

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

INITIAL DECISION

(Private Proceeding)

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

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.

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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

*/ 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 15c1-2 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

^{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

^{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

^{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

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 individ-

ual 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
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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 installation 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
	<hr/>
	\$ 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

^{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 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 Laboratories, 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

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.

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

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

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 extraordinary 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

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.

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

^{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:

<u>January 31</u>	<u>Cash</u>	<u>Accounts Receivable</u>	<u>Inventory</u>
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.

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

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 alcohol 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.

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.

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.

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.

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.

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."

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

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.

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

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

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.

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.

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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 availability of information to investors through such communication. In this connection, the respondents

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.

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 Binder

Samuel Binder
Hearing Examiner

Washington, D.C.
September 25, 1967

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	:	INITIAL DECISION
EDGAR F. ISAACS	:	
HAROLD J. RAU	:	ERRATA
	:	
CORTLANDT INVESTING CORPORATION (8-5630)	:	(Private Proceeding)
MELVIN CANTOR	:	
SAMUEL E. STONE	:	
MAX REITER	:	
MICHAEL KRAMER	:	

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".

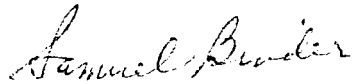
Page 54 - fn. 19 last line - Insert "also" between "and" and "fiscal".

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
Hearing Examiner

Washington, D.C.
October 2, 1967