ADMINISTRATIVE PROCEEDING
FILE NO. 3-7719

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
	)
MARTIN HERER ENGELMAN,	)
PETER PAUL KIM, and	)
LAWRENCE DAVID ISEN	)
	)

INITIAL DECISION

Washington, D.C.
November 8, 1993

Warren E. Blair
Chief Administrative Law Judge

ADMINISTRATIVE PROCEEDING
FILE NO. 3-7719

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)	
	)	
MARTIN HERER ENGELMAN,	)	
PETER PAUL KIM, and	)	INITIAL DECISION
LAWRENCE DAVID ISEN	)	
	)	

APPEARANCES: Deborah R. Meshulam and Daniel H. Rubenstein, of the Commission Headquarters Office, for the Division of Enforcement.

Stephen E. Kapnik, of Lohf, Shaiman & Jacobs, P.C., for Martin Herer Engelman.

David A. Zisser, of Berliner, Kaplan, Zisser, & Walter, P.C., for Peter Paul Kim and Lawrence David Isen.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

These public proceedings were instituted by an order of the Commission dated April 27, 1992 ("Order") issued pursuant to Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether allegations of misconduct made by the Division of Enforcement ("Division") against Martin Herer Engelman ("Engelman"), Peter Paul Kim ("Kim"), and Lawrence David Isen ("Isen"), collectively ("respondents"), are true and what, if any, remedial action would be appropriate in the public interest.

In substance, the Division alleged that from about April, 1988 through at least September, 1990 Engelman wilfully violated antifraud provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act and Rule 10b-5 thereunder in connection with the purchase and sale of securities and in the offer and sale of securities, and that from April, 1988 through at least November, 1990 he failed reasonably to supervise Kim and Isen with a view to preventing their violations of the Securities Act and of the Exchange Act. The Division also alleged that from about July, 1988 through May, 1990 Kim wilfully violated the antifraud provisions of the Securities Act and of the Exchange Act and Rule 10b-5 thereunder in the purchase, offer, and sale of securities, and that Isen also committed wilful violations of those antifraud provisions in the purchase, offer, and sale of securities during the period from about April, 1988 through May, 1991.

General denials of the alleged misconduct were filed in respondents' answers. All respondents appeared through counsel during the prehearing procedures and throughout the hearing and post-hearing stages of these proceedings.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings were made by the

parties. 1/

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the various witnesses.

RESPONDENTS

Engelman

Engelman, a resident of Escondido, California, entered the securities business in July, 1985 as a registered representative with Stuart-James Co., Inc. ("Stuart-James"), a now defunct broker-dealer. He worked until November, 1990 in that firm's Clearwater, Florida; Irvine, California; and San Diego, California offices. 2/ He became assistant manager of the Irvine office in February, 1987, and in July, 1987 became branch manager of the then newly opened San Diego office. Engelman stepped down from manager to "co-assistant manager" in February, 1989. He resumed the position of branch manager of the San Diego

---

1/ Conjoined with the counter-statement of proposed findings of fact and conclusions of law filed by respondents Kim and Isen is a motion by them to strike the Division's proposed findings of fact and conclusions of law on the ground that those proposed findings of fact are in improper form. They assert that the proposals relate to what witnesses testified at the trial and to the contents of exhibits rather than findings of fact and argue further that the Division has proposed voluminous findings that are irrelevant to the issues. The motion to strike is denied. The Rules of Practice do not prescribe the style or content of a party's post-hearing proposals. Moreover, since neither the proposals of the Division nor of the respondents have any binding effect upon decisional authority and may or may not be accepted in the formulation of a decision, there is no reason to strike any of the proposals the Division has offered for consideration.

2/ The San Diego office was also known as the La Jolla office.

office in July, 1989 and remained in that position until November, 1990 when Stuart-James was liquidated.

Engelman was next employed in November, 1990 by Chatfield Dean & Company ("Chatfield Dean"), a registered broker-dealer, in its San Diego office where he held the position of co-manager until March, 1992. Since then he has continued in the employ of Chatfield Dean as an account executive.

Kim

Kim, a resident of San Diego, California, was a registered representative for Stuart-James at its San Diego office from December, 1987 through November, 1990. For six months beginning in late 1989 he was an assistant manager in that office. From November, 1990 until December, 1991 Kim was employed as a registered representative in the San Diego office of Chatfield Dean, and in December, 1991 started working in the same capacity in the Solana Beach, California office of Cohig & Associates.

Isen

Isen, also a resident of San Diego, started in the securities business in March, 1987 as a registered representative in the Irvine, California office of Stuart-James and transferred to the firm's San Diego office in July, 1987. From July, 1987 through June, 1988 Isen was a registered representative in the San Diego office and for a part of that time served as an assistant manager. Thereafter Isen became manager of Stuart-James' Los Angeles office until approximately June, 1989 when he returned to the San Diego office. From November, 1990 until November, 1991 Isen worked as a registered representative in the San Diego

office of Chatfield Dean and since 1991 he has worked in the same capacity with Cohig & Associates.

FRAUD VIOLATIONS

During the relevant period relating to the charges against respondents, the securities business of the San Diego office of Stuart-James was primarily devoted to the offer and sale of unseasoned and highly-speculative securities. Investors were induced by respondents to purchase those securities by use of false or misleading statements concerning potential profits to be realized through a rise in market price, the extent of the risk of loss involved in those investments, and by use of high-pressure sales techniques similar to the tactics "boiler-room" salesmen adopt to accomplish sales of "penny-stocks" and unseasoned securities. 3/ Additionally, the record evidences that Engelman and Kim indulged in unauthorized trading in the accounts of their customers, some of whom had specifically rejected the securities being offered to them.

A. Engelman

One of Engelman's sales pitches to a customer of his named "Ron," whose full name is not disclosed in the record, was captured November 3, 1989 on a tape recording made by Robert Newman, a salesman in the San Diego office sitting directly across from Engelman at a distance of three to four feet. In the course of that taped conversation Engelman can be heard saying that he was getting away from penny-stocks and "doing nothing but the dollar, two, three, four-dollar stocks that are, you know, quality

---

3/ Cf. William Glanzman & Co., Inc. 42 S.E.C. 365 (1964).

companies." 4/ Ron was told that his holdings of Disease Detection International, Inc. ("Disease Detection") stock were heading down and that the share price was 12 1/2 cents. Engelman recommended that Ron sell that stock and buy Preferred Home Care of America ("Preferred Homecare"). Engelman told Ron, "It's a two-dollar stock, but I feel next year, it will be trading around five." 5/

Ron apparently accepted the recommendation and then expressed an interest in a more conservative investment. Engelman then continued his sales efforts, stating, "For your conservative money, I am currently getting my clients a 16.08% interest. You get a monthly check from the Chase Manhattan Bank. In buying these unit trusts at a deep discount to par. . . . There's no -- there's no gamble at this price." 6/ Engelman went on to advise Ron that the portfolio he recommends are units at a deep discount to their real worth with the risk thereby having been taken out. 7/ After several more references as to the 16.08% interest return, Engelman concluded by telling Ron that 50 units were left which were bought that day from "Merrill Lynch," that Ron can't lose, and that if Ron checks his finances and finds he can afford to tie up $5,000 for a couple of years he should call back. Upon completion of the conversation, Engelman sold Ron's holding of 10,000 shares of Disease Detection stock and reinvested the proceeds for Ron in 600 shares of Preferred Homecare in accordance with Engelman's recommendation early on in their conversation.

4/ Div. Ex. 84A, at 4.

5/ Id., at 5.

6/ Id., at 8.

7/ The unit trusts being recommended by Engelman to "Ron" and to other clients of his were Merrill Lynch Corporate Income Fund unit trusts having high-yield "junk" bonds in their portfolios with a coupon of around 13%. Tr. 3/11/93, at 696-697, 729-730.

Engelman's presentation regarding the merits of Preferred Homecare as an investment was false, misleading, and fraudulent. As of November 3, 1989 the company had been public for less than five months and had reported a net loss of 2 cents per share for the nine months ending September 30, 1989. 8/

The Commission has long and repeatedly inveighed against specific price predictions similar to those made by Engelman, stating unequivocally that "predictions of specific and substantial increases in the price of a speculative security are inherently fraudulent." 9/

Similarly, Engelman's representations regarding absence of risk in a purchase of unit trusts of the Merrill Lynch Corporate Income Fund were patently false as evidenced by his own testimony that, "well, maybe I over-exaggerated by saying all the risk was taken out. I -- there was risk in these high yield bonds." 10/

With respect to Susan Lamb ("Lamb"), who opened a securities account on or about November 22, 1989 with Engelman, her credible testimony was that her purchase of 12,000 shares of Disease Detection stock at an ask price of 25 cents per share was induced by dint of numerous telephone calls to her from Engelman in which he used sales tactics Lamb characterized as "ruthless" to the extent that she couldn't do her job and was afraid to answer the telephone because of a feeling of being harassed. Lamb purchased the stock because she felt that it would be worth it to get Engelman off of her back. 11/ Among

---

8/ Div. Ex. 189A.

9/ Armstrong, Jones and Co., 43 S.E.C. 888, 896 (1968); Floyd Earl O'Gorman, 43 S.E.C. 83, 85 (1966); Hamilton Walters & Co., Inc., 42 S.E.C. 784, 787-88 (1965).

10/ Tr. 3/11/93, at 696-97.

11/ Tr. 9/24/92, at 208.

Engelman's representations regarding the prospects of Disease Detection were that the company manufactured a card that used blood to test for diseases in pregnant women and that it made a similar card for AIDS which was marketed in Scandinavia and was then pending before the Federal Drug Administration for approval, an event that would cause Disease Detection stock to take off. Engelman predicted that within three months the price of Disease Detection stock would rise from 25 cents to $10.00 per share. He also told Lamb that he owned $35,000 worth of Disease Detection stock. All of Engelman's representations relating to the prospects for profit from an investment in Disease Detection were false or misleading, as was his representation that he personally had $35,000 worth of that stock. Additionally, it does not appear that Lamb was apprised of the risks of loss inherent in an investment in Disease Detection, which was operating at a loss, or that the AIDS test card used in Scandinavia had not been submitted to the FDA for approval.

By early 1990 the Disease Detection stock purchased by Lamb had lost half of its value, and Lamb told Engelman she wanted to sell her holdings. She was dissuaded from doing so by Engelman's telling her that stocks always go down a little bit and that rather than selling her shares of Disease Detection, it was "a great chance to buy stock at a lower rate." 12/ Again Engelman failed to mention anything about the company's financial condition or the risk of further losses if Lamb purchased more shares of that stock.

About April, 1990 Engelman spoke to Lamb about a company named Immucell Corporation ("Immucell") which went public in April, 1987 with an initial public offering underwritten by Stuart-James. The cover page of Immucell's prospectus as well as the recitation in the prospectus under the caption "Risk Factors" warned that these securities

---

12/ Tr. 9/24/92, at 211.

"involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." 13/ Immucell sustained losses from operations from its inception in August, 1982 through 1989 except in 1983 when it realized net income of slightly more than $26,000. 14/ During the first two quarters of 1990 its net losses were respectively $285,700 and $96,774. 15/

Engelman told Lamb that Immucell stock "was going to go from six cents per share to $4, and from $4 to $10" and that would occur "right away," 16/ but gave her no information regarding the risks of loss nor the fact that Immucell was operating at a loss. Engelman suggested that Lamb buy Immucell immediately and pay for that purchase by selling her Disease Detection stock, whose value had decreased from $3,000 to $1,500. Although Lamb neither agreed to sell Disease Detection nor buy Immucell, she received Stuart-James confirmations that Engelman had effected a sale in her account on April 10, 1990 of 12,000 shares of Disease Detection stock at a price of 12 1/2 cents per share 17/ and that simultaneously a purchase of 25,000 shares of Immucell at a price of six cents per share had been made. 18/

Lamb became furious upon receipt of those confirmations because she had not authorized those transactions. She called the San Diego office and upon being referred to the Stuart-James Denver office spoke to Ron Saunders ("Saunders"), a customer service

---

13/ Div. Ex. 167, at 1 and 3.

14/ Id. at 13; Div. Ex. 174, at 11.

15/ Div. Ex. 175, at 5; Div. Ex. 176, at 5.

16/ Tr. 9/24/92 at 213-14.

17/ Div. Ex. 52.

18/ Div. Ex. 53.

representative, telling him of the unauthorized trading and demanding that the transactions be canceled. Saunders investigated Lamb's complaint and initially concluded that the trades were unauthorized but because his supervisor raised a question regarding whether both the transactions were unauthorized, Saunders attempted to call Lamb for more information and, not reaching her, wrote a letter dated May 7, 1990 asking for additional information. Lamb, having not received Saunder's calls and concluding that Stuart-James was doing nothing, decided not to pursue her complaint. By the time Saunders' letter arrived the value of Immucell was down to $150 and Lamb concluded that she would abandon the transaction as no longer being worth her while.

The record clearly establishes that not only did Engelman use false statements and omit to state material facts in offering Immucell stock to Lamb but compounded the fraud upon her by effecting an unauthorized sale of Disease Detection and an unauthorized purchase of Immucell in her account.

On or about July 17, 1990 Engelman, during a telephone conversation with a customer named "John" who had previously purchased 100,000 shares of Immucell, attempted to induce John to buy another 100,000 shares of that stock. Engelman's part in that conversation happened to have been captured on a tape recording which Mario Fuentes, another San Diego office salesman, was running to record his own customer presentations as a means of improving his sales techniques. On the tape Engelman can be heard to ask John what he wanted to do with his 100,000 Immucell shares purchased at 15 cents and then to tell John that he was recommending that he buy another 100,000 shares at 5 1/4 cents a share to average the cost down to a dime for the 200,000 shares. Engelman went on to explain that it was Immucell's plan to do a 1 for 100 reverse split at the end of the month with the result that the number of shares John then owned would go

down to 1,000 and the stock price go up to $15.62. He told John that he (Engelman) is buying the stock at 5 1/4 cents per share, that Immucell is a good little company, that John is not going to lose money, and that he and John had bought Immucell at too high a price. Instead of placing an order to purchase additional Immucell stock, John apparently expressed a strong desire to sell his holding, with Engelman telling him not to get excited and that John would be spiting his face. He continued on to say, "I'll tell you when to sell the stock; when it hits $10 two years from now." Engelman then shifted away from Immucell, saying, "I'm offering you a new issue of Command Security at $5," and closed the conversation by telling John to write on his pad, "Today, I lost a fortune." 19/ Engelman knew that Command Security Corporation (" Command Security"), another initial public offering by Stuart-James that came out in May or June, 1990, was a speculative stock offering. 20/

The taped statements of Engelman in soliciting John to purchase additional Immucell stock and offering Command Securities stock prove that Engelman again used false representations regarding the prospective profits to be made in the purchase of those securities.

Engelman's initial contact with Fred Orton ("Orton") was a telephone inquiry Orton placed to the San Diego office in April, 1988 regarding the status of Floating Point Technologies ("Floating Point"), whose stock Orton owned. After indicating that Orton should give up on that stock, Engelman recommended Disease Detection as a stock he had

---

19/ Div. Ex. 38A, at 5.

20/ Div. Ex. 256, at 137.

"good information on" which had "some explosive growth ahead." 21/ A few days later, on April 13 or 14, 1988, Engelman called Orton to persuade Orton to buy Disease Detection stock. He told Orton that the stock was "more or less one of those once in a lifetime real opportunities" and that he saw "the stock doubling or tripling in the very, very near future" with a potential, if Orton held "for a prolonged period of time, perhaps 10 to 20 times [his] money back." Engelman also said that he had private knowledge regarding the company and knew things that were not yet known on the street, and that if Orton did not buy right then Orton would miss the boat because "Opportunities like this don't occur all the time, and you've got to buy now because if you don't buy now, it will be gone, it will run away from you." 22/ Engelman made no reference to the then existing condition of the company nor to the fact that Disease Detection was operating at a loss, and omitted any reference to the potential risks of loss from investing in that company. Engelman replied, in response to Orton's request for written information about the company, that by the time Orton received it the stock would have moved up and that Orton was lucky that Engelman was calling. Finally, following what Orton described as forceful, aggressive, and bullying sales tactics on Engelman's part which Orton testified left him feeling as if he had been in a fight and exhausted, Orton agreed to purchase 15,000 shares of Disease Detection stock with the understanding that payment for the stock could be made with a check post-dated to the end of April.

On April 16, 1988 Orton mailed his check in the amount of $2,670 with a letter addressed to Engelman in which Orton complained at length about Engelman's sales tactics.

21/ Tr. 9/25/92, at 47.

22/ Tr. 9/25/92, at 51-52.

The next day Orton sent a letter to the manager of the Stuart-James San Diego office and to the president of Stuart-James informing them of the "intimidating methods and high pressure sales tactics used by Martin Engelman . . . ." 23/ and enclosing a copy of his earlier letter to Engelman.

About eleven months later, on or about March 7, 1989, Orton had a further conversation with Engelman who, knowing of Orton's interest in real estate, recommended that Orton sell Disease Detection which had not increased as expected and use the proceeds to buy stock in Universal Medical Buildings ("UMB"). 24/ Engelman told Orton that there was a far better chance of doubling or tripling Orton's money in the very near future through a purchase of UMB, also saying that UMB was then a $4 or $5 stock that would appreciate to $10 to $15. Engelman further stated that Orton would have no money at risk, would have nothing to do but make money, and that it was just a matter of how much Orton would make and how quickly. 25/ Following Engelman's recommendations, Orton agreed on March 7, 1989 to sell his Disease Detection stock and use the proceeds to buy 800 shares of UMB.

In fact, UMB suffered a net loss of nearly $2 million, or 7 cents per unit, for the three months ended September 30, 1988 and did not report any other financial information until March 16, 1989, which date was subsequent to Orton's purchase at Engelman's insistent

---

23/ Div. Ex. 88.

24/ UMB is a limited partnership formed in 1986 with partnership units that began trading on the New York Stock Exchange on April 25, 1988.

25/ Tr. 9/25/92, at 83.

behest. 26/

In September, 1989 Engelman again spoke to Orton, recommending a purchase of Europa Cruises Corporation ("Europa") which had been formed in 1988 to promote and operate moderately priced day and evening ship cruises of about six hours with gambling and other entertainment provided aboard. Europa went public in June, 1989 with a stock offering underwritten by Stuart-James which thereafter made a market in Europa's stock. Europa's offering prospectus stated in bold print on page 1, "These securities involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." 27/

Disregarding that caveat in the prospectus and never mentioning the risks enumerated in the prospectus, Engelman assured Orton that as soon as it became known that Europa was coming to San Diego the price will go up and "you'll make a lot of money, and the stock will double or triple," and reach a price of $10 to $15. 28/ Orton also specifically recalled Engelman stating with respect to the risk of an investment in Europa that "There is no risk." 29/ By September, 1989 when Engelman made the recommendation of Europa, the price of UMB had gone down and Orton decided to cut his losses by selling UMB and using the proceeds and an additional $300 to purchase 1,000 shares of Europa.

26/ In 1989 the highest closing price for UMB partnership units was $4.75, a considerable drop from the high of $7.00 in 1988. In the period from January, 1990 through April 24, 1990 the highest closing price dropped further to $2.25.

27/ Div. Ex. 156, at 1.

28/ Tr. 9/25/93, at 87-89.

29/ Id., at 91.

It is clear from the record and it is concluded that Orton's testimony demonstrates that in order to induce Orton's purchases Engelman used high-pressure sales tactics and resorted to misrepresentations through unwarranted predictions of profits within a relatively brief time and intentionally omitted any mention of the inherent risk of loss attached to an investment in the highly speculative securities he was offering and selling.

Kenneth Wasmundt became Engelman's customer when Wasmundt's former broker left Stuart-James. Early in September, 1990 Engelman called Wasmundt in an attempt to get Wasmundt to sell his existing investments and to buy securities of Prime Financial Partners, L.P. ("Prime Financial"), a limited partnership formed in April, 1987 to acquire the ongoing financial services and real estate activities of its predecessor companies.

Prime Financial's initial public offering commenced July 24, 1987. In 1988 and 1989 Prime Financial operated at a loss and for the quarter ended March 31, 1990 reported a loss of nearly $150,000, or five cents per Class A unit. In the next quarter ending June 30, 1990, Prime Financial suffered a loss of almost $500,000, or eight cents per Class A unit. On November 29, 1992 the limited partnership filed for protection under Chapter 11 of the Bankruptcy Act.

In attempting to persuade Wasmundt to follow his recommendation, Engelman represented that Prime Financial was a subsidiary or an affiliate of Metropolitan Life and that Prime Financial was a high quality better investment than the previous investments in Wasmundt's Stuart-James account, the value of which had fallen by September 6, 1990 from about $18,000 to $4,000. Engelman did not mention the losses that Prime Financial had incurred nor any of the risks of loss involved in an investment in that limited partnership.

During their conversation Wasmundt told Engelman that he no longer was interested in additional speculative investments and refused to invest in Prime Financial. Despite that

refusal, Wasmundt received Stuart-James trade confirmations several days later reflecting that on September 6, 1990 Engelman sold three different stocks in Wasmundt's account without his authorization and used the proceeds to purchase over $3,000 worth of Prime Financial units. Wasmundt reacted by sending a letter dated September 14, 1990 to the Stuart-James Compliance Department in Denver, Colorado stating that he did not authorize any transaction and that he considered "this to be irresponsible on the part of your broker, if not actually unethical and fraudulent." 30/ After Stuart-James refused to act upon his complaint, Wasmundt transferred his account to his former broker's new firm.

It is concluded that again with Wasmundt as he had with other of his customers, Engelman resorted to the use of false and misleading representations in his attempts to induce Wasmundt to purchase the offered securities and that failing to convince Wasmundt to buy Prime Financial, Engelman caused unauthorized trades to be put through Wasmundt's account at Stuart-James.

It is further concluded that the preponderance of the evidence in the record establishes that Engelman wilfully violated Sections 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by use of unwarranted and extravagant price predictions, by his failure to inform the offerees that he was recommending purchases of highly speculative stocks without disclosing the dangers and extent of the risks of loss inherent in any investment in those securities, and, further, by effecting unauthorized trades in the accounts of customers.

Engelman's contention that the Division's allegations against him as well as its proposed findings and brief and entire position throughout the proceeding are limited to

---

30/ Div. Ex. 119.

alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a)(1) of the Securities Act and cannot now be expanded to include violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act is without merit. It is true that the Division has strongly urged, and, in fact, has proved the necessary element of scienter with which Engelman acted in violating Section 10(b) and Rule 10b-5 thereunder and Section 17(a)(1) of the Securities Act, but it does not follow that by doing so the Division abandoned a theory that also encompassed possible violations of Section 17(a)(2) or (3) of the Securities Act. Scienter is not an element that must be shown to establish Section 17(a)(2) or (3) violations but when the evidence reflects that a respondent acted with scienter, that showing does not exclude a finding that the proved misconduct also constituted violations of Section 17(a)(2) or (3) of the Securities Act.

Here, there is ample proof of Engelman's misconduct and of the fact that he acted with scienter, which proof supports the conclusions that he wilfully violated not only Section 10(b) and Rule 10b-5 under the Exchange Act and Section 17(a)(1) of the Securities Act but that the same misconduct established wilful violations of Section 17(a)(2) and (3) of the Securities Act. Further, beyond recklessness, which Engelman scorns as the appropriate measure by which to determine the presence of scienter in his misconduct, 31/ the record reflects knowing and intentional misconduct that constituted his wilful violations of the antifraud provisions of the securities laws.

The record belies Engelman's contention that the Division has not proved its case

---

31/ Engelman does acknowledge that "the Commission and a variety of circuit courts, including the 9th Circuit, have adopted a recklessness standard," but then points out that the United States Supreme Court has not so ruled. Brief of Respondent Engelman in Support of His Proposed Findings and Conclusions, dated August 9, 1993 at pp. 5-6.

by a preponderance of the evidence. The opposite is the fact, and contrary to Engelman's protestations that the vast bulk of the case against him is comprised of the inconsistent testimony of disgruntled former employees of Stuart-James who worked under his supervision, the testimony of those former employees bolsters the credibility of the testimony of the investor witnesses. The former salesmen may well have felt some antagonism toward Engelman, but that antagonism would not be sufficient reason to ignore or discredit their testimony which consistently depicted the operation of the San Diego office as dedicated to use of high-pressure sales tactics and suppression of information regarding the high risks of loss to investors in purchases of the speculative securities offered to the public. 32/ The representatives' depiction of the sales practices and operations in the San Diego office mirrors the testimony of Engelman's customers regarding his tactics in offering and selling them low-priced, highly speculative securities.

Wholly lacking in persuasiveness are Engelman's arguments that the unauthorized trades he effected in the accounts of Lamb and Wasmundt were in fact authorized by those customers and that, in any event, unauthorized trades do not violate the antifraud provisions of the securities laws.

Having heard the testimony of Lamb and Wasmundt and observed their demeanor while they were testifying, the conclusion is inescapable that they were being truthful and straightforward in their tales of the telephone conversations with Engelman in which they refused to authorize the trades in question that he effected in their accounts. Both Lamb's account and that of Wasmundt of their conversations with Engelman, his sales tactics, and his effecting the trades that they did not authorize were in keeping with his self-appraisal

---

32/ Cf. Batkin & Co., 38 S.E.C. 436, 442, n. 11 (1958).

in which he characterized his sales techniques and his opinion as "forceful, persistent, and enthusiastic." 33/ Engelman's argument that the small amounts involved indicate that he had no incentive to run the unauthorized trades must be viewed in context with all of the testimony on that issue including the fact that in violation of Stuart-James policy Engelman failed to make contemporaneous notes regarding the claimed authorizations by Lamb and Wasmundt. In context, the versions of the conversations with Engelman as testified to by Lamb and Wasmundt prevail.

Engelman is completely in error in his contention that the unauthorized trades he effected do not violate the antifraud provisions of the securities laws. The Commission has long viewed the sending of confirmations of trades to customers who had not agreed to those trades as violative of the anti-fraud provisions of the securities acts. 34/

B. Kim

In July, 1988 Kim called Stuart Kam ("Kam") to introduce himself and to persuade Kam to purchase Disease Detection stock. Kim said that it was a strong company and that the stock would go up to $1 within a year. At the time they were talking, the price was around 16 cents per share. Kam then asked for more information about the stock and Kim agreed and immediately sent Kam "Venture Views," a Stuart-James newsletter. After receiving the newsletter Kam again spoke to Kim a few times before July, 1988 when Kam and a friend of his jointly purchased 1,600 shares of Disease Detection stock through Kim.

33/ Tr. 3/11/93, at 626.

34/ R.A. Holman & Co., Inc. v. S.E.C., 366 F.2d 466, 451 (2d Cir. 1966) aff'd R.A. Holman & Co., Inc., 42 S.E.C. 866, 876 (1965); Shelley, Roberts & Company of California, 38 S.E.C. 744, 751 (1958); First Anchorage Corporation, 34 S.E.C. 299, 304 (1952).

In those conversations Kam expressed reservations about buying Disease Detection stock because of the investment risks described in "Venture Views," but Kim calmed Kam's concerns by telling him that there was no risk involved in purchasing Disease Detection stock and that Kam need not worry because Kim would keep track of the company and let Kam know "if there would be any problems with the company," 35/ and whether Kam should get out or stay with his investment. On August 3, 1988 Kam purchased additional Disease Detection stock based upon Kim's recommendation. Neither prior to Kam's July, 1988 purchase nor prior to the August, 1988 purchase did Kim advise Kam that Disease Detection was operating at a loss.

Becoming concerned about the drop in Disease Detection's market price, Kam spoke to Kim in October, 1988 about not having all of his investments in Disease Detection and Kim responded with a recommendation that Kam buy stock of Protein Databases, Inc. ("Protein Databases"), a corporation formed in 1983 to develop, market, and sell protein analysis software systems and protein database service to research laboratories and hospitals. Stuart-James was the underwriter of the company's initial public offering made in July, 1988 and thereafter made a market in Protein Databases stock. The cover page of the prospectus used in offering Protein Databases to the public carried the legend in bold-face type, "these securities involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." 36/ The warning was repeated under the prospectus section captioned "Risk Factors." 37/ Protein Database consistently

---

35/ Tr. 9/23/92, at 149.

36/ Div. Ex. 197, at 1.

37/ Id., at 6.

lost money from its operations from 1980 through September 30, 1988 and the highest bid for its stock was 15 5/8 cents during 1988 and 9 3/8 cents during 1989.

In touting Protein Databases stock Kim told Kam that "it would go up hopefully to a dollar, if not within a year or maybe sooner than Disease Detection." 38/ As a result of Kim's recommendation Kam purchased 5,000 shares of Protein Databases in October, 1988 for 21 cents per share. During 1989, when Kam saw the price of Protein Databases drop to about 3 cents per share, he asked Kim in September or October of that year "if they should get out of penny stocks and move into something more secure, something over a dollar." 39/ Kim then suggested that Kam take his money and buy stock of The Kushner-Locke Company ("Kushner-Locke") which was selling at about $3 per share.

Kushner-Locke, formed in July, 1986, was engaged in development and production of television series, movies for television, and animated programming. The company went public in December, 1988 with an offering which had Stuart-James as a co-underwriter. On the cover-page of the Kushner-Locke prospectus in bold-face type was the legend "These securities involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." 40/

Instead of disclosing the risks involved in a purchase of Kushner-Locke stock, Kim told Kam the stock was strong and that its price would move up to $5 as soon as a movie being produced by the company was released on TV. On Kim's recommendation Kam purchased 500 shares of Kushner-Locke stock at a price of approximately $3 per share.

38/ Tr. 9/23/92, at 154.

39/ Id.

40/ Div. Ex. 177, at 1.

Although Kam did not authorize Kim to make a purchase in September, 1989 of stock of Preferred Homecare, Kam received a Stuart-James account statement reflecting his purchase of 2,000 shares of that stock in the principal amount of $3,420. The transaction was cancelled without Kam's speaking to Kim because Kam did not pay for the stock on the settlement date. Further unauthorized trades in Kam's account by Kim occurred in May, 1990, evidenced by a confirmation from Stuart-James of a purchase for Kam's account of 15,000 shares of Immucell stock at 6 cents per share. 41/ Kam had never heard of Immucell before and had never received any information about the company. He assumed that Stuart-James had made a clerical error that would correct itself as had been the case with the earlier Preferred Homecare situation but instead Kam received a confirmation from Stuart-James advising him that his 500 shares of Kushner-Locke stock had been sold. Kam had not authorized that sale, and on August 6, 1990 he called Stuart-James in Denver and spoke to Patrick Van Laere, a customer service representative, about the unauthorized trades. Van Laere arranged a conference call in which Kam, Kim, Van Laere and Dennis Albanese, the regional vice-president of Stuart-James, participated. Stuart-James then reversed the unauthorized trades in Kam's account and fined Kim $500 for those unauthorized trades.

At the end of July, 1989 Kim called Henry Demena, a Stuart-James customer, and told Demena that he had become Demena's broker. Kim told Demena that his prior Stuart-James broker was incompetent, adding that the Kushner-Locke held by Demena was a good stock which Kim expected would make a lot of profit and would skyrocket over the next six to eight months, reaching a price of $8 to $10. Kim also recommended Europa

---

41/ Div. Ex. 33.

stock as being a more conservative investment than Disease Detection, another of Demena's holdings at that time. Kim also represented that he had personally invested in Europa. Based upon Kim's recommendations and comments about his existing holdings and the prospects for Europa, Demena decided to keep his Kushner-Locke stock, sell his Disease Detection holdings, and purchase 3,500 shares of Europa.

About September 6, 1989 Kim called to tell Demena that Europa and Kushner-Locke stock had gone quite a bit higher and that he expected Europa to go up in the near term from its existing price of about $2 a share to a range of $2.50 to $3. Based on Kim's recommendation, Demena on September 7, 1989 purchased 2,500 additional Europa shares, with Demena's order to sell half of his Europa stock when it reached $2.50. 42/ In October, 1989 at a time when both Europa and Kushner-Locke prices had retreated from their highs, Kim called Demena and recommended that he sell some of his Europa stock and buy Kushner-Locke. Demena accepted Kim's recommendation, selling 3,500 shares of Europa and buying 2,000 shares of Kushner-Locke with proceeds from the Europa sale. In May or June, 1990 Demena closed his account with Stuart-James, selling all of his remaining Europa stock and Kushner-Locke stock and suffering a net loss of about $4,000 on trades recommended by Kim.

Kim acquired Ken Lai ("Lai") as a customer in September, 1989 following a cold call in which Kim recommended that Lai purchase Europa and Kushner-Locke stocks. Lai did not place an order for either stock in the initial conversation but after several more calls from Kim, Lai agreed on September 14, 1989 to buy 1,500 shares of Europa at a price of

---

42/ The order to sell at $2.50 was never carried out because Europa stock never reached that price. Tr. 9/16/92, at 393.

$2.25 per share. During the conversations leading to Lai's purchase Kim did not disclose the risks associated with an investment in Europa, nor did he furnish Lai with a copy of Europa's prospectus which disclosed the risks of an investment in that company, but Kim did predict that the price of Europa would rise to $3 per share by the end of the year 1989 from the price of about $2 that existed at the time of Kim's forecast. Kim repeated his prediction of the price rise in several of his talks with Lai and Kam was "always very positive and very confident" 43/ about the accuracy of his predictions. Upon receipt of the confirmation of his purchase Lai change his mind about Europa as an investment and also had a question about the miscellaneous charge of $10 shown on the confirmation but when he spoke to Kim about canceling the transaction Kim falsely told Lai that the transaction had been completed and that he was liable for the transaction cost although the $10 charge would be waived. 44/

Eric Yama opened an account with Stuart-James in February, 1989 after Kim had made three or four telephone calls to him over a period of a week in which Kim used high-pressure sales tactics to induce Yama to purchase 1,800 shares of Kushner-Locke stock. Yama did so on February 27, 1989 at a cost of about $2,900. After that purchase Kim continued to telephone Yama about three or four times a week trying to get Yama to buy other stocks Kim was recommending and also asking Yama to refer him to Yama's acquaintances and friends. Yama refused to place any further orders with Kim, but nonetheless in July, 1989 received a statement from Stuart-James that reflected that a purchase of 3,000 shares of Kushner-Locke stock had been made by Kim in Yama's account

---

43/ Tr. 9/25/92, at 18.

44/ Id., at 21.

on or about June 20, 1989 in the principal amount of $5,610. Shortly after receiving the account statement Yama received a confirmation from Stuart-James to the effect that 3,000 shares of Kushner-Locke stock had been sold out of Yama's account on July 7, 1989. Yama did not authorize either the June 20, 1989 purchase nor the July 7, 1989 sale, both of which Kim effected.

On July 10, 1989 Yama mailed a letter to Kim advising him of the unauthorized transactions and requesting that Kim correct the errors and within a week Kim spoke to Yama telling him not to worry because computer errors involving a similarity of names with another Stuart-James customer caused the problem. In fact, it appears that Kim deliberately filled out an order ticket using Yama's name and account number covering the June 20, 1989 purchase of 3,000 shares of Kushner-Locke stock for Yama's account.

Although Kim assured Yama that his account would be corrected, Yama's July, 1989 Stuart-James statement again reflected the unauthorized sale of 3,000 shares of Kushner-Locke stock in Yama's account and again Yama requested Kim to take action to correct the account. That request was ignored by Kim and Yama learned that nothing had been done when he received an IRS Form 1099 from Stuart-James in February, 1990 reflecting the 3,000 share sale of Kushner-Locke stock. Yama then sent a letter dated February 9, 1990 to a Stuart-James vice-president demanding immediate corrective action which ultimately resulted in Yama receiving a corrected Form 1099.

Yama's version of his relationship with Kim and of the unauthorized transactions is supported not only by Yama's testimony but by the chronology of the documents received and the ensuing correspondence, including the fact that Stuart-James deemed fit to revise the Form 1099 initially sent to Yama to reflect that no sale of 3,000 shares of Kushner-Locke stock had been sold by Yama through Stuart-James.

Gregory Harrington became a customer of Kim's as a result of a friend of Harrington's referring his name to Kim. Harrington purchased stocks, including Disease Detection and Protein Database, through Kim during 1988 but because Harrington decided to go into business for himself and needed money, he directed Kim in December, 1988 to sell all of his holdings of penny-stocks except Disease Detection. Kim continued thereafter to recommend stocks to Harrington for purchase but was told emphatically by Harrington that he did not have money to invest. Despite Harrington's negative responses to his recommendations, Kim put through an unauthorized purchase of 20,000 shares of Protein Databases in Harrington's account on July 17, 1989.

The Stuart-James confirmation of the July 17, 1989 purchase did not come to Harrington's attention until he opened his mail in early August, 1989. When he read the confirmation Harrington was concerned that he would be in debt to Stuart-James and eventually talked about the matter with a Stuart-James supervisor in California. Following that conversation Stuart-James reversed the unauthorized trade in Harrington's account and imposed a $250 unauthorized trade assessment against Kim. 45/

Additional evidence of unauthorized trading by Kim was placed in the record by the testimony of Ronald Saunders ("Saunders"), who worked in the Stuart-James customer service department, from June, 1988 to about August, 1990. His responsibility during that period was to handle written and telephone complaints of customers of Stuart-James. In that capacity Saunders received on November 2, 1989 a telephone complaint from Napoleon Maneses ("Maneses") regarding unauthorized trades in his account by Kim in the period between November, 1988 and March, 1989. Following normal procedure in handling such

---

45/ Div. Ex. 137.

complaints, Saunders had a three-way conference call in which he, Kim, and the Stuart-James regional vice-president participated. Saunders' contemporaneous notes of that conversation include a statement that Kim admitted effecting two unauthorized trades in Maneses' account. 46/ In a later three-way telephone conference on January 8, 1990 in which Engelman and Kim participated with Saunders, the latter's notes state that Kim said that Maneses had authorized all of the trades in his account except one, and that the following day Kim called Saunders advising him that Maneses' complaint was a result of Maneses' failure to recollect trades which he did not purchase by using a check, and that the unauthorized trades Maneses referred to were trades using proceeds of other transactions rather than payments by checks. Although Maneses' complaint did not result in any adjustment in his account, the reason given by Stuart-James for declining was the failure of Maneses to timely inform Stuart-James of his complaint and not for lack of proof of Kim's unauthorized trading. 47/

Based upon the foregoing findings of fact, largely uncontroverted, 48/ it is concluded that as alleged by the Division Kim wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by making false and misleading statements, including baseless price projections of increased prices, in the stocks he was offering and selling to investors, and by effecting unauthorized trades in the accounts of customers. It is also concluded that the record establishes that Kim acted with scienter in the alleged and proved misconduct.

46/ Div. Ex. 141, at 28.

47/ Div. Ex. 141, at 2.

48/ When called to the stand by the Division to testify, Kim claimed his privilege under the Fifth Amendment to the United States Constitution.

Kim's contention that his constitutional rights were violated by the Division's action in calling him to the stand knowing that he would assert his Fifth Amendment privilege borders upon the frivolous. The Fifth Amendment is applicable to a criminal case, while these proceedings are civil in nature. 49/ The fact that Kim feels that the nature and extent of the sanctions that may be imposed by the Commission upon findings of wilful violations of the securities laws cannot and does not transform the character of this proceeding from civil to criminal. The Division properly exercised its discretion in deciding to have the record reflect that Kim, having been afforded the opportunity to testify, declined to respond to appropriate questioning by the Division. Further, although it would be appropriate to draw an adverse inference from the invocation of Kim of his privilege against self-incrimination, 50/ the evidence of Kim's misconduct in the record is so compelling that it is unnecessary to rely upon such an inference to make the findings of Kim's wilful violations, and those findings are now made without reliance upon any such inference.

Kim also erroneously contends that unauthorized trades may constitute a breach of fiduciary duty but are not a fraud unless they are a part of a broader pattern of fraudulent conduct not present in this instance. Kim's contention totally ignores the Commission's long-held position that the sending of confirmations of trades to customers who had not agreed to those trades is violative of the antifraud provisions of the securities acts. 51/

Kim's further argument that the Division failed to prove that he made fraudulent

---

49/ Strathmore Securities, Inc., 43 S.E.C. 575, 590 (1967), aff'd 407 F.2d 722 (D.C. Cir. 1969).

50/ Id.

51/ See n. 34, supra.

price projections is without merit. Although all price projections may not be fraudulent, those which Kim made to various investor witnesses had no reasonable basis and were inherently fraudulent 52/ and the fact that some of the projections were couched in terms of opinion is irrelevant. 53/ Further, it would avail Kim nothing if it were found that Kim's projected price increases had a reasonable basis, for he unquestionably assured various customers that there was no risk of loss involved in an investment in his recommended stocks and he failed to disclose the high risks involved in those investments. Kim had no financial or other information about the companies whose stocks he was recommending on which he could reasonably base his representations concerning the lack of risk of loss or the safety of an investment in those securities. Lacking a reasonable basis, his statements were false and misleading and constituted wilful violations of the antifraud provisions of the securities laws. 54/

52/ See n. 9 supra.

53/ Armstrong, Jones & Co., supra at n. 9.

54/ Ronald L. Brownlow, 47 S.E.C. 662 (1981); First Pittsburgh Securities Corporation, 47 S.E.C. 299, 303-04 (1980); Willard G. Berge, 46 S.E.C. 690, 693 (1976).

C. Isen

Mrs. Frances Rawleigh's first contact with Isen was an unexpected telephone call from him sometime around April, 1988. He was making the call to solicit her securities business.

Isen recommended that she purchase stock of Qubix Graphic Systems, Incorporated ("Qubix"), a company initially incorporated in California in 1982 and reincorporated in Delaware in September, 1987. Qubix was engaged in the design, manufacture, and marketing of a graphic illustration system and as of September, 1987 its only product was a Designer Workstation System. Stuart-James was the underwriter of the Qubix initial public offering in 1987 and made a market for Qubix securities. At the time Isen was attempting to sell Qubix to Rawleigh, he knew that Qubix was "an unseasoned company without an earnings history." 55/

Isen told Rawleigh in that first conversation with her that within a year she would make a dollar over the price she would pay for Qubix, but he made no mention of the results of Qubix' operations. Rawleigh told Isen that she wanted to check with her broker at another securities firm to find out more about Stuart-James and Isen's background.

Several days later Isen again telephoned and talked with Rawleigh about her investment philosophy. She told Isen then that she did not want risk and repeated that she was very conservative. She also said that she worked very hard for her money and that she did not want to risk it. Isen assured her that the worst thing that would happen would be that after a minimum of a year she would get her money back. He suggested to Rawleigh that she buy 30,000 shares of Qubix stock and said she would make $30,000. Taking that

---

55/ Tr. 3/9/93, at 173.

suggestion, Rawleigh purchased 30,000 shares of Qubix at $.15625 per share on April 26, 1988 for $4,687.50. Before purchasing Qubix Rawleigh received no written information about the company nor any information whatsoever about the risk of loss of an investment in Qubix. Isen made no mention of the high degree of risk and no mention of the potential for losing an entire investment if the stock were purchased.

Isen continued his efforts to induce Rawleigh to purchase additional securities and about May, 1988 in a telephone call recommended the stock of Immucell, telling her that the company was doing vaccination research or making a new vaccine. Isen said that when the product was available to the public an investment by her would have a good prospect of doubling her money and told her that "If you invest $2,000, it will be $4,000." 56/ Isen told Rawleigh nothing about the financial condition of Immucell during the time it had been public even though he had acquainted himself with available financial information about the company and knew that it was an unseasoned company and a highly speculative situation in which an investor could lose her entire investment. By his representations of safety and future profits, Isen induced Rawleigh to purchase 15,000 shares of Immucell at a cost of $2,670.

About July, 1989 Rawleigh received a telephone call from Robert Clawson, another Stuart-James broker, in which Clawson told her that he was her new broker and that he was a bearer of bad news to the effect that she had lost her money in Qubix. Rawleigh attempted to reach Isen by telephone several times over a period of a month or so, leaving messages asking Isen to call, but when he never returned a call she wrote a letter to Isen asking for an explanation of his failure to advise her of the loss on Qubix and suggesting

---

56/ Tr. 9/21/92, at 131.

that his loss was greater than hers because he was losing integrity in her sight. Isen never replied to her letter. Rawleigh also wrote to Stuart-James in September or October, 1989 complaining about Isen and requesting restitution of some of her money but Stuart-James turned her down, saying she acted at her own risk. Rawleigh then assembled all her documents to assist her in being more explicit and again wrote to Stuart-James summarizing her experiences with Isen. About two weeks later Rawleigh accepted an offer from Stuart-James of $2,500 to settle her complaint.

Isen made an unsolicited telephone call to Calvin Nakanishi ("Nakanishi") about April, 1989 and during their conversation Isen recommended the purchase of Disease Detection stock. Isen told Nakanishi that the company had a non-patented product that would enable people to detect AIDS or the HIV virus by using a small card that was portable and disposable. Isen said that as soon as the patent was cleared or some sort of clearance was received from the government, "the stock was expected to virtually skyrocket." 57/ Nakanishi also recollected that Isen said that he had purchased 100,000 shares of Disease Detection stock for himself with the intention of "retiring in Idaho based on the expected returns from the stock." 58/ Nakanishi expressed reluctance about purchasing penny stocks because he had been "burned" in the past, but after Isen said that he personally knew the president of the company to an extent that he could visit the firm and find out about its operations first-hand, Nakanishi became more confident about listening to Isen.

At no time prior to or after May 2, 1989 when Nakanishi bought 15,000 shares of Disease Detection stock for $4,697.50 through Isen did Isen tell him that Disease Detection

---

57/ Tr. 9/24/92, at 127.

58/ Id., at 128.

was operating at a loss nor advise him of the risks of loss of his investment in Disease Detection.

About June 25, 1989 Isen called Nakanishi and again in mid-July, 1989 to recommend a purchase of Europa stock. Isen represented to Nakanishi that he expected Europa to be twenty times its then current value within 18 months, that "the opportunity was too good to be true," and that the "stock should be purchased immediately because Europa stock was in limited supply." 59/ Nakanishi, acting on Isen's recommendation and predictions of profit, purchased 1,300 shares of Europa on July 29, 1989 at $1.44 per share. Around September 8, 1989 Isen told Nakanishi that he expected Europa, then at $2.30 per share, would be trading at $3 in November, 1989 and that in a year he expected Europa's stock to rise to $8 per share or 20 times earnings. Isen was very emphatic about those predictions, "almost as if they were statements of fact." 60/ Persuaded by Isen, Nakanishi bought 1,500 additional shares of Europa stock on or about September 9, 1989 for a new account Nakanishi opened in the name of his son Brad.

William Evelsizer ("Evelsizer"), also an Isen customer, opened his account with Stuart-James about September, 1989 after being solicited by Isen to purchase Europa stock. Initially, Isen introduced himself in a telephone call, telling Evelsizer that he had received his name from a friend of Evelsizer and that he wanted to tell Evelsizer about "a really super hot stock" 61/ he hoped Evelsizer would invest in. They were on the telephone for 30 minutes or more during which at the outset Evelsizer emphasized that the only stock

---

59/ Div. Ex. 77, at 3.

60/ Tr. 9/24/92, at 141.

61/ Tr. 9/14/92, at 115.

investments he was interested in making were conservative "blue chip" stocks as he was building his retirement portfolio. Isen told Evelsizer that Europa would fit in with Evelsizer's investments and was not a speculative stock. Isen further said that Europa stock was a major part of his own retirement program, that the stock was $2.30 per share, and that his projection was that within the next 12 to 15 months the stock would be in the $8 to $9 range. Isen also claimed to have met the president and officers of Europa many times and that the president was a financial genius whose judgment Isen highly respected. He assured Evelsizer that an investment in Europa was "sound and solid." 62/ The initial conversation concluded with Evelsizer's saying that he would discuss the matter with his wife.

The next morning Isen called again to ask for Evelsizer's decision on Europa which Isen told Evelsizer had gone up to $2.40 since the day before. Evelsizer said that he wanted to go ahead with a purchase of 2,000 shares of Europa, and that purchase was effected for him at a price of $2.40 per share on September 20, 1989. 63/ Evelsizer testified that he had never seen a copy of the Europa initial offering prospectus dated June 22, 1989 64/ and emphatically denied that Isen had ever in words or substance repeated the warning placed on the cover page of their prospectus regarding the high degree of risk in Europa securities and the fact that only persons who can afford the loss of their entire investment should consider purchasing them.

During the next ten months after his purchase of Europa stock, Evelsizer talked with

---

62/ Tr. 9/14/92, at 132.

63/ Div. Ex. 12.

64/ Div. Ex. 156.

Isen four to six times in telephone calls initiated by Isen and each time was told that the falling price of Europa stock was attributable to a "little glitch here but everything was going ahead according to plan." 65/ In his testimony Evelsizer recounted that in each of those conversations Isen told him, "very forcefully, that now would be the time for me to buy more, that the price was down and I should come in so I could average down my dollar investment on this." 66/ Each time Evelsizer rejected Isen's recommendation.

Evelsizer had his last conversation with Isen about July, 1990 at which time Isen said that his opinion of Europa had changed and that the president of Europa was running the company into the ground. Evelsizer asked Isen what he had done with his own holdings of Europa and he replied that he had sold out. Evelsizer then spoke to his wife and upon their agreement to salvage what they could out of their Europa investment he told Isen to sell at the market price that day. Stuart-James sent Evelsizer a confirmation of the sale of 2,000 shares of Europa on July 16, 1990 out of the joint account he had with his wife at a price of 72 cents per share, 67/ realizing a loss on their investment of approximately $3,400.

Based upon the foregoing findings which are predicated upon the preponderance of the credible evidence in the record, it is concluded that, as alleged by the Division, Isen wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act by making false and misleading statements, including baseless predictions of increased prices in the stocks he was offering and selling to his customers.

65/ Tr. 9/14/92, at 136.

66/ Id.

67/ Div. Ex. 14.

Isen's apparent claims that he did not know prior to his misconduct of the standards of conduct expected of him in the securities business and that the broad allegations by the Division that he violated the general prohibitions against fraud do not provide sufficient notice of the nature of his alleged misconduct are without merit. Not only did the Order allege specific misconduct by Isen but the prehearing conference and procedures gave Isen far more than adequate notice of the charges against him.

Nor is Isen's argument concerning the interpretation of the suitability rule of the National Association of Securities Dealers, Inc. ("NASD") 68/ of avail to him. The Commission has made it clear that a broker-dealer must have an "adequate and reasonable basis" for any recommendation that he makes and that the "reasonable basis" test is subsumed within the suitability rule. 69/ However, the unsuitability of the investments recommended by Isen to his customers is only one aspect of the fraud he perpetrated. Even more flagrant was his reckless disregard and outright false statements concerning the highly speculative nature of the recommended investments and the risk of entire loss of investments by those customers. The record establishes that Isen acted with scienter in the alleged and proved misconduct on his part.

Another facet of Isen's misconduct is reflected in his projections of future price increases in the stocks he recommended to his customers. While Isen contends that case law supports his position that there is no deception where the basis for an opinion or price projection is disclosed, his citations do not lend authority to that view and are inapposite.

68/ Article III, Section 2 of the Rules of Fair Practice, NASD.

69/ F.J. Kaufman and Company of Virginia, SEA Release No. 27535, 45 SEC Dkt, 120, 126 (1989).

Neither Union Carbide Corporation v. Consumer Products Business Securities Litigation 70/ nor Friedman v. Mohasco 71/ is analogous, and in part Union Carbide Corporation weakens Isen's argument by especially noting that any forecast must have a reasonable basis. 72/ Isen's cited case of Estate of Detwiler v. Offenbecker 73/ also requires that a reasonable basis exist for a price projection to be lawful. As that Court explained, "Forecasts represent an opinion about what may happen in the future and therefore differ from statements regarding 'hard facts' that are knowable at the time they are made. However, forecasts contain implicit representations that they were made in good faith and were based upon a reasonable method of preparation, and those representations constitute 'facts' actionable under Rule 10b-5." The record here contradicts any notion that Isen made his projections in "good faith" or were based "upon a reasonable method of preparation."

The foregoing findings of fact regarding Isen's misconduct are the basis on which the conclusions are reached that, as alleged by the Division, Isen wilfully violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 thereunder by making false and misleading statements and projections to investors to induce their purchases.

70/ 676 F. Supp. 458, 469 (S.D.N.Y. 1987).

71/ 929 F.2d 77 (2d Cir. 1991).

72/ 676 F. Supp. at 466, 467.

73/ 728 F. Supp. 103, 137 (S.D.N.Y. 1989).

DELAYS IN EXECUTION OF ORDERS

The Division alleges that during the relevant time period Engelman refused to allow brokers under his supervision to execute their customers' trade orders promptly and delayed his customers' market orders and allowed brokers under his supervision to delay executing their customers' market orders promptly. The Division charges that the alleged delays were prompted by Engelman's desire to profit by having customers reinvest proceeds of sales in other stocks "touted" by Stuart-James, and by increasing brokers' commissions.

Kim was alleged to have delayed customers' market orders with a view to increasing his commission on trades. He is also accused of refusing to allow one salesman he supervised to execute a customer's order promptly in an attempt to increase the commission by having the customer increase the size of his purchase order.

No customer witnesses were called by the Division in support of its allegations of delayed order executions by Engelman and Kim. Instead the Division chose to rely upon the testimony of former salesmen employed in the San Diego office.

Under the system in effect at Stuart-James, the commissions earned by their salesmen were calculated as the difference between Stuart-James' inside bid or ask price set by the firm's trading department, 74/ and could be ascertained by a salesman's looking at a Quotron located in the center of the sales area in the San Diego office. Depending upon how actively a stock was being traded, the inside prices could change as many as three or four times a minute, or if the stock had little volume, the inside prices could remain unchanged from three days to a week.

74/ The inside bid and ask prices set by the trading department were not the inside quotations in NASDAQ which reflect the best bid and ask quotations of market makers.

Glenn Holbert ("Holbert") was a salesman during the period May, 1988 to August, 1990 in the San Diego office of Stuart-James and during each of two three-month periods sat within three feet of Kim. Holbert also sat within three feet of Engelman in one two or three-month period and on another occasion within eight to ten feet. Holbert testified that on a number of occasions Kim delayed executing market orders upon being dissatisfied with the inside price. Holbert stated that the reason for the delay was Kim's desire for a larger commission upon the inside price going down. The longest period that Holbert knew Kim held up executing an order was 3 to 3 1/2 hours, and he knew of one instance where Kim's delaying the execution resulted in one of Kim's customers paying more because of that delay. Holbert also testified that he heard Engelman tell salesmen to delay orders in order to earn more commission.

John Sieckert ("Sieckert") was with Stuart-James as a salesman in its San Diego office from early July, 1989 until January, 1990. Sieckert testified that on occasion he observed that Engelman refused to execute an order because of its size and told the salesman to go back to his customer and get a larger order, which caused a delay in the execution of the customer's order. Sieckert also observed Kim on two occasions waiting for 15 to 30 minutes to see what the inside price would do before execution of an order. According to Sieckert, when Engelman saw Kim delaying execution he would tell Kim it was a bad idea but did not direct him to execute the order. Sieckert also testified that Engelman's office policy was that transactions were to involve a minimum of $3,000.

Matthew Forget ("Forget") was employed as a salesman in the San Diego office of Stuart-James from October, 1989 through March, 1990. Forget testified that about the second week of February, 1990 he saw Kim make out a ticket on a customer's market order for Kushner-Locke stock but fail to turn in the trade ticket for approximately 20 minutes

while he telephoned a Stuart-James trader in Denver. Kim then held onto the ticket for another ten minutes after ending his conversation with the Denver trader at which time Kim had a return telephone call from the trader. At the completion of that conversation, Kim yelled over to Isen, "I just got, like, you know, 13 cents." 75/ Kim then took the ticket to the wire room for execution. Forget also recalled seeing Kim engage in a similar practice three or four other times and seeing Engelman refuse three or four times to sign a trade ticket because the order was too small. Forget also testified that around January 15, 1990 he brought an order for Kushner-Locke stock to Kim for signature and that Kim refused to sign until after Forget went back to his customer and received a larger order. Forget further testified that on one trade he had with a customer he handed the order ticket to Isen but Isen refused to sign it, telling Forget to go back and get a larger order before he would sign it. Forget then obtained the larger order in less than a minute.

Robert Newman ("Newman") was a salesman for Stuart-James for a year from March, 1989 until March, 1990 in the San Diego office. During that employment there were two instances in which Engelman refused to approve a sell order ticket, one of which, on October 16, 1989, represented a market order by one of Newman's customers to sell 1,600 shares of Kushner-Locke stock. Instead of approving the order ticket Engelman asked Newman what the customer was buying and upon being told that the customer was buying nothing because the customer needed the profit in the stock being sold Engelman told Newman to go back to the customer and tell her that she should reinvest in some other stock. 76/ Instead of calling the customer back Newman went to Isen, who signed the

---

75/ Tr. 9/22/92, at 147.

76/ Tr. 9/21/92, at 54, 58.

ticket. In the second instance, after first refusing, Engelman approved an order ticket brought to him by Newman.

The testimony of Marco Fuentes, a salesman in the Stuart-James San Diego office for about a year and a half beginning in early 1989, was to the effect that he saw Kim delay execution of customer orders at least once a week. The delays "could be any where between a few minutes until most of the day." 77/

Another salesman, Shelly Jones ("Jones"), who worked in the San Diego office from July 17, 1990 until Stuart-James closed in the latter part of that year, testified that Engelman's policy was that a broker should not hold up on a ticket. The reason Engelman gave was "you're there to write business, not hold tickets." 78/ Jones also testified that he did not leave Stuart-James because he did not want Kim, Isen or Engelman to inherit the accounts of his family members and that Kim was a "hard-sell" salesman with a reputation in the office "for holding order tickets until he could a better spread." 79/ In the same vein James also testified that one of his customers, inherited from Kim and whose name Jones was unable to recall, told him that the price he was billed for on an order was higher than expected as a result of Kim's holding up the trade for three days. Jones further testified that the customer gave that as his reason for refusing to pay for the trade, and ended his testimony on that subject by adding "that doesn't mean it happened, that means that that's what the client said." 80/

Reed Johnson ("Johnson"), employed as a salesman in the San Diego office of

---

77/ Tr. 12/16/92, at 254.

78/ Tr. 3/9/93 at 409.

79/ Id., at 414-15.

80/ Id., at 428.

Stuart-James from about October, 1989 until August, 1990, testified regarding his experience with Kim in attempting to obtain approval for execution of orders received from a customer. Johnson recalled that after several telephone conversations with his customer regarding National Media the customer decided on Friday, May 25, 1990 to sell stock of Craft Made International which he had purchased earlier through Johnson and to buy 150 shares of National Media stock with the proceeds. After filling out the buy and sell tickets, Johnson gave the tickets to Kim for approval. Kim looked at the tickets, gave them back to Johnson, and said, "call him and get more money out of him." 81/ Johnson called his customer as directed but was unable to get the customer to increase his buy order. Kim then called the customer and when he finished that conversation told Johnson that the customer had decided to keep his stock and that "the trades won't run." 82/ Johnson felt badly about Kim's resolution of the matter and on the following Tuesday, May 29, 1990, the first work day after the Memorial Day weekend, telephoned his customer and told him that the trades had not run on the previous Friday but that he would try to rerun them. The customer declined Johnson's offer and instead told him to sell out his Craft Made stock, send the proceeds, and close out the account.

Based upon the foregoing findings with respect to the delays in the execution of trades by Engelman and Kim, it is concluded that despite the evidence that delays in execution of trades for a few minutes to up to three days occurred, the Division has not by a preponderance of the evidence shown that those delays constituted fraud within the purview of the antifraud provisions of the Securities Act or the Exchange Act. A great deal

---

81/ Tr. 9/21/92, at 220.

82/ Id., at 222.

of the testimony of the salesmen was hearsay in nature and consequently was not as persuasive as would have been testimony of individuals who had direct knowledge of the pertinent facts. Additionally, the evidence presented cannot overcome the fact that in the very nature of the securities business which requires brokers to obtain the best available price for customers, time delays will necessarily occur in the execution of an order while the order tickets move through the required brokers' procedures leading to the final execution of the order.

The Division's reliance upon Opper v. Hancock Securities Corp. 83/ is misplaced. Although the failure of the broker in Opper for nearly 30 days to effect a sale of securities as directed by the customer while the broker was at the same time buying and selling the same securities for its own account and representing to its customer that no buyer could be found for the customer's securities was found by the court to violate the antifraud provisions of the securities laws, the facts evidenced here are not analogous to those that the court in Opper found fraudulent. Similarly, the facts in Nye v. Blyth Eastman Dillon & Co., 84/ an action for damages against a broker who made an unauthorized and then delayed a sell order for eight days, causing a loss to its customer, cannot be regarded as sufficiently factually analogous to this matter as to be regarded as authority upholding the Division's position. Forma Securities, Inc., 85/ a default order, is without precedential value and were it to be considered authoritative would be apposite only to the extent that one of the allegations against the respondent was that it failed "to execute customers'

83/ 250 F. Supp. 668 (S.D.N.Y.), aff'd, 367 F.2d 157 (2d Cir. 1966).

84/ 588 F.2d 1189 (8th Cir. 1978).

85/ SEA Release No. 11181, 1975 SEC Lexis 2433 (Jan. 15, 1975).

orders promptly." Here the evidence is almost devoid of facts upon which a conclusion could be reached that either Engelman or Kim delayed the execution of orders to the extent that a finding of fraud would be appropriate.

It is therefore concluded that the Division has failed to carry its burden of showing that Engelman, as alleged, wilfully violated the antifraud provisions of the Exchange Act and Securities Act by delaying his customers' market orders without notifying them, or allowed brokers under his supervision to delay executing their customers' market orders promptly. It is further concluded that the Division has failed to prove that Kim fraudulently delayed customers' market orders of his customers or that he refused to allow one broker under his supervision to execute his customer's market order promptly in an attempt to increase the commission by having the customer increase the size of his stock purchase order.

FAILURE TO SUPERVISE

In addition to the Division's charges that Engelman wilfully violated the antifraud provisions of the securities laws by the specific misconduct alleged against him, the Division charges that from about April, 1988 through November, 1990 Engelman failed reasonably to supervise Kim and Isen with a view to preventing their alleged violations. Inasmuch as Kim and Isen have each been found to have committed wilful violations of the Securities Act and Exchange Act antifraud provisions while Engelman as branch manager of the San Diego office was their supervisor, consideration must be given to whether Engelman failed to supervise Kim and Isen within the intent and meaning of Section 15(b)(4)(E) of the

Exchange Act with a view to preventing their violations. 86/

Engelman argues that Kim and Isen were assistant managers and that he, Kim, and Isen were each authorized to act both as a salesman and as a manager for his own accounts. Engelman then contends that when the assistant managers ran tickets for their own accounts he was not even made aware of the trades. The flaw in his argument is that he does not account for his supervisory responsibilities over the activities of Kim and Isen when one or the other was acting as a salesman. At those times Kim and Isen should have been given and were not the oversight of Engelman. It is no answer to his failure to exercise supervision over Kim and Isen that he was not aware of their trades, for one of his responsibilities as branch manager was to know what the salesmen, including Kim and Isen,

---

86/ Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer or a person associated with a broker or dealer who:

> ...has failed reasonably to supervise, with a view to preventing violations of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purpose of this subparagraph (E) no person shall be deemed to have failed reasonably to supervise any other person if -
>
> > (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and
> >
> > (2) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to beieve that such procedures and system were not being complied with.

were doing, and whether their conduct needed his intervention "with a view to preventing violations" of the Securities Act and Exchange Act.

The Division correctly argues that Engelman has not overcome the evidence that he knew of the repeated allegations of unauthorized trading by Kim, and not only permitted Kim and Isen to use fraudulent representations in their sales efforts but encouraged them in that type of misconduct. However, it does not appear that a finding that Engelman failed to supervise as required under Section 15(b)(4)(E) of the Exchange Act would be appropriate under the circumstances in this record.

As explained by the Commission in Anthony J. Amato 87/ in setting aside an NASD finding of a failure of Bills, the manager of a member's Los Angeles office, to exercise proper supervision, that finding is inconsistent with the active and central role the manager played in his office's involvement and in that of his subordinate in the activities on which the NASD proceeding was instituted. In reaching its determination on the issue of failure to supervise, the Commission stated:

> Failure of supervision -- which may result in derivative responsibility for the misconduct of others, connotes an inattention to supervisory responsibilities, a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them. That is not the situation here. In view of Bills' active and central role in the whole matter, affirmance of the findings of failure to supervise would entail a confusion of concepts. 88/

The Commission has carried a similar concept into its own disciplinary actions in which failure to supervise within the meaning of Section 15(b)(4)(E) has been an

---

87/ 45 S.E.C. 282 (1978).

88/ Id., at 286-87.

issue. 89/ As pointed out in Fox Securities, Inc.:

> In some situations the difference between aiding and abetting and failure of supervision may be somewhat shadowy, with aiding and abetting connoting more of an active participation in or awareness of improprieties, and failure to supervise connoting more an inattention to supervisory responsibilities when more diligent attention would have uncovered improprieties. 90/

Under that guideline for distinguishing aiding and abetting from failure to supervise, Engelman must be regarded as having aided and abetted the violations of Kim and Isen. His own violations in the offer and sale of securities to his own customers mirrored the violations committed by Kim and Isen and the testimony of former salesmen establishes that Engelman encouraged and counseled Kim and Isen to emulate his method of profiting at the expense of gullible customers through fraudulent and deceptive representations and by persistent repetition of those misrepresentations. It would therefore be inappropriate and inconsistent to find him responsible for a failure to supervise with respect to the same misconduct.

PUBLIC INTEREST

Respondents' wilful violations of the antifraud provisions of the Securities Act and Exchange Act require consideration of what remedial action is appropriate in the public interest. The Division argues that each of the respondents should be barred from association with any broker-dealer and that each of them should be ordered to cease and desist from committing or causing any violation and from committing or causing any future violation of Sections 17(a) of the Securities Act and 10(b) of the Exchange Act and Rule

---

89/ Cf. Fox Securities Company, Inc., 45 S.E.C. 377 (1973); M.V. Gray Investments, Inc., 44 S.E.C. 567, 575 (1971).

90/ Fox Securities Company, Inc., supra, at 383.

10b-5 thereunder.

In support of that position the Division points to the lack of candor of respondents in their testimony, the lack of remorse for their fraudulent conduct, and to the greed that each has exhibited during the long period of their violations. As to Engelman, the Division also calls attention to contradictory testimony he gave during the investigatory phase and that elicited during the hearing in this matter. With respect to Isen, the Division calls to mind Isen's destruction of one of his records and his lies to a supervisor and to a Stuart-James internal auditor in an effort to conceal his illegal trading from them and to the fact that Stuart-James fined Isen $2,000 for that and other illegal trading in states where he was not licensed to sell securities. The Division also notes that Isen was not licensed to sell securities in Idaho because of his felony conviction in 1981 in connection with a scheme to distribute a half pound of cocaine.

The Division points to the discrepancies in Kim's testimony during the investigative stage preceding the institution of this proceeding and his fabrication of excuses regarding his unauthorized trading. "Most egregious" in the eyes of the Division was Kim's attempt to persuade a former colleague who had been subpoenaed by the Division to testify at the hearing in these proceedings not to comply with the subpoena, saying that two other brokers had been subpoenaed but would not testify.

Engelman does not concede that he committed any of the violations attributed to him, but appropriately requests that if findings are made against him that consideration be given to his exemplary military service record, his seven years in the securities business, and the absence of complaints or problems since leaving Stuart-James in 1990 for employment with the Chatfield Dean Securities firm. Engelman further points out that half of his sales now involve mutual funds and tax-free bonds.

Neither Kim nor Isen submit mitigating factors for consideration in connection with the necessary remedial action in the event that they are found to have committed violations of the securities laws. They simply argue that the Division did not meet its burden and that the proceeding should be dismissed.

Upon careful consideration of the record and the factors to be taken into account in reaching the appropriate decision regarding remedial action as noted in Steadman v. S.E.C., 91/ it is concluded that Engelman, Kim, and Isen, and each of them, should be barred from association with any broker or dealer, and that they be directed to cease and desist from committing or causing any future violation of Section 17(a) of the Securities Act or of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

It is clear from the record that Engelman, Kim, and Isen have no conception or understanding that a fundamental purpose common to the statutes administered by the Commission was and is, as explained by the Supreme Court in S.E.C. v. Capital Gains Research Bureau, Inc.:

> . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, "it requires but little appreciation . . . of what happened in this country during the 1920's and the 1930's to realize how essential it is that the highest ethical standards prevail." 92/

For 25 years before he became a registered representative with Stuart-James,

---

91/ 603 F.2d 1126, 1140 (5th Cir. 1979) aff'd 450 U.S. 91 (1981).

92/ 375 U.S. 191, at 186 (1963).

Engelman was employed in the restuarant business and it is evident that when he entered the securities business he brought with him the morals of the market-place and the philosophy of caveat emptor and that the little training he may have received with respect to the high standards of business ethics expected of a person in the securities business while preparing for his Series 7 examination was either lost or discarded by him prior to the relevant periods in these proceedings. Engelman as branch manager inculcated his market-place morality in Kim and Isen and the sales methods used by them were identical to those employed by Engelman.

Under these circumstances it is reasonable to seriously doubt that if any one of the three were allowed to associate with a broker-dealer in any capacity there would be adequate protection afforded to public investors from renewed predations of Engelman, Kim, or Isen. Further, the wrong signal would be sent to others in the securities business with a loss of the deterrent factor should respondents' long-continued misconduct not be recognized as requiring stern remedial action. 93/

ORDER

IT IS ORDERED that Martin Herer Engelman, Peter Paul Kim, and Lawrence David Isen, and each of them, is barred from association with any broker or dealer; and

FURTHER ORDERED that Martin Herer Engelman, Peter Paul Kim, and Lawrence David Isen, and each of them, is required to cease and desist from committing

---

93/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

or causing a violation and from committing or causing any future violation of Section 17(a) of the Securities Act of 1933 or of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon that party, filed a petition for review of this initial decision pursuant to Rule 17(b) unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to a party. 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.

Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
November 8, 1993