

UNITED STATE OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
JUAN CARLOS SCHIDLOWSKI

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INITIAL DECISION

Washington, D.C.
May ~~25~~, 1994

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Edward J. Kuhlmann
Administrative Law Judge

This proceeding was instituted by an order of the Commission on September 29, 1993 pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78o(b), 78s(h) to determine whether the allegations set forth in Section II of the Order are true, to provide the respondent an opportunity to establish any defense to the allegations, and to determine what, if any, remedial action is appropriate against Juan Carlos Schidlowski in the public interest pursuant to Sections 15(b) and 19(h), 15 U.S.C. §§ 78o(b), 78s(h). A hearing was held on January 21, 1994 and the Division of Enforcement filed proposed findings of fact, conclusions of law, and brief on February 24, 1994; the respondent filed proposed findings of fact, conclusions of law, and brief on March 25, 1994. The Division filed a reply on March 30, 1994.

FINDINGS OF FACT

On June 3, 1982, the Commission filed a civil complaint against the respondent and others in the United States District Court for the District of Colorado in which it requested an injunction and other equitable relief; it was amended on June 23, 1982. Ex. 1. A "Final Judgment of Permanent Injunction by Default with Respect to Juan Carlos Schidlowski" was filed on August 7, 1987. Ex. 2. The injunction was issued after Schidlowski failed to appear for his deposition and was found to be in default. Ex. 2 at 2. The court order enjoined Schidlowski from engaging in the illegal activities that had been alleged in the complaint. The complaint alleged that the respondent had engaged, was engaging in or was about to engage in violations of Sections 5(a) and 17(a) of

the Securities Act of 1933, 15 U.S.C. §§ 77e(a), 77q(a), Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78j(b), in connection with the offer for sale, purchase and sale of the securities of International Remote Imaging Systems, Inc., Balboa Exploration Company, Elan Air Corporation, Synthetic Fuels, Inc., and Gentex Corporation.

It was alleged that the respondent aided and abetted, in violation of 15(a) of the Exchange Act, 15 U.S.C. § 78o(a), Otecenet S.A. and Arlan I. Preblud's failure to register with the Commission as broker-dealer, that he aided and abetted OTC Net in violating Sections 17(a) and 15(c)(3) of the Exchange Act, 15 U.S.C. §§ 78q(a), 78o(3) and Rules 15c3-1, 15c3-3, 17a-4, 17a-5 and 17a-11, 17 C.F.R. §§ 240.15c-1, .15c-3, .17a-4, .17a-5, .17a-11, promulgated thereunder. In that regard, respondent was alleged to have engaged in: (1) fraud in the purchase and sale of securities, (2) the sale of unregistered securities, (3) bidding for or purchasing securities being distributed before completing participation in the distribution, (4) aiding and abetting OTC Net in violating Section 15(c)(3) of the Exchange Act and Rule 15c3-1 by inducing or attempting to induce the purchase and sale of securities while OTC Net's capital was less than the minimum required, and (5) aided and abetted OTC Net in violation of the customer protection rule, the books and records requirements, the preservation of books and records, reporting and notice requirements. Ex. 1.

Following from the complaint, the Commission under the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78 aaa-111 requested that the court appoint a trustee to protect the customers of OTC Net and to liquidate the company. Exs. 2 and 3.

The respondent was OTC Net's president, financial and operations principal and an active participant in the management of the firm. Ex. 5 at 6. On March 13, 1985, the National Association of Securities Dealers (NASD) found that Schidlowski was responsible for: (a) OTC Net's net capital violations on several days, and (b) the failure to provide telegraphic notice of the firm's net capital deficiencies to regulatory authorities. The NASD also found that Schidlowski placed his interests before those of his customers by permitting the withdrawal of \$33,330 from the firm for himself and another principal immediately prior to the firm's demise which caused checks to customers to be dishonored, and that he permitted Joseph V. Pignatiello to function in a principal capacity at OTC Net without requiring him to become properly registered as a principal. The NASD censured the respondent, barred him from association with any member of the NASD in any capacity and fined him \$31,665, which it believed reflected the funds the respondent withdrew from the firm as it ceased operations. Ex. 5.

On May 27, 1986, the respondent entered into a plea agreement in which he pled guilty to having conspired to defraud the United States by failing to file income tax returns. Ex. 6. The fraud, according to the prosecutor's statement, arose from failing to pay taxes on illegal stock transactions. Id. The respondent affirmed

in court that he had engaged in the illegal transactions described in the prosecutor's statement. Ex. 11 at 8. That statement recounted as follows: Schidlowksi was a principal of OTC Net, a Denver based brokerage firm primarily involved in underwriting over-the-counter public stock distributions. Schidlowksi and the other principals of OTC Net expanded their marketing capabilities to Europe by establishing a Swiss affiliate, Otecenet, S.A. In early 1981, OTC Net became the primary underwriter of stock of Balboa Exploration Company. OTC Net's principals, Schidlowksi, Joseph V. Pignatiello, Kim D. Rust, Daniel Walters, and Arlan I. Preblud, increased the number of Balboa shares to be distributed from 15 million to 20 million. Otecenet was allocated 4,450,000 Balboa shares for distribution in Europe.

Schidlowksi and three other OTC Net principals purchased the Balboa shares allocated to Otecenet through accounts opened for their benefit at Swiss financial institutions. On March 16, 1981, Schidlowksi and the other OTC Net principals borrowed \$450,000 from Metro National Bank in Denver, ostensibly to buy furniture and fixtures. Instead, \$404,000 of the loan proceeds were converted to cashiers checks payable to Manin Trust Ltd. and deposited in the Swiss accounts of Schidlowksi and the other OTC Net principals. From these accounts Schidlowksi and the other OTC Net principals purchased from OTC Net's affiliate, Otecenet, 4,040,000 shares of Balboa stock. Between April 8, 1981 and April 16, 1981, the new issue shares purchased by Schidlowksi and the other OTC Net principals were sold back to OTC Net for a profit of \$1,000,000.

In May of 1981, Schidlowski and the OTC Net principals engaged in the same scheme with regard to new issue shares of Piezo Electric Products, Inc., where OTC Net was again the underwriter. The profits to Schidlowski and the other OTC Net principals were \$850,000. The profits, which were hidden in numbered Swiss bank accounts, were transferred back to the United States through foreign corporations created for the benefit of the principals of OTC Net. In 1981, Schidlowski received a salary of \$652,241.44 from OTC Net and his share from the illegal European stock transactions. Schidlowski was fined \$25,000 and sentenced to prison for two years. The plea agreement resulted from a grand jury indictment of Schidlowski and other owners and principals of OTC Net and Otecenet. Ex. 9.

On February 12, 1993, respondent was found guilty of failure to surrender for service of the sentence and his sentence was increased by three years. Ex. 8.

On September 4, 1987, the Commission suspended the registration statement of Pagetus, Inc., which was filed on June 4, 1986, after it found that the statement included untrue statements of material facts and omitted to state material facts. Ex. 7. The Pagetus registration statement failed to disclose, inter alia, the activities of the respondent who acted as a control person, promoter or performed the functions of an officer or director of the issuer. Id. The respondent denied in this hearing that he was a control person, officer or director of Pagetus. Tr. 78. The proof of his assertion, he said, "is in a lot of

paperwork." Id. He said that he was a consultant to Pagetus and he tried to develop capital sources for the company in Europe. Tr. 78. Nevertheless, Schidlowksi did not deny that he performed the functions of an officer or director of Pagetus. He engaged in these activities while he was a fugitive from serving his prison sentence.1/

The respondent testified that he has "no interest in doing business in the United States" and that once he is "released from jail ... [he] will leave this country to never return; that [he] did not do any business [in the United States] while [he] was gone." Tr. 77. Schidlowksi described his running of OTC Net "as one of the shining examples in its time of what venture capital is really all about." Id. He concedes that he "screwed up, ... to which [he] pleaded guilty." Schidlowksi agrees that his illegal activities at OTC Net warrants "being barred from dealing in the United States." Tr. 79. Schidlowksi represented that he will renounce his American citizenship and will ask the Chilean government to reinstate his passport. Tr. 82.

After Schidlowksi fled from the United States he lived for a time in Europe where he conducted business. One of the people who sought his assistance was an American business person who lives in New York City, Jamie Darder. Schidlowksi conceded that after a

1/ The Division, based on Exhibit 10, requests a finding that "Schidlowksi was president of Sundance International and attempted to merge Sundance International with another company" while he was a fugitive. Exhibit 10, which is cited for that proposition, does not establish that Schidlowksi engaged in that conduct while he was a fugitive.

number of meetings with Darder, he put Darder in touch with Pignatiello, who had been a vice president of OTC Net, about raising capital for Darder's invention. At the time, Schidlowksi was a fugitive living in Barcelona, Spain and Pignatiello was in prison in Texas. Id. Darder knew that Schidlowksi was a fugitive while he was dealing with him and eventually he discovered that Pignatiello was in prison during the time he was seeking his help in raising capital. Tr. 36.

Darder stated that he also met with Schidlowksi at a company in Zurich, Switzerland called Zurfinanz, which Darder believed was Schidlowksi's company, and where Schidlowksi had an office. Tr. 32. Darder believed that it was the entity doing all the financing of Schidlowksi's projects. Tr. 32. Schidlowksi did not refute what Darder said directly but his testimony implies that he did not own Zurfinanz. He said that Zurfinanz "ended up owing [him] a lot of money, which they never paid." He conceded that he developed plans for Zurfinanz to do business in Chile which could have resulted in his earning money and shares in Zurfinanz. The credible record evidence does not support the claim that Schidlowksi owned Zurfinanz, however, or that he used the company to engage in business transactions in the United States while he was a fugitive.

The Division maintains that Schidlowksi was lured to the Dominican Republic from his home in Chile on the pretext that he could become part of a money laundering transaction for some foreign owners of gambling casinos in the Dominican Republic. The Division submitted the testimony of Robert Masaitis, a supervisory

deputy U.S. Marshall to support that claim. Tr. 49. Masaitis explained that he directed Richard Marchese, a former business associate of Schidlowski, in developing the business transaction to lure Schidlowski from Chile to the Dominican Republic. Masaitis said that it was the government's intention to use the transaction to gain custody of Schidlowski and extradite him to this country.

Marchese and Schidlowski had over a dozen telephone conversations about the Dominican Republic business transaction. Masaitis represented that he directed the majority of Marchese's telephone conversations with Schidlowski. Tr. 51. Marchese was at the time under investigation by the Internal Revenue Service and U.S. Postal Service. Tr. 52. Masaitis was not able to provide any details about how the concocted transaction would have been effectuated since he conceded he is "not very familiar with the financial dealings of stocks, securities, laundering." Tr. 53. His knowledge is about how to repatriate fugitives. Tr. 53. Marchese, in any event, purportedly communicated the scheme to Schidlowski through telephone calls and one visit to Schidlowski in Santiago, Chile, according to Masaitis. Tr. 54.

Masaitis heard two of Marchese's conversations with Schidlowski about the transaction. Those two conversations were transcribed and are Exhibits 13 and 14. Tr. 54-57. Masaitis said that Marchese developed a code to talk to Schidlowski about the transaction in which he referred to money as packages and carats. Tr. 57-58. Of the dozen conversations, only two were made in Masaitis's presence and only three of the conversations were

transcribed. Tr. 61. When Masaitis was asked why the others were not used in this proceeding, he said he witnessed only two of the conversations. Id. The tapes also apparently have conversations between Masaitis and Marchese which were not transcribed. Tr. 63. Schidlowski said he knew that carats and packages meant money. Tr. 67. On one of the tapes, Schidlowski said that a new source of over-the-counter trading was opening up in Chile and that, if it happened, it would be a "completely different network of all the old players with nothing to do anymore." Ex. 14.

Schidlowski is concerned that the allegations made in this case about his willingness to engage in money laundering will be presumed to be true because he has not addressed them. Tr. 79-81. He maintains that his extradition from the Dominican Republic was carried out by the Presidential Drug Task Force and that in order to do so the Task Force falsely claimed that he was a drug dealer. Tr. 81.

CONCLUSIONS

On August 7, 1987, Schidlowski was permanently enjoined from engaging in violations of Sections 5(a) and 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, as amended. The injunction was granted when Schidlowski defaulted by failing to appear for a deposition. The complaint stated that Schidlowski violated securities laws when he offered for sale, purchase and sale the securities of International Remote Imaging Systems, Inc., Balboa Exploration Company, Elan Air Corporation, Synthetic Fuels, Inc., and Gentex Corporation.

The complaint also alleged that, in violation of 15(a) of the Exchange Act, the respondent aided and abetted Otecenet and Preblud's failure to register with the Commission as a broker-dealer, that he aided and abetted OTC Net in violating Sections 17(a) and 15(c)(3) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-4, 17a-5 and 17a-11 promulgated thereunder. It is further stated in the complaint that the respondent engaged in: (1) fraud in the purchase and sale of securities, (2) the sale of unregistered securities, (3) bidding for or purchasing securities being distributed before completing participation in the distribution, (4) aiding and abetting OTC Net in violating Section 15(c)(3) of the Exchange Act and Rule 15c3-1 by inducing or attempting to induce the purchase and sale of securities while OTC's capital was less than the minimum required, and (5) aided and abetted OTC in violation of the customer protection rule, the books and records requirements, the preservation of books and records, reporting and notice requirements.

The respondent was president of the brokerage firm OTC Net where the illegal transactions occurred. On March 13, 1985, the National Association of Securities Dealers found that Schidlowski was responsible for OTC Net's net capital violations on several days, and the failure to provide telegraphic notice of the firm's net capital deficiencies to regulatory authorities. The NASD also found: Schidlowski placed his interests before those of his customers by permitting the withdrawal of money from the firm for himself and another principal immediately prior to the firm's

demise which caused checks to customers to be dishonored, and he permitted Pignatiello to function in a principal capacity without requiring him to become properly registered as a principal. The NASD censured Schidlowksi, barred him from association with any member of the NASD in any capacity and fined him \$31,665, which it believed reflected the funds the respondent withdrew from OTC Net as it ceased operations.

On May 27, 1986, the respondent pleaded guilty to having conspired to defraud the United States by failing to file an income tax return for 1981. The underlying facts, which he admitted, exhibited that he had engaged in illegal stock transactions. Those activities he admits involved the purchase of initial offering shares which his firm was underwriting and reselling to the firm in the aftermarket at a substantial profit.

Respondent fled from this country instead of reporting to serve a prison term. He was extradited to this country from the Dominican Republic and is currently in a federal prison in Colorado, where this hearing was held. He is serving a five year sentence. While he was out of the country, Schidlowksi continued to engage in financial transactions involving American companies and American entrepreneurs, where the intention was to conduct business in this country.

The Sanction to Be Imposed

The Division urges that Schidlowksi should be barred from association with any broker or dealer, based on his criminal conviction and the civil injunction imposed on him, and that he

should be barred from participating in an offering of penny stock. The Division's proposed sanction would bar Schidlowski from participating in any offering of penny stock including acting as a promoter, finder, consultant, agent in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase of any penny stock, as provided in § 15(b)(6)(c) of the Exchange Act.

The Public Interest Factors that Require Remedial Action

Schidlowski was a principal in crimes that involved stock manipulation, Swiss numbered bank accounts and fraudulent loans. He benefited by reaping enormous and quick profits. Schidlowski and his partners, Pignatiello, Rust, Walters and Preblud, made profits of one million dollars in eight days in April 1981 and another \$850,000 a month later in May 1981 from their illegal activities. Schidlowski admitted in federal court that he had engaged in this conduct. He did not introduce evidence in this proceeding that contradicted the prosecutor's statement or his own admission of his guilt to the court. In numerous ways, he violated the regulations of the NASD and statues and regulations of this Commission. He put his own interest first over his duty to the customers of the firm. When his brokerage firm was about to go out of business, Schidlowski took money for his personal use that was in an account set aside for money owed to customers of the firm. Moreover, after agreeing to a guilty verdict and having been sentenced, he fled this country in order to escape serving the sentence and continue his business activities. In addition,

Schidlowski has not shown that the allegations that he manipulated the market for five stocks between 1979 and 1982 are inaccurate. In fact, he concedes he acted illegally in operating OTC Net. This conduct is egregious by even the most lenient standard and warrants barring him from associating with a broker or dealer and from participating in any offering of a penny stock.^{2/}

The evidence indicates that the respondent acted with scienter. He knowingly violated the securities laws. The respondent conceded at the hearing that "I also screwed up, ... I plead guilty. I believe the screw up was bad enough that I am perfectly comfortable with being barred from dealing in the United States" Schidlowski has not countered the statements in the criminal and civil complaints that he knowingly and repeatedly violated the securities laws. Despite Schidlowski's avowal that he deserves to be barred from being associated with a broker or dealer, the record indicates that his conduct outside of that possible association would be a risk to investors and warrants remedial action. After Schidlowski fled to avoid incarceration, he immediately started to direct financial transactions from

^{2/} Before Schidlowski was brought back to this country to serve his sentence, the government recorded some of his telephone conversations. On December 9, 1991, in the course of one of those conversations, Schidlowski told Richard Marchese that there was a possibility of starting a new, major worldwide source of over-the-counter trading in Chile. Schidlowski said that if it happened it would be "awesome." It would put together a new network of all the "old players" from his "old over-the-counter days in the U.S." Ex. 14 at 3. This bravado demonstrates that the respondent intended to continue his penny stock activity with the same players even after he had pleaded guilty and was a fugitive from the U.S. justice system.

Barcelona, Spain, Zurich, Switzerland, and later Santiago, Chile. There is evidence that he intended to engage in business in London, also. The record reflects that during this period Schidlowski was involved as a control person, promoter or performed the functions of an officer or director of a stock issuer, Pagetus, with offices in Westport, Connecticut. The Commission found that Pagetus failed to disclose the respondent's activities on behalf of the company. The respondent denied in this hearing that he was a control person, officer or director of Pagetus. But his denial was carefully stated and he did concede that he was a consultant to Pagetus and that he attempted to develop capital sources for the company in Europe while he was a fugitive.

The testimony of Jamie Darder lends further credence to the argument that there is a likelihood Schidlowski will be involved in transactions which present the possibility of securities law violations. While he was a fugitive, living in Barcelona, Spain, he put Darder in touch with his former business associate and OTC Net principal, Pignatiello, who was in prison in Texas, about raising money through investment pools in the United States for Darder's invention. He admits that he was planning an over-the-counter trading system with the OTC Net principals when he was a fugitive living in Chile.

There is little doubt that Schidlowski recognizes that he was involved in wrong doing. But it is equally evident that he believes he should not be held fully accountable for it. While he agreed that he should be barred, he also said that "if there's

somebody to blame for hurting America, it is not me. On the contrary, I feel very proud of some of the things I've done." Tr. 79. In the respondent's conclusion to his post hearing filing he states that "For an instant I was part of the most vibrant and freest venture capital mechanisms that man has devised, and I did many good and proper things." Schidlowski has given every sign that he cannot be trusted to keep his word or accept the consequences of his conduct. When his conduct involving his securities transactions was at issue before the court and the NASD, he failed to appear. And after he agreed to be sentenced for tax fraud he fled. He did not return voluntarily. In this proceeding, he offered no affirmative evidence to counter the numerous facts demonstrating that he has engaged in illegalities. Instead, he repeatedly urged that he was being wrongfully maligned. Overall, his statements in this proceeding have been unreliable and have indicated that he still is unwilling to accept responsibility for his wrongdoing.

Based on a preponderance of the evidence, the appropriate sanction in the public interest is to bar the respondent from any association with a broker or dealer and from participating in any offering of a penny stock.

ACCORDINGLY, IT IS ORDERED, that pursuant sections 15(b) and 19(h) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b), 78s(h), Juan Carlos Schidlowski is barred from association with a dealer or broker and from participating in an offering of penny stock.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision will become the final decision of the Commission as to any party who has not, within fifteen days after service of this initial decision, filed a petition for review pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review the decision. If the applicants timely file a petition for review, or the Commission takes action to review, the initial decision will not become final. 3/


Edward J. Kuhlmann
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- 3/ The respondent raises various other arguments which have been considered and rejected. All proposed findings and conclusions submitted by the parties have been considered, as have their arguments. To the extent such proposals and contentions are consistent with this initial decision, they are accepted. In all cases where applicable, the demeanor of the witnesses has been considered in assessing their testimony. The conclusions reached are based upon a preponderance of the evidence.