INITIAL DECISION RELEASE NO. 297
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11856

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of	:	
	:	
CHARLES CINI	:	INITIAL DECISION
and GORDON NOVAK	:	September 27, 2005
	:	

APPEARANCES: Christopher E. Martin for the Division of Enforcement, Securities and Exchange Commission

Gordon Novak, pro se

BEFORE: Lillian A. McEwen, Administrative Law Judge

SUMMARY

Respondent Gordon Novak (Novak) pleaded guilty to one count of conspiracy to commit wire fraud and securities fraud for which he was sentenced to twenty-one months in prison. Novak, in a related civil matter, was also permanently enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder, and from aiding and abetting any violation of Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder. This Initial Decision bars Novak from participating in an offering of penny stock.

PROCEDURAL HISTORY

The Securities and Exchange Commission (SEC or Commission) instituted this proceeding on March 15, 2005, pursuant to Section 15(b) of the Exchange Act. Novak filed his Answer to the Order Instituting Proceedings (OIP) and requested a hearing. However, because of his previous felony conviction in the United States, Novak, a Canadian resident, has been barred from reentry into the United States and could not attend a hearing in this country. (Order of May 27, 2005.) Under the circumstances, I held a one-day public hearing in Toronto, Canada, on July 21, 2005, at the Ontario Securities Commission. See 5 U.S.C. § 554(b)(3). Both parties consented to the hearing's venue, which was cleared through Canadian and United States authorities.

At the hearing, fourteen exhibits from the Division of Enforcement (Division), ten exhibits from Novak, and one joint exhibit were admitted into evidence. The Division called one witness and Novak called two. The Division and Novak filed their post-hearing briefs on August 12 and August 19, 2005, respectively.[1] Respondent Charles Cini, the other Respondent in this proceeding, was barred on June 8, 2005, by order of default, from participating in an offering of penny stock. Charles Cini, Exchange Act Release No. 51798.

ISSUES PRESENTED

The OIP alleges that Novak has previously been (1) convicted of conspiracy to commit wire fraud and securities fraud, and (2) permanently enjoined from violating the antifraud provisions of the Exchange Act and from aiding and abetting reporting violations of the Exchange Act. According to the OIP, the underlying scheme giving rise to the criminal and the civil actions was revealed in a two-year undercover investigation designed to expose and prosecute those attempting to engage in the fraudulent purchase and sale of public companies' stock. It is alleged that Novak, among others, arranged to receive kickbacks based on a proposed securities transaction with a corrupt mutual fund manager, who turned out to be an undercover Federal Bureau of Investigation (FBI) agent (Agent) capturing the illegal conspiracy on tape.

If I conclude that the allegations in the OIP are true, I then must determine what remedial sanction, if any, is appropriate and in the public interest. The Division seeks a penny stock bar against Novak pursuant to Section 15(b) of the Exchange Act based on his criminal conviction and civil injunction.

FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof for the Division's case. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

Criminal Conviction and Civil Injunction

Novak, age fifty-seven, is a resident of Hamilton, Ontario, Canada. (Answer; Div. Ex. 1; Div. Ex. 14 at 4.) From February 1999 through October 31, 2001, he served as vice president for Rhino Ecosystems, Inc. (Rhino), a Florida corporation with its principal place of business in Woodbridge, Ontario, Canada. (Answer; Tr. 24, 59; Div. Ex. 6 at 2; Div. Ex. 10 at 20; Div. Ex. 12 at 16.) At that time, Rhino was purportedly in the business of designing, developing, and marketing a restaurant plumbing device, and was registered and made filings with the Commission. (Tr. 124-25; Div. Ex. 6 at 2; Div. Ex. 10 at 4; Div. Ex. 12 at 4; Resp. Exs. 3, 4.) Rhino's common stock, from June 2000 through October 2001, traded on the Over-the-Counter

[1] Citations to the transcript of the hearing will be noted as (Tr. __.). Citations to the Division's and Respondent Novak's exhibits and the joint exhibit will be noted as (Div. Ex. __.), (Resp. Ex. __.), and (Joint Ex. __.), respectively. Citations to the Division's and Respondent's post-hearing briefs will be noted as (Div. Brief at __.) and (Resp. Brief at __.), respectively.

Bulletin Board under the symbol RHNC, and was a penny stock, having never traded above $5 per share. (Tr. 126, 155; Div. Ex. 9 at 4; Div. Ex. 11 at 4; Div. Ex. 13; Resp. Ex. 9.) From August 22, 2000, through October 31, 2001, Novak was a signatory to Rhino's filings with the Commission. (Tr. 58-59; Div. Exs. 9-12.)

After a two-year undercover FBI investigation, Novak and others were indicted by a grand jury on July 30, 2002, for conspiracy to commit securities fraud and wire fraud, wire fraud, and securities fraud. (Div. Exs. 2, 6.) Novak subsequently pleaded guilty on October 7, 2003, before the United States District Court for the Southern District of Florida to one count of conspiracy to commit wire and securities fraud, a felony, in violation of 18 U.S.C. § 371. (Answer; Div. Ex. 14.) During the allocution before the district court, Novak admitted, among other things, that he voluntarily participated in the greater conspiracy to defraud "as an officer of [Rhino]" and "didn't withdraw from [it], knowing what he was doing was wrong." (Div. Ex. 14 at 11.) Based on his guilty plea, the district court entered judgment on December 17, 2003, and sentenced Novak to twenty-one months' imprisonment at Eglin Air Force Base, Pensacola, Florida, followed by two years of supervised release. The district court also fined him an assessment of $100.00. (Answer; Div. Ex. 1; Div. Ex. 6 at 6.) Upon release from incarceration, Novak would be deported to Canada and barred from reentry into the United States as a convicted felon. (Answer; Tr. 49; Div. Ex. 14 at 6.)

On August 15, 2002, based on the same underlying facts as the criminal matter, the Commission filed an injunctive complaint in the United States District Court for the Southern District of Florida against Novak and others, to enjoin them from making materially false and misleading statements and failing to disclose material information in filings with the Commission in violation of the securities laws. (Div. Ex. 3.) On January 20, 2005, the district court granted the Commission's motion for summary judgment and entered a judgment permanently enjoining Novak from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and from aiding and abetting any violation of Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder. (Answer; Div. Ex. 7.) The district court, in granting the Commission's motion for summary judgment, found all material facts set forth in the Commission's Statement of Material Facts Not in Dispute to be true. (Div. Ex. 7 at 2.) The following is a summary of these facts, which I also find to be true.

Kickback Scheme

In the summer of 2000, Novak and others agreed to participate in a scheme that involved the fraudulent offering of S-8 stock and the payment of undisclosed kickbacks. (Div. Ex. 6 at 2; Div. Ex. 14 at 11.) SEC Form S-8 registers the offer and sale of securities to an issuer's employees, consultants, and advisors who render "bona fide services" to the issuer. Such services may not be rendered in connection with the offer or sale of securities in a capital-raising transaction. See General Instruction A.1(a) to Form S-8; Registration of Securities on Form S-8, 66 SEC Docket 1644, 1644 (Feb. 17, 1998). As part of the scheme, Novak and others, on behalf of Rhino, agreed to execute fictitious consulting agreements with certain nominees controlled by Novak and his co-conspirators and to grant the nominees approximately 650,000 shares of Rhino common stock. (Div. Ex. 6 at 3; Div. Ex. 9 at 13-67.) The 650,000 shares would then be transferred from the nominees to an investment company, controlled by one of the co-

conspirators, which in turn, would sell the shares to Connelly & Williams, Inc. (Connelly & Williams), the United States-based representative of a foreign mutual fund (the Fund). (Div. Ex. 6 at 2-3.)

In reality, however, the Fund never existed. Its representative was the Agent who was posing as a corrupt securities trader employed by the fictitious Fund. (Div. Ex. 6 at 2.) The Agent claimed that he worked for Connelly & Williams along with a due diligence officer whose job was to research and approve which securities the Agent could purchase through Connelly & Williams on behalf of the Fund's investors. (Div. Ex. 6 at 2.)

Novak and others agreed to pay the Agent and his associates undisclosed kickbacks for them to induce the Fund, through Connelly & Williams, to purchase a large amount of overpriced Rhino stock. The kickbacks would amount to approximately sixty percent of the Fund's total purchase price for the stock, or approximately $6 million, as the Fund, through Connelly & Williams, was to pay $13.23 per share, or approximately $8.6 million in total, for the stock. Rhino's stock, at the time, had a prevailing market price below $2.00 per share. (Div. Ex. 6 at 2-3.) For his part in the scheme, Novak would receive $500,000. (Div. Ex. 6 at 4.)

False Filings

In connection with the fraudulent offering of S-8 stock, Novak, as a signatory for Rhino, caused a materially false and misleading Form S-8 registration statement to be filed with the Commission on September 14, 2000 (S-8 filing). (Div. Ex. 6 at 3; Div. Ex. 9 at 12.) The S-8 filing identified ten consultants, including a family member of one of the co-conspirators, who purportedly were retained to provide bona fide services to the company in exchange for Rhino stock. (Div. 6 at 3; Div. Ex. 9 at 1-2.) In reality, these persons were the nominees directed to facilitate the fraudulent sale of 650,000 shares of Rhino stock. (Div. Ex. 6 at 3.) Shortly after the S-8 filing was made, the Agent canceled the proposed $8.6 million transaction, and as a result, on November 13, 2000, Rhino amended its S-8 filing and canceled, or deregistered, the offering of Rhino's shares. (Div. Ex. 11.) The amended S-8 filing falsely represented that the shares were deregistered because Rhino had not received services "of equal value for the shares." (Div. Ex. 11 at 2.)

Rhino repeated this misrepresentation in its annual report on Form 10-KSB for the fiscal year ended July 31, 2000, filed on November 14, 2000. (Div. Ex. 10.) The Form 10-KSB, again signed by Novak, "was materially false and misleading because it failed to disclose the fraudulent nature of the [S-8 filing]." (Div. Ex. 6 at 3.) Like the amended S-8 filing, the Form 10-KSB stated that Rhino deregistered the Rhino shares intended for the purported consultants because "services would not be rendered." (Div. Ex. 10 at 53.) The shares of Rhino stock, however, were never legitimately registered pursuant to Form S-8, as they (1) at no time were issued to the purported consultants "for bona fide services," and (2) were, in fact, issued in connection with the offer and sale of securities in a capital-raising transaction. (Div. Ex. 6 at 3.) On June 7, 2004, the registration of Rhino's securities was revoked for Rhino's failure to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder. Rhino Ecosystems, Inc., 82 SEC Docket 3956. On several occasions, Novak has admitted that he knew these filings were false and misleading at the time they were filed. (Tr. 133, 143-44 ("I knew

that S-8s were not okay. . . . [T]he S-8s were created . . . to get money to fund the company, because that was always the main issue."), 156; Div. Ex. 14 at 11 ("[W]e did wrong in issuing [the] S-8 shares. . . .")).

CONCLUSIONS OF LAW

It is uncontroverted that Novak was previously convicted and permanently enjoined from violating and aiding and abetting violations of the securities laws. I have taken official notice of Novak's criminal conviction in United States v. Wiertzema, Case No. 02-20636-CR-Martinez (S.D. Fla. Dec. 17, 2003), in which the district court sentenced Novak to twenty-one months' imprisonment for conspiracy to commit wire and securities fraud in violation of 18 U.S.C. § 371. I have also taken official notice of the civil injunction ordered against him in SEC v. Rhino Ecosystems, Inc., Case No. 02-80768-CIV-Hurley (S.D. Fla. Jan. 20, 2005), enjoining him from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and from aiding and abetting any violation of Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder. See 17 C.F.R. § 201.323. I also conclude that the United States District Court for the Southern District of Florida is a court of competent jurisdiction.

Novak argues, in essence, that he was the victim of entrapment on the part of federal authorities investigating and prosecuting his criminal case, and by inference the civil injunction, before the United States district court. He states that the underlying scheme giving rise to both the criminal indictment and civil action against him was "created, instigated, and for two years aggressively and continuously promoted to [him] by the FBI and its collaborating witnesses." (Answer at 3; Resp. Brief at 1.) In his defense, he attacks many of the factual findings and the ultimate decision made by the district court, that he: never initiated any discussions with collaborating witnesses, never communicated with collaborating witnesses nor with the Agent, never sold a single Rhino share, was a minor shareholder of Rhino, never set the price for the fraudulent sales, never agreed to recruit securities or to assist in artificially inflating the market stock, and never understood the fraudulent transaction. (Resp. Brief at 1-2.)

A criminal conviction, however, cannot be collaterally attacked in a follow-on administrative proceeding, such as this one. William F. Lincoln, 53 S.E.C. 452, 455-56 & n.7 (1998) (collecting cases); see also United States v. Podell, 572 F.2d 31, 35 (2d Cir. 1978). Similarly, findings of fact and conclusions of law made in an injunctive action cannot be attacked in a subsequent administrative proceeding. Jospeph P. Galluzzi, 78 SEC Docket 1125, 1129 (Aug. 23, 2002); Ted Harold Westerfield, 54 S.E.C. 25, 32 n.22 (1999); Demetrios Julius Shiva, 52 S.E.C. 1247, 1249 (1997). Accordingly, Novak is collaterally estopped from attacking the merits of the criminal action against him, to which he pleaded guilty, and from challenging the findings of fact and conclusions of law made by the district court. Novak's objections of this nature are not properly raised in this forum and are hereby rejected. See Michael Batterman, 84 SEC Docket 1349, 1356 (Dec. 3, 2004) (challenges to a district court's decision are properly addressed to the appellate court).

SANCTION

The Division seeks a penny stock bar against Novak. (Div. Brief at 13.) Section 15(b)(6)(A) of the Exchange Act, in relevant part, provides two avenues for imposing such a bar, after notice and opportunity for a hearing. First, the Commission may bar a person from participating in offerings of penny stock if (1) a bar is in the public interest, and (2) the person has been enjoined in connection with the purchase or sale of a security, and, at the time of the misconduct alleged in the injunctive action, was participating in a penny stock offering. Ralph W. LeBlanc, 80 SEC Docket 2750, 2756-57 (July 30, 2003). Second, the Commission may also impose a penny stock bar if (1) a bar is in the public interest, and (2) the person was participating in a penny stock offering at the time of the alleged misconduct and has been convicted of an offense specified in Section 15(b)(4)(B) of the Exchange Act within ten years of the commencement of the instant proceeding. Benjamin G. Sprecher, 52 S.E.C. 1296, 1297 n.2 (1997). Among the offenses enumerated in Section 15(b)(4)(B) are "any felony or misdemeanor [that] involves the purchase or sale of any security . . . or conspiracy to commit any such offense." See Frederick W. Wall, Exchange Act Release No. 52467 at 4 n.8 (Sept. 19, 2005).

As previously determined, Novak was, in the past ten years, convicted and imprisoned for conspiracy to commit wire and securities fraud and permanently enjoined from violating the Exchange Act's antifraud provisions, and aiding and abetting violations of the Exchange Act's reporting provisions. Both Novak's criminal conviction and permanent civil injunction involved the purchase or sale of a security or conspiracy to commit such an offense. Wall, Exchange Act Release No. 52467 at 2 (respondent previously convicted of conspiracy to commit securities, mail, and wire fraud); LeBlanc, 80 SEC Docket at 2757 (underlying conduct may include "any activity in connection with the purchase or sale of any security"). Further, Novak does not dispute the fact that, during the period in the criminal indictment and injunctive complaint, Rhino stock was a penny stock, as defined under Section 3(a)(51)(A) of the Exchange Act and Rule 3a51-1 thereunder, having traded throughout its duration at less than five dollars per share. (Tr. 155.) Novak's unlawful conduct, thus, occurred while he was participating in the offer and sale of this stock. The remaining issue, then, is whether a penny stock bar, the only sanction sought by the Division, is necessary and appropriate in the public interest.

In determining whether a sanction is appropriate in the public interest, the following factors are examined:

> [T]he egregiousness of the [respondent's] actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the [respondent's] assurances against future violations, the [respondent's] recognition of the wrongful nature of their conduct, and the likelihood that the [respondent's] occupations will present opportunity for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (citation omitted), aff'd on other grounds, 450 U.S. 91 (1981). Mitigating and aggravating factors may offset evidence that a proposed bar is in the public interest. John S. Brownson, 77 SEC Docket 3636, 3640 n.12 (July 3, 2002), pet. denied, 66 Fed. Appx. 687 (9th Cir. 2003). However, "absent 'extraordinary mitigating circumstances,' an individual who has been convicted cannot be permitted to remain in the

securities industry." Wall, Exchange Act Release No. 52467 at 8 (citing Brownson, 77 SEC Docket at 3640); see also Charles Trento, 82 SEC Docket 785, 791 (Feb. 23, 2004).

Novak's conduct was both egregious and recurrent, with the conspiracy spanning several months. While Rhino's vice president, Novak actively participated in a conspiracy to commit fraud that endeavored to pay approximately $6 million in kickbacks to a corrupt securities trader. In exchange for the kickbacks, that trader, who turned out to be an undercover FBI agent, was to induce a foreign mutual fund to purchase approximately $8.6 million worth of Rhino stock at about $11 per share over the prevailing market price. Novak was to receive $500,000 for his part in the fraudulent sale and subsequent issuance of Rhino's shares. In furtherance of the greater conspiracy, Novak knowingly caused Rhino to file a Form S-8 registration statement and an annual report with the Commission that were materially false and misleading. Novak, subsequently, pleaded guilty to criminal charges and was sentenced to twenty-one months in prison for his misconduct, to be deported and barred from reentry in the United States upon his release. He was also later permanently enjoined from violating and aiding and abetting violations of the securities laws. By pleading guilty to 18 U.S.C. § 371, Novak admitted that he acted with scienter, that is, an intent to defraud. See United States v. Wynn, 61 F.3d 921, 929 (D.C. Cir. 1995) (listing intent to defraud as an element of 18 U.S.C. § 371).

Although Novak's guilty plea in the underlying criminal matter is evidence that Novak acknowledges the wrongfulness of his conduct, Novak has since sought to qualify his admittance of guilt and distance himself from the conspiracy. In fact, Novak argued at the hearing that in the criminal proceeding he "pled guilty to things [he] didn't do." (Tr. 143.) Novak now denies participating in all parts of the conspiracy, except for that relating to the false S-8 filing, which Novak admits "were not okay." (Id.) Novak attempts to point fingers at other co-conspirators who he believes were more culpable. (Tr. 24-32, 139.) However, these attempts to minimize his role in the conspiracy and deflect responsibility are futile. Novak was an officer of a public company with a duty to Rhino's shareholders. He abused his position as a fiduciary by participating in a conspiracy to defraud the public and in return receive a substantial monetary kickback of his own. At no point did Novak attempt to back out of the conspiracy and alert the authorities before the day of his arrest. (Tr. 50-52; Div. Ex. 14 at 11.) Furthermore, Novak admitted during his plea allocution in the criminal proceeding that he was adequately represented and fully understood his guilty plea to criminal conspiracy. (Div. Ex. 14 at 4.) I decline to credit Novak's self-serving testimony at the hearing that he was an unfortunate bit player entrapped by overzealous FBI agents. His willful filing of a false Commission report in furtherance of a known conspiracy is sufficient grounds for sanction.

I find it appropriate in the public interest to bar Novak from participating in an offering of penny stock. Although there is no evidence that Novak is currently participating in an offering of penny stock, I agree with the Division that it would be inconsistent for Novak to be barred individually from entry into the United States, as a convicted felon, but for him to be allowed "to solicit investors located within the United States" from Canada. (Div. Brief at 10.) Legislative history from the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 voices a considerable concern over the prevalence of convicted felons contributing to the growth of abuse in the penny stock market. LeBlanc, 80 SEC Docket at 2757 (citing H.R. Rep. No. 101-617 at 10, CCH Fed. Sec. L. Rptr. No. 1424, Part II at 156 (Dec. 6, 1990)). To allow Novak the

opportunity to trade penny stocks in the future will present him ample opportunity to prey on United States investors from just across the border with relative impunity. Novak has presented no extraordinary mitigating circumstances to warrant a lesser sanction.

CERTIFICATION OF RECORD

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I hereby certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on August 22, 2005.

ORDER

Based on the findings and conclusions set forth above, IT IS ORDERED that, pursuant to Section 15(b)(6)(A) of the Securities Exchange Act of 1934, Gordon Novak be, and hereby is, BARRED from participating in an offering of penny stock.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Lillian A. McEwen
Administrative Law Judge