ADMINISTRATIVE PROCEEDING
FILE NO. 3-11537

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
September 14, 2004

In the Matter of	
RICHARD S. KERN, DONALD R. KERN, and CHARLES WILKINS	ORDER DENYING MOTION OF RICHARD S. KERN AND CHARLES WILKINS TO SET ASIDE DEFAULT

The Securities and Exchange Commission (Commission) instituted this proceeding on July 7, 2004. Richard S. Kern (R. Kern) and Charles Wilkins (Wilkins) each received the Order Instituting Proceedings (OIP) on July 13, 2004. Their Answers to the OIP were due on or before August 2, 2004, and no Answers were filed.[1]

Paragraph IV of the OIP specifically informed the Respondents that if they failed to file timely Answers, they could be deemed to be in default. The OIP further advised the Respondents that the proceeding could be determined against them based upon consideration of the OIP, the allegations of which could be deemed to be true. See Rules 155(a)(2) and 220(f) of the Commission's Rules of Practice.

On August 5, 2004, I issued an Order Making Findings and Imposing Sanction by Default (Default Order). I found that it was in the public interest to bar R. Kern, Wilkins, and a third Respondent, Donald R. Kern (D. Kern), from participating in any offering of penny stock.

[1] The Office of the Secretary delivered the OIP by certified mail, return receipt requested, to R. Kern and Wilkins at their respective residences, at the office of a Florida attorney, and at the office of a New York attorney. Postal Service Forms 3811 (Green Cards), the signed receipts for certified mail delivery, show that R. Kern, Wilkins, and the Florida attorney received the OIP on July 13, 2004. The New York attorney received the OIP on July 15, 2004. The time for filing Answers is computed from the earlier date, not the later date.

Even if the time for R. Kern and Wilkins to file Answers were to be computed from July 15, 2004, the Answers (or motion to extend the time for filing Answers) would have been due by August 4, 2004. See Rule 151(a) of the Commission's Rules of Practice ("Papers required to be filed with the Commission must be received within the time limit, if any, for such filing.").

On August 19, 2004, this Office received a "Motion to Vacate Default and for Leave to File Answer" (Motion to Vacate) from R. Kern and Wilkins. See Rule 155(b) of the Commission's Rules of Practice. The Motion to Vacate includes several exhibits. Eric W. Berry, Esq. (Berry), also submitted a supporting declaration (Berry Declaration).[2]

The Berry Declaration raises five points: (1) the failure to submit timely Answers was not the fault of the respondents in default, but rather, resulted from Berry's own neglect; (2) the present proceeding should be stayed because the respondents in default are appealing the injunction upon which this proceeding is based to the United States Court of Appeals for the Second Circuit; (3) the present proceeding is automatically stayed as to R. Kern and Wilkins because of D. Kern's pending bankruptcy proceeding; (4) the respondents in default have meritorious defenses to the charges in the OIP; and (5) vacating the Default Order would not cause prejudice to the Division of Enforcement (Division).

On August 25, 2004, the Division filed a Memorandum in Opposition to the Motion to Vacate (Opposition). On September 1, 2004, this Office received a "Reply Declaration in Support of the Motion by Richard Kern and Wilkins to Vacate the Default" from Berry (Berry Reply Declaration).

I.

R. Kern and Wilkins offer only one excuse for their failure to answer the OIP. Berry states that he neglected to read a July 21, 2004, letter from the Division advising him that there would be no prehearing conference until after Answers were filed (Berry Declaration ¶ 7; Opposition, Exhibit B). Berry had "assumed" that a prehearing conference would afford him an opportunity to request a lengthy, indefinite extension of the time to file Answers (Berry Declaration ¶¶ 5-6).

With respect to the Division's July 21 letter, Berry now represents:

> Unfortunately, this fax was filed by a temporary secretary in my office without me first seeing it, and I did not read it until I reviewed the files after [I] received the August 5, 2004, Order. Since Richard Kern and Wilkins always intended to contest this proceeding, and were relying on me to file an Answer for them, all the fault was on my part, and they should not suffer as a result of my neglect.

(Berry Declaration ¶¶ 7-8).

Berry's explanation shows neglect, but not excusable neglect. See Connecticut Natl. Mortgage Co. v. Brandstatter, 897 F.2d 883, 884-85 (7th Cir. 1990) (holding that routine back

[2] Both the Motion to Vacate and the Berry Declaration are dated August 13, 2004. However, the certificate of service demonstrates that the documents were not tendered to Federal Express until August 18, 2004.

office problems do not rank high in the list of excuses for default and do not require a district court judge to relieve a party from a default judgment).

Wholly apart from the Division's July 21 letter, Respondents had been properly served with the OIP, both individually and through their attorney. The OIP ordered them to file Answers within twenty days. On the surface, this appears to be mere neglect. However, when the failure to file timely Answers to the OIP is considered in the context of the overall litigation between the Division and the respondents in default, I find that counsel's conduct was more than merely negligent or careless. It was willful, within the meaning of SEC v. McNulty, 137 F.3d 732, 738-40 (2d Cir. 1998); see also SEC v. Breed, 2004 U.S. Dist. LEXIS 16106, at *17-34 (S.D.N.Y. Aug. 13, 2004); State of N.Y. v. Green, 2004 U.S. Dist. LEXIS 11624, at *15-21 (W.D.N.Y. June 18, 2004).[3]

Normally, the conduct of an attorney is imputed to his client, because allowing a party to evade the consequences of the acts or omissions of his freely selected agent is inconsistent with our system of representative litigation, in which each party is deemed bound by the acts of his lawyer-agent. See Link v. Wabash R.R. Co., 370 U.S. 626, 633-34 (1962). In the context of a default judgment, the courts have consistently refused to relieve a client of the burdens of a final judgment entered against him due to the mistake or omission of his attorney. See McNulty, 137 F.3d at 739 (collecting cases). Where the attorney's conduct has been found to be willful, the willfulness will be imputed to the party himself where the party makes no showing that he has made any attempt to monitor counsel's handling of the lawsuit. Id. at 740.

There is no evidence in the record that R. Kern and Wilkins gave specific instructions to Berry, or even communicated with Berry, at any time between July 13, 2004, when they received the OIP, and August 2, 2004, when their Answers were due. In the absence of sworn declarations to that effect from R. Kern and Wilkins, I decline to rely on Berry's representation that his clients "always intended to contest this proceeding" (Berry Declaration ¶ 8). I impute Berry's willfulness to R. Kern and Wilkins.

II.

The pending appeal of the underlying injunction is not a valid reason for setting aside the Default Order, or otherwise delaying the resolution of this matter. See Joseph P. Galluzzi, 78 SEC Docket 1125, 1130 n.21 (Aug. 23, 2002); Jon Edelman, 52 S.E.C. 789, 790 (1996); Charles Phillip Elliott, 50 S.E.C. 1273, 1276 n.15 (1992), aff'd on other grounds, 36 F.3d 86 (11th Cir. 1994). If the respondents in default eventually succeed in having the underlying district court injunction vacated, they may then petition the Commission to reconsider the sanction imposed in this administrative proceeding. See Gary L. Jackson, 48 S.E.C. 435, 438 n.3 (1986); cf. Jimmy Dale Swink, Jr., 59 SEC Docket 2877 (Aug. 1, 1995).

[3] The district court described the underlying injunctive proceeding as "extended." See SEC v. Lybrand, 281 F. Supp. 2d 726, 727 (S.D.N.Y. 2003). The district court also expressed "substantial concern" over D. Kern's, R. Kern's, and Wilkins's "lack of cooperation with the Commission" with respect to the dimunition of frozen assets. See id. at 731.

III.

R. Kern and Wilkins have failed to show why D. Kern's ongoing bankruptcy proceeding compels a stay of this administrative proceeding as to them. There is no suggestion that they are subject to the protection of a bankruptcy court.

In any event, D. Kern's bankruptcy proceeding does not warrant a stay of this administrative proceeding. Law enforcement actions, such as the present proceeding, are expressly exempt from the automatic stay provisions of the Bankruptcy Code. 11 U.S.C. § 362(b). Subsection 362(b)(4) provides an exception from the stay for Commission enforcement actions and other exercises of police or regulatory power by governmental units. The purpose of the police and regulatory power exemption for governmental units is "to prevent the bankruptcy court from becoming a haven for wrongdoers." SEC v. Elmas Trading Corp., 620 F. Supp. 231, 240 (D. Nev. 1985), aff'd, 805 F.2d 1039 (9th Cir. 1986) (quoting CFTC v. Co Petro Mktg. Group, Inc., 700 F.2d 1279, 1283 (9th Cir. 1983)). R. Kern and Wilkins are well aware of this line of case law. See Lybrand, 281 F. Supp. 2d at 732.

IV.

In order to make a sufficient showing of a meritorious defense in connection with a motion to vacate a default judgment, respondents in default need not establish their defense conclusively, but they must present evidence of facts that, if proven at trial, would constitute a complete defense. See McNulty, 137 F.3d at 740.

R. Kerns and Wilkins have not demonstrated that they have meritorious defenses. Their first proposed defense is essentially an argument that the district court incorrectly decided the merits of the underlying injunctive action as to Sections 5(a) and 5(c) of the Securities Act of 1933 (Berry Declaration, third ¶ 11(a) and (c)). However, findings of fact and conclusions of law made in prior injunctive actions are immune from attack in subsequent administrative proceedings, such as this one. See Ted Harold Westerfield, 69 SEC Docket 722, 729 n.22 (Mar. 1, 1999) (collecting cases). Their second proposed defense is an argument that the injunction under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Exchange Act Rule 10b-5 is not entitled to collateral estoppel effect in this proceeding because it resulted from a consent judgment, rather than a full trial on the merits. They also emphasize that they neither admitted nor denied the antifraud allegations of the Commission's complaint (Berry Declaration, third ¶ 11(d)). The Commission has held that consent judgments are entitled to collateral estoppel effect in follow-on administrative proceedings. See Marshall E. Melton, 80 SEC Docket 2812, 2822-26 (July 25, 2003); Martin R. Kaiden, 70 SEC Docket 439, 453 n.39 (July 20, 1999).

Respondents in default also argue that the district court lacked jurisdiction to enter an injunction under Section 10(b) of the Exchange Act and Rule 10b-5 because, when the district court acted, exclusive jurisdiction of the underlying proceeding rested with the Second Circuit. This is an argument that should be presented to the Second Circuit, not to the undersigned.

V.

The Division has not argued that it would be severely prejudiced if the Default Order were to be vacated. However, an absence of prejudice to the nondefaulting party does not in itself entitle the defaulting party to relief from the judgment, because the adjudicatory forum has an interest in expediting litigation. See McNulty, 137 F.3d at 738. It is unlikely that a reopened administrative proceeding could be completed within 210 days, as the Commission has directed. Moreover, if the Default Order were to be vacated, R. Kern and Wilkins could resume their participation in offerings of penny stocks, a result that the injunctive action strongly suggests would be inconsistent with the public interest. See Lybrand, 281 F. Supp. 2d at 732-33 (ordering disgorgement and civil penalties); SEC v. Lybrand, 200 F. Supp. 2d 384 (S.D.N.Y. 2002) (granting summary judgment to the Commission under Sections 5(a) and 5(c) of the Securities Act); SEC v. Lybrand, 2000 U.S. Dist. LEXIS 9388 (S.D.N.Y. Jul. 6, 2000) (granting preliminary injunction). Prejudice would result in those respects.

VI.

As a final matter, the Berry Reply Declaration states:

> The [Division] does not reveal how the order holding respondents in default was obtained. Nevertheless, it appears that it was obtained by an ex parte application by the Division of Enforcement. . . . [I]t is fair to infer that the Division of Enforcement made an ex parte action for the order holding respondents in default or, at minimum, caused the Office of the Secretary to communicate the dates upon which the OIP was allegedly received by Kern and Wilkins.
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> . . . .
>
> Regardless of whether the communication which prompted the default order was made by the Office of the Secretary or by the Division of Enforcement, the application was improperly made on an ex parte basis. . . .
>
> The default should therefore be vacated because it was based on improper ex parte communications from the SEC to the Hearing Officer.

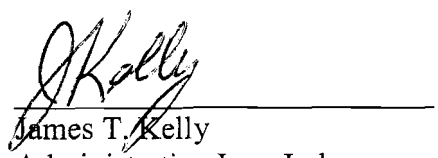
(Berry Reply Declaration ¶¶ 3, 4, 6). This is a serious allegation, and there is no explanation as to why it is raised for the first time in a reply pleading, to which the Division cannot respond.

The communications between the Office of the Secretary and the Office of Administrative Law Judges (OALJ) regarding this matter were electronic mail messages on July 26, 2004, and August 5, 2004. These messages alerted OALJ to the fact that the Office of the Secretary had received the Green Cards demonstrating service of the OIP. The practice is standard in all adjudicatory cases. A copy of these electronic mail messages is attached. The Green Cards appear in Exhibit A of the Opposition. This was the evidence referenced in the second sentence of the Default Order.

The Division never made an application for the Default Order. I issued it sua sponte. To the extent that the respondents in default contend that the issuance of a sua sponte Default Order somehow violates the requirement of separation of functions, their argument is rejected.

ORDER

R. Kern and Wilkins have not shown good cause for setting aside the Default Order. Their motion is denied in all respects. If R. Kern and Wilkins wish to seek review of this Order by the Commission, they must do so within twenty-one days after the service of this Order. Cf. Rule 360(b) of the Commission's Rules of Practice, as applied in Richard Cannistraro, 53 S.E.C. 388 (1998).



James T. Kelly
Administrative Law Judge