ADMINISTRATIVE PROCEEDING
FILE NO. 3-6847

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
MALCOLM KANAN	:
	:

INITIAL DECISION

Washington, D.C.
May 09, 1988

Warren E. Blair
Chief Administrative Law Judge

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APPEARANCES: Patricia C. Holland and Steven S. Scholes, of the Chicago Regional Office of the Commission, for the Division of Enforcement.

David M. Richman, of Dublirer, Haydon, Straci & Victor, for Malcolm Kanan.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

These public proceedings were instituted by an order of the Commission dated May 26, 1987 ("Order") issued pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Malcolm Kanan ("Kanan") had engaged in the misconduct alleged by the Division of Enforcement ("Division"), and what, if any, remedial action would be appropriate in the public interest.

In substance, the Division alleged that Kanan wilfully violated Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") by using the mails and means and instruments of transportation and communication in interstate commerce to offer and sell to members of the public the common stock of Emervac Corporation ("Emervac"). The Division further alleged that the Emervac stock was not registered under the Securities Act and that Kanan sold 55,000 shares of that stock in the over-the-counter ("OTC") market during the period from about March, 1982 to about September, 1982.

Counsel for Kanan appeared and participated throughout the hearing. 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.

The findings and conclusions herein are based on the preponderance of the evidence as determined from the

record and upon observation of the witnesses.

RESPONDENT

During the relevant period from about March, 1982 to about September, 1982 Kanan was a registered representative in the employ of M. Rimson & Co. ("Rimson & Co."), a New York City securities firm registered under the Exchange Act. Kanan's experience in the securities industry dates from 1959. He became a registered representative in 1961. For the first seven or eight years he held a variety of jobs in the financial district as a financial analyst. He then went to work for a public relations firm writing research reports for three years before opening his own public relations firm. In 1982 Kanan left the public relations field to join Rimson & Co. as a salesman.

In June, 1983 Kanan Securities, Inc. ("Kanan Securities"), a securities firm whose president and controlling stockholder was Kanan, became registered as a broker-dealer under the Exchange Act. On April 2, 1986 the registration of Kanan Securities was revoked by the Commission because of various wilful violations of regulatory provisions of the Exchange Act and rules thereunder. Kanan was barred from being associated with any broker-dealer in any proprietary capacity. Presently, Kanan is employed by a securities firm in New York.

EMERVAC CORPORATION

In 1982, Emervac, a corporation formerly known as Absaroka, Inc., had a formal office in Las Vegas and two informal offices located in combination bar and grill establishments in that city where prospective investors were entertained. The formal office was maintained only for the months of February and March, 1982. No registration statement with respect to any securities of Emervac has been filed or is in effect under the Securities Act.

Emervac was represented to be engaged in the business of marketing a high-rise building rescue device designed to enable occupants to descend on the outside of a building in case of emergency but it never actually marketed the device. The sole business activity of Emervac, at least from January, 1982 through June, 1982, was confined to promoting sales of Emervac common stock and creating publicity for the rescue device. Initially, Emervac's unregistered stock was sold in Las Vegas through presentations to prospective investors by Marshall Zolp ("Zolp") and Dennis Thomas ("Thomas"), who were equal partners in the Emervac venture. Although neither Zolp nor Thomas had official titles because they did not wish to be publicly identified with Emervac, they, in fact, made all the decisions with respect to Emervac's activities.

VIOLATIONS OF SECTION 5 OF THE SECURITIES ACT

About mid-February, 1982 Kanan had a telephone conversation with Zolp regarding Emervac. The two had been previously acquainted. That call was followed up a week or two later by a meeting between Kanan, Zolp, and Thomas at the office of Rimson & Co. Kanan knew Zolp was involved in the promotion and sponsorship of Emervac and listened while Zolp did most of the talking about the Emervac promotion. Thomas also participated, telling Kanan that he was an investor in Emervac and had 40,000 shares of its stock that he wanted to sell. Thomas said his purpose for being at Rimson & Co. was to open an account with Kanan. Kanan then filled out a new account card opening the Thomas account. At that meeting Kanan gained the impression that Thomas was an officer of Emervac or, at least, "felt he had some official capacity" [1/] with the company, and knew that Thomas was "trying to help in the marketing . . . of the stock," and "trying to create an interest in the company." [2/] In fact, the records of Emervac's transfer agent reflected that Thomas was the holder of 650,000 Emervac shares representing over 20% of the 3,213,000 shares issued and outstanding as of May 3, 1982.

1/ Tr. at 377-78.

2/ Id., at 423-24.

On March 3, 1982 Thomas delivered six certificates totaling 40,000 shares of Emervac common stock to Rimson & Co. for the account of Thomas and on April 6, 1982 delivered three more certificates, each for 5,000 shares, for credit to the Thomas account. During the period March 8, 1982 through September 22, 1982, inclusive, Kanan sold these 55,000 shares of Emervac stock on the over-the-counter market for the Thomas account by using the mails and means and instruments of transportation and communication in interstate commerce. Checks payable to Thomas representing the proceeds from the sales of the stock out of the Thomas account were mailed or delivered to Thomas by Rimson & Co.

The record clearly establishes that during the period alleged by the Division Kanan was instrumental in and responsible for offering and selling unregistered stock of Emervac through use of the mails and of the means and instruments of transportation and communication in interstate commerce. Because it further appears that no exemption from the registration provisions of the Securities Act was available and that Kanan knew or should have known at the time the stock was being offered and sold that no registration statement under the Securities Act was on file or in effect as to Emervac securities, it is concluded that Kanan wilfully violated Sections 5(a) and 5(c) of the Securities Act.

Recognizing that the burden of proving the availability of an exemption from the registration requirements of the Securities Act is upon the person claiming it, [3/] Kanan asserts that the record establishes that the exemption for brokers' transactions under Section 4(4) of the Securities Act was available for his sales of Emervac stock. For his position to prevail, Kanan is required to show that in effecting the Emervac sales he was acting in the capacity of a broker, not an underwriter.

An "underwriter," for purposes of the Securities Act, is defined by Section 2(11) of the Act as follows:

> (11) The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commmission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer; or any person under direct or indirect common control with the issuer.

In order to avoid becoming a statutory underwriter under Section 2(11) Kanan must affirmatively establish that he did not have a direct or indirect participation

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3/ SEC v. Ralston Purina Co., 346 U.S. 119 (1953).

in a distribution of Emervac common stock by a person who was either directly or indirectly controlling or controlled by Emervac or who was under direct or indirect common control with Emervac. Kanan has failed to carry that burden.

Contrary to Kanan's contention, the testimony of Jeffrey Chain, an Emervac employee and later its secretary-treasurer, is credible with respect to the control status of Thomas during the relevant period. Chain's interest in protecting himself from civil liabilities for his activities with Emervac and his willingness to lie at the behest of Zolp and Thomas to induce purchases of Emervac stock do not separately or together destroy the credibility of his testimony. Although Chain was susceptible to the influence of Zolp and Thomas while with Emervac, that influence had dissipated by the time he took the witness stand. In testifying, he was candid in his description of Emervac's operations and purposes and did not spare himself in giving details about the Emervac stock promotion scheme of Zolp and Thomas and his role in carrying it out. Chain's testimony concerning Thomas involvement in the daily activities of Emervac must be credited. Additionally, his testimony regarding Thomas' control of Emervac's financial affairs finds corroboration in Thomas' own testimony to that effect. Further, the probability of the truthfulness of Chain's testimony that

Thomas together with Zolp managed Emervac, made all the decisions regarding the company, and made the sales of Emervac stock in Las Vegas is evident from the fact that according to the records of Emervac's stock transfer agent, Thomas was as of May 3, 1982 the owner of 650,000 Emervac shares representing 20.2% of the 3,213,000 shares then issued and outstanding. The record is clear that Thomas and Zolp were both control persons in common control of Emervac.

Moreover, even if Chain's testimony were disregarded, Kanan could not prevail. By his own admission he became aware that Thomas was associated in some official capacity with Emervac and assumed that Emervac's location was wherever Zolp and Thomas might be found. Kanan also knew that Thomas was trying to help market Emervac stock and that Thomas, with the help of Zolp, organized public demonstrations of the high-rise rescue device. One of those demonstrations took place in New York City and was attended by a number of the stock brokers Thomas was trying to interest in Emervac. At a meeting with the stockbrokers following the demonstration, Kanan was present when Thomas and Zolp continued their efforts to generate interest in Emervac stock.

The knowledge that Kanan acquired concerning Thomas' activities even on brief acquaintance was more than enough to require Kanan at the least to undertake further inquiry into whether Thomas was a person in control or sharing common control of Emervac, and whether

Emervac stock required registration under the Securities Act. If he had made reasonable inquiry, Kanan would have learned the facts to which Chain testified or gained knowledge that would have alerted him to Thomas' control status.

The extremely limited inquiry initiated by Kanan and Rimson & Co. into whether Thomas' stock was free and clear and tradable did not satisfy the requirements imposed upon broker-dealers when offered a substantial block of a little-known security. On that very point, the Commission has stressed the obligation of a broker-dealer who is relying upon a Section 4(4) exemption under circumstances similar to those found here to make a searching inquiry into the character of the securities his customer desires to sell, saying: 4/

> A broker-dealer (and its registered representative) relying on Section 4(4) cannot act as a mere order-taker. It must make whatever inquiries are necessary under the circumstances to ensure that its customer is not an underwriter. Distribution by Broker-Dealers of Unregistered Securities, Securities Act of 1933 Release No. 4445 (February 12, 1962); Sales of Unregistered Securities by Broker-Dealers, Securities Act of 1933 Release No. 5168 (July 7, 1971). When circumstances call for it, a broker-dealer wishing to avail itself of the broker's exemption cannot treat the inquiry it must make as a matter of form, but must make a reasonable inquiry to learn the facts concerning the character of the securities his customers wishes to sell. Since any broker-dealer claiming an exemption from the registration requirements has the burden of proving its availability, it is the

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4/ Evans & Company, Incorporated, 32 SEC DOCKET 577, 583 (1985).

broker-dealer that must establish the adequacy of the inquiry. As the Commission stated in Release No. 4445:

> The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to discuss exactly where the securities come from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is call for.

The record establishes that Thomas was in a control relationship with Emervac, and that consequently Kanan cannot avail himself of the Section 4(4) exemption. Because no other exemption from registration was available, Kanan's sales of unregistered Emervac stock constituted wilful violations of Section 5 of the Securities Act.

Kanan's further argument that the Section 5 violations were not wilful is without merit. In arguing the factual differences between his situation and Tager v. SEC,[5/] Kanan ignores the fact that in the latter instance the court was considering and deciding the meaning of "wilful" in the context of Section 15(b) of the Exchange Act. The court there stated that "It has been

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5/ 344 F.2d 5 (2d Cir. 1965).

uniformly held that 'wilfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts." The Tager view of "wilfulness" was followed in Gearhart & Otis v. SEC, where the D.C. Circuit Court of Appeals rejected the argument that "specific intent to violate the law is an essential element of the wilfulness required to violate Section 15(b)." 6/ The Ninth Circuit is also in accord with Tager, ruling in Nees v. SEC that Nees was subject to the Commission's sanctions for Section 5 violations if his conduct was "wilful" within the terms of Section 15(b) of the Exchange Act and "if he had reason to know or should have known that the securities should have been registered." 7/ Additionally, the Tenth Circuit sustained a Commission finding of a wilful violation of the registration provisions of the Securities Act in Quinn and Company, Inc. v. SEC, holding that "Brokers and securities salesmen are under a duty to investigate, and a violation of that duty brings them within the term 'wilful' of the Securities Act." 8/

6/ 348 F.2d 798, 802-03 (D.C. Cir. 1965).

7/ 414 F.2d 211, 220-21 (9th Cir. 1969).

8/ 452 F.2d 943, 947 (1971).

Kanan knew or should have known that the circumstances of his introduction to Thomas and Emervac strongly indicated that Thomas was attempting a secondary distribution of Emervac stock. Since Kanan failed to make the searching inquiry demanded of him as a securities salesman in order to determine the character of the Thomas stock, Kanan's violations are found to be wilful violations of Section 5 of the Securities Act.

Public Interest

Having found that Kanan wilfully violated Section 5 of the Securities Act, it is necessary to consider the remedial action appropriate in the public interest.

The Division urges that a suspension of twelve months is necessary and appropriate in the public interest. In support of that position the Division argues that Kanan acted in "blatant disregard of the federal securities laws" which allowed Thomas to sell his stock illegally and calls attention to the three prior disciplinary actions against Kanan. 9/ On the

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9/ Kanan Securities, Inc., 35 SEC DOCKET 700 (1986); District Business Conduct Committee for District No. 12 v. Kanan Securities, Inc., Complaint No. NY-3025, District No. 12 (Bd. of Gov'nrs, NASD, March 4, 1987); Brown, Knapp & Co., Inc., Administrative Proceeding No. CD-86-19 (Ala. Sec. Comm'n. January 9, 1986). These three actions involved infractions occurring subsequent to the Section 5 violations found here.

other hand, Kanan discounts the importance of the disciplinary actions, rejects the Division's assertions regarding the extent and impact of Thomas' sales of Emervac, and suggests that the sanctions demanded by the Division are not warranted.

Upon careful consideration of the record and the arguments and contentions of the parties, it is concluded that in the public interest Kanan should be suspended from association with any broker or dealer for a period of six months and that for a period of six months thereafter he not be permitted to solicit or accept buy or sell orders for any security unless the security is either listed on a national securities exchange or included in the NASDAQ National Market System.

Although the sanction may seem lenient in the eyes of the Division and harsh from Kanan's viewpoint, the suspension and limitation appear to be sufficient to impress upon Kanan the need to give close attention to the origin and character of the securities he sells and the customer for whom he acts. Additionally, the sanction should suffice to deter other securities salesmen from neglecting or ignoring their responsibility to make a "searching inquiry" when circumstances dictate that they do so.

Kanan is not the securities professional that the Division seeks to portray even though he began working in the securities industry in 1959 and became a registered representative in 1961. As he notes, his early work was as an analyst for seven years after which he went into public relations, returning to employment as a securities salesman after a lapse of over 20 years. Nor does Kanan appear to be the "recidivist" that the Division claims. The disciplinary actions of the Commission and the NASD are tandem actions involving the same violations of the net capital and bookkeeping and reporting rules and the Alabama action was caused by a failure to register as a sales agent. Those violations while not to be disregarded tend more upon examination of the underlying facts to establish incompetence or lack of appropriate training on the part of Kanan rather than flagrant disregard of the securities laws and rules and regulations. It is assumed that Kanan will recognize his shortcomings and pursue a course of training and study that will enable him to avoid further infractions of the securities laws. 10/

ORDER

IT IS ORDERED that Malcolm Kanan is suspended

10/ 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.

from association with any broker or dealer for a period of six (6) months from the effective date of this order; and

FURTHER ORDERED that for a period of six (6) months after the expiration of the ordered suspension, Malcolm Kanan may not solicit or accept a buy or sell order for any security unless the security is either listed on a national securities exchange or is included in the NASDAQ National Market System.

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, the 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 him, 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 him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
May 09, 1988