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S.E.C. v. Tuchinsky
 S.D.Fla., 1992.

United States District Court, S.D. Florida.
 SECURITIES AND EXCHANGE COMMISSION

v.

TUCHINSKY.

No. 89-6488-CIV 1-1 RYSKAMP.

June 29, 1992.

Opinion

RYSKAMP, District Judge.

*1 THIS CAUSE is before the Court on the Commission's motion for summary judgment against Defendant Herbert S. Cannon. The Commission contends that there is no material factual dispute that Cannon violated section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, by selling unregistered securities.^{FN1}

Summary judgment is appropriate if the pleadings, depositions, answers to interrogatories, and admissions on file together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). The moving party has the burden of informing the Court of the basis of its motion. It must therefore identify those portions of the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits (if any) which it believes demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 2553, 91 L.Ed.2d 265, 274 (1986). If the movant meets that burden, the burden shifts to the non-moving party to demonstrate that there is indeed a genuine issue of material fact that precludes summary judgment. *Id.*

FACTUAL BACKGROUND

Unless otherwise noted, the following facts are not in dispute. Cannon currently resides at 3145 Estates Drive, Pompano Beach, Florida. He has been associated with several companies as a financial consultant, and he operates a company under the name Cannon Enterprises, which is located at 1180 S.W. 36 th Avenue, Pompano Beach, Florida.

Cannon is married to Edith Cannon, who is the sole shareholder of SW Computer Corp., a consulting company. Cannon was president of SW Computer.

On August 3, 1954, International Communications, Inc. ("ICOM") was incorporated in Nevada as Utah Uranium Corporation. Its name was changed to Nuclear International, Inc. in 1968 and to Imperial Gold Corporation ("Imperial Gold") in 1974. In April 1986, Imperial Gold's name was changed to International Communications, Inc. In 1954, Utah Uranium Corporation issued ten million shares of common stock in an initial public offering pursuant to Regulation A of the Securities Act. As of approximately March 1985, ICOM had 10,189,750 shares of common stock outstanding.

ICOM common stock is a security within the meaning of section 2(1) of the Securities Act. No registration statement has ever been filed or been in effect with the Commission for either ICOM's or Imperial Gold's securities pursuant to the provision of the Securities Act or the Securities Exchange Act. No Forms D, Forms 144, offering circulars, or notices of claiming an exemption from registration were filed with the Commission under the names International Communications, Inc., Utah Uranium Corporation, Nuclear International, Inc., or Imperial Gold Corporation. No offering circulars were given to prospective purchasers of ICOM common stock. ICOM common stock was listed and offered for sale to an unlimited amount of offerees by its transfer agent Equity-One in the National Quotation Bureau's "pink sheets" for national over-the-counter trading.

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*2 Cannon first became aware of ICOM through Defendant Steve Weil in or about March 1986. Cannon had previously met Defendant Arthur Tuchinsky six months to a year earlier on a separate matter. Weil represented to Cannon that Tuchinsky owed L'il Tiger Leasing. Cannon helped Tuchinsky obtain loans for L'il Tiger through several friends as well as Cannon's wife. Defendant Harold Levy and Tuchinsky offered ICOM stock as collateral security for the loans. Cannon also helped Tuchinsky to guarantee a loan for \$50,000 that was secured by additional ICOM stock.

Cannon requested that Levy put 100,000 shares without legend or restriction on them in the name of SW Computer. This was part of the collateral for a \$50,000 bank loan from County Trust.

Tuchinsky originally gave Cannon eight ICOM stock certificates in Levy's name, numbered 1189 through 1192, 1216 through 1218, and 1240. Thereafter, Tuchinsky gave Cannon Certificate No. 1012, which represented one hundred thousand shares of ICOM common stock, in exchange for the return of the Levy stock originally given to Cannon.

Cannon decided to sell his ICOM shares after learning that L'il Tiger was going out of business and that Tuchinsky had defaulted on several of his loans. Cannon caused a securities trading account to be opened in the name of SW Computer at Cowen & Co. through Viceroy International Securities Corp. and gave the trading instructions for the account. Cannon caused 100,000 shares of ICOM stock to be deposited into the trading account and the shares were sold at \$1.00 per share. Cannon claims that in selling the ICOM stock he acted in his capacity as President of SW Computer. The money from the sale of the stock was used to pay off at least some of the aforementioned loans that Cannon had helped to arrange.

Cannon made use of the instruments of interstate commerce in connection with the sale of the ICOM securities. More specifically, he used the mails and the facilities of broker-dealers registered with the Commission, including Bear, Stearns & Co., Inc., to effect the sales of ICOM common stock.

DISCUSSION

To establish a *prima facie* case of a section five violation, the Commission must prove three elements. First, it must show that no registration statement was in effect as to the securities. Second, it must establish that Cannon sold or offered to sell these securities. Third, it must prove that Cannon used interstate transportation or communication or the mails in connection with the sale, offer to sell, or delivery. See *Dennis v. General Imaging, Inc.*, 918 F.2d 496 (5th Cir.1990); *Swenson v. Engelstad*, 626 F.2d 421, 425 (5th Cir.1980); *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680, 688 (5th Cir.1971); *Lively v. Hirschfeld*, 440 F.2d 631, 631 (10th Cir.1971); see also Harold S. Bloomenthal, *Securities Law Handbook* § 11.02 (1990-91 ed.). Thus, at least where the defendant is not being prosecuted criminally and where his liability is primary rather than secondary, the Securities Act imposes strict liability on offerors and sellers of unregistered securities, who are held accountable regardless of whether there was any degree of fault, negligent or intentional. See, e.g., *Swenson*, 626 F.2d at 424.

*3 Once the Commission has established a *prima facie* case, Cannon has the burden of raising and proving that the securities or transaction involved were exempt from the Securities Act's registration requirements. See *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126, 73 S.Ct. 981, 97 L.Ed. 1494 (1953); *Swenson*, 626 F.2d at 425.

Here there can be no doubt from the undisputed facts that the Commission has foreclosed the existence of a genuine factual issue with respect to the first and third elements of its *prima facie* case. Cannon's principal contention in opposition to the motion is simply that he did everything he reasonably could to determine whether the securities at issue were registered, and that he did not know that they were in fact unregistered. That, however, is no defense, because neither negligence nor scienter is an element of a *prima facie* case under section five.

The second of the three elements—the sale of securities by Cannon—requires discussion. The

securities sold were registered in the name of SW Computer and Cannon says he sold them in his capacity as president of that company. Further, the Commission has not established the Cannon received the consideration for the ICOM securities. Whether Cannon may be found liable under section five depends on whether he acted as a seller within the meaning of section five.

The Supreme Court has recently held that one may be a seller within the meaning of section 12(1) of the Securities Act, 15 U.S.C. § 771, without being the person who transfers title to the security. *See Pinter v. Dahl*, 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658, 679-80 (1988). (This is relevant because section 12(1) merely confers a private right of action for violations of section five upon purchasers of the unregistered securities.)

The *Pinter* Court held that liability under section 12(1) may be imposed upon a person who successfully solicits a purchase, provided that he is motivated at least in part by a desire to serve his own financial interest or those of the securities' owner. *Id.* at 647, 108 S.Ct. 2063, 100 L.Ed.2d at 682. If a person solicits the buyer's purchase in order to serve the financial interests of the owner, he may be liable without showing that he expects to participate in the benefits the owner enjoys as a result of the sale. *See id.* at 655, 108 S.Ct. 2063, 100 L.Ed.2d at 687. In contrast, liability may not be imposed upon one who is motivated entirely by a gratuitous desire to share an investment opportunity with friends and associates. *Id.* at 647, 108 S.Ct. 2063, 100 L.Ed.2d at 682.

The *Pinter* Court did not define the term "solicit." This Court, however, is not without guidance concerning Cannon's putative status as a seller. The *Pinter* Court's opinion was grounded in the statutory language of the Securities Act, and section 2(3) of the Act in particular. 15 U.S.C. § 77b(3). That section defines the terms "sale" and "sell." Whether Cannon's actions, allegedly on SW Computer's behalf in his capacity as president, qualify as solicitation is an issue of more theoretical than practical concern, however. This is so because section 2(3) includes within its scope "every attempt or offer to dispose of ... a security."

Like the phrase "solicitation of an offer to buy," this phrase is not inherently confined to the actual owner of the security. *See id.* at 643, 108 S.Ct. 2063, 100 L.Ed.2d at 679. Thus, a distinguished scholar has expressed the view that an officer or director of the seller who actively participates in the sale may be held liable as a seller. *See* Louis Loss, *Fundamentals of Securities Regulation* 1017 (1988). Cannon's actions clearly qualify at the very least as an offer to dispose of ICOM common stock. If Cannon's actions were motivated at least in part by a desire to serve his own financial interests or those of SW Computer, then he qualifies as a seller of those securities within the meaning of section five. Holding Cannon liable as a seller under these circumstances would comport with the language of the Securities Act and would be consistent with the *Pinter* Court's concern that collateral participants, such as attorneys and accountants, not be subjected to liability under sections 5 and 12(1).

*4 Cannon admits that he acted on behalf of SW Computer in his capacity as president. Leaving aside the fact that he was an officer of SW Computer and that his wife was its sole shareholder, it is manifest from his own admission that he acted to serve SW Computer's financial interests. It is therefore unnecessary to show that he also had his own financial interests at heart in orchestrating the sale of ICOM stock.^{FN2} Thus, Cannon was indisputably a seller of the ICOM common stock within the meaning of section five. The Commission has therefore established that there is no triable issue of fact with respect to the second element of its *prima facie* case.

It is therefore Cannon's burden to raise and prove that the ICOM common stock was exempt from the registration requirements of the Securities Act. Cannon has not claimed that his sales of ICOM common stock were exempt from the Securities Act's registration requirements.

Even if Cannon had raised such a defense, several such exemptions are clearly unavailable. The exemption for wholly intrastate offerings under section 3(a)(11) of the Securities Act, 15 U.S.C. § 77c(a)(11), is unavailable because ICOM common stock was offered nationally through the National

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Quotation Service's pink sheets. Further, the exemption created by this section is limited to the original issue of the securities and does not exempt secondary distributions. See III Louis Loss & Joel Seligman, *Securities Regulation* 1142-44 & nn. 5-6 (3d ed. 1989) (citing cases). (Unlike most of the other exemptions contained in section three, section 3(a)(11) exempts transactions rather than securities. *Id.*)

Section 4(2)'s exemption for private offerings, 15 U.S.C. § 77d(2), is available only to transactions by the issuer. The same is true of Regulation D's safe harbor, 17 C.F.R. § 230.504-06 (1991). See Reg.D, Prelim. Note 4. (Regulation D was promulgated under section 4(2) as well as section 3(b) of the Securities Act, 15 U.S.C. § 77c(b). See III Louis Loss & Joel Seligman, *Securities Regulation* 1406 (3d ed. 1989).) Of course, no one contends that Cannon was an issuer of ICOM common stock.

Cannon must therefore rely on section 4(1) of the Securities Act, 15 U.S.C. § 77d(1) or Rule 144 promulgated thereunder, 17 C.F.R. § 230.144 (1991). Section 4(1) makes section five inapplicable to transactions by anyone "other than an issuer, underwriter, or dealer." Rule 144 creates a safe harbor which establishes a simple test of probable underwriter status. See generally Harold S. Bloomenthal, *Securities Law Handbook* § 8.01, at 269 (1990-91 ed.). The Commission's position is that Cannon acted as an underwriter.

Section 2(11) of the Securities Act defines an "underwriter" as 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.... 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.

*5 15 U.S.C. § 77b(11). The term "distribution" as it is used in section 2(11) is essentially synonymous with the term "public offering." See III Louis Loss & Joel Seligman, *Securities Regulation* 1476 n. 4

(citing SEC, *Disclosure to Investors: A Reappraisal of Administrative Policies under the '33 and '34 Securities Acts* 171-72 (1969)). Section 2(4) defines an issuer in relevant part as "every person who issues or proposes to issue any security." 15 U.S.C. § 77b(4). Section 2(11) expands that definition to include persons who control issuers as defined in section 2(4). "Control," while not expressly defined, is best viewed as the ability to obtain the required signatures of the issuer and its officers and directors on a registration statement. See *Pennaluna & Co. v. SEC*, 410 F.2d 861, 865 (9th Cir.1969), cert. denied 396 U.S. 1007 (1970).

A reasonable finder of fact could conclude that Cannon did not act as an underwriter within the meaning of section 2(11). The facts are unclear as to whether he obtained the ICOM common stock from one who falls within section 2(11)'s expanded definition of "issuer." The question would appear to be reduced to whether Tuchinsky controlled ICOM. Therefore, the Commission has not demonstrated the presence of facts in the record which would indisputably establish the unavailability of an exemption under either section 4(1).

The same is true with respect to rule 144's exemption. Under rule 144, a person may be deemed not to be engaged in a distribution of securities and therefore not an underwriter only if several conditions are met. 17 C.F.R. § 144(b). One condition is that a person who, within a three month period, sells more than 500 shares, or shares whose aggregate sale price is greater than \$10,000, must file a form 144 with the Commission. *Id.* § 144(h). Cannon sold enough shares of sufficient value to require the filing of such a form, but only if he acquired ICOM stock from an issuer or affiliate. Cannon failed to file a form 144.

Unfortunately for the Commission, the necessity of filing a form 144 is premised upon the assumption that Cannon acquired the securities at issue from the issuer or an affiliate of the issuer. *Id.* § 144(k). An "affiliate" under rule 144 is simply a person who controls the issuer. *Id.* § 144(a)(1). It is unclear whether Tuchinsky qualifies as an affiliate. If he

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does not, and if Cannon acquired the ICOM stock from someone other than the issuer or an affiliate, then Cannon is exempt from the Securities Act's registration requirements because he is not an underwriter under both rule 144 and section 4(1). The Commission has not established that Cannon acquired the ICOM stock he later sold from the issuer or an affiliate, and hence the Commission has not foreclosed the availability of rule 144's exemption.

Because issues of fact remain concerning the availability of both the section 4(1) and rule 144 registration exemptions, summary judgment against Cannon is not appropriate. Nonetheless, all three elements of the Commission's *prima facie* case under section five may be deemed established at trial, if one is ultimately necessary.^{FN3} Cannon will bear the burden of proving such an exemption at trial.

ORDER

*6 For the foregoing reasons, it is hereby

ORDERED AND ADJUDGED that the Commission's motion for summary judgment against Cannon is DENIED. The Commission's motion to deem certain facts admitted against Cannon at trial is MOOT.

FN1. The Court received a courtesy copy of Cannon's memorandum in opposition to the motion for summary judgment, which it took under consideration in reviewing the motion. It has come to the Court's attention, however, that Cannon's memorandum is not filed in the record. The parties are advised of the desirability of correcting this matter.

FN2. Even if Cannon were not a seller within the meaning of section five, section 15 of the Securities Act, 15 U.S.C. § 77o, imposes liability on any person who "controls" a seller or offeror of unregistered securities. See *Swenson*, 626 F.2d at 425.

The Commission would have the burden of establishing control. *Id*; *Hill York*, 448 F.2d at 694. Cannon could then rebut the Commission's *prima facie* case of control with evidence that he "had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." 15 U.S.C. § 77o; See *Swenson*, 626 F.2d at 425; *Hill York*, 448 F.2d at 695 n. 22. It is, of course, undisputed that Cannon had actual knowledge of the facts that could give rise to liability on SW Computer's part, because Cannon himself orchestrated the sale.

FN3. The Court's denial of the Commission's motion for summary judgment is without prejudice to the Commission's right, consistent with the Federal Rules of Civil Procedure, the Local Rules of this District, and the Court's orders, to raise these issues on a subsequent motion if additional undisputed facts surface which show the Commission's entitlement to judgment as a matter of law.

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