ADMINISTRATIVE PROCEEDING
FILE NO. 3-7977

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
	)
RAY H. KOBAYASHI	)
	)

INITIAL DECISION

Washington, D.C.
November ~~9~~ 5, 1993

Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: Daniel Shea, Herbert F. Janick and Phil Gross, for the Division of Enforcement.

Ray H. Kobayashi, pro se

BEFORE: Max O. Regensteiner, Administrative Law Judge

I. INTRODUCTION

In these proceedings pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), the issues are (1) whether, as alleged by the Division of Enforcement, Ray H. Kobayashi unlawfully offered and sold unregistered securities at a time when he was associated with a broker-dealer, and was enjoined from engaging in such misconduct in the future, and (2) if so, what, if any, remedial action is appropriate in the public interest.

Following hearings, the Division filed proposed findings of fact and conclusions of law and a supporting brief, Kobayashi filed a "post-hearing brief," and the Division filed a reply brief. 1/ The findings and conclusions herein are based on the preponderance of the evidence as determined from the record and upon observation of the witnesses.

The Allegations and Kobayashi's Answer

The Division alleged that in July 1988, at a time when Kobayashi was associated with a broker-dealer, he willfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 in connection with the offer and sale of 68,081 shares of common stock of American Aircraft Corporation ("AAC"), and that in October 1992 a United States District Court by summary judgment permanently enjoined him from violating those provisions. According to the allegation, the shares were part of a block of 1.9 million shares of unregistered AAC stock that a shareholder of Phalanx Organization had received in March 1988 in exchange for Phalanx restricted stock in connection with AAC's acquisition of Phalanx's assets in

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1/ Kobayashi filed a "Post-Hearing Reply Brief." However, the filing of such a brief by a respondent is not authorized by the Commission's Rules of Practice (17 C.F.R. 201.16(e)), and I made no provision for such a filing in the schedule I established for post-hearing submissions. Kobayashi has made no showing of extraordinary circumstances warranting a departure from the specified procedures. Accordingly, I decline to receive the reply brief as part of the record herein. This makes it unnecesary to rule on the Division's motion to strike the brief.

return for AAC stock. The Division further alleged that the AAC stock was restricted stock within the meaning of Rule 144 under the Securities Act (17 CFR 230.144), and that the shareholder transferred the 68,081 shares to Kobayashi as compensation for the latter's efforts to assist the shareholder in raising money for AAC and another company.

In his answer, Kobayashi denied that he committed any violations, stated that he had appealed the injunctive order and asserted that while he was a registered representative of a broker-dealer at the time he received the AAC shares, he was unemployed at the time of their sale.

Rule 144

Under this rule, a person who sells "restricted securities" (defined as including securities acquired directly or indirectly from an issuer in a transaction or chain of transactions not involving a public offering) is deemed not to be engaged in a distribution of such securities and therefore not an underwriter thereof if the sale is made in accordance with all of the rule's conditions. One of those conditions is that at least two years must elapse between the date of acquisition of the securities from the issuer and any resale in reliance on the rule for the account of either the acquiror or any subsequent holder of those securities. Where the securities are sold for the account of a person who is not, and has not been during the preceding three months, an affiliate of the issuer, the conditions are relaxed, provided that at least three years have elapsed since the securities were acquired from the issuer.

II. FINDINGS OF FACT, DISCUSSION AND CONCLUSIONS

Respondent's Background and Broker-Dealer Association

Kobayashi is 49 years old. He has taken various college business courses, but has no college degree. He served several years in the Army and was discharged as a captain in 1970. Beginning in 1974, he held sales positions with several broker-dealers. From June 1985 to about July 14, 1988 (see Division Exhibit 6 at 114), he was a registered representative of Bateman Eichler, Hill Richards, Inc. ("Bateman") in Los Angeles. He left Bateman in order to return to Hawaii, his home state, and to work in the securities business there.

Section 15(b)(6) of the Exchange Act applies not only to a person who was associated with a broker or dealer at the time of the alleged misconduct, but equally to one seeking to become so associated at that time. While Kobayashi was temporarily unemployed at the time of the transactions at issue here in late July 1988, his own deposition testimony establishes that he intended to resume work as a securities salesman following his return to Hawaii. In fact, after a hiatus of a few months, he again became associated with a broker-dealer. Under the circumstances, he clearly falls within the reach of Section 15(b)(6).2/

The Injunction

In December 1991, the Commission filed an injunctive action in the United States District Court for the Central District of California against Kobayashi, alleging that he violated Sections 5(a) and 5(c) of the Securities Act in the offer and sale of AAC stock and seeking an injunction against further violations of those provisions. The parties

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2/ The Division alleged that Kobayashi was a registered representative of Bateman through July 1988 and was therefore associated with Bateman at the time of the alleged misconduct. However, since the statute also covers persons seeking broker-dealer association at the time of the alleged misconduct, I do not consider the variance between the allegation and the evidence to be material.

stipulated to proceed before a magistrate judge. The Commission subsequently moved for summary judgment, supported by a Statement of Uncontroverted Facts and Conclusions ("the Statement"). The Statement was based on the deposition testimony of Kobayashi himself as well as that of William Phelps, Bateman's compliance director in 1988, and Marie Eaton, compliance officer of Wedbush Morgan Securities ("Wedbush"), the firm through which Kobayashi sold the AAC shares; documents that were marked as exhibits during those depositions; and Kobayashi's answer to the Commission's Request for Admissions.

On October 30, 1992, the magistrate judge, stating that Kobayashi had filed no opposition to the motion, issued an Order Granting Summary Judgment and a Final Judgment permanently enjoining Kobayashi from violating Sections 5(a) and 5(c) of the Securities Act. In her Order, she adopted all but one of the "uncontroverted facts" in the Commission's Statement as well as its conclusions.

Kobayashi had apparently attempted to file a timely response to the motion for summary judgment, but this did not come to the magistrate judge's attention until Kobayashi filed a document protesting the summary judgment. Construing that document as a motion for reconsideration, the magistrate judge concluded that even had she seen the response before granting the motion, the result would have been the same.

Kobayashi appealed to the district court. The court dismissed the appeal on jurisdictional grounds and directed Kobayashi to take the appeal to the Court of Appeals. When he did so, that court, in turn, ruled that to the extent the appeal was from the magistrate judge's orders, it was untimely. To the extent the appeal was from the district court's order, the court of appeals summarily affirmed.

Kobayashi's Violations

The doctrine of collateral estoppel precludes relitigation of issues actually litigated and determined in a prior action, including instances where the prior action was resolved by summary judgment. See, e.g., Lujan v. United States Dept. of the Interior, 673 F.2d 1165, 1168 (10th Cir. 1982). Accordingly, the facts found by the magistrate judge and her conclusions are binding in this proceeding. As noted, those findings and conclusions were taken from the Commission's Statement.

The following findings reflect the magistrate judge's findings and conclusions:3/ In early 1988, one Donald Wright, who had received a large amount of unregistered AAC stock in exchange for Phalanx stock, requested Kobayashi's assistance in selling about 3 million AAC shares owned by him and others. He informed Kobayashi that the shares were freely tradeable. However, when Kobayashi received Wright's share certificate, he discovered that it had a Rule 144 restrictive stock legend affixed.

Kobayashi, who was familiar with the requirements of Rule 144, told Wright that legal opinions were necessary in order to remove the restrictive legend. Thereafter, Wright provided Kobayashi with two legal opinions, one by outside counsel and one by G. Alfred Roensch, an AAC in-house counsel. These concluded that former owners of Phalanx stock such as Wright could "tack" their period of Phalanx ownership onto their AAC stock ownership period, thereby meeting the holding period requirement of Rule 144. Thereafter the legend was removed.

On or about May 18, 1988, Kobayashi sold 43,540 shares for the account of one of the persons associated with Wright. About a week later, he was told by Bateman's

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3/ Footnote statements accompanying this section reflect supplemental information based on the record before me (which is largely the same record that was before the court).

compliance department to stop selling AAC stock, because there was a question relating to the tacking period and the firm wanted to clarify whether Wright's stock should have been cleared for sale.

In late May 1988, Kobayashi attended a meeting with Wright, Kobayashi's branch manager and a Bateman attorney. He learned that AAC's outside counsel had changed his opinion concerning the tacking period and had concluded that the AAC shares received by the former Phalanx shareholders were not freely tradeable. The Bateman attorney also indicated that he could not trust Roensch's opinion letter. He told Wright that he might consider permitting him to sell his AAC stock through Bateman if he obtained a no-action letter from the Commission or a better opinion letter from a more reputable attorney. The attorney expressed his concern that if the firm sold any more AAC stock for former Phalanx shareholders, it would be potentially liable to AAC for improperly handling Rule 144 stock. He told Kobayashi that Bateman was not going to do any more Rule 144 sales of AAC stock received by former Phalanx shareholders as a result of the AAC/Phalanx merger. And he told Wright that he was going to give back his AAC stock with the legend reaffixed. Kobayashi saw that the certificate returned to Wright had a restrictive legend.

Kobayashi expressed disappointment at losing large anticipated commissions from the sale of AAC stock. In June 1988, Wright gave him a certificate for 68,081 shares of AAC stock in the name of Global Capital Management & Venture Co., Inc. ("Global"), a company owned by Kobayashi. The certificate did not contain a Rule 144 legend.

Subsequent to receiving this certificate, Kobayashi did not seek legal advice as to whether his AAC stock was freely tradeable. In July, he resigned from Bateman. On or about July 19, 1988, he opened accounts at Wedbush in the name of Global and in his own

name.4/ On or about that date, he visited Wedbush's Los Angeles office to sign account opening documents and to deposit the AAC stock certificate in the corporate account.

During his visit to Wedbush, Kobayashi was assisted by Marie Eaton, Wedbush's compliance officer.5/ He answered in the negative her question whether he was an insider of or affiliated with AAC. She also asked him whether he knew about Rule 144 and whether the AAC stock was Rule 144 stock. He responded that he knew about Rule 144 and denied that the stock was Rule 144 stock. Eaton also asked Kobayashi whether he was going to sell the stock right away, to which he responded "I don't think so."6/

On or about July 21, 1988, Kobayashi placed an order with Wedbush to sell all 68,081 shares from his corporate account. Sales for 40,000 shares were executed through the NASDAQ system at prices ranging from 1-1/4 to 1-7/16 per share. Kobayashi's account executive told him that he could not sell any more AAC stock that day because there was not a very active market for the stock. Kobayashi directed the account executive to purchase in Kobayashi's personal account the 28,081 shares remaining in the corporate account. That transaction was executed through the NASDAQ system at 1-5/16 per share

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4/ The accounts were opened with a friend of Kobayashi's who was a salesman in Wedbush's Honolulu office.

5/ Eaton was also head of the new accounts department.

6/ Eaton's testimony at the hearing put a somewhat different slant on this aspect of her conversation with Kobayashi. She testified that she did not ask Kobayashi whether he planned to sell the AAC stock, but that he volunteered that he did not intend to sell it and only wanted to deposit it because he was moving. The Division's post-hearing submissions refer to and rely on this testimony. However, the Division is bound by the magistrate judge's findings to the same extent as the respondent. And her finding on this issue is as stated in the text, reflecting the Commission's own Statement. In that part of the Statement, the Commission chose to rely on Kobayashi's deposition testimony rather than that of Eaton.

to, in Kobayashi's words, "stabilize the market." Kobayashi sold these shares from his personal account on or about July 29, 1988. 7/

The magistrate judge concluded that since no registration statement had been filed with respect to the AAC stock and since Kobayashi used means of interstate transportation or communication in connection with the offer or sale of the stock, a prima facie violation of Section 5 was established, and that Kobayashi had not met his burden of showing that an exemption was available when he offered and sold the stock. Therefore he had violated Sections 5(a) and 5(c) of the Securities Act.

It was not necessary for the magistrate judge to find explicitly that Kobayashi's violations were willful, and she made no such finding. In Section 15(b)(6) proceedings, violations must be found to be willful if they are to be a basis for the imposition of sanctions. The Commission, with judicial support, has consistently held that a finding of willfulness does not require an intention to violate the law, and that it is enough that the respondent intentionally committed the act that constitutes the violation.8/ Thus, there can be no question here that Kobayashi's violations were willful.

Public Interest

With the issue of Kobayashi's violations of Section 5 having been resolved in the court action, the evidence adduced at the hearing before me related to the issue of what sanction, if any, should be imposed on him in the public interest. On that issue, the focus

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7/ According to Eaton's testimony before me, Wedbush paid Kobayashi upon sale of the securities and then was informed by the transfer agent that the shares were restricted and could not be transferred. Wedbush then began efforts to recover the sale proceeds.

8/ See, e.g., Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); G.C.George Securities, Inc., 47 S.E.C. 1007, 1010 n.10 (1984), aff'd in unpublished opinion sub. nom. Jerry T. O'Brien, Inc. v. SEC (9th Cir., April 2, 1985).

was, and is, on the degree of Kobayashi's culpability and the nature of mitigating or aggravating circumstances. The Division's evidence, in addition to documentary material relating to the injunctive action, consisted essentially of the Kobayashi and Phelps depositions and related exhibits and Eaton's testimony. Kobayashi testified in his own behalf and presented a character witness.

The Division urges that I suspend Kobayashi from association with a broker or dealer for 12 months,9/ a more stringent sanction than the Commission has generally imposed in Section 5 cases. It stresses that, unlike the salesmen involved in most of those cases, Kobayashi sold the AAC stock for his own account, and it asserts that he did so with the knowledge that it was restricted stock that could not be sold; that he acted in a deceptive manner in his dealings with Eaton; and that he still fails to acknowledge that he engaged in wrongdoing and seeks to shift the blame to others. As an instance of additional misconduct by Kobayashi, the Division cites the fact that in 1980 the New York Stock Exchange admonished him for falsely answering in the negative a question on an application for broker-dealer employment submitted to the Exchange as to whether he had ever been declared bankrupt. The Exchange stated that in determining not to take formal disciplinary action against him, it had taken into consideration his explanation that he believed the question pertained only to business failure and that he had no intention to deceive employers or the Exchange.10/

9/ The Division asks that I also suspend Kobayashi for the same period from association with an investment adviser, investment company or municipal securities dealer. In my view, however, such action cannot be taken in a proceeding under Section 15(b)(6) of the Exchange Act.

10/ As a further instance of asserted misconduct, the Division characterizes the purchase of 28,081 shares by Kobayashi's personal account from his corporate account as a (continued...)

Kobayashi contends that it is not in the public interest to impose any sanction on him. In support, he argues, among other things, that (1) the stock he received from Wright had no restrictive legend and was represented by Wright to be "free trading"; (2) he made no misrepresentations to Eaton; and (3) if there was unlawful conduct, it was due to "bad business conduct and poor ethical behavior" (Resp. Brief at 2) by the issuer, its counsel and its transfer agent, who permitted the shares to be issued without a restrictive legend, and by Wedbush, which permitted settlement of his sales transactions without ascertaining whether the shares could in fact be freely traded, and that he was a victim of their conduct.11/

Kobayashi testified that before accepting the AAC stock, he insisted to Wright that it had to be freely tradeable. He further testified that Wright informed him that Wright's attorney, AAC and Roensch had told Wright that they had resolved "this thing," and that Wright repeatedly assured him that the stock was freely tradeable. According to Kobayashi, he would not have tried to sell securities that he believed would not clear, because he would not get paid, and also because he intended to stay in the securities business and did not want any problem or embarrassment. However, in the face of his experiences at Bateman with Wright's AAC shares, he was derelict in simply relying on Wright's word

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10/(...continued)
fabrication of demand, i.e., a manipulative device. However, the order for proceedings did not allege manipulative or fraudulent conduct on Kobayashi's part. Under the circumstances, it is not appropriate to consider this alleged misconduct on the public interest issue. International Shareholders Services Corporation, 46 S.E.C. 378, 386 n.19 (1976).

11/ Because of Kobayashi's pro se status, I have not limited myself to his brief in looking for his contentions, but have also looked to his deposition in the injunctive action, his opening statement and testimony in the hearing before me and documents filed by him in the two proceedings.

and on the fact that the securities were not legended. Admittedly, Wright showed him no opinion letter from counsel or no-action letter from the Commission. And he himself did not seek legal advice or check with AAC or the transfer agent.

It has been repeatedly held that a securities salesman, as a professional in the securities business, has a responsibility to be reasonably certain, before selling securities, that those securities may lawfully be sold under the Securities Act's registration requirements. 12/ This principle applies to Kobayashi, an experienced securities salesman, even though he was between jobs at the time of the sales in question. By virtue of his involvement in Bateman's extended consideration of the status of Wright's AAC securities, he knew that there were at the least serious questions regarding the free tradeability of those securities and indeed that Bateman had concluded that it could not permit those securities to be sold. Nonetheless, he blithely accepted Wright's assurances and did not bother to investigate. That others, such as the transfer agent or Wedbush, may have been deficient in the way they performed their functions does not mitigate Kobayashi's conduct. 13/ Indeed, his consistent attempt to place blame on others and his failure to acknowledge his own misconduct are cause for concern regarding his attitude toward compliance with regulatory requirements.

12/ See, e.g., Quinn and Company, Inc. v. S.E.C., 452 F.2d 943, 947 (10th Cir. 1971); Butcher & Singer, Inc., 48 S.E.C. 640, 642 (1987); Paul L. Rice, 45 S.E.C. 959, 961 (1975).

13/ See Owen V. Kane, 48 S.E.C. 617, 623 (1986), affirmed 842 F.2d 194 (8th Cir. 1988).

In Gilbert F. Tuffli, Jr., 46 S.E.C. 401, 409 (1976), the Commission stated that the absence of a restrictive legend on certificates did not warrant the conclusion [by a salesman] that they must be freely tradeable. See also Quinn, 452 F.2d at 946-947 (securities salesman not entitled to rely on lack of cautionary legends on stock certificates).

A further aggravating circumstance is the way he dealt with Eaton, Wedbush's compliance officer. Kobayashi lied to her concerning his intention to sell the AAC stock and was at best less than candid in his answers to her other questions. He himself characterized his statement regarding his intentions as "a white lie, a minor lie" (tr.117), but claimed that he did not intend to deceive Eaton. He explained his responses to her as prompted by a need to return quickly to his car, which he had left with the engine running and his teenage son inside. Kobayashi also testified that in his view the person he was dealing with at Wedbush was his registered representative in Honolulu, who knew that Kobayashi wanted to sell the stock, and not Eaton, the compliance officer. As he put it, "I didn't care what I said to Ms. Eaton, because to me, she was not my broker." (Tr. 110). Kobayashi's "explanations" do not mitigate his deceptive conduct.

The violations and injunction, and the surrounding circumstances described above, indicate that a substantial sanction is required in the public interest in order to impress upon Kobayashi that if he returns to the securities business he must be committed to full compliance with regulatory requirements and cannot hide behind the deficiencies of others. In my judgment, a suspension of six months from association with a broker or dealer is appropriate in the public interest.14/

III. ORDER

Accordingly, IT IS ORDERED that Ray H. Kobayashi is hereby suspended for a period of six months from being associated with a broker or dealer.

14/ All proposed findings and conclusions and all contentions have been considered. They are accepted to the extent they are consistent with this decision.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice. Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him, unless 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 for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Max O. Regenstein
Administrative Law Judge

Washington, D.C.
November 5, 1993