INITIAL DECISION RELEASE NO. 323
ADMINISTRATIVE PROCEEDING
FILE NO. 3-12228

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	INITIAL DECISION
JAMES E. FRANKLIN	:	November 15, 2006

APPEARANCES: Kenneth J. Guido and Brian J.M. Sano for the Division of Enforcement, Securities and Exchange Commission

Respondent James E. Franklin, pro se

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision bars James E. Franklin (Franklin) from participating in an offering of penny stock. Franklin was previously enjoined against violations of the securities laws based on his wrongdoing in a fraudulent scheme involving a penny stock.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Proceedings (OIP) against Franklin on March 6, 2006, pursuant to Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act). The OIP alleges that Franklin was permanently enjoined in 2005 from violating the antifraud and other provisions of the federal securities laws. The only sanction authorized by the OIP is a penny stock bar. Franklin failed to file an Answer to the OIP and was barred, by default, from participating in an offering of penny stock. James E. Franklin, Exchange Act Release No. 54069 (A.L.J. June 29, 2006). Thereafter, on Franklin's motion, the default was set aside pursuant to 17 C.F.R. § 201.155(b). James E. Franklin, Exchange Act Release No. 54453 (A.L.J. Sept. 15, 2006). Pursuant to the schedule set at the September 26, 2006, prehearing conference, the Division of Enforcement (Division) and Franklin filed Motions for Summary Disposition on October 26, 2006,[1] and the Division filed an opposition on

[1] Leave to file the Motions for Summary Disposition was granted at the prehearing conference, pursuant to 17 C.F.R. § 201.250(a).

November 9, 2006.[2] The administrative law judge is required by 17 C.F.R. § 201.250(b) to act "promptly" on a motion for summary disposition.

This Initial Decision is based on: (1) the parties' Motions for Summary Disposition; (2) the Division's opposition; and (3) Franklin's Answer, dated September 13, 2006. There is no genuine issue with regard to any fact that is material to this proceeding. All material facts that concern the activities for which Franklin was enjoined were decided against him in the civil case on which this proceeding is based. Any other facts in his pleadings have been taken as true, pursuant to 17 C.F.R. § 201.250(a). All arguments and proposed findings and conclusions that are inconsistent with this decision were considered and rejected.

B. Allegations and Arguments of the Parties

The OIP alleges that Franklin was enjoined in December 2005 from violating the antifraud, registration, and antitouting provisions of the federal securities laws, in the civil action entitled SEC v. Franklin, No. 3:02CV0084 DMS (RBB) (S.D. Cal.) (SEC v. Franklin), based on his wrongdoing concerning seven stocks, including a penny stock. The Division urges that he be barred from participation in an offering of penny stock. Franklin argues that, having brought an action for an injunction, disgorgement, and civil penalties against him in United States District Court, the Commission is foreclosed from bringing an administrative proceeding against him seeking a penny stock bar. Further, he argues that the district court has assumed sole jurisdiction over the matter and also that he is currently appealing its judgment and until his appeals are exhausted, all issues remain with the appellate court. Additionally, he argues that Commission staff engaged in misconduct in their investigation and prosecution of SEC v. Franklin, (and in SEC v. Cavanagh, 98 CIV. 1818 (DLC) (S.D. N.Y.) (SEC v. Cavanagh), a separate case in which Franklin was a defendant) and that various adverse rulings by the court hampered his ability to defend himself. Finally, he argues, he should not be penalized for appealing the judgment against him under the guise of failing to recognize the wrongful nature of his conduct. Franklin urges that the charges against him be dismissed. Also, he urges that the case not be decided by summary disposition, but rather that a full hearing be conducted so that he can elicit testimony from Commission staff and present other evidence to show their wrongdoing.

[2] Franklin did not file an opposition.

C. Exhibits Admitted into Evidence

The following items, of which official notice is taken pursuant to 17 C.F.R. §§ 201.250(a), .323, in the Division's Motion for Summary Disposition at Exhibits A-E, P, and X and in its opposition at Exhibit CC are admitted into evidence as Division Exhibits A-E, P, X, and CC:

January 2002 Complaint in SEC v. Franklin (Div. Ex. A);

Docket Report in SEC v. Franklin (Div. Ex. B);

Minutes of August 19, 2005, In Limine Motion Hearing in SEC v. Franklin (Div. Ex. C);

Minutes of Jury Trial, Exhibit List, Jury Instructions, and Verdict Form in SEC v. Franklin (Div. Ex. D);

December 15, 2005, Order and Final Judgment against Defendants James E. Franklin and Samuel Wolanyk in SEC v. Franklin (Div. Ex. E);

July 16, 2004, Opinion & Order in SEC v. Cavanagh (Div. Ex. P);

Transcript, November 15, 2005, Jury Trial/Phase Two/Ruling in SEC v. Franklin (Div. Ex. X); and

December 11, 2003, Order in SEC v. Franklin (Div. Ex. CC).

The following items, of which official notice is taken pursuant to 17 C.F.R. §§ 201.250(a), .323, in Franklin's Motion for Summary Disposition at Exhibits 1, 2, 7, 9, and 1[0] are admitted into evidence as Respondent Exhibits 1, 2, 7, 9, and 10:

Minutes of August 19, 2005, In Limine Motion Hearing and August 25, 2005, Order ruling on parties' Motions in Limine in SEC v. Franklin (Resp. Ex. 1);

Transcript, October 26, 2005, proceedings in SEC v. Franklin (Resp. Ex. 2);

Transcript, October 19, 2005, proceedings in SEC v. Franklin (Resp. Ex. 7);

Partial Transcript, May 28, 1987, proceedings in U.S. v. Richards, CR- 86-784-Kn (C.D. Calif.) (Resp. Ex. 9); and

Transcript, October 25, 2005, proceedings in SEC v. Franklin (Resp. Ex. 10).

Additionally, the following Affidavit and Exhibit 5 in Respondent's Motion for Summary Disposition are admitted into evidence:

Affidavit of James E. Franklin (Aff.); and

March 11, 2004, Letter from Stephan Jan Meyers to Stephen M. Cutler, with various attachments (Resp. Ex. 5).

II. FINDINGS OF FACT

Franklin was (and is) permanently enjoined from violating the antifraud, antitouting, and registration provisions of the federal securities laws, Sections 5(a), 5(c), 17(a)(1), 17(a)(2), 17(a)(3), and 17(b) of the Securities Act of 1933 (Securities Act) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, following a jury trial and verdict that he had violated those sections.[3] SEC v. Franklin, No. 3:02CV0084 DMS (RBB) (S.D. Cal. Dec. 15, 2005); Div. Ex. D at Verdict Form, Div. Ex. E. Franklin is appealing the judgment. Answer at ¶ 2, Aff. at 2. The court found that Franklin was the most culpable of three individual defendants[4] implicated in a pump-and-dump scheme involving, in Franklin's case, seven stocks and that he was orchestrating the activities of the other defendants. Div. Ex. X at 7, 9. The seven stocks included Easy Cellular. Div. Ex. D at Verdict Form, Div. Ex. X at 6. Easy Cellular was a penny stock. Answer at ¶ 8. The court calculated that Franklin had ill-gotten gains of about $830,000, but decided to impose a third-tier civil penalty of $770,000 in lieu of, rather than in addition to, disgorgement. Div. Ex. E at 5-6.

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[3] The Commission does not permit a respondent to relitigate issues that were addressed in a previous civil proceeding against the respondent. See Michael J. Markowski, 55 S.E.C. 21, 26-27 (2001), pet. denied, No. 01-1181 (D.C. Cir. 2002) (unpublished); John Francis D'Acquisto, 53 S.E.C. 440, 444 (1998); Demitrios Julius Shiva, 52 S.E.C. 1247, 1249 (1997).

[4] The other individual defendants were Dieter Raabe and Samuel Wolanyk. The Commission's complaint alleged that Franklin, Raabe, and Wolanyk, acting through defendants Avalon Trust, Initial Public Offering Consultants, Inc. (IPO Consultants), Net Income, and Vector Keel Ltd. engaged in a pump-and-dump and scalping scheme by touting certain companies, acting as a promoter or consultant to some of the companies, and inducing or attempting to induce investors to purchase the touted stocks; Franklin was alleged to have touted at least seven stocks on a website, Red Hot Stocks, in furtherance of the scheme. Div. Ex. A. The court entered default judgments against Avalon Trust, IPO Consultants, Net Income, and Vector Keel Ltd. in 2003. Div. Ex. CC at 2. In addition to the direct violations referred to above, Franklin was found liable as a controlling person for the antifraud violations of Net Income and Vector Keel Ltd. and stipulated to being a controlling person of IPO Consultants and Avalon Trust. Div. Ex. E at 2-3.

Franklin, forty-three, resides in San Diego, California. Aff. at 1. He has been a financial consultant for the last eighteen years and, prior to that, was a stockbroker for two years. Aff. at 12. Directly, or indirectly, he raised over $30 million for at least thirty companies. Aff. at 12. Some did well; some failed. Aff. at 12. Since the Commission filed charges against him in 2002, no one wants to do business with him. Aff. at 13. In the future he intends to limit himself to financial analysis, working only on a fee basis and on a referral basis. Aff. at 13. He has no intention of operating as a broker or dealer or of promoting penny stocks in any way. Aff. at 13. He intends to fully obey all laws, and most certainly, all securities laws. Aff. at 14.

Franklin's prior disciplinary history includes a permanent injunction from violating Sections 5(a) and 5(c) of the Securities Act, imposed on July 16, 2004, in SEC v. Cavanagh,[5] for wrongdoing that occurred in 1997 and 1998. Div. Ex. P. In evaluating the likelihood of future violations, the court in that case concluded that Franklin was at least reckless as to whether his profits in the sale of certain securities were earned through fraud and stated that in the course of the investigation underlying SEC v. Franklin, Franklin had instructed another defendant to send abroad documents pertaining to the investigation. Div. Ex. P at 70-72. The court also ordered Franklin to pay a civil penalty of $125,000 and disgorgement, plus interest, individually, of $50,926.50, and jointly and severally with two other defendants, of $889,275. Div. Ex. P at 81.

In 1987, at risk to himself, he denounced a fraudulent stock promoter, Melvin Lloyd Richards, to the authorities, advising them that Richards intended to kill the prosecutor who was prosecuting him for fraud. Aff. at 11, Resp. Ex. 9 at 72. Franklin testified against Richards and Richards threatened to kill him as well.[6] Aff. 11-12, Resp. Ex. 9. At a hearing at which the threats were addressed, the court revoked Richards's bond and remanded him to custody. Resp. Ex. 9 at 73.

Franklin's affidavit describes the arguments on which his appeal of the judgment against him in SEC v. Franklin is based. These include various difficulties and adverse rulings by the court which hampered his ability to defend himself and an allegation that Commission staff engaged in misconduct in their investigation and prosecution of SEC v. Franklin and SEC v. Cavanagh. Aff. at 2-10. For example, he believes that had certain evidence been provided to him earlier, he would have been able to use it to convince the jury that Dieter Raabe, not he, controlled the Vector Keel Ltd. account.

III. CONCLUSIONS OF LAW

Franklin has been permanently enjoined "from engaging in or continuing any conduct or

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[5] Aff'd (as to Franklin) sub nom. SEC v. Franklin, 175 Fed. Appx. 467 (2d Cir. 2006). See also SEC v. Cavanagh, 445 F.3d 105 (2d Cir. 2006).

[6] The court credited Franklin's testimony even though noting that he "is of questionable character, no question of that." Resp. Ex. 9 at 72.

practice in connection . . . with the purchase or sale of any security" within the meaning of Sections 15(b)(4)(C) and 15(b)(6)(A)(iii) of the Exchange Act. Further, Easy Cellular stock was a penny stock within the meaning of Exchange Act Section 3(a)(51) and Rule 3a51-1, and in the wrongdoing that underlay his injunction, Franklin was a "person participating in an offering of penny stock" within the meaning of Exchange Act Section 15(b)(6)(C). Franklin is precluded from relitigating in this proceeding the district court's findings of fact or conclusions of law. Michael Batterman, 84 SEC Docket 1349, 1356 & n.18 (Dec. 3, 2004); Robert Sayegh, 54 S.E.C. 46, 51 (1999); John Francis D'Acquisto, 53 S.E.C. 440, 444 (1998). Likewise, the court's procedural rulings on evidence and other matters cannot be relitigated in this proceeding. Vladislav Steven Zubkis, 86 SEC Docket 2618, 2623 & n.19 (Dec. 2, 2005), recon. denied, 87 SEC Docket 2584 (Apr. 13, 2006). Thus, his difficulty in defending himself due to the court's rulings on evidence and other matters cannot be relitigated in this proceeding and will not be considered.

Further, the issues in the OIP in this proceeding concern Franklin, not the Commission, and thus his allegation of misconduct by Commission staff in SEC v. Franklin and SEC v. Cavanagh is not relevant to the issues in this proceeding. Any challenge to the propriety of the staff's conduct should have been brought before the courts in which those cases were heard. Harold F. Crews, 87 SEC Docket 350, 359 (Jan. 13, 2006). In sum, Franklin's only means of challenging the validity of the injunction against him is through an appeal to the Court of Appeals for the Ninth Circuit, which Franklin is pursuing. Zubkis, 86 SEC Docket at 2623. Finally, contrary to Franklin's argument, the pendency of his appeal does not preclude "follow-up" action based on the injunction. Joseph P. Galluzzi, 55 S.E.C. 1110, 1116 n.21 (2002). If the Court of Appeals vacates the injunction on which this proceeding is based, the Commission will entertain an application to reconsider the sanction herein. C. R. Richmond & Co., 46 S.E.C. 412, 414 n.11 (1976).

Franklin argues that, having brought an action for an injunction, disgorgement, and civil penalties against him in district court, the Commission is foreclosed from bringing an administrative proceeding against him seeking a penny stock bar. This argument fails as a defense because Section 15(b) of the Exchange Act specifically authorizes an administrative proceeding seeking to bar an individual that is based on an injunction against that individual. See Sections 15(b)(4)(C) and 15(b)(6)(A)(iii) of the Exchange Act. In a related argument, Franklin argues that the court has sole jurisdiction over the matter, thus excluding the Commission from pursuing an administrative remedy against him. This argument fails as well. The injunctive proceeding and this proceeding are independent, although this proceeding necessarily follows from the injunctive proceeding. Zubkis, 86 SEC Docket at 2626. Finally, Franklin suggests that since the court did not impose a penny stock bar, the Division is foreclosed from seeking a bar in this administrative proceeding. This argument fails as well. There is no indication in the record that the court even considered a penny stock bar much less that it affirmatively decided not to impose one; the Commission did not request one. See Michael T. Studer, 83 SEC Docket 2853, 2858 (Sept. 20, 2004).

IV. SANCTION

The Division requests a penny stock bar. As discussed below, Franklin will be barred from participating in an offering of penny stock because of the seriousness of his violation, taking account of the facts and circumstances of his conduct, including the facts and arguments that he presented.

A. Sanction Considerations

The Commission determines sanctions pursuant to a public interest standard. See Section 15(b)(6) of the Exchange Act. The Commission considers factors including:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, 80 SEC Docket 2812, 2814 (July 25, 2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., 87 SEC Docket 848, 862 & n.46 (Jan. 31, 2006).

In proceedings based on an injunction, the Commission examines the facts and circumstances underlying the injunction in determining the public interest. Melton, 80 SEC Docket at 2814. "An injunction, by its very nature, is predicated on conduct that . . . violate[s] laws, rules or regulations." Id. at 2822. The Commission considers an antifraud injunction to be particularly serious. Id. at 2823. The public interest requires a severe sanction when a respondent's past misconduct involves fraud because opportunities for dishonesty recur constantly in the securities business. Richard C. Spangler, Inc., 46 S.E.C. 238, 252-54 (1976).

B. Sanctions

Franklin's conduct was egregious and recurrent. He orchestrated a fraudulent scheme in connection with seven stocks. Recurrence is indicated by SEC v. Cavanagh, in which Franklin received an injunction against violating the registration requirements, a civil penalty, and an order of disgorgement for his activities with a different group of people and in which the court found that he was at least reckless as to whether his profits in the sale of certain securities were earned through fraud. A high degree of scienter is indicated by Franklin's violations of Securities Act Section 17(a)(1) and Exchange Act Section 10(b) and Rule 10b-5.

Franklin has worked for twenty years in the securities industry and desires to continue in some capacity. Thus, his occupation will present opportunities for future violations. Despite his present intention not to resume promoting penny stocks, he would be free to do so in the future absent a penny stock bar. Franklin's violations are recent; he was enjoined in 2005.

Additionally, he was enjoined in 2004 in SEC v. Cavanagh, based on misconduct in 1997 and 1998 in an unrelated pump-and-dump scheme. The degree of harm to investors is quantified in the court's calculation that his ill-gotten gains were about $830,000 from the wrongdoing that was the subject of SEC v. Franklin. Further, as the Commission has often emphasized, the public interest determination extends beyond consideration of the particular investors affected by a respondent's conduct to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975).

Franklin has stated his present intent to comply with all laws, especially all securities laws, pointing to his injunction as a sword hanging over his head that would lead to draconian consequences should he violate the securities laws. The sincerity of his intent is somewhat offset, however, by the fact that it is only after the second injunctive proceeding against him that he has come to this realization. As Franklin points out, vigorously pursuing his appeal of the judgment against him is inconsistent with any overt recognition of the wrongful nature of his past conduct. However, as stated above, the Commission would reconsider the penny stock bar should he prevail in his appeal. Thus, he will not in fact be harmed by exercising his right to pursue his appeal.

In mitigation, Franklin points to his conduct in helping bring a fraudulent securities promoter to justice in 1987 while placing himself at risk. While this action was meritorious, its effect is outweighed by the need to protect the public through a penny stock bar. In sum, consideration of the Steadman factors indicates that Franklin is unsuited to function in the securities industry. A penny stock bar is also necessary for the purpose of deterrence.

V. ORDER

IT IS ORDERED that, pursuant to Section 15(b) of the Securities Exchange Act of 1934, JAMES E. FRANKLIN IS BARRED from participating in an offering of penny stock.[7]

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

[7] Thus, he will be barred from acting as a promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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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Carol Fox Foelak
Administrative Law Judge