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September 11, 1994

Finance

DID THE AMEX TURN A BLIND EYE TO A `SHOWCASE' STOCK?

Frank J. Barnes stood on the mezzanine of the American Stock Exchange, watching the balloons. It was Mar. 18, 1992, the birthday of the Emerging Company Marketplace, the Amex' showcase for "some of the best companies in the country," and the balloons cascading onto the trading floor were a patriotic red, white, and blue.

Sure, it was a corny spectacle. But the 49-year-old Barnes, a marketing consultant from Long Island, couldn't help but feel excited. Only six weeks before, after closing on the sale of his house, Barnes had deployed a huge slice of his nest egg--$217,000--to buy shares in a company that, he was assured, would likely be among the ECM's charter listings. And when the ECM roster came out, there it was: Printron Inc.

Printron was an enticing combination of political correctness and profit potential, for it was pioneering a pollution-free process for manufacturing printed circuit boards. Its chairman and chief executive officer, 56-year-old Eleanor Lorraine Schuler, was an American success story. In her wildly varied career, she had been a welder, entrepreneur, corporate executive, and even a pistol-packing Federal Bureau of Investigation double agent who had battled Soviet spies during the Cold War. But she didn't like to talk about that.

CHECKERED RECORD. As Barnes watched the festivities, the conservatively dressed Schuler was but a few feet away, also looking on as the balloons fell and as Securities & Exchange Commission Chairman Richard C. Breeden rang the opening bell. Schuler would not be interviewed for this article, so her emotions on that day can only be guessed at. But when Breeden rang that bell, her feelings were, very likely, mixed--for along with her many accomplishments there was a stain on her record. She had twice been sued in Federal Court by the SEC, twice agreeing to injunctions, without admitting or denying guilt, that prohibited her from violating the securities laws. One of the injunctions was known to the Amex when it approved Printron's listing on the ECM. The other was not.

Eleanor Schuler had two records of alleged securities law transgressions--one as a woman, and one as a man. In fact, the name "Eleanor Schuler" was one that she had made up out of thin air. Before a sex-change operation in the late 1970s, she had used the name her parents gave her: John Huminik Jr. Her earlier SEC record, and her change in gender, were concealed by Printron not only from Barnes but from the Amex' "blue ribbon" panel of Wall Street notables that had handpicked the 23 ECM companies. Schuler also hid her previous identity, and the injunction, from securities regulators in New York, in a "sunshine law" filing 14 months before the day the balloons fell on the Amex floor (box).

March 18, 1992, marked the beginning of Frank Barnes's nightmare--and he was far from alone. The Albuquerque-based company--along with most of the charter ECM roster--has been a disaster for investors. And the Amex is still reeling from the ECM imbroglio, even though its greatest embarrassment, Printron, has never been publicly aired. The executive director of the ECM, Mark Klein, refused comment on Printron, the Amex's selection process, or any element of the Schuler/Huminik affair, saying that the exchange doesn't talk about companies that are no longer listed. (Printron withdrew from the ECM in March, 1993, because it had ceased to meet the ECM's listing standards.) Printron CEO Donald C. Wunsch says that Printron fully complied with the law in its public disclosures.

SEVERE STRAITS. Printron epitomizes the woes that have beset the uncounted thousands of investors who bought into the ECM charter stocks. Printron stock, which traded at $14 a share on that glorious March day, now changes hands at less than the cost of a postage stamp--22 cents. The company, its filings disclose, is in severe financial straits. The vaunted "Printron process" for manufacturing circuit boards, which Barnes says he was assured would begin producing revenues in 1992, has come to naught. And Barnes is pursuing a lawsuit against Printron, Schuler, and other defendants. Among other things, he maintains that Printron reneged on an agreement to refund his $217,000. Wunsch, who replaced Schuler as CEO but not as chairman, in March, 1993, says that the company is vigorously contesting the allegations. He declined further comment, calling Barnes a "troublemaker."

Trouble, alas, has been the ECM's middle name. Of the 23 stocks in the ECM, 16 have fallen like lead balloons, or ceased trading entirely, since the day the balloons fell (table, page 82). Meanwhile, the Russell 2000 index of small-cap stocks has sustained a rousing 23% gain. In light of the ECM charter members' awful record, the story of Printron is as illuminating as it is bizarre.

The Barnes litigation paints a portrait of Printron that is even more dismal than its share price collapse would indicate. As alleged in the suit, which was dismissed on technical grounds in March and refiled the other day in U.S. District Court in Manhattan, Printron was little more than a fraud--a "sting," as the suit puts it, in which Barnes was the target. For the Amex, the Printron imbroglio raises fundamental questions about the ECM. How did Printron get past the gatekeepers at the Amex? Could the Printron fiasco be repeated? The answer to that question is disturbing--a firm "yes."

A good place to address these questions is at the very beginning--in the story of Eleanor Schuler's previous manifestation, John Huminik Jr. Born in a working-class neighborhood of southeast Washington, D.C., in 1935, the qon of a Navy musician of Russian extraction, young John had, apparently, an ordinary childhood. He married his high school sweetheart--with whom he had four children--and served in the Air National Guard. He began work as a welder (a "welding engineer," as the Printron bio puts it) at 19.

MOONLIGHTING. Huminik never graduated from college--something that made his (and her) later achievements all the more remarkable. He studied metallurgy at night, and eventually, in Horatio Alger fashion, rose to the post of senior scientist at a company called Value Engineering. In 1963 he founded a chemical company, Chemprox. Meanwhile, Huminik was moonlighting. It was an unusual job. He was a double agent for the FBI and the Soviet government.

As recounted in his slickly written 1967 book, Double Agent, Huminik was recruited as a spy by agents working out of the Soviet Embassy in Washington. In the adventures that followed, Huminik found himself, among other things, caught up in the disorders in the Dominican Republic in 1965. "I slipped my .45 pistol into my holster and headed for the city," goes one typical passage. But Huminik kept the FBI posted every step of the way, leading a double life for six years. In 1967, Huminik, a prosaic-looking man wearing horn-rimmed glasses, testified before Congress about the dangers posed by Soviet

espionage.

Neither the book nor the double-agent career were mentioned in any of Printron's filings with investors and regulators. And that, apparently, is permitted by SEC rules that only require disclosure of activities within the past five years. What isn't so clear is just how much Printron had to reveal about Schuler's history. At issue is not her sex change, but rather the extent to which her concealment of that change masked other things. "We have nothing against transsexuals," Barnes's lawyer Victor L. Zimmerman, formerly with the SEC's enforcement division, takes pains to point out.

"MATERIAL EVENTS." The trouble, from the Barnes perspective, arises whenever Schuler's pre-Schuler activities are mentioned in Printron's public disclosures. Time after time, they refer to Schuler as a "she"--even when discussing positions held when Schuler was a "he." Moreover, the filings say that Schuler was a "self-employed technology and corporate consultant" from 1966 to 1991.

In fact, Schuler, as Huminik, was president of General Industrial Corp. and General Enterprises Corp., which allegedly defrauded investors during the 1970s. According to a federal court suit that the SEC filed against Huminik and the two companies in December, 1975, Huminik repeatedly lied to investors about GIC. Huminik agreed to a permanent injunction barring him from making untrue statements, and otherwise defrauding investors, in the future. He agreed to the injunction without admitting or denying the SEC's allegations.

Was Schuler being shy--or was she improperly misleading investors? Wunsch maintains that Schuler was within her rights to hide her previous gender and to not disclose the 1976 injunction, because of the SEC rule requiring such disclosures only for five years. Zimmerman maintains that a previous injunction is a "material event" that must be disclosed beyond the five-year period set by the rules. Who is right? "If you ask a dozen lawyers, you'll get a dozen answers," observes Ira L. Sorkin, a securities lawyer and former head of the New York office of the SEC.

The GEC/GIC allegations drew nary a mention in the financial press. But the next Huminik/Schuler exploit received considerably more ink. As detailed in a lengthy article in the Style section of The Washington Post in December, 1977, John Huminik was no longer exhibiting a James Bond persona. "Marine blue shadow haloes the eyelids," the article began. "`What do you think?' she asks, for she really doesn't know if she is pretty. `Judging from the number of men that chase me . . .' The low voice trails off." The Post went on to describe the sex change and, in graphic detail, how it affected every aspect of her life.

None of this would amount to a hill of beans if Eleanor Schuler, as Printron CEO, hadn't fallen afoul of the SEC. In September, 1991, the SEC filed suit against Printron and Schuler. The suit alleged that Schuler was brought into the company by Karl R. Huber Jr., a convicted felon and disbarred lawyer. According to the SEC's allegations, which were neither admitted nor denied by Schuler and the company, Huber's hidden role in the company violated the federal securities laws. Schuler and Printron settled the charges by agreeing to a consent decree barring them from future securities law violations. "There were no victims. No shareholders were harmed," Schuler told BUSINESS WEEK in an article on the ECM in April, 1992.

The Huber-Schuler ties were shrugged off by the blue-ribbon panel. "We were assured by the Amex staff that the issue had been resolved," panel member Nedim Hamarat, president of Beekman Capital Management Ltd., told BUSINESS WEEK at the time. But Hamarat and another former panel member, L. Keith Mullins, a managing director at Smith Barney Shearson Inc., now say that the panel didn't know that Eleanor Schuler used to be John Huminik--or that Schuler consented to not one but two injunctions by the SEC. If they had known, they say, Printron's listing would never have been approved.

The SEC's mild treatment of Schuler in 1991 raises yet another issue: Did the SEC know in 1991 that Schuler was Huminik? After all, the 1976 injunction barred the kind of conduct dealt with in the 1991 suit--alleged violations of Sections 10(b) and 17(a) of the Securities Exchange Act of 1934, which contain broad prohibitions against securities fraud. One explanation might be that the SEC felt so much time had passed that it would not pursue a criminal contempt action against Schuler. Stephen J. Crimmins, an attorney in the SEC's enforcement division, says he can't comment on the Huminik/Schuler matter because it may be the subject of an investigation. However, Crimmins says that normally a person suspected of contempt of a previous order is brought up on that charge immediately, without the interim step of a second consent decree--even if a second company is involved.

If the SEC didn't know that the Eleanor Schuler of 1991 was the John Huminik of 1976--and the Amex surely didn't know--there was one possible explanation. The central registry of the National Association of Securities Dealers, the electronic bible of securities regulators nationwide, has John Huminik on its data base. And Eleanor Schuler, too. But they are listed as two separate people, with one "incident" to his name and one to hers. A NASD spokesman notes that more detailed information, such as social security numbers, is only maintained for NASD members--not corporate officers who fall afoul of the SEC.

So the SEC couldn't have found out anything by checking with the NASD. And as for the Amex--well, it never even tried. According to a study of the ECM last May by the General Accounting Office, the investigative arm of Congress, the ECM tightened its screening procedures in the spring and summer of 1992, and that included checking computer databases such as the NASD's. But even so, the GAO observed, the Amex continues to allow companies on the ECM even if they have no earnings or revenues or are losing money when "the companies were judged capable of improving their finances in the future."

With marginal companies still permitted on the ECM, it's far from clear if the Amex has learned the lessons of Printron and the other troubled companies that found their way on to the ECM. In an interview, the ECM's executive director for the past year, Mark Klein, said that he is "trying to position the ECM as a superior alternative to the NASDAQ small-cap marketplace." The main obstacle, he believes, is one of PR. There has been, he feels, too much "bad press." His "mission," he says, is one of marketing--to correct misconceptions about the ECM and "disseminate the facts to the target market," the small companies targeted by the Amex and the NASDAQ in the hunt for listings. Klein claims statistics show that companies that move to ECM from NASDAQ get dramatically narrower spreads between bid and ask prices.

DOUBLE-DIGIT DECLINES. But as for performance, ECM statistics are far less glowing. In fact, they stink. The Amex' own figures show that 40 of the 60 ECM companies that have listed to date--one as recently as last June--have declined through last July 1. And although there were a few isolated winners, the losers were largely awful, with 38 sustaining double-digit declines in a generally up market. Moreover, the data were skewed in Amex' favor because the list does not include companies that have stopped trading.

The Amex no longer advertises the ECM as the champagne of small-cap markets, and its screening panel is no longer called "blue ribbon." But the Printron disaster and the miserable performance of the other ECM companies make it plain that the Amex hasn't gone far enough. By allowing on to the ECM a host of clearly marginal companies, the Amex is alienating its ultimate "target market"--the Frank Barneses of the world. Small time, retail investors have long sustained small-cap stocks. Some of them have made the mistake of believing that the ECM was a conglomeration of the best companies in the country. Clearly that was a tall order. But if the ECM companies can't be among the best in America, is it too much to ask that they not be among the worst?THE CLASS OF '92: MOST ARE FLUNKING

Share price Percent

Company 3/18/92 8/30/94 change

ADVANCED PHOTONIX 8.125 2.188 -73.1%

ALTA ENERGY* 6.750 Not trading

AMERICAN PACIFIC MINT 3.750 1.938 -48.3

AUDRE RECOGNITION SYSTEMS 4.875 0.938 -80.8

CANCER TREATMENT HOLDINGS 5.000 2.250 -55.0

COLONIAL DATA TECHNOLOGIES 1.875 4.750 153.3

DIGITRAN SYSTEMS* 3.063 Not trading

EPIGEN 3.250 0.500 -84.6

INTERTEL COMMUNICATIONS 9.375 13.125 40.0

ION LASER TECHNOLOGY 2.969 0.938 -68.4

MEDIA LOGIC 3.380 1.875 -44.5

MEDPHONE 1.750 0.020 -98.9

NORTH COAST ENERGY 2.391 1.250 -47.7

NORTHERN INSTRUMENTS** 2.875 2.938 2.1

OCEAN OPTIQUE DISTRIBUTORS 6.359 3.688 -42.0

PNF INDUSTRIES* 9.250 Not trading

PRINTRON 14.000 0.219 -98.4

PROFESSIONAL DENTAL

TECHNOLOGIES 4.313 2.625 -39.1

RANDERS GROUP 1.782 0.688 -61.4

THREE-FIVE SYSTEMS 2.375 39.000 1542.1

TOP SOURCE 3.907 6.500 66.4

TOPOX* 5.375 Not trading

UNIQUE MOBILITY 2.130 6.125 187.6

RUSSELL 2000 23.0%

*No longer trading **Began trading 3/27/92

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Gary Weiss in New York, with Michael Schroeder in Washington

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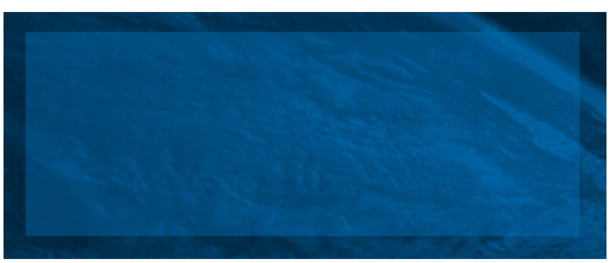

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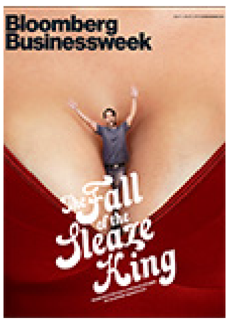

American Apparel's Future

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