. . . ." In addition the letter pointed out that Old Empire had encountered various other problems including "grave difficulties and problems in getting its production lines operating on an efficient basis in respect to both volume and quality of goods due to the loss of personnel and the time involved in training new persons. As a result of these production troubles, shipments to customers became substantially in arrears. There was also sizable returns on goods claimed to be substandard by customers. As time elapsed and orders were still not shipped or only partly shipped they began cancelling orders and in late 1962 a wave of cancellations amounting to almost $1 million occurred.

Unfortunately, the wave of cancellations hit at a time when the company had most of their working capital in inventory of raw materials for their generic drugs and vitamins production. This situation reduced liquid working capital drastically. The combination of events which happened quickly, constituted a difficult and serious crisis for the company, however, most of the crisis culminated in late December of 1962."

Rau added, that:

> "Old Empire was sold in good faith as a speculative over-the-counter appreciation situation, based on the past 3 years performance (tripling sales and earnings per share each year, 1959 thru 1961)."

Contrary to this representation the wave of cancellations occurred in late 1961 or early 1962. Furthermore, Rau's statement concerning "tripling sales and earnings per share each year 1959 thru 1961" was grossly false and misleading, among other reasons, because Old Empire earned 8 cents per share in 1959 and only 2 cents per share in 1960. These earning figures appeared in the prospectus covering the debentures for which Laird Bissell was a co-underwriter.

In response to an inquiry from Technical Sergeant Henry S. Roche, a customer of Laird Bissell, Isaacs advised Sergeant Roche in a letter dated November 27, 1962 not to sell his Old Empire stock. The letter stated, in pertinent part, that:

> "Old Empire is not accurately quoted but I feel sure I could get $3 for you but feel it would be a bad time to sell. They have some good news to the effect of the acquisition of another company in Jersey City and they expect their earnings report to look very favorable but they will release nothing of this until after the first of the year. Probably the middle of January or the first of February, we can expect some improvement in price."

There was no basis for Isaacs' representation concerning "good news" about the effect of the acquisition of another company in Jersey City. Isaacs was not privy to any information regarding earnings prior to its release to the public. There was no basis for Isaacs representation that "we can expect some improvement in price." As a matter of fact, the company's serious financial and production problems had come to head long before November 27, 1962, and there was no reasonable basis for saying they "expect their earnings report to look very favorable".

In late March or early April 1961, Isaacs sent a note dated March 30, 1961 to a customer, Otis Smith, reading as follows:

> "Old Empire, Inc. is a drug and cosmetic manufacturer, wholesaler and retailer.
>
> It is listed under 'Local Securities' daily in the Wilmington papers. It is currently selling @7½.
>
> Notice from the attached statement that in the comparable '59 - '60 periods sales approximately doubled. Profits increased 27 X's.
>
> I have reason to believe that the next profit statement will also show decided improvement.
>
> This stock has the potential to easily go to 20.
>
> If interested call."

The letter was signed "Ed Issacs". (sic)

There was no basis whatever to represent that Old Empire's profits increased 27 times or to represent that the stock had the potential to easily go to 20. Isaacs did not deny sending the letter.

The letter was grossly fraudulent and there was no justification for writing such a letter.

Isaacs had never seen any interim financial figures for Old Empire, nor did he ever make any inquiries as to the status of the company's vitamin program or its generic drug program to ascertain their effect on earnings.

Isaacs never advised any of his customers to sell their holdings in Old Empire although by August 1962 he had sold all of his shares in the company.

In addition to the written misrepresentations made by Laird Bissell and the individual respondents associated with this respondent, Laird Bissell offered and sold shares of Old Empire by means of oral misrepresentations and omissions in violation of the anti-fraud provisions of the securities laws.

Four witnesses testified concerning oral misrepresentations made to them by Kuehner. In late 1960 or early 1961 Mrs. Sonya Berger ("Berger") purchased and thereafter sold 200 shares of Old Empire through Laird Bissell's New York office.

Kuehner called Mrs. Berger on October 31, 1961 and urged her to buy back the 200 shares she had sold. Kuehner advised her that he was quite sure that in about a year she would double her money. He did not inform Mrs. Berger concerning any of the management's problems with regard to working capital, personnel, and the production problems of the company.

Mrs. Berger followed Kuehner's advice and purchased 100 shares of Old Empire at $5 per share. Kuehner's statements to her were false and misleading.

In 1960 Richard Pisano ("Pisano"), an executive in the oils and aromatic chemical business, had some transactions in Old Empire through Kuehner. In February or March 1962 Kuehner telephoned Pisano recommending that he invest in Old Empire securities. Kuehner also mailed Pisano a copy of the February 1962 market letter on Old Empire. Kuehner told Pisano that the purchase of additional companies by Old Empire reflected a complete change in the company's situation and that personnel from the Philadelphia companies were coming to New Jersey to help run Old Empire. Pisano purchased 25 shares of Old Empire at $5.125 per share.

In late 1962 or early 1963 Pisano asked Kuehner why Old Empire wasn't paying its bills and wanted to know what was happening to Old Empire. Kuehner told Pisano that the "bond issue" was going to give Old Empire the necessary working capital to resolve its problems and that Laird Bissell was interested in Old Empire and had too many people involved in Old Empire to let it go down the drain.

The debenture issue to which Kuehner referred as the "bond issue" was one in which Laird Bissell was co-underwriter and the prospectus covering the debentures clearly showed that no part of the funds derived by Old Empire from the sale of debentures would provide any working capital for Old Empire. There was no justification for making this representation. Nor was there any justification for representing that Old Empire had too many people involved in Old Empire to let it go down the drain. Kuehner's representations to Pisano were false and misleading.

Dr. George M. Hadda, a physician, telephoned Kuehner in about May 1962 and told him that he wanted to purchase an investment security. Prior to this time Hadda had never purchased any securities. Kuehner recommended that he buy Old Empire convertible debentures and Kuehner told Hadda that since he was a director, Hadda could rely on his statements.

Kuehner never informed Hadda that the debentures were unsecured except by the general assets of the company and were subordinate to all senior indebtedness. Hadda purchased one Old Empire convertible debenture on July 20, 1962 for $940. Thereafter, Hadda telephoned Kuehner from time to time because he had been unable to find a quotation for the debenture in The New York Times. Kuehner told him that the fact that quotations on Old Empire debentures did not appear in the papers was meaningless, and that he would supply Hadda with a quotation at any time. Early in 1963 Hadda called Kuehner for a quotation on the debentures. When Kuehner told Hadda that the debentures had dropped in value he asked Kuehner whether he should sell the debenture. Kuehner advised Hadda it would be very foolish to sell the security and that while there had been some difficulties with labor they were in the process of being resolved.

In the fall of 1963 after having received a letter from Old Empire describing various problems, Hadda called Kuehner and asked for a report by Laird Bissell's Research Department on Old Empire. Kuehner sent Hadda copy of a page of an October 22, 1963 Standard & Poors Market Report which mentioned Old Empire. Hadda called Kuehner at this time and Kuehner told him that the debenture was now worth about 20% of the price Hadda had paid, but that Hadda should not sell the debenture because Old Empire might be merging with either New York Trap Rock, Maridel, or Marrud. On the basis of Kuehner's representations Hadda did not sell the debenture. Kuehner's affirmative representations to Hadda regarding Old Empire, as well as the material omissions to disclose the serious financial problems of Old Empire were seriously misleading.

Joseph Weber, a hairdresser first heard of Old Empire in 1960 when he engaged in transactions in the stock through Kuehner. 36/ Weber received a copy of Laird Bissell's February 1962 market letter in the mail. Thereafter, in about July 1962 Kuehner telephoned Weber and told him that he was a director of Old Empire and recommended that he purchase Old Empire debentures.

Kuehner sold Weber $3,000 of Old Empire debentures. Weber paid a total of $2,877 for the debentures and Laird Bissell mailed him a confirmation.

Kuehner never told Weber that the debentures were subordinate to all senior indebtedness nor did he refer to Old Empire's inability

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36/ Subsequently Weber purchased Old Empire securities through Cortlandt. These transactions will be discussed hereinafter.

to make delivery of its products or to the lack of success of Old Empire's promotional programs, or to any of Old Empire's serious financial problems. Kuehner's representations to Weber were false and misleading.

Four witnesses testified concerning offers and sales of Old Empire stock by Isaacs.

Isaacs had purchased a total of 760 shares of Old Empire common stock and one $1,000 debenture between May 1961 and December 1961 for himself. By January 1962 he had sold 750 shares of the common stock as well as the debentures. In addition, he liquidated holdings of 50 shares of Old Empire purchased for his two daughters. Five hundred shares of Old Empire was sold by Isaacs in August 1962 at prices ranging from $5.50 down to $2.75. During the same period Isaacs was recommending that the customers either purchase additional shares or hold on to shares of Old Empire stock. Isaacs mailed copies of the February 1962 market letter to all his customers.

As has been noted hereinabove, Isaacs sent Otis Smith, a customer of Laird Bissell, a note dated March 30, 1961 which was grossly misleading. Otis Smith, a very impressive witness, was an executive in a large privately owned company, which was engaged in fish processing, and testified concerning purchases he made through Isaacs of Old Empire securities. In late March or early 1961 Isaacs represented to Smith that Old Empire was an up and coming company bound to do good; that as a result of mergers and consolidations Old Empire had dynamic management and that the price of Old Empire shares would go reasonably rapidly to 20 within a year or so.

As a result of the conversation, Isaacs sold Smith 200 shares of Old Empire at a price of \$7.25 per share. Between March 1961 and February 1962 Smith and Isaacs had several additional conversations concerning Old Empire and as a result Smith purchased some 5,800 shares of additional stock of Old Empire at prices varying from \$7.25 to \$5.25 per share. Prior to February 23, 1962 Smith received in the mail a draft of Laird Bissell's February 1962 market letter on Old Empire which he read. On February 23, 1962 Smith purchased an additional 2,000 shares of Old Empire at a price of 4 1/8 per share as well as \$2,000 face amount Old Empire debentures.

In connection with these transactions Isaacs omitted to inform Smith concerning the serious production and financial problems encountered by Old Empire. Isaacs' representations to Smith were grossly false and misleading.

Isaacs recommended to Garret L. Grier who was in the retail lumber business that he purchase Old Empire stock in November 1961. Between November 1961 and February 1962 Isaacs sold Grier 1000 shares of Old Empire stock. He never informed Grier of any of the facts during this period concerning any of Old Empire's working capital problems or other financial or production problems, or its inventory problems or its personnel problems. However, on January 29, 1962 when Grier asked Isaacs about buying another 300 shares of Old Empire for the purpose of "averaging down" Isaacs informed Grier that Old Empire "was still going all right and was still a worthwhile investment."

Isaacs had made no investigation of his own concerning the facts relating to Old Empire and had no basis for making any of his representations to Grier except his claimed reliance upon representations made to him by Sneed.

James B. Clements ("Clements"), a real estate salesman first heard of Old Empire in the spring of 1961 when he received a memorandum in the mail on the letterhead of Laird Bissell's Dover office, stating, among other things, that "Any purchases of Old Empire should be made before JUNE 10." (Underscoring and capitalization appear in the memorandum) The letter was dated May 19, 1961.

Clements, telephoned the Dover office and talked with Isaacs in August 1961. Isaacs recommended Old Empire to Clements as a good short-term investment. Isaacs told Clements that Old Empire had tested the sales of vitamins on milk routes, and such tests had been successful. The fact was directly to the contrary of Isaacs' representations.

Isaacs sold Clements 200 shares of Old Empire on August 22, 1961 at $5.75 per share.

Clements intended to sell his stock in January 1962. In November or December 1961 Clements telephoned Isaacs and asked him why Old Empire was not showing any progress. Isaacs told Clements that certain plans had been delayed but would take place later in the next year and Clements did not sell his stock in January as he had planned to do. In January or February 1962, Isaacs told Clements that Old Empire was having production problems but did not inform Clements concerning the serious nature of Old Empire's problems, such as its delivery and financial problems or the refusal of technical personnel to move to Newark.

In February 1962 Clements asked Isaacs for written information about Old Empire and Isaacs mailed Laird Bissell's February 1962 market letter to Clements. Clements sold 100 shares in December 1962 at $2.125 per share. Isaacs representations to Clements were false and misleading.

Frederick G. Hubbard, a mechanic employed by the telephone company had purchased some listed securities prior to the spring of 1961. In the spring of 1961 he went to Laird Bissell's Dover office and Isaacs recommended that he buy Old Empire stock. Isaacs told Hubbard that the stock "had good potential. The aspects were good for it in about a year," and that if "the price didn't go up he would have to leave town". Isaacs also told Hubbard that Old Empire was going to institute a program of delivering "drugs door-to-door through like you deliver milk or with milk". Isaacs never gave Hubbard any information concerning the history of failure with regard to the marketing of vitamins through milk routes. As a result of the conversation Hubbard bought 150 shares of Old Empire at $7 per share and subsequently sold it at $3 per share. Isaacs' representations to Hubbard were false and misleading.

Rau also engaged in the offer and sale of Old Empire securities from May 1961 to the middle of 1962. Rau made no independent investigation as to the status of Old Empire nor had he visited Old Empire's plant but instead he relied upon Sneed and Isaacs' for information regarding the company. During the course of his conversations during the summer and fall of 1962 with Sneed, Rau became aware of the difficulties with production and deliveries of merchandise and the resulting loss of profits to Old Empire.

During April, May and June of 1961, Rau purchased for his own account a total of 1,000 shares of Old Empire common stock. By September 1961 he had sold all of his shares. Nevertheless, in March 1962 Rau told his customers that he had bought Old Empire for his family but omitted to state that he had sold all such shares. In January 1963 Rau bought 1000 shares of Old Empire for his own account and 100 shares for his mother-in-law at $1 per share. Three investor witnesses namely, Sergeant Bedsworth, Charles Hirsch ("Hirsch") and Dr. John Lazzeri ("Lazzeri") who had telephone conversations and meetings with Rau testified that he had encouraged them to purchase Old Empire securities.

As discussed hereinabove Rau wrote two letters to Sergeant Bedsworth which were grossly false and misleading. In addition Rau had a number of discussions with Sergeant Bedsworth in which he made numerous grossly false and misleading statements. For example, in June 1961 Rau told Sergeant Bedsworth that Old Empire had plans for buying a new building and expanding their markets to South America; and that the aerosol business was a booming thing and that "Old Empire had the machinery and the wherewithal to expand this market."

Based on these representations and the fact that Rau "was buying more for himself" Sergeant Bedsworth bought 250 additional shares of Old Empire.

In addition Bedsworth recalled that he had been informed that an officer of Laird Bissell had considered Old Empire stock and had assured Rau that it was all right. At this time Sergeant Bedsworth told Rau that it would be necessary for him to sell other securities in order to purchase additional securities of Old Empire. On June 1, 1961 Rau sold Sergeant Bedsworth 250 shares of Old Empire at $7 per share. In order to pay for these shares Sergeant Bedsworth sold 100 shares of Royal MacBee and made up the difference to pay $1,750 for the stock. Between June and September 1961 Sergeant Bedsworth spoke to Rau several times concerning the decline in Old Empire stock. Rau told the Sergeant that he should not sell his Old Empire stock because the company was growing and was going to issue some debentures and that as soon as the Securities and Exchange Commission had cleared this the stock would "go places". During one of his conversations Sergeant Bedsworth saw and discussed with Rau a letter from Sneed stating that Old Empire had some difficulties with production, but that everything was going to be all right.

Rau never told Bedsworth the extent or nature of Old Empire's production difficulties, or gave him any information regarding the company's need for working capital, or the serious nature of its financial problems.

Both Rau's written and oral representations were false and misleading.

Charles F. Hirsch, Jr. ("Hirsch"), a salesman purchased 100 shares of Old Empire on June 8, 1961 at a price of 6 1/8 per share following a recommendation for the purchase of such securities made by Rau.

Prior to March 1962 Hirsch received a copy of the February, 1962 market letter in the mail. In March 1962 Hirsch visited Laird Bissell's Dover office and asked Rau why the stock had dropped from 6 1/8 to 5 1/2. Rau told Hirsch that the decline in the price of Old Empire stock was due to packaging and distribution problems which had been corrected and that by September 1962 Old Empire's shares could easily reach 16.

As a result of this conversation, Hirsch purchased 55 additional shares of Old Empire on March 8, 1962 at a price of 5 1/2 per share.

The representations made to Hirsch by Rau were grossly false and misleading.

In March 1962 Dr. John Lazzeri ("Lazzeri"), a physician visited Laird Bissell's Dover office to purchase shares of Sperry Rand but

Rau recommended instead that he buy shares of Old Empire. Rau told Lazzeri that he had purchased shares of Old Empire for himself, his wife and his mother-in-law and that Old Empire was selling vitamins to a milk company in Pennsylvania and was a good buy with a good future, and that Old Empire shares would go to 20 before long. Thereafter, Rau mailed Lazzeri a copy of Laird Bissell's February 1962 market letter. As a result of the conversation with Rau and his reading of the February, 1962 market letter Lazzeri purchased 100 shares of Old Empire for Laird Bissell at $5.25 per share.

The representations in the market letter were false and misleading as were Rau's oral representations to Dr. Lazzeri.

Laird Bissell in its brief claimed, among other things, ". . . even if Sneed and Kuehner had made additional investigations as suggested by the Division, the real cause of Old Empire's difficulties would not have come to light because of the deliberate concealment on the part of the management."

This contention does not meet the evidence in this case concerning the price and earnings predictions and the other false and misleading written and oral statements made by Laird Bissell's registered representatives. As the Commission pointed out in R. Baruch & Co., Securities Exchange Act Release No. 7932, p. 6 (August 9, 1966):

> "We have repeatedly pointed out that predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are inherently fraudulent and cannot be justified, and it is also well established that the making of representations to prospective purchasers without a reasonable basis couched in terms of either opinion or fact and designed to induce purchases

is contrary to the basic obligation of fair dealing of those who sell securities to the public." 37/

In addition, Laird Bissell's contention does not meet the fact that Laird Bissell's registered representatives were pointing out to investors that Laird Bissell had a director on the board of Old Empire and that, therefore, Laird Bissell's optimistic representations concerning Old Empire could be relied upon by the customers as correct. Furthermore, the suggestion in this contention that additional investigation would have been useless is inconsistent with the position of Laird Bissell in other parts of their proposed findings that the representations made in the market letter were in fact true. In fact, Laird Bissell's proposed finding is really an admission that the evidence developed in this case is inconsistent with the representations made in its market letters.

During the period from February to August 1962 when the February market letter was being used extensively by Laird Bissell both Sneed, Kuehner, and the other respondents associated with Laird Bissell knew or should have known of the continuously declining position of Old Empire in earnings, and of its seriously critical working capital position. Kuehner who had been ill prior to August, 1962 attended meetings of the board of directors of Old Empire thereafter. He was aware of the increasing financial difficulties

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37/ The Commission buttressed these views by reference to Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6846, p. 4 (July 11, 1962) aff'd sub nom. Berko v. S.E.C., 316 F.2d 137 (C.A. 2, 1963); J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7337, p. 6 (June 8, 1964); N. Pinsker & Co., Inc. 40 S.E.C. 285, 291 (1960).

of the company and of Old Empire's inability to overcome these difficulties. Kuehner was also aware of the fact that Laird Bissell had given approximately 1000 copies of the August market letter to Cortlandt and he knew that its use after August would be highly misleading and fraudulent, yet neither Kuehner or any other official of Laird Bissell took any effective steps to prevent the use of the August market letter by Cortlandt. It is true that one of Kuehner's superiors had directed him to obtain the return of the August 1962 market letter from Cortlandt because he objected to the use of the document on Laird Bissell's letterhead by some other firm, but Laird Bissell never offered to return the money paid to it by Cortlandt in connection with the preparation of the. document for public circulation, and never wrote to Cortlandt directing it not to use the document because it contained false and misleading statements. However, the fact that one of Kuehner's superiors had directed him to obtain the return of the document and had not circulated such documents through its own registered representatives is a fact which will be given consideration in connection with the public interest determination made in this proceeding concerning Laird Bissell.

In considering the February and August market letters it must be kept in mind that Laird Bissell was an underwriter for the debentures which had been offered and sold only a short time before the February 1962 market letter was employed.

In Charles E. Bailey, 35 S.E.C. 33, the facts were that an underwriter put out some false and misleading literature in addition to a prospectus, that some of the respondents had purchased stock themselves, and that other prominent persons had expressed their confidence by investing heavily in the stock.

The Commission pointed out that:

> "Bailey emphasizes, as an exculpatory factor, his purported substantial reliance on information furnished him by the issuer. Such reliance did not constitute discharge of the duty to exercise reasonable care that rested on registrant as underwriter, or a defense to circulation of the materially misleading and deficient statements noted above. Moreover, where, as here, an issuer seeks funds from the public to finance a new and speculative venture, the underwriter must be particularly careful in verifying the issuer's obviously self-serving statements as to its operations and prospects. All individual respondents had copies of the press release and the prospectus, which, as shown above, contained inconsistent assertions on such material matters as the machine's capacity and production, and these discrepancies should have raised serious doubts as to the accuracy of the information furnished." [Footnotes omitted.)

The reliance of Sneed, Kuehner, and Laird Bissell upon the statements by Old Empire's management officials was seriously misplaced. Furthermore, since Laird Bissell represented to customers that because Kuehner was a director, they could rely upon the broker-dealers' representations concerning Old Empire's business, 38/ its defense that it relied upon the management's representations rather than upon the broker-dealer's knowledge of the business is without merit. The Commission pointed out in Shearson Hammill & Co.,

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38/ In Equity General Investment Corporation, Securities Exchange Act Release No. 7388 (August 13, 1964) the Commission stated that:

"Garber contends that he had no intention to deceive his customers, who he asserts were experienced investors. He

(continued on following page)

Securities Exchange Act Release No. 7743, p. 18 (November 12, 1965), that whatever business practice there may be for directors to rely on information supplied by management, where a director is engaged in the business of selling securities, his duty to deal fairly with customers requires that recommendations and representations made to them be based on facts, not self-serving statements by management unaccompanied or unsupported by financial statements. Here the representations made in the market letters received no support in financial statements by the management of Old Empire. Furthermore, Old Empire's consistent need for working capital expressed on numerous occasions to Sneed throughout the period involved in this proceeding should have alerted Laird Bissell to the necessity to setting forth the facts concerning Old Empire's inadequate working capital position and other materially adverse business and financial problems in any letter sent to investors.

38/ (continued from preceding page)
claims that he merely passed on to them information he received from Huey and from the president and other personnel of Cemex to the effect that Cemex was then making money, would earn $1 per share and had filed a listing application, and that he disclosed the fact that the stock was a speculation. However, there was no justification under the circumstances for Garber's acceptance at face value and relaying to his customers of the self-serving optimistic statements of Huey and the Cemex officials. These statements, insofar as they related to present and projected earnings, were inconsistent with the picture portrayed by the offering circular of a highly speculative venture. And in any event, the information furnished to him could not provide an adequate basis for his specific prediction as to future price increases." (Footnotes omitted.) See also Shearson Hammill, footnote 17 supra; Alexander Reid & Co., 40 S.E.C. 986 (1962). Cf. A.J. Caradean & Co., Inc. 4 S.E.C. 234. In this case, the fact is that Laird Bissell had its designee, Kuehner on the board of Old Empire and called this to the attention of investors as an attribute of reliability as to their representations concerning the company.

The February market letter was seriously misleading and by reason of the unwarrantedly optimistic predictions of increased sales and earnings, and by reason of its failure to state material facts concerning Old Empire's financial conditions and operations, it was sufficient in and of itself to induce investors to purchase the stock. In this connection, eight investors appeared as witnesses who testified that they had made purchases of Old Empire after they received the February market letter. Some of these sales were made through certain of Laird Bissell's registered representatives who were not named as respondents in this proceeding but who also made false and misleading statements concerning Old Empire. Some of these investors, however, purchased Old Empire stock relying solely on the misleading representations made in the February market letter. These sales involved not only the New York and Dover offices of Laird Bissell but also their offices located in Wilmington, New Haven and Philadelphia.

Among the oral representations made to some of these investors by Laird Bissell's registered representatives were that the expected price-earnings ratio for Old Empire would be around 10; that there was nothing "basically wrong with the company; it was just growing pains. . .;" 39/ that Old Empire was a very good thing to put one's money into, that it was an old company that had new life and good possibilities; and that it was acquiring new managerial ability and,

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39/ This representation was made to a customer after the price of Old Empire had dropped to about ½ of what the customer had paid for the stock.

therefore, would be in a position to do better.

Cortlandt and its registered representatives mailed between 100 and 200 copies of the August 1962 market letter to customers.

During the period after the market letters were being distributed both Laird Bissell and Cortlandt increased their sales of Old Empire securities significantly.

Cortlandt made a market in the securities of Old Empire from 1960 to 1964. In 1960 Cantor wrote and distributed a "Special Situation Report" recommending Old Empire. During the period from April 1961 to September 1963, Cortlandt sold 45,640 shares.

During the period involved in this proceeding, the securities of Old Empire were offered and sold by Cortlandt principally through the mailing of Laird Bissell's market letters followed by telephone solicitations by registered representatives of Cortlandt.

Cantor had obtained a list of Old Empire's stockholders and a list of Welton Labs customers from DeElorza, and Cortlandt contacted these stockholders and customers in order to sell them Old Empire securities.

Cantor hired and supervised the salesmen employed by Cortlandt. He claimed that he monitored telephone calls of Cortlandt's registered representatives but never found that any of the salesmen had ever violated any of the anti-fraud provisions of the Securities Acts.

Cantor and all the respondents (except Stone) [40/] associated with Cortlandt claimed that they relied upon the truth of the representations

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40/ Stone did not participate in the proceeding other than to file an answer denying generally the allegations made against him.

made in Laird Bissell's market letters. They contend that they were justified in repeating to their customers the representations made in the market letters primarily because of the excellent reputation and large size of Laird Bissell who furnished these letters to Cortlandt and because the representations made in the market letters were confirmed to them by DeElorza the chief executive officer of Old Empire; and they contend that they did not intend to practice a fraud upon their customers and that they acted in good faith.

They contend that they were without knowledge of any facts inconsistent with the representations made in the market letters and claim that if the market letter contained misstatements or omitted material facts so that members of the public were victimized, they also were victimized and, therefore, they cannot be held to have violated the anti-fraud provisions in the Securities Acts.

In addition, the respondent Reiter contended that he "is presumed to be innocent of any violation and such presumption must continue until overcome by evidence which removes any reasonable doubt. The mere preponderance of evidence should not be sufficient. To prove wilful violation, the Division must prove a conscious knowing intent." His views are echoed by the other respondents associated with Cortlandt.

The term "wilfulness" as used in the Securities Acts is not to be so narrowly interpreted as contended by the respondents.

For the purposes of a revocation proceeding under Section 15(b) of the Securities Exchange Act the term "wilful" characterizes an act as being neither unintentional or inadvertent. It refers to a conscious intentional act, and does not embrace knowledge that such act constitutes a violation of law. 41/ The fact that the person commiting the act does so because he believes it is lawful does not negate wilfulness. 42/ Contrary to Reiter's claims the imposition of a sanction is not a penalty but a remedial action taken by the Commission to protect the public against future danger of exposure to the type of conduct which impelled the Commission to order the sanction. 43/

The standards invoked by Reiter may be applicable in certain types of criminal proceedings but are not applicable in an administrative proceeding in which the Division seeks remedial action against a broker-dealer.

The fact that a broker-dealer and his registered representatives relied solely upon the self-serving statements of the management of the company in recommending securities has been held by the Commission as being inconsistent with his obligation to make an independent investigation of the facts. The reliance of a broker-dealer and his registered representatives upon the self-serving statements of the management of a company in recommending its securities has been held

41/ See Schuck v. S.E.C., 264 F.2d 358, 363, n. 18 where the Court said: "In Hughes v. S.E.C., 85 U.S. App. D.C. 56, 64, 174 F.2d 969, 977 (1949) we held that wilfulness for the purpose of Section 15(b)(D) means 'no more than that the person charged with the duty knows what he is doing. It does not mean that in addition, he must suppose that he is breaking the law."

42/ Halsey Stuart & Co., Inc., 30 S.E.C. 106, 126 (1949).

43/ Blaise D'Antoni Associates v. S.E.C., 289 F.2d 276, 277 (5th Cir. 1961); Kimball Securities, Inc., 39 S.E.C. 921, 924, 925 1960).

by the Commission as not constituting compliance with its obligation to deal fairly with customers and where he has not made an independent investigation of the facts the Commission has held that he has violated his obligation to deal fairly with the customers and has violated the anti-fraud provisions of the Securities Acts. 44/

Contrary to the views expressed by Cantor, Cortlandt, and its registered representatives, the obligations imposed by the anti-fraud provisions of the Securities Acts are much broader than they contend. 45/

The anti-fraud provisions not only prohibit false and misleading statements of a material nature, but also prohibit statements made without adequate basis, 46/ even though the person making them may believes them. 47/ Thus, broker-dealers have a duty of investigation. This rule applies to statements in the form of opinions as well as statements of facts, and in the case of predictions, it is immaterial that they ultimately prove correct if the person making them had no basis on which to make them at the time. 48/

44/ N. Pinsker & Co., Inc. 40 S.E.C. 285, 291-292 (1960); A.G. Bellin Securities Corp., 39 S.E.C. 178 (1959).

45/ See Cohen & Rabin, Broker-Dealer Selling Practice Standards; The Importance of Administrative Adjudication in Their Development, 29 Law & Contemporary Problems, 691, 702 (1964).

46/ e.g. Barnett & Co., Inc., 40 S.E.C. 521 (1961); Leonard Burton Corp., 39 S.E.C. 211 (1959).

47/ Alexander Reid & Co., Securities Exchange Act Release No. 6727 at p. 5 (February 8, 1962).

48/ Securities Exchange Act Release No. 6721 at p. 3 (February 2, 1962) (Statement of Policy); Cf. Standard Bond & Share Co., 34 S.E.C. 208 (1952). See also Cohen & Rabin, Broker-Bealer Selling Practice Standards; The Importance of Administrative Adjudication in Their Development, 29 Law & Contemporary Problems 691 (1964).

Furthermore a salesman is not entitled to rely upon statements by his superiors who in turn rely upon self-serving statements of the issuer's officers.[49/]

Cantor claimed that he did not have and could not get up to date financial statements on Old Empire but accepted statements by the management that such difficulties as they had would be resolved. This contention did not relieve him of the responsibility for making statements concerning the business of Old Empire which misrepresented the facts. In these circumstances, if he did not have the facts, he should not have made representations concerning them.

Cantor was fully aware that Old Empire had shifted its principal business from contract manufacturing to manufacturing for itself, a different kind of business from that in which the company was previously engaged. In these circumstances, he was or should have been aware of the danger of making unfounded representations and predictions concerning Old Empire's business.

Cantor was clearly responsible for representations made by his registered representatives.[50/] It is inherent in the broker-dealer registration requirements that a registrant be accountable for all violations of the anti-fraud provisions of the Securities Acts committed

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49/ J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7737 (June 8, 1964); Berko v. S.E.C., 316 F.2d 137 (1963).

50/ S.P. Levine & Co., Inc., Securities Exchange Act Release No. 7401, p. 3 (August 20, 1961); Best Securities, Inc., 39 S.E.C. 931, 934, n. 137 (1960).

by any person employed by him as a registered representative. 51/ This principle which has been expressed in Commission opinions was codified in Section 15(a)(5)(E) of the Securities Exchange Act of 1934 calling for appropriate administrative sanctions against a registrant's failure to supervise his employees. It is a requirement under the Exchange Act that a registrant establish a system of internal controls for the purpose of preventing violations of the securities laws by controlled persons. 52/

A broker-dealer has a very important obligation to exercise more than ordinary care in hiring employees. As we have noted Stone was president of S.A.E. Corporation whose registration was denied by the Commission because it had filed false financial statements and had filed false information concerning Stone's prior employment. Stone was found to have aided and abetted such violations. Within a period of approximately ten years, Stone held twelve different jobs as a registered representative with eight different brokers. He had been employed at McGrath Securities Corp. at the time he was indicted by a federal grand jury in the Southern District of New York for his sales in United Dye Corporation but this indictment was dismissed as had a similar indictment against Kramer. Kramer had been employed by sixteen different broker-dealers in approximately ten years.

51/ See National Association of Securities Dealers, Inc., 20 S.E.C. 508, 516 (1945); see Securities Exchange Act Release No. 3674 April 9, 1945, pp. 1-2.

52/ R.H. Rollins & Sons, 18 S.E.C. 347 , 390, 395 (1945); Bond & Goodwin, Inc., 15 S.E.C. 584, 599, 601 (1944).

Reiter had been employed as a registered representative by M.J. Reiter & Co. from January 1959 to April 1962 when the firm came under investigation of the Attorney General of the State of New York. On July 13, 1962 the Commission issued its findings and opinions revoking the registration of M.J. Reiter because it had violated various provisions of the Securities Acts including violations of the anti-fraud provisions relating to the offers and sales of securities. In April 1962 Reiter was a registered representative at S.P. Levine & Co.

While none of the registered representatives were ever convicted of any crime, Kramer and Stone floated from one securities firm to another.

Under the Exchange Act, a registered broker-dealer may not engage in careless hiring practices.[53/] In view of the background of the registered representatives, close supervision was necessary. Cantor conceded in testimony which he gave during the Division's investigation of this case that he did "bend the line" when he hired Kramer and Stone. In any event, Cantor's claim of adequate supervision in this case is negated by evidence that he himself aided Kuehner and Stone to make sales of Old Empire securities by means of false and misleading statements, and that he himself made false and misleading statements to investors.

53/ See S.E.C. v. Rapp, 304 F.2d 786 (2d Cir. 1962); J. Logan & Co., Securities Exchange Act Release No. 6848, p. 11. And see Boruski v. S.E.C., 289 F.2d 738 (2d Cir. 1961).

Cantor conceded in his testimony taken during the investigation that he had been informed by John Horn in early 1962 that some of the technical and managerial personnel were not coming to Newark from Philadelphia, but that DeElorza did not consider it a major problem. In any event, Cantor never made any independent investigation to ascertain the accuracy of the representations in Laird Bissell's market letters which he was using to sell securities.

In November or December 1962 Cantor had a conversation with Sneed and asked him what he thought about the future of the company Sneed told Cantor ". . . it is a situation that could go either way according to John DeElorza" and, in addition, Sneed told Cantor, "You will just have to ride it out and see what happens. You have a choice of taking a big loss for your customers, or ride it out and see if it can be turned back on the proper basis."

Cantor had also been informed by DeElorza prior to receiving the August 1962 market letter that the generic drug program had been moving along slower than the company had anticipated.

In January 1963 both Sneed and DeElorza informed Cantor that Old Empire was having financial problems. In January 1963 Sneed also told Cantor that the problems of personnel and the problems of production had not been overcome, that as a result of these problems losses were incurred and that the losses that incurred were now presenting problems. In January 1963 Cortlandt sold 2,800 shares of Old Empire to Cortlandt's customers. In late February or early March 1963

DeElorza spoke with Cantor about the financial problems of Old Empire and told Cantor that Old Empire was trying to borrow $1 million. DeElorza also spoke about the possibility of merging Old Empire with another company as a way of "bringing in the necessary funds to put the company back on its feet." Cantor asked DeElorza to let him know if the company was successful in arranging the financing he needed because Cortlandt had many anxious stockholders. In May 1963 DeElorza telephoned Cantor and told him that Old Empire was getting a loan from a factor of approximately $1 million. DeElorza was optimistic and thought Old Empire stock was a good buy. Cantor knew, however, that the loan from the factor was senior to any other equity security of Old Empire and that it would have an important impact on the financial structure of the company. Cantor also knew that the factoring loan was made at the rate of 12½ percent per annum and that bank loans were made at the time at the rate of 5 percent to 5½ percent, and that this was an extremely high interest to pay in relation to borrowing from a bank.

Even though the August 1962 market letter was almost word-for-word copy of the February 1962 market letter, and even though Cantor knew that Old Empire was having personnel and working capital problems, he still did not conduct any independent investigation as to the accuracy of the August 1962 market letter.

Cantor spoke to DeElorza about the market letter, but did not question him in detail about it. Cantor stated:

> "There were many things stated in the letter and I didn't check out every single item. I relied on the statements of Laird Bissell . . . I did check with DeElorza as to the

> prospects for the company. He was very optimistic and that was the extent of my questioning the letter. . . . I did not go into the generic drug program or dissect the letter per se. I was only interested in the bottom line, the end results. He was optimistic that they were going to make money and that was good enough for me."

Cantor did not undertake any independent investigation to determine the accuracy of the statements contained in the market letter. Cantor did not examine any of the current books and records of Old Empire to determine the accuracy of the predictions contained in the market letter, nor did he make any industry survey to determine the basis for any of the sales predictions in the market letter.

Between July and October 1962, Cortlandt sold 24,000 shares of Old Empire.

In January 1963, DeElorza told Cantor that Old Empire was having serious production and personnel problems, that the company was losing money and that the company had financial problems.

However, in January 1963, Cortlandt sold 2,800 shares of Old Empire to customers. Cortlandt sold 5,300 shares of Old Empire to customers during May and June 1963 and 9,300 shares of Old Empire to customers during August 1963.

Four witnesses testified that they were solicited to purchase Old Empire's securities on the telephone by Cantor, namely Janice Bowen ("Bowen"), a social worker, Eleanor Lauffer ("Lauffer"), a widow living on retirement income, Charles Pieper ("Pieper"), a photostat operator, and Joseph Weber ("Weber"), a hairdresser.

Bowen had never heard of Old Empire until she received a telephone call from Cantor in July 1962 recommending that she buy Old

Empire stock because, according to Cantor, it was an excellent growth stock in a good company. Cantor represented to Miss Bowen that Old Empire's earnings were expected to double in 1962, that the company expected to pay dividends that year and that the company's promotional programs had been successful and would be more successful in the future. Old Empire had never paid a dividend in its entire history.

He omitted to advise her about the failure of key personnel to move to Newark with the newly acquired subsidiaries and did not inform her concerning the disruption of the company's production due to the move to Newark, or the inability of Old Empire to make vitamin deliveries or give her any other information concerning the straitened financial condition of the company.

Bowen asked Cantor to send her some literature on Old Empire and Cantor mailed her a copy of the February market letter together with some Old Empire newsletters and a financial statement for Old Empire.

About ten days after mailing this literature, Cantor had another telephone conversation with Bowen. Cantor told her that Old Empire had been successful and they would be more successful in the future.

Cantor asked Bowen what her reaction was to the material he had mailed to her. Bowen emphasized that at this point in her life she wasn't particularly interested in investing in speculative stock but had learned from the literature Cantor had sent her that the company had issued a "convertible debenture bond" which was paying 6 percent and she believed that it would be better for her to purchase a bond which would give her an opportunity to participate in the growth of the company since it was convertible into common stock. Cantor did not advise the witness of material facts concerning the debentures, specifically that the debentures were unsecured except by the general assets of the company and were subordinate to all senior indebtedness. Bowen had never purchased a bond before she decided to buy the Old Empire debenture. As a result of this conversation on July 20, 1962, Cantor sold Bowen one Old Empire convertible debenture at a price of $940. Bowen mailed Cortlandt a check for $940 and received a confirmation by mail.

Some time in December 1962 Joseph Weber, who owned Old Empire debentures purchased through Kuehner and had purchased and sold Old Empire shares through Kuehner, received a telephone call from Cortlandt. Both Cantor and Kramer spoke to Weber during the course of this conversation. Weber, a hairdresser living in New York City had never done any business with Cortlandt and had never met either Kramer or Cantor. Kramer and Cantor knew that Weber owned Old Empire securities and recommended that Weber purchase additional shares of Old Empire. Weber told Kramer that he wanted to invest in blue chip securities. During this conversation Kramer and Cantor told Weber that Old Empire "would be a good investment and probably make a few points". Kramer and Cantor told Weber that Old Empire "was a productive drug firm" but they did not tell him any of the facts concerning the critical financial condition of Old Empire; the problems of production of Old Empire; and the lack of success of Old Empire's programs.

As a result of the conversation, Kramer and Cantor sold Weber 500 shares of Old Empire at a price of $2.625 per share for which he paid by check and for which he received a confirmation in the mail.

In May 1963 Cortlandt sold Weber additional securities but this sale was made by Kramer alone. Kramer represented that Old Empire had received a $1,000,000 loan in May 1963 and due to this loan the value of Old Empire shares would go up again. However, Kramer did not inform Weber about the serious financial condition of the company or the terms and provisions of the loan.

Lauffer, a widow living in Brooklyn, New York on her retirement income first heard of Old Empire in July 1962 when she received a telephone call from Stone, urging her to buy Old Empire stock. Lauffer explained to Stone that her husband was seriously ill and that she was not in a position to buy any stock. Stone continued to urge Lauffer to buy Old Empire stock. He told her that Old Empire shares were selling at $3.50, had sold for $5.50 per share and would go to $6.00 in the near future. Lauffer purchased 200 shares at $3.50. In order to pay for these securities, she took $700 from her savings account. Stone omitted to state material facts to Lauffer concerning the problems of consolidation of Old Empire's new subsidiaries, the failure of scientific and technical personnel to move to Newark with the new subsidiaries, and the problems of production at Old Empire and its effect on Old Empire's new promotional programs. In August 1962 Stone again called Lauffer and persuaded her to purchase an additional 100 shares of Old Empire. Stone omitted to state to Lauffer material facts concerning the problems of production at Old Empire, the problems of consolidating Old Empire's new subsidiaries and the difficulties of Old Empire in replacing scientific and technical personnel that did not move to Newark with the new subsidiaries. After Lauffer's conversation with Stone she received a copy of Laird Bissell's February market letter in the mail. She thereafter telephoned Cortlandt and asked to speak with Stone. Cantor spoke with her on the telephone and advised her that Stone was ill. Several weeks later she called Cortlandt again asking to speak with Stone. Cantor spoke with her on the telephone again and advised her that Stone was in Chicago. Lauffer then told Cantor she was calling in regard to Old Empire, and she asked various questions of him. During the course of this conversation, Cantor told her that Old Empire was involved in a $3,000,000 deal and that the president of Old Empire was a very hard-working man. Cantor told Lauffer that Old Empire "was $5.50 at one time and he expected it would be $6.00 in the near future".

The reason Cantor assigned for the stock going up was that there was a deal of $3,000,000 and it would put the company in a much better position, and that the stock would go up to $6.00 in the near future. Cantor's representations to Lauffer concerning Old Empire were false and misleading.

Pieper, a photostat operator initially purchased and sold Old Empire stock in 1960 or 1961 through Cortlandt. He did business at that time with Cantor and Stone. Pieper had seen Old Empire's plant because it was located near his daughter's home.

Between July and September 1962 Pieper had several conversations with both Stone and Cantor concerning Old Empire both on the telephone and in their offices. Stone and Cantor told Pieper that Old Empire was a family-held affair and now would be the time when they were going to expand and get public money to increase the size of the business. Stone gave him this advice over the telephone and Stone got Cantor on the phone and they both told him that "now the thing was going to expand."

Pieper testified that:

> "According to Ed Stone, supplemented and amplified by Melvin Cantor, Old Empire was now going to embark on a -- a new phase of the packaging.
>
> Up to that time they were in the packaging business exclusively. That is, they received the bulk from Helena Rubenstein or Burma Shave, or somebody else, and they would package it, put it in these little containers, and they would wrap it all up and get it ready for sale.
>
> The amount of profit could be a fraction of a cent, as you could readily understand.
>
> Now, with this additional money they were going to go into the business of making these things directly, completely without some other intervening firm."

Stone and Cantor also told Pieper that when Old Empire packaged their products, ". . . the amount of profits as they mentioned to [him] would not be a fraction of a cent per unit, but would be seven to eight or nine cents profit on each little item, and it made sense to me".

Pieper asked Cantor and Stone why he couldn't buy any of Old Empire's products around the New York and Newark area, and they told him that the company was going to use the public money and buy outlets like Whelan's or Liggets down in the Philadelphia area, and that by doing this the company would make substantial profits. Both Cantor and Stone informed Pieper that the company "had this geriatrics, some kind of vitamins for elderly people. . ." and that by manufacturing the products themselves Old Empire "would be able to sell them at lower cost than the average vitamin pills . .. and still make a fairly good profit." Pieper also testified that at ". . . any time that Mr. Stone would have any trouble selling me he would say, well, I will let you speak to Mr. Cantor". In addition, Stone told him that Old Empire was going "into the business of making drugs for prescription. Stone told him "the profits on prescription drugs is pretty high. . . ."

Later, Cortlandt sent Pieper by messenger a copy of the August market letter put out by Laird Bissell and Meeds, and the letter impressed the witness. Stone also telephoned the witness and said that Old Empire was "going to have a tie-in with having milkmen deliver your vitamins with the milk;" that in fact there were several conversations about the tie-in of vitamin sales with the delivery of milk.

Stone told Pieper that with the acquisition of Garde Drug, PD&S, and Welton Labs, the earnings of Old Empire would go up and in time would lead to dividends and that the market price of the stock would go up with the earnings. Pieper also informed Cantor and Stone that his investment objective was not to engage in speculation, but that he wanted to make an investment that he could leave to his daughter. Stone told Pieper that Old Empire was as good as anything he had bought. In the course of Pieper's conversations with Stone and Cantor, neither one informed Pieper concerning Old Empire's problems with the consolidation of the new subsidiaries and the problems of production of merchandise of Old Empire and he was never informed of the failure of scientific and technical personnel to move from Philadelphia with the subsidiaries being acquired. As a result of these conversations, supplemented by either Laird Bissell's February or August market letters, Stone and Cantor sold Pieper 100 shares of Old Empire in July 1962, 300 shares in August 1962 and 300 shares in September 1962 at prices ranging from $3.375 per share to $3.625 per share.

Cantor and Stone sold Old Empire to Pieper by means of false and misleading statements.

In addition to Lauffer and Pieper who were sold securities of Old Empire through the efforts of both Cantor and Stone, three additional witnesses testified concerning sales of Old Empire made to them by Stone without the active assistance of Cantor. All of these witnesses received telephone calls from Stone and discussed with him the purchase or the retention of Old Empire securities.

In July 1962 Stone telephoned Charles Trowbridge, who was a retired product sales manager formerly employed by Kraft Foods Company. Trowbridge had been a customer of Cortlandt beginning about 1958. He made two purchases of Old Empire in 1960 totalling 500 shares of Old Empire through Stone as a registered representative of Cortlandt, and thereafter sold the 500 shares in December 1960. In July 1962 Stone telephoned Trowbridge and recommended that he buy Old Empire again. At that time Stone recommended to Trowbridge that he reinvest in Old Empire because the company had made an acquisition and "it looked like they were coming up." Stone said that Old Empire had put in a new line of equipment, that the company should have a very good year, and that the price of Old Empire might go to maybe 5. The stock at that time was selling at $3.50 per share. Trowbridge purchased 100 shares. Stone omitted to inform Trowbridge concerning the failure of personnel to move to Newark with the new acquired subsidiaries but did tell Trowbridge that the move from Philadelphia to Newark had increased the efficiency of Old Empire's operation. Stone omitted to inform Trowbridge regarding the disruption of production caused by the move and its serious effect on Old Empire's problems.

In August or September 1962 Stone telephoned Trowbridge again to recommend that he purchase additional shares of Old Empire and told Trowbridge that Old Empire still looked good to him, but Trowbridge declined to make such purchases informing Stone that he did not have any money available to invest at that time.

The representations made to Trowbridge by Stone were false and misleading.

Mrs. Elaine Friedman ("Friedman"), a secretary, telephoned Cortlandt in August or September 1962 and had a conversation with Stone. Friedman informed Stone that she knew nothing about the securities market, was putting herself in his hands and would rely on his advice for any purchase of securities that she might make. Stone recommended that Friedman purchase Old Empire stock. He told her that "the price of the stock at this time was quite low but it had a great deal of potential because the company was going to merge and take on additional subsidiaries . . . ." Stone also said that the stock was going to go to approximately 5½ or 6 and that the company had growth possibilities. Old Empire's stock was being offered at this time at $3.75 per share. Several days later, Stone telephoned Friedman and urged her to purchase securities of Old Empire at that time in order to get in right at the bottom before the market changed. As a result of these conversations Friedman purchased 400 shares of Old Empire on September 7, 1962 at $3.75 per share and received a confirmation from Cortlandt by mail.

In the latter part of 1962 Friedman made a series of telephone calls to Stone regarding the price of Old Empire shares. She was informed that the price of Old Empire was falling and asked Stone whether she should sell her shares. Stone advised Friedman not to worry that things would be different and to wait. He advised Friedman to be patient that there were going to be changes made in Old Empire which would ultimately affect the stock and not to sell her stock.

Stone's representations to Friedman were false and misleading.

Jack Margolis ("Margolis"), an insurance broker, had dealings with Cortlandt both as an insurance broker and as a customer. In early July and August 1962 Stone discussed with Margolis stock which he had sold to Margolis when he was at Schram & Co., another brokerage house. Margolis told Stone that he wasn't happy with the stock that Stone had sold him previously. Stone advised Margolis that the stock he had sold him previously didn't have much potential and advised him to sell it and buy Old Empire. Stone told Margolis that Old Empire was in the process of merging and that Old Empire stock had "terrific potential, will go up in price" and that Margolis "will be able to make a substantial profit on this stock." Stone also told Margolis that Old Empire was an "old established company" and had "quite a bit of experience in the manufacture of these items, these drugs. . . ." Stone added that Old Empire had "merged with these other companies and they had a vaster distribution. These other companies had other outlets -- and can increase the sales potential of Old Empire." Stone told Margolis that Old Empire was "going to be able to produce and develop a much larger market because of the merger and they had the know-how and experience, etc." Stone added that the merger would "give [Old Empire] the additional executives or people who had the know-how to mass produce and sell it on a national scale of that nature. He said the merger would improve their marketing position."

Stone omitted to inform Margolis about the problems with consolidation of Old Empire's new subsidiaries; the failure of technical and scientific personnel to move to Newark with the new subsidiaries and the problems of production of Old Empire and its effect on Old Empire's new promotional programs. At the time of this conversation Stone showed Margolis a copy of one of Laird Bissell's market letters.

As a result of the conversation Stone sold Margolis 200 shares of Old Empire at $3.25 per share and Margolis paid for the stock by selling other stock and paying the difference in cash. The representations made to Margolis by Stone were false and misleading.

Reiter offered and sold the securities of Old Empire from May 1962 to August 1963. Reiter mailed copies of the February market letter which he received from Cantor to both his own and Cortlandt house customers. In June 1962 Reiter, Stone, and other persons visited Old Empire's offices in Newark and spoke to DeElorza who advised them that all the representations made in Laird Bissell's February market letter were correct, and took them through the plant where goods were being manufactured and which appeared to be in good condition. DeElorza said that the representations in the market letter would be exceeded by the company. Reiter did not question the accuracy of any of the statements made to him by Old Empire's management. He asked DeElorza if he anticipated earnings per share would run approximately 40 to 45 cents and DeElorza said "yes, may be better". However, Reiter did not inquire as to the basis for the predictions with respect to future sales and earnings nor was he shown any financial statements of Old Empire or subsidiaries. Reiter made no independent investigation concerning the accuracy of the contents of the February 1962 market letter or the representations made by DeElorza. However, during the period between November 1962 and May 1963 Reiter had information from Cantor that Old Empire was having trouble with working capital, production and deliveries.

Reiter testified that in November 1962 Cantor had asked its registered representatives to stop recommending Old Empire, that he had heard that they had problems and there was a conversation in reference to these problems. In May 1963 Reiter became aware through Cantor that Old Empire had negotiated a loan from a factor. Cantor told Reiter that DeElorza had informed him that with this loan the company would have "clear sailing". On this basis and despite his knowledge that prior representations and predictions by the management of Old Empire had been inaccurate, and without independent investigation Reiter continued to sell securities of Old Empire on the basis of predictions made by DeElorza to Cantor.

Three investor witnesses namely, Samuel Wittlin ("Wittlin"), a plumbing contractor, Dr. John C. Weaver ("Weaver"), a practicing physician and F. Wilson Smith ("Smith"), who is in the restaurant food and supply business, testified concerning representations made to them by Reiter.

In August 1962 Reiter telephoned Wittlin and recommended that he purchase Old Empire stock. Reiter told Wittlin that Old Empire was an old company and was doing well; that business was down now but it would be better shortly and that Old Empire might pay dividends later.

Reiter made no reference to the material facts concerning Old Empire's problems of consolidating new subsidiaries, the failure of scientific and technical personnel to move to Newark with the subsidiaries, the disruption of production and its effect on Old Empire's new promotional programs and the effect on the financial condition of the company.

Later in the month of August, Wittlin received in the mail a copy of Laird Bissell's August 1962 market letter on Old Empire. As a result of Wittlin's conversation with Reiter and after reading the market letter, Wittlin purchased on August 16, 1962 200 shares of Old Empire at $3½ per share.

Reiter telephoned Wittlin in May, 1963 and in one or two conversations with him, recommended additional purchases of Old Empire. At this time Reiter informed Wittlin that the financial condition of Old Empire "was not good at the time" but that "it is going to do better, later"; and that the price of the stock would "do much better than what it has done." Reiter omitted to inform Wittlin of material facts concerning the losses of Old Empire for the year ended January 31, 1962 and Old Empire's need for more working capital or the company's working capital problems or delivery problems. As a result of these conversations on May 16, 1963 Reiter sold Wittlin an additional 300 shares of Old Empire at $1.25 per share.

There was no basis in August 1962 and May 1963 for Reiter's representations to Wittlin and they were false and misleading.

Weaver first heard of Old Empire sometime in May or June of 1962 when he received a telephone call from Reiter recommending that he purchase stock of the company. At the time Reiter was offering Old Empire at $3½ per share. Weaver told Reiter that he wanted assurance from him that Old Empire would not go down. Reiter assured Weaver that the price would stay up. Weaver then asked Reiter whether Old Empire shares would go as high as $10 and Reiter expressed the opinion that Old Empire would go to $10 over the next several months. In addition Reiter represented that Old Empire was in the black and was a substantial company; the value of its stock would stay up and the company was expected to pay dividends in a short time. During Weaver's cross-examination he conceded that he had between 1960 and 1963 engaged in possibly 50 transactions with a number of broker-dealers in highly speculative securities and had also bought and sold other highly speculative securities through Reiter. He testified that he always asked Reiter to make price predictions on the securities he purchased through him and while Reiter did not always make a price prediction, he frequently did, "And he was pretty good at it. That is why I kept buying from him."

Weaver had testified on direct examination that he had only purchased 100 shares of Old Empire through Reiter. On cross-examination it developed that there was documentary evidence showing that Weaver had made two purchases of Old Empire stock, one on July 11, 1962 for 100 shares at $3.50 per share, and one on August 16, 1962 for 250 shares at $3.50 per share. The documentary evidence consisting of confirmations also reflected that Weaver had sold 150 shares of Old Empire on November 2, 1962 at $2 3/8 per share. Weaver had no recollection of the second purchase or the representations made to him with regard to the second purchase. In addition it appeared that Weaver's check for $350 in payment for the 100 shares was returned for insufficient funds but that he gave Cortlandt another check on July 20, 1962 which was paid. He also conceded that a few other checks had "bounced". While Weaver was aware of the speculative nature of securities he believed that because Reiter had a lot of experience in securities his opinion had more value than someone else's opinion and that he considered Reiter "to be an expert in his field". Weaver testified that he was aware that predictions of prices with regard to speculative securities could not be made with "scientific accuracy" but believed that "people who have been in business in securities for years must have some idea."

Weaver testified that he now believes that "nobody can predict with any degree of certainty which way the stock market will go", but prior to 1962 he was not of this opinion, and that he didn't know in 1962 that nobody could predict the market.

The hearing examiner observed all the witnesses including Weaver and Reiter and credits Weaver's testimony as to his transactions with Reiter and does not credit Reiter's testimony concerning his transactions with Weaver. Reiter's general "sales pitch" to Weaver was consistent with the generally false and misleading approach taken by him in making sales to other customers. Weaver apparently was busy with his medical practice and did not recall his second purchase of Old Empire securities or the facts surrounding such purchase. However, his failure to recollect this purchase did not destroy his credibility as a witness.

Reiter omitted to state material facts to Weaver concerning problems of Old Empire's acquisitions in the consolidation of its new subsidiaries, the failure of scientific and technical personnel to move to Newark with the new subsidiaries and the problems of production of Old Empire and its adverse effect on Old Empire new promotional programs. In July Weaver purchased 100 shares of Old Empire at a price of $3.50 per share.

Smith received a telephone call in August 1962 from Reiter who recommended that he purchase 200 shares of Old Empire. Reiter represented that Old Empire was going to do very well and that its sales would double in a year.

Reiter omitted to state material facts to Smith concerning the problems with the consolidation of Old Empire's new subsidiaries, the failure of scientific and technical personnel to move to Newark with the subsidiaries and the problems of production at Old Empire. On August 16, 1962 Smith bought through Reiter 200 shares of Old Empire at $3.50 per share and he received a confirmation from Cortlandt in the mail thereafter.

Approximately a year later in August 1963 Reiter telephoned again and recommended that he purchase additional shares of Old Empire. At the time Old Empire was offered by Reiter at a dollar per share. Reiter recommended that Smith "average down" because in that way he would come out well in the long-run. Reiter represented that Old Empire was in good shape and should have good earnings and that "the stock would go to double the original price [Smith had] paid for it. . . ."

At that time Reiter omitted to state material facts to Smith concerning the company's lack of working capital, the facts regarding the loan which Old Empire had received from a factor, the failure of the company to get scientific and technical personnel to move to Newark with the subsidiaries and the problems of production of Old Empire and its effect on Old Empire's ability to make deliveries and the company's straitened financial condition. As a result of the conversation on August 9, 1963 Reiter sold Smith an additional 200 shares of Old Empire at a price of $1.00 per share.

Kramer offered and sold securities of Old Empire from November 1962 to September 1963. Cantor gave Kramer a file in November 1962 containing Cortlandt's house accounts as well as several names from Old Empire's shareholder list and told him to sell stock of Old Empire. In addition, Cantor gave Kramer copies of the August 1962 market letter which Kramer mailed to all prospective customers throughout 1962 and into the fall of 1963.

At no time did Kramer conduct any independent investigation as to the reliability of the statements contained in the market letter. The information contained in the market letter was Kramer's only basis for recommending Old Empire stock.

In May 1963 Kramer learned through Cantor that Old Empire was about to get a loan to improve its financial position. He had no other information from Cantor or anyone else regarding the company at that time. Old Empire's annual report for 1963 came out in June 15, 1963 and that report contained information which indicated clearly that the predictions in the August 1962 market letter had not been realized. Nevertheless, Kramer was still recommending Old Empire in August 1963 on the basis of the August 1962 market letter.

In addition to Kramer's selling activities discussed hereinabove, the Division presented evidence by two additional witnesses concerning Kramer's sales of Old Empire securities.

Filomena Sokola ("Sokola"), a credit manager of East Orange, New Jersey bought and sold shares of Old Empire in 1960 through Cortlandt. In August 1963 Kramer telephoned Sokola recommending that she purchase Old Empire securities. Kramer told Sokola that Old Empire was a good buy that the company was expanding its plant; that she would make a profit in Old Empire securities; that Old Empire was in good financial condition and its stock would go up.

Kramer omitted to state material facts to Sokola concerning Old Empire's lack of working capital, its inability to make vitamin deliveries, and the effect of such inability on Old Empire's promotional programs. He omitted to inform her of the failure of the company to get some of the important scientific and technical personnel to move to Newark with the new subsidiaries and did not inform her of the problems of productions which Old Empire had.

As a result of this conversation, Sokola purchased on August 29, 1963, 200 shares of Old Empire at $1.00 per share, for which she received a confirmation in the mail. Kramer's representations to Sokola were false and misleading. In August 1963 Kramer telephoned Garnett Newton ("Newton"), a roofing contractor, and spoke with him concerning Old Empire. Kramer recommended that Newton sell other securities he had purchased through Cortlandt and buy shares of Old Empire. Kramer had several conversations with Newton in which he told Newton that Old Empire was a growing company, was a good investment and that its shares would go up in price. Newton purchased 500 shares of Old Empire from Cortlandt at $1 per share on August 15, 1963. Newton paid for his shares by selling other stock which he owned. In none of the conversations with Newton did Kramer ever inform

Newton concerning Old Empire's financial condition, the earnings of Old Empire for the year ended January 31, 1963, the company's problems in consolidating new subsidiaries acquired by Old Empire, the failure of scientific and technical personnel to move to Newark, and the problems of production of Old Empire and its effect on promotional programs. Between August 15, 1963 and September 1963, Newton received a copy of the August 1962 market letter.

In addition to Kramer's sales discussed herein, it will be recalled that Kramer together with Cantor sold shares of Old Empire to Joseph Weber and the facts and the circumstances relating to this matter have been discussed hereinabove.

. . . .

The respondents in their supporting briefs contended, among other things, that the Division is attempting to persuade the Commission to judge their market letters by the same standards as it would judge a prospectus under the provisions of the Securities Act of 1933. In this connection, they argue that the Division's theory is at variance with the recognized function of market letters to provide a legitimate source of readily available information for investors and they further contend that application of a 1933 Act standard to market letters would be contrary to the public interest in that it would inhibit the avilability of information to investors through such communication. In this connection, the respondents quote the following statement in the Commission's Report of its Special Study of the Securities Markets:

> "The responsible dissemination of sound investment advise, even as a method of sales promotion, is clearly beneficial to the investment community at large." Report of Special Study of Securities Markets, Part I, p. 386 (1963).

In addition, respondents call attention to a statement issued by the NASD on on September 1, 1964 reading as follows:

> "The proper use by members of advertisements, sales literature, market letters . . . to interest and inform the public concerning securities . . . is encouraged." National Association of Securities Dealers, Inc. Manual G-19 (1964)

The contentions of the respondents seem to the hearing examiner to be an overstatement of the Division's position in this proceeding. The Division's position is not inconsistent with the quotations contained in the respondents' briefs. The Division's contentions were not directed against the responsible dissemination of information in market letters. Its attack was on material which it contended was irresponsibly prepared and was false and misleading. It was in this connection that the Division in its reply brief quoted the following language from the study:

> "When responsibly prepared, these materials play a useful part in the flow of reliable information about securities which is so important to sound investment decisions. When irresponsibly or recklessly prepared, or when too casually based on unfounded statements of unreliable company managements, they can start a chain reaction which may end in disaster for many investors." Report of Special Study of Securities Markets, Part I, p. 383 (1963).

The hearing examiner concludes that:

A. During the period from approximately April 19, 1961 through approximately September 1963 the respondents Laird Bissell, Sneed, Kuehner, Isaacs, Rau, Cortlandt, Cantor, Stone, Kramer and Reiter, singly and in concert, directly and indirectly, made use of the mails and means and instruments of transportation and communication in interstate commerce and wilfully violated Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Securities Exchange Act and Rules 10b-5 and 15c1-2 in connection with the offer and sale of Old Empire common stock and debentures.

B. Respondents Cortlandt and Cantor were permanently enjoined by the United States District Court for the Southern District of New York on January 4, 1966 from:

(a) engaging in the securities business in violation of the Commission's Net Capital Rule;

(b) violating Rule 15c1-2 under the Securities Exchange Act in failing to disclose material facts concerning the net capital deficit of Cortlandt;

(c) hypothecating securities carried for the account customers in violation of Rule 15c2-1 under the Securities Exchange Act.

Public Interest

We have noted that a receiver was appointed for Cortlandt and that both Cortlandt and Cantor were permanently enjoined by the United States District Court for the Southern District of New York from engaging in violations described hereinabove. So far as this record is concerned there is no evidence that Cortlandt is actively engaged as a broker-dealer. Furthermore, Cantor who was the sole owner of Cortlandt pointed out in his brief that he "has not worked in the securities business for over one year" and referred to the "loss of his business" which he claimed was due to the action taken by the Commission. The record also reflects that Cortlandt violated the Rules of Fair Practice of the NASD in 1964 and that Cantor was found to be a cause in that proceeding. (See footnote 5 supra).

The record is abundantly clear that Cortlandt, Cantor, Stone, Kramer and Reiter made numerous grossly false and misleading statements in violation of the anti-fraud provisions of the Securities Acts over an extended period of time in the offer and sale of Old Empire's common stock and debentures. Furthermore, Cortlandt and Cantor failed to maintain and enforce adequate standards of supervision. Their defense to the charges made against them was devoid of merit.

Stone was found to be a cause of the denial of registration of S.A.E. Corporation, a broker-dealer. (See p. 6 hereinabove). In these circumstances it is concluded that the appropriate remedy in the public interest is the revocation of Cortlandt's registration with the Commission and its expulsion from membership in the National Association of Securities Dealers, Inc.

In view of the numerous fraudulent representations to investors made by Cantor, Stone, Kramer and Reiter the appropriate sanction is to bar each one of them from being associated with a broker or dealer.

Kuehner, Isaacs and Rau also made grossly false and misleading statements to investors both in writing and orally. In view of their numerous and serious violations of the anti-fraud provisions in connection with the sale and purchase of Old Empire securities, they also should be barred from being associated with any broker or dealer.

Sneed also violated the anti-fraud provisions of the Securities Acts as has been pointed out in detail hereinabove. It has been stressed on Sneed's behalf that he lent $112,000 to Old Empire during the period December 1962 to April 1963 and that his loss of this sum of money indicates that Sneed exercised a genuine effort to extricate the company from its financial predicament. It also appears to indicate a sense of responsibility and concern towards the purchasers of Old Empire securities in that such loans were made when the company was in serious financial straits and was made to protect the investment made by purchasers of the securities. An additional evidence of this attitude was the retention by Sneed of Old Empire stock resulting in a loss to him of over $22,000 and a loss of over $17,000 to guarantee payment to a supplier of Old Empire.

It appears to the examiner that Sneed may have been entrapped into this situation in part by his own gullibility concerning the truth of DeElorza's representations to him and in part by his reliance upon Kuehner to inform him responsibly concerning the company's market letter, and was responsible for the delivery of the August market letter to Cantor. Further, he misrepresented financial facts to Bank Rohner. In addition he did not properly supervise the activities of the registered representatives. He is not without serious responsibility in this matter.

It appears that Sneed has been retired from the business of Laird Bissell. Although Sneed's violations were substantial, there were some extenuating circumstances. Further his testimony in this case was not contrived as was Kuehner's. Based on the existence of these extenuating circumstances, the hearing examiner has concluded that it is not necessary to bar Sneed and that an appropriate sanction would be suspension for a 12-month period.

Since the institution of this proceeding, it appears that Laird Bissell has made organizational changes for the purpose of preventing the recurrence of the kind of violations which occurred here. Its business has been incorporated and its organization has been restructured. Major responsibilities of the firm have been diversified among a number of senior officers. It has set up a compliance committee headed by a vice president who was formerly an examiner of the New York Stock Exchange. Furthermore, Laird Bissell has installed electronic data processing equipment which is used for compliance processes. The company has established an institutional department whose sole function is research and the preparation of reports.

In this connection, it will be recalled that Sneed did not ordinarily write market letters and it is possible that his inexperience in this field, although he had been in the securities industry for many years, led to the making of representations which an experienced market letter writer for Laird Bissell might not have made. In addition, Laird Bissell is an established firm with a good reputation.
Laird Bissell has pointed out that its primary business comes from commissions on the trading of listed securities and from wholesale trading

of bank and insurance stocks. It was pointed out by the respondents that the firm specializes in two high-grade over-the-counter securities, Christiana Securities Company and American Express Company. It conducts very little trading in over-the-counter stock. An officer of Laird Bissell testified that its sales in Old Empire stock in 1962 amounted to only 1/25th of 1 percent of Laird Bissell's total business. Furthermore as has been noted hereinabove, while Laird Bissell was responsible for the preparation and delivery of the misleading August 1962 market letter delivered to Cortlandt, one of its partners directed Kuehner to recover such letter from Cortlandt, and Laird Bissell did not itself use such document in the sale of Old Empire securities, and lost approximately $138,025 in connection with Old Empire.

The violations of the anti-fraud provisions in this case arose from transactions in an over-the-counter security. Considering the serious violations involved it appears clear that some sanction should be imposed. However, the revocation of Laird Bissell's registration as recommended by the Division does not appear to the hearing examiner to be the necessary remedy in the public interest. The hearing examiner considers that suspension of Laird Bissell from membership in the National Association of Securities Dealers, Inc. for a period of 60 days is a sanction which would be adequate to serve the public interest.

Accordingly, IT IS ORDERED that the registration as a broker and dealer of Cortlandt Investing Corporation be, and it hereby is revoked and that Cortlandt Investing Corporation be and it hereby is expelled from the National Association of Securities Dealers, Inc., and

IT IS FURTHER ORDERED that Melvin Cantor, Samuel E. Stone, Max Reiter, Michael Kramer, Hanns E. Kuehner, Edgar F. Isaacs and Harold J. Rau be, and they hereby are barred from being associated with a broker or dealer; and that from the effective date of this order Louis J. Sneed be suspended from being associated with any broker or dealer for a period of twelve months; and

IT IS FURTHER ORDERED that from the effective date of this order Laird Bissell and Meeds is suspended from membership in the National Association of Securities Dealers, Inc. for a period of thirty days.[54]

This 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 Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the

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

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 files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.

Samuel C. Binder

Samuel Binder
Hearing Examiner

Washington, D.C.
September 25, 1967

ADMINISTRATIVE PROCEEDING
FILE NO. 3-133

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 2, 1967

In the Matter of LAIRD, BISSELL AND MEEDS (8-18) LOUIS J. SNEED HANNS E. KUEHNER EDGAR F. ISAACS HAROLD J. RAU CORTLANDT INVESTING CORPORATION (8-5630) MELVIN CANTOR SAMUEL E. STONE MAX REITER MICHAEL KRAMER	INITIAL DECISION ERRATA **(Private Proceeding)**

Page 29 - line 14 - Add the following sentence to the paragraph.

A similar exaggeration of the facts was made in Laird Bissell's representation that Old Empire's Newark plant and equipment had "been designed to conform to the highest standards of modern efficiency."

Page 32 - line 6 - Change "Laborities" to "Laboratories".

Page 38 - line 9 - Delete "company's".

Page 38 - line 13 - Change "January" to "February".

Page 54 - fn. 19 last line - Insert "also" between "and" and "fiscal".

Page 64 - line 21 - Change "due" to "date".

Page 65 - line 6 - Change "January" to "February".

Page 97 - line 9 - Change "for" to "from".

Page 135 - line 15 - Insert "not" after the word "was".

Page 135 - line 16 - Insert "but was an aider and abettor" after the words "broker-dealer."

Page 138 - line 21 - Change "60" to "30".

Samuel Binder

Samuel Binder
Hearing Examiner

Washington, D.C.
October 2, 1967