1969

A REPORT TO THE HONORABLE LOUIS J. LEFKOWITZ

ATTORNEY GENERAL OF THE STATE OF NEW YORK,

PURSUANT TO SECTION 352 OF THE

GENERAL BUSINESS LAW

ON <u>NEW ISSUES OF SECURITIES</u>

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SECTION 1

SURVEY OF NEW ISSUES

TO: HONORABLE LOUIS J. LEFKOWITZ

FROM: DAVID CLURMAN
Assistant Attorney General
in Charge

At the end of May 1969 you requested that a study be made pursuant to Section 352 of the General Business Law into the so-called "hot new issues" market of securities that had resulted in severe upswings in the price of certain new issues of stocks sold in this State. Pursuant to that Section which authorizes the Attorney General to conduct an investigation into transactions relating to the offering and sale of securities within or from the State of New York when he deems it to be in the public interest, I assigned several members of the Bureau headed by the undersigned to conduct such inquiry under my direction. During the initial phase of the inquiry we were aided by documents and records made available to us by the Securities Bureau of this office headed by the Honorable Meyer H. Mencher.

The first stage of this inquiry was conducted during a 90 day period ending on September 1, 1969. Because of the important material gathered to that date it is felt that an initial report should be issued on several matters which have come to our attention because of the urgent public interest involved.

The report which is contained below is based upon records, documents, interviews and testimony obtained by staff of the Department of Law of the State of New York in the course of this initial inquiry and the conclusions contained herein are thus based upon such latter compilation upon information and belief, in furtherance of Section 352 of Article 23-A of the General Business Law of this State.

In examining the recent new issue market in the 1968-1969 period, perhaps the most striking feature is the nearly total ineffectiveness in this area of the traditional disclosure approach to regulation of securities offerings. The basic philosophy behind disclosure is that it will have some effect not only in deterring "fraudulent" promotions but in directing the flow of capital resources into those ventures which can make most effective use of them. Obviously, disclosure cannot achieve these goals completely; still, its failure here is too serious to overlook.

In this recent new issue market, a pattern emerged whereby substantial sums of money went into new and highly speculative ventures. The securities of these companies generally rose, frequently beyond all rational value and then returned somewhat to earth when the inevitable cooling off period began.

At the time interest in the new issues market was particularly high, investments in these companies were rarely made on the basis of their merit. Rather, the atmosphere became one of pure gambling and in the process it was not too difficult to rig the game. The big winners were underwriters, insiders of these companies and those who had contacts with these groups. The losers were those investors who purchased at inflated prices and the economy itself. As money poured into newly formed companies, these ventures had little choice but to seek quick investment of the funds received, thereby placing greater inflationary pressure on an already troubled economy.

In coming to these conclusions the study initially analyzed various aspects of some 103 companies all of which went public for the first time in the 1968-1969 period.

The first matter examined was the quality of the companies and the securities involved. A notable factor was the pattern in these new issues of dilution of the public equity. Corporate insiders acquired large blocks of stock at nominal prices. As a result, public investors purchasing at the offering price had the book value of their shares substantially reduced. The average dilution was 65 percent and one case reached the preposterous amount of 89 percent.

The dilution analysis prepared as part of the new issue survey utilized a sample of one hundred and three new issues whose initial offering ranged from $148,500 to $13,390,000. The following schedule presents details as to the size of the new issue security offerings selected for use in this study:

Size of Offering	Number of New Issues
$ 300,000 or less	52
300,001 to 500,000	5
500,001 to 1,000,000	17
1,000,001 to 2,000,000	15
2,000,001 to 3,000,000	5
3,000,001 to 4,000,000	4
4,000,001 to 5,000,000	1
6,000,001 to 7,000,000	1
8,000,001 to 9,000,000	2
13,390,000	1
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These reductions in book value are of considerable significance as these ventures frequently had no other objective criteria of value for investors. Our findings showed that earnings per share, prior to the public offering, were non-existent for 16 percent of companies and where such figures were present they were of a negative variety in an additional 29 percent. The only other key factor left upon which a company could be judged is its potential for future development. Yet, there was little in the prospectuses of most of these new issues to indicate that the issuing companies had any great promise. Indeed as will be seen, faith in a company's long term prospects was not a significant factor in inducing purchases of their securities.

Public participation and price movement were sometimes shocking. For example, the stock of one company with an appropriate space age name was issued at $2.00 and ran up to 7 1/2 before severe swings downward. That particular company represented in its prospectus that 60 percent of the proceeds were to be used for such items as past due accounts, repayment of loans, back wages, back rents and similar items. The issuer was a constant loser in operations and had a working capital deficit. In effect we concluded that the public issue was the method used to delay bankruptcy. Yet the price of the stock more than tripled in a short period of trading.

The study reached the conclusion that many companies are merely manufactured by underwriters for stock profits rather than bona fide new enterprises seeking capital in the securities market. Because of this situation, the underwriter may be placed in an awkward position with respect to disclosure of adverse information about the company during the course of issuance or trading. For example, in one case involving an underwriter which had made a $250,000 loan to create a new issue, later embarrasing information obtained about one of the new company's officers could not lead to relinquishment of the issue before actually going public. Direct loans, guarantee of loans and similar common "manufacturing" aspects by underwriters remove much of the public protection which should be expected from a dealer in securities negotiating with the public. Moreover, in 67 percent of issues analyzed, underwriters obtained warrants generally at a price of $.01 (one cent) each which may be exercised at or within 10 percent of the original offering price during a three to five year period beginning one year after the offering. The blocks of stock involved ranged from 5 to 25 percent of the amount of stock in the original issue.

Despite the obviously weak quality of most of the new issues analyzed, they were readily sold out and almost inevitably rose in price in the after market. How this came to pass and the ramifications of it prove an interesting story.

To determine the motivations of purchasers of these issues, the study interviewed 122 persons who bought initial offerings. Certain patterns of behavior clearly emerged. In only a small minority of cases did investors state that the prospectus had any influence on their decision. In fact, the typical language in these documents indicating high risk was largely disregarded by readers, many of whom were less than certain of even the exact business the company was in.

What was occurring was a very different process than investors selection of stock based upon judgment as to merit. Quite to the contrary, the most potent factor was a desire to obtain a new issue--preferably one regarding which they had received an "inside tip." In the great majority of instances, investors purchased at the original offering price with the intent of a quick resale at a premium above the offering price. Approximately 73 percent of this group who bought at the original issue price did in fact resell, usually quite soon after the time of purchase.

In part this situation was created by a generally rising market which makes cheaply priced stock attractive. However, what may have begun as a natural economic phenomenon was exploited by issuers and the investment banking community. In the process, an already dangerous situation was made worse.

Various techniques were used by this group to induce as much interest as possible in these securities to increase their price moves. They then took full advantage of the rising temperature in the new issue market.

Turning first to the question of the techniques used to further overheat the market, the basic concept was the classically simple one of stimulating demand while simultaneously reducing supply.

Increased demand was brought about by such means as brokers frequently emphasizing to their customers the difficulty of obtaining these shares. These statements were of course often true, but by playing upon this fact still greater demand was created. Salesmen regularly predicted that the after market prices would be higher than the original or current prices. Cruder techniques include brokers informing customers that they must make additional purchases in the after market upon pain of being cut off from any further new issues. In addition, a steady flow of "tips" was fed into the market and purchasers often stated that it was this type of information which had stimulated their interest in a particular security. The question of the validity of this information is not even a logical one to ask--these companies were generally in such an early stage of development that any predictions as to their future were unwarranted.

The study group uncovered instances where intra-office brokerage memoranda were inconsistent with offering literature. Such former material no doubt provided the rudiments for customers men. In one case, such memo contained the following gem: "OTC initially, NYSE eventually." In another case where the prospectus contained a substantial risk section and a cover legend emphasizing such risks, the confidential underwriter memo contained a section called "Factors Limiting Risks" as an obvious offset.

Some of the names chosen by companies were misleading on their face. Thus, a company with the word "aerosystems" in its title was mainly involved in manufacturing ball point pen parts. The latter stock was issued at $4.00, reached a high bid of 9 1/4 until the decline began.

Concurrently, various methods of reducing supply were utilized. In nearly all of these offerings substantial percentages of shares are reserved for sale to employees, principals and the like. Instances have been found indicating that this can run as high as 25 percent of the shares registered for sale. At times, the underwriter holds back some shares either for his own account or for those associated with or related to him.

At other times the underwriter makes an effort to limit supply once trading begins. Thus, a customer may be informed that if he sells his shares without permission he would receive no new shares from the underwriter. In other instances, underwriters recommended to customers that a stock had a good long term investment potential and should not be quickly resold. How an underwriter can determine this regarding a new untried company is impossible to answer.

The effect of all this of course was that the increased pressures of demand upon a shortened supply resulted in prices being bid sharply in the after market. A sampling was made of the price rise of some 40 companies from their various times of initial offering through January, 1969. The results were as follows:

Number of Companies	Percentage of Increase
7	Up to 50%
5	Between 51% and 100%
10	Between 101% and 200%
11	Between 201% and 300%
3	Between 301% and 700%
4	Over 1,000%
40	

Company insiders and investment bankers have taken full advantage of the opportunities presented to them by the generally heated situation--which was partially of their own creation.

The most obvious method available to them is the acquisition of shares at a low price for resale when the time appeared right. Thus, at times, underwriters withhold part of the shares for their own account and then resell when they think the market has reached its peak. Company insiders of course would frequently do the same with stock they had received. An interesting factor is the heavy purchase of a new issue for discretionary accounts of the underwriter, giving him a large degree of effective trading control. Some such underwriters do not deal with the general public except for new issue distributions and trading. In one case involving such an underwriter, a new issue stock moved up in price ten times its issue price. After moving from $10.00 per share to approximately $100, it has recently been marketed at the $12.00 range.

Resales by insiders occurred in approximately 23 percent of all cases analyzed. The figure which is based on questionnaries sent to 103 companies is undoubtedly low as further insider resales must have occurred since the various times the questionnaires were received. Further, in at least one instance insider resales appear to have been concealed.

Beyond this both underwriters and the issuers have fully utilized the opportunity to reward business associates, friends or favorite customers for either past transactions or anticipated future ones.

As new issues become progressively more difficult to obtain, the ability of issuers and their underwriters to allocate shares is a matter of some considerable import. That this was used to favor certain individuals is indicated by the fact that approximately 2/3 of the new issue purchasers interviewed had prior business or social contacts with either company insiders or the broker through whom the purchase was made. Several underwriters who were interviewed by the study stated that allocations were based upon the customer's prior business dealings with the firm and the likelihood of a continued relation with him. Interviews were held with several investment bankers who had been significantly involved in the new issue market.

The full value of the power to allocate is seen when it is realized that underwriters can usually predict which issues are most likely to be mercurial in price. An excellent barometer of this is the indications of interest received during the registration period. In extreme cases these indications have been as high as six times the shares available for public sale. The fact that such shares will sell at substantial premium in the after market would be realized by even the most simple-minded. In effect, in this situation, the power to allocate meant the ability to make a gift to the favorite few.

Obviously those investors truly in the favored group would receive neither threats nor suggestions that they hold the shares for any prolonged period. As noted earlier, most investors purchased for quick resale and of those original purchasers interviewed who did resell, only 2 percent took a loss on the transaction.

While this group was able to quickly turn over their shares at substantial profits, members of the public purchasing after the stock had risen in price were not so fortunate. A random sampling of 37 new issues has indicated that their price level in the majority of these companies has declined from the original issue price more than 40 percent from the end of January 1969 through August 27, 1969. A fuller statement of the price behavior of these companies in this period is as follows:

PERCENT OF DECREASE FROM END OF JANUARY, 1969 THROUGH AUGUST 27, 1969

Number of companies that showed increase	2
Number of companies showing decrease up to 10%	4
Number of companies showing decrease 11%-20%	2
Number of companies showing decrease 21%-30%	2
Number of companies showing decrease 31%-40%	7
Number of companies showing decrease 41%-50%	5
Number of companies showing decrease 51%-60%	9
Number of companies showing decrease 61%-70%	3
Number of companies showing decrease 71%-80%	1
Number of companies showing decrease 81%-90%	1
Number of companies showing decrease 91%-100%	1
	37

The study also made random samplings of the use of proceeds by the issuing company, as against representations in the prospectus. We concluded that promoters interpreted prospectuses quite liberally in certain cases. In one $300,000 new issue that more than tripled in price after its issue, the prospectus enumerated the various purposes of the public issue. Not included were personal loans to officers. Yet, $19,000 of the $247,000 net proceeds were applied to make loans to officers. In addition, the prospectus indicated that $130,000 of proceeds were to be used for asset acquisition. However, only $59,000 was used for such purpose. The company did adhere to its representation that $40,000 would be used for management salaries.

Even though the purpose of this inquiry was to report on the mechanics of new issues, we were forced to recommend immediate remedial action by one company with respect to the use of proceeds: In such situation a "prestige" offering that jumped 75 points inside of 4 weeks after being marketed to the public took 13.5 millions of dollars out of its proceeds and applied it to investments considered by this office inconsistent/with the prospectus representations. On our insistence, the money was immediately redirected where it should have gone in the first place.

We have concluded that the last situation and similar ones are caused by the drive for company performance for the sake of maintaining an initial high market price.

SECTION 2

SPIN-OFFS

During the course of our initial inquiry into new issues it became apparent that the device of spin offs was being employed in various ways that in effect resulted in new issues coming to market with special problems. For this reason, it was felt that an analysis should be made of a particular situation that could provide information as to the problems involved and the possibility for solutions in the future. For that reason Assistant Attorneys General Orestes J. Mihaly, Martin Weber and Principal Securities Accountant Julius Rom were assigned to work on recording the history of spin-offs steming from the activities of a publicly held corporation known as Herman & Appley, Inc. This is an attempt to record the conclusions of the study group based on the work and analysis by the aforesaid members.

That spin-offs are fraught with evils is exemplified by our recent investigation of Herman & Appley, Inc. Herman & Appley, Inc. is a real estate company with over 700 stockholders, which was insolvent by the end of 1968. The corporation at that time was barely alive and in no position to go to the public for funds by any conventional registration process. However, by spinning off five asset-less subsidiaries, the principals of Herman & Appley, Inc. not only succeeded in putting money into their own pockets, but bailed themselves out of certain bankruptcy, and placed, into the hands of the unwary public, hundreds of thousands of shares of spin-off companies whose actual merits, as compared with their traded market prices, was and is extremely dubious.

To illustrate the last point, on the 20th day of May, 1969, a share of stock in Equity Group, Inc. (one of the spin-offs) was quoted on the over-the-counter market at $5.00 bid and $8.00 asked. Although this company had and has no assets whatsoever and is not operating in any fashion, its market price at its zenith would indicate the value of the company to be 5 to 8 million dollars, based on the outstanding stock of one million shares.

On December 12, 1968 the controlling interest of Herman & Appley was contracted to be sold by Bernard and Harold Herman to a syndicate of road, tar, asphalt and construction men in New Jersey, headed by Salvatore DeBlasio of Bloomfield, New Jersey. Under the agreement, the purchasers agreed to advance $75,000 in funds to carry the company until the closing on March 21, 1969. These loans were to be repaid from the first proceeds of the company. During February, March and April of 1969, the Herman brothers spun off five companies, as follows:

Name	Date of Closing	Purchase Price	Ratio of Spin-off
Vodel Corp. (formerly Vode Estates, Inc.)	3/19/69	$35,000	1 for 2 1/2
Gilled Industries, Inc. (formerly Adama Realty Corp.)	3/10/69	$40,000	1 for 5
Concepts & Holdings, Inc. (formerly Greport Realty Corp.)	2/11/69	$50,000	1 for 2 1/2
The Equity Group, Inc. (formerly Halil Realty Corp.)	4/22/69	$50,000	1 for 5
1325 Union Corp. (formerly 1325 Union St. Corp.)	3/25/69	$30,000	1 for 5

The sale of these five spin-offs provided for a total of $205,000 to be paid to the treasury of Herman & Appley, Inc. In addition, because of the fact that Herman & Appley, Inc. itself owned close to 90,000 shares in treasury stock, the parent corporation by virtue of this ownership, also acquired spin-off shares. In a notice to stockholders dated May 29, 1969, the corporation proclaimed to its stockholders that included in its assets was a sum in excess of $290,000 by virtue of the ownership of these spin-off stocks. The DeBlasio group was now in a position to sell the spin-offs and repay the advances made by them in their acquisition of the control of the corporation.

The use of the spin-off vehicle not only enabled the DeBlasio syndicate to obtain cash to reimburse themselves for advances, but also enabled the Herman brothers, by reason of their ownership of stock in Herman & Appley, Inc., to obtain thousands of shares of the spin-off companies for their own use and benefit. For instance, the transfer sheets of 1325 Union Corp. indicate that the Hermans and individuals controlled by them were issued in excess of 25,000 shares of that company. At a high point on May 21, 1969, 1325 Union Corp. was quoted at $13.00 bid and $16.00 asked. The day before it had traded at $14.50. Thus, the Hermans extricated themselves from their desperate position of December 1968 and gifted themselves with assets whose "market value" was in excess of $250,000 by this simple device. Indeed, even though their Herman & Appley stock was restricted under federal law, the Hermans have disposed of the bulk of their spin-off stock.

CONCEPTS AND HOLDINGS, INC.

On February 11, 1969, Edwards & Hanly, members of the New York Stock Exchange, and Lee Elman, its director of corporate finance and vice-president, entered into a contract to purchase 1,600,000 shares of Greport Realty Corp. for the sum of $50,000 from Herman & Appley, Inc. Greport Realty Corp. had been recapitalized by the Hermans so that at that point it had 4 million authorized shares. Two million shares were to be outstanding at the time of closing. An integral part of the agreement provided that up to 400,000 shares of the issued and outstanding stock of the company was to be spun off to the shareholders of Herman & Appley, Inc. on a one share for two and one-half share basis. Thus, the purchasers at the time of closing not only acquired a shell corporation which had no assets, but more importantly, had effected a public distribution of stock to over seven hundred shareholders of Herman & Appley, Inc. without complying with any federal or state registration, filing or reporting requirements. As in the case of the other shell corporations disposed of by Herman & Appley, Inc., which we will discuss in the course of this report, the stock of the spin-off corporations immediately began to be traded by traders in the over-the-counter market. The stock first appeared in the National Daily Quotation Service at 1/16th bid on March 19, 1969 and reached a high of $3 bid and 4 1/2 asked on May 21, 1969. Mr. Lee Elman testified at this office that although the stock reached such highs, he had done nothing with the corporation. He stated that it was totally dormant and to this day has no assets or liabilities. This spin-off corporation has been "put on the shelf" until Edward & Hanly finds a situation that needs a ready made public vehicle. The name of the corporation was changed from Greport Realty Corporation to Concepts & Holdings, Inc.

The only information that was available to the public was that Edwards & Hanly had purchased the spin-off. This information came to the stockholders of Herman & Appley by means of a mimeographed statement accompanying their stock distribution in which the name of the purchaser was given.

The traders in this spin-off, as well as the other spin-offs, were generally those traders who had traded the stock of Herman & Appley, Inc. They readily admitted in testimony at this office that they had no information concerning these corporations and such information was not really essential or needed by them in the course of their trading activities. They merely traded "a number". One trader stated that even if information was available, he had no time for such information. He couldn't care less what the information was. He would trade if there were buyers or sellers. The public, meanwhile, merely on rumors that Edwards & Hanly was acquiring or had acquired the spin-offs, commenced to buy shares of Concepts & Holdings, resulting in the market reaching $3.00 a share. Although Concepts & Holdings, Inc. has no assets and no particular form of business enterprise at present, its market value based on over-the-counter quotations reached a point in May of between 6 and 9 million dollars.

It might well be helpful at this juncture to generally categorize the evils of spin-offs. It is, of course, apparent that the safeguards of registration and full disclosure are thwarted by the use of this vehicle of public distribution. In the case of the five spin-offs of Herman & Appley, there was no information available to the public concerning the financial status of the companies and in some cases the nature of the business of the spin-off was not even known. The public bought on the basis of tidbits of information and rumors. The requirements of full disclosure were circumvented. The investing public caught up in the swell of the hot new issue market was not afforded even a minimum of information concerning the stock that they were buying. If the concept of full disclosure and reporting remains valid, this form of public distribution and the trading that inevitably follows omits entirely such mandated concepts. Full advantage was taken of the basest "get rich quick" instincts of the public. Even in the heyday of the boiler room, more information was available to the public than in the case of these spin-offs.

The apparatus of the over-the-counter trading market gives the promoter instant market value which might never have been reached if conventional distribution had been utilized, even in a corporation that has no assets. This is true even, as in the present case, where the traders establish a market value with a total lack of knowledge of the stock they are trading. This condition can only lead to the public detriment and must be eliminated.

Once this "value" is established by the trading mechanism, the promoter can then proceed to negotiate acquisitions by means of the issuance of stock and to capitalize in other ways on the fact that his stock is being traded at a certain figure. Thus, in the case of 1325 Union Corp., which is now controlled by Rolling International, Inc., by early July, 1969, according to a proxy notice sent to stockholders, this spin-off corporation acquired two new corporations and contracted to purchase a series of others by the issuance of additional stock. The authorized shares of the spin-off were to be increased from 5 to 20 million.

GILLED INDUSTRIES, INC.

On March 10, 1969, Edward M. Eglowsky, a former insurance salesman, through a privately held air pollution corporation by the name of Hald Pneumatics Systems, Inc. purchased 825,000 shares of the 1,000,000 issued and outstanding shares of Adama Realty Corp., a subsidiary of Herman & Appley, Inc. for a total price of $40,000. The balance of 175,000 shares was spun off to the stockholders of Herman & Appley, Inc. and distributed amongst finders of the deal. The name of this spin-off was then changed to Gilled Industries, Inc. Eglowsky had purchased this company in 1968 for $15,000 down and $35,000 payable in 1969.

Although Hald Pneumatics had an operating business, it is significant that in this case the promoter Edward M. Eglowsky had been barred on January 14, 1969 by the Securities & Exchange Commission "from association with any broker-dealer or investment adviser" as a result of his activities with the Institute for

Medical Management, Inc.. Thus, Eglowsky, who had a previous record of alleged securities violations, was free to promote a publicly held company without disclosing his background. The dangers of this type of occurrence are plainly apparent. Like a magician conjuring up objects from thin air, Eglowsky, in turn, proceeded to spin-off a shell subsidiary of Gilled Industries, Inc. This shell, Caitlin Industries, Inc.. was acquired by American Franchise Network Corp. by exchanging the assets of American Franchise Network Corp. for 900,000 shares of Caitlin. One hundred thousand shares of American Franchise Network Corp. was spun off to the stockholders of Gilled Industries, Inc. Caitlin Industries, Inc. had no assets at all and was formed by Eglowsky solely to be used for the spin-off transaction.

In this case, Mr. Eglowsky distributed to his stockholders a letter of American Franchise Network Corp. which glowingly told of the diversified business of American Franchise Network Corp. Its business purports to cover the gamut from chicken and pizza pie franchises to dental and computer school franchises. Mr. Eglowsky, on August 11, 1969, testified at this office that for the first four months of operations, Gilled Industries, Inc. realized sales totaling $130,000 and profits amounting to $11,000.

Cursory examination of Martin Baum, president of American Franchise Network Corp. indicates that a company controlled by him was placed in involuntary bankruptcy in 1968.

The market price of Gilled which commenced trading on or about March 20, 1969 went from 1/16th bid to $7 bid and $9 asked, on May 21, 1969. Again this very modest company with one million outstanding shares measured by the market established by the traders was an outlandish 7 to 9 million dollars.

THE EQUITY GROUP, INC.

On February 14, 1969, a contract was entered into between Martin Berman, a registered representative with Emanuel Deetjen & Co., members of the New York Stock Exchange, and Robert Goldstein, Vice-President of John DiNigris & Co., Inc., a financial public relations firm, and Herman & Appley, Inc. to purchase Halil Realty Corp., another wholly owned asset-less subsidiary of Herman & Appley for $50,000. The name of Halil was changed to The Equity Group, Inc. Berman & Goldstein purchased 800,000 shares of the 1 million shares outstanding. Herman & Appley, Inc. distributed 200,000 shares to finders and to its stockholders. Testimony of Messrs. Berman and Goldstein indicate that this corporation has been dormant since its acquisition and that at the present has no assets or liabilities. The only communication received by its stockholders since the acquisition was a letter indicating to them the names of the officers of the corporation. It also stated that it had no assets and had not commenced activity. Their testimony indicated that it would be very difficult to start up a new business where registration was required. It was quicker to have public shareholders in a ready made corporate vehicle. They further testified that it was their present intent to have The Equity Group, Inc. eventually function as the manager of an investment hedge fund. The Equity Group, Inc. commenced trading on or about March 25, 1969 at 1/16th bid and reached a high of $5 bid and $8 asked on May 20, 1969. There is no apparent justification for the valuation of 5 to 8 million dollars at its high for this company's outstanding stock. The promoters stated that they did not know of any reason for the rise in the price. The present price is approximately 3/4 bid, 1 and 1/4 asked.

VODEL CORP.

Another subsidiary, Vodel Corp., was acquired in early March for $35,000 by Fraydun Manocherian, a real estate man. The contract provided that he would acquire two and one-half million shares of the stock of that corporation and one-half million shares would be distributed to finders and to the stockholders of Herman & Appley. Similarly, this corporaton has engaged in no business and has been dormant since its acquisition by Mr. Manocherian. He testified that he has given a lot of "thought" to the corporation but has actually done nothing with it. He further testified that he was positively shocked when he learned that the stock had risen to $3.00 in the traded market but stated that he was at a loss as to what to do about it. He also said that after reading the Times and Wall Street Journal, he assumed that this was one of two ways to "go public". On May 21, the stock reached a high of 3 3/4 bid and 4 1/2 asked. Again with 3 million shares outstanding, there was no justification for the market value of 12 million dollars for its total stock outstanding. No communications were made to its stockholders.

1325 UNION CORP.

Perhaps the most blatant example of spin-off machinations and the resulting harm to the public is the situation involving 1325 Union Corp. This corporation's stock reached its high on June 17, 1969 when it was around $14.00 bid and $17.00 asked. By May of this year 1325 Union Corp. was in the control of Rolling International, Inc. a Texas based mobile home franchise corporation. Before reaching its present resting place it traveled a hastily constructed road, well-oiled by the Hermans.

During the course of selling the various spin-offs, negotiations were had with a potential purchaser of 1325 Union St. Corp. The purchaser was also a New York Stock Exchange member firm. So confident were the Hermans of closing this deal, that 1.8 million shares of 1325 Union Corp. were transferred on the transfer agent's records as of March 10, 1969 to the partners of the member firm. Negotiations, however, never resulted in a final contract and the purchaser thought better of the acquisition. This break off in negotiations took place on or about March 14, 1969. The Hermans knew they were closing on March 21, 1969 to sell control of Herman & Appley, Inc. to the DeBlasio group. Only a period of six days remained. Why not buy the spin-off themselves at a bargain price and cast about for a purchaser in turn?

On March 20, 1969, therefore, a contract was quickly entered into by Herman & Appley, Inc. as seller and Calcamatics Inc. as purchaser to acquire 225,000 shares of 400,000 issued and outstanding shares for $30,000. This, naturally, was the lowest price of all the spin-offs sold. The contract provided that up to 122,000 shares were to be spun off to Herman & Appley, Inc. stockholders. As of March 10, 1969, not only had such shares been spun off, but the Hermans and their nominees were issued over 50,000 additional shares of the stock for no apparent consideration.

On March 26, 1969 the contract was closed with Harold Herman who had a power of attorney from Herman & Appley, Inc. to close the deal. The sum of $5,000 was paid. The balance of $25,000 was due within six months of the closing. Calcamatics, Inc. was an asset-less corporation whose record owners are Herman's sister and his husband, Leonard Crystal.

Within a few weeks Herman found a buyer for control of 1325 Union Corporation. This buyer was Rolling International, Inc. of Dallas, Texas. A contract was executed on May 1, 1969 to sell 100,000 shares of Calcamatic's stock in 1325 Union Corp. for $50,000 to Rolling International, Inc. This acquisition closed on May 15, 1969. Simultaneously, on May 15, 1969 Harold Herman presumably purchased 50,000 shares of Calcamatic's stock in the name of Shelrich Company an entity controlled by him.

Rolling International, Inc. having acquired control of 1325 Union Corporation proceeded to issue an additional 2.6 million shares of stock to itself in exchange for the stock of Bollinger Mobile Homes, Inc., a Tulsa, Oklahoma mobile home corporation controlled by Rolling International, Inc. So that, at the end of the completed transfer on May 15, 1969, Rolling International, Inc. now held 2.7 million shares of stock; Crystal and his wife held 66,500 shares; and the Herman's and the rest of the Herman family held in excess of 100,000 shares.

Rolling International, Inc. is an allegedly private company whose President and founder is Sam C. Evans. Sam C. Evans is also Chairman of the Board of 1325 Union Corporation. A routine check has revealed that a Sam C. Evans has been indicted on three occasions for the fraudulent sale of securities in the State of Tennessee, and is presently on bail and awaiting trial. A telegram sent to 1325 Union Corporation by this office to confirm positive identification has gone unanswered. This report should not in any manner be construed as passing on the facts relating to such proceeding or whether Mr. Evans was involved.

In a proxy statement to stockholders dated July 11, 1969, the company outlined elaborate plans to acquire by the issuance of stock a considerable number of mobile home sales and manufacturing corporations. The public presented with this formidable array of contemplated expansion was thereby encouraged to maintain its demand for the stock. The proxy statement does not give audited figures or financial statements for 1325 Union Corporation. Communication with the company in Tulsa, Oklahoma indicates that audited figures are still not available.

Needless to say this literature does not disclose the pertinent background of Evans. The whole proxy statement, and any financial figures contained therein and the entire operations described therein is suspect.

It is questionable whether Mr. Sam C. Evans could have gone public by conventional means. Within a span of six weeks, however, he had a public company having three million shares outstanding and the price of the stock at $17.00 a share, all without "telling it like it is".

The Hermans and their group helped themselves to close to 200,000 shares of this stock for nothing. Crystal in testimony given at this office was unable to explain where the $80,000 received by him from the sale of 1325 Union Corporation went except to say that it went to his lawyer who was to disburse it. Apparently, the sale of 50,000 shares to Shelrich Co., Herman's nominee, washed out Crystal's purchase of the 225,000 control from Herman & Appley, Inc. The $50,000 received from Rolling International, Inc. was the profit. Who really was the beneficiary of this profit is still not known. Crystal with the help of Harold Herman sent a letter to stockholders announcing the impending acquisition by Rolling International, Inc. setting forth that Bollinger Mobile Homes, Inc. had sales of 3.7 million for 1968. This letter was dated May 7, 1969. A news item in the Wall Street Journal also appeared on May 7, 1969. What of the market behavior of the stock? The stock was first quoted on April 1, 1969 at 1/4 bid. On May 1, 1969 when Rolling International, Inc. contracted to purchase its control it was selling at 3/4 - 1 1/2. By May 15, 1969 the date of closing, it rose to $7 - $9. It reached $13 - $16 on May 21, 1969. In spite of a dilution in capital by the issuance of 2.6 million additional shares the stock continued to rise until June 17, 1969 when it was $14.00 bid and $17.00 asked. The real value of the assets received by 1325 Union Corp. for the issuance of 2.6 million shares of its stock is not known. It is quoted presently at 5 1/2 - 7 1/2.

DIVIDEND CONFUSION

An interesting aspect of the spin-offs was the manner in which they were handled. Confusion attended everything concerning them. To their annoyance, the traders were required to retrace their trades in order to straighten out who was to get what spin-off stocks. The dividend announcement and distribution took the financial community by surprise since it took place as of 3/10/69 retroactive to February 20, 1969 and was distributed by letters of transmittal dated 4/4/69. Many previous holders of Herman & Appley stock received spin-off dividends which they later found they were not entitled to. Apart from the extra paper work involved and additional handling of stock certificates that had to be surrendered, reissued, and forwarded to subsequent acquirers of Herman & Appley stock, in a number of instances individuals who received spin-off stocks sold them immediately. Much later they were informed that such spin-offs were not their property. Since they could no longer produce the spin-off shares, having sold them, their brokers had to go out into the open market to "buy in". This kind of transaction had the effect of putting heavy buying pressure on a limited supply of stock and drove up the price phenomenally.

For example, one customer thinking he owned them, sold the following spin-offs and then had to be "bought in":

	Sold Date of Sale	Price	Bought In Date of Purchase	Price
Concepts & Holdings, Inc.	4/9/69	2	5/20/69	4 1/2
Vodel Corporation	4/10	1 1/4	5/20	4 1/2
The Equity Group, Inc.	4/9	1 1/2	5/20	6 1/2
Gilled Industries, Inc.	4/11	4 1/2	5/20	8 1/2
Vodel Corporation	5/19	2 3/4	5/20	4 1/2
1325 Union Corporation	5/9	7 1/2	5/20	14 1/2

When we see a magician pulling a seemingly endless supply of handkerchiefs from a box which he previously very carefully exhibited as entirely empty, we know that despite the evidence of our eyes, a trick has been played on us - by a clever illusion or sleight of hand.

When a company with its stock selling for around $3 a share begins to spin-off to each such share dividends of stock which in the aggregate are traded at about $4, something has materialized from nothing. And, if after divesting itself of property worth more than the market value of its underlying stock, the underlying stock itself (logically now worth less than zero) begins to rise to new heights, some great feat of magic has taken place. In this case Herman & Appley, Inc. rose from about 50 cents in December 1968 to 12 3/4 on May 22, 1969. Unbelieveably, though these transactions filtered through some 200 or more brokers and traders, only one timid voice arose that even suggested that "the emperor was wearing no clothes". Therewith a telex inquiry from a brokerage firm in Boston to an over-the-counter dealer in New York.

> "I notice you trade Herman & Appley, Inc. Class A I understand they spin off five stock including Concepts & Holding, Equity Group, Inc. Gilled Indus. Inc. and Vodel and Union Corp. Making a quick figuration on the prices of these stocks in ratio to be received, Herman & Appley could not possibly have been selling around 3-7/8. Could you give me some info on this? Was it an unexpected windfall or is my dividend book wrong? Or is it just a crazy market. Appreciate any help you can give - will await your reply.
>
> It was discovered when the payment was made the smart money ran the stock from one to over five. We knew about it when we rec(d) the stock from the company and the NASD made a ruling which is in Standard and Poors. Hope this helps."

Apparently the NASD was not informed of the spin-offs at the beginning. One of the principals of The Equity Group, Inc. found out that the NASD was not informed by Herman & Appley, Inc. about the spin-off of The Equity Group, Inc. stock. He brought up this point at the closing of the sale of the Halil Realty Corp. "shell", desiring to know "why not?" Harold Herman and his lawyer shifted the blame to each other for the omission of the notification of the NASD. This episode ended in a "flurry of confusion", without solving the mystery of the failure to notify.

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