

1 UNITED STATES COURT OF APPEALS  
2 FOR THE SECOND CIRCUIT

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4 August Term, 2016

5 (Argued: October 19, 2016

Decided: December 6, 2016)

6 Docket No. 13-3191-cv

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8 SECURITIES AND EXCHANGE COMMISSION,

9 *Plaintiff-Appellee,*

10 - v. -

11 JOHN B. FROHLING,

12 *Defendant-Cross-Claimant-Cross-Defendant-*  
13 *Appellant,*

14 HISAO SAL MIWA,

15 *Defendant-Cross-Claimant-Cross-Defendant,*

16 VIRGINIA K. SOURLIS,

17 *Defendant-Cross-Claimant,*

18 DANIEL D. STARCZEWSKI, JOE V. OVERCASH, JR., FRANK J. MORELLI, III,  
19 THOMAS F. PIERSON,

20 *Defendants-Cross-Defendants,*

21 ACTIVE STEALTH, LLC, BAF CONSULTING, INC., BLUEWATER EXECUTIVE  
22 CAPITAL, LLC, EMERGING MARKETS CONSULTING, LLC, KCS REFERRAL  
23 SERVICES, LLC, MBA INVESTORS, LTD., NEW AGE SPORTS, INC., POWER  
24 NETWORK, INC., PROJECT DEVELOPMENT, INC., SEVILLE CONSULTING, INC.,  
25 STARR CONSULTING, INC., TUSCANY CONSULTING, INC., YT2K, INC.,

26 *Relief-Defendants-Cross-Defendants,*

1 GREENSTONE HOLDINGS, INC., JAMES S. PAINTER, III,

2 *Defendants.\**  
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4 Before: KEARSE, POOLER, and DRONEY, *Circuit Judges.*

5 Appeal by defendant attorney from a November 25, 2015 final judgment of the United  
6 States District Court for the Southern District of New York, Miriam G. Cedarbaum, *Judge*, granting  
7 plaintiff Securities and Exchange Commission's motion for summary judgment in this enforcement  
8 action, holding defendant liable for securities laws violations (§§ 5 and 17(a) of the Securities Act of  
9 1933, 15 U.S.C. §§ 77e, 77q(a); § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b),  
10 and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5) in connection with false opinion letters he wrote  
11 or approved to enable impermissible public offerings of unregistered shares of stock of defendant  
12 Greenstone Holdings, Inc.; ordering him to pay a total of \$204,161.86 as a civil penalty, disgorgement,  
13 and prejudgment interest; and permanently barring him from participating in certain stock offerings.  
14 Defendant contends principally that the district court erred in ruling that there was no genuine issue  
15 to be tried as to his knowledge of the falsity of the letters.

16 Affirmed.\*\*

17 ALLAN A. CAPUTE, Special Counsel to the Solicitor,  
18 Washington, D.C. (Anne K. Small, General Counsel,  
19 Michael A. Conley, Deputy General Counsel, Jacob H.  
20 Stillman, Solicitor, Securities and Exchange  
21 Commission, Washington, D.C., on the brief), *for*  
22 *Plaintiff-Appellee.*

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\* The Clerk of Court is directed to amend the official caption in this appeal to conform with the above.

\*\* Originally filed as a summary order on November 8, 2016, this decision is now being published as an opinion on motion of the Securities and Exchange Commission dated November 14, 2016, granted on December 1, 2016.

1 JOHN B. FROHLING, *pro se*, Jersey City, New Jersey,  
2 *Defendant-Cross-Claimant-Cross-Defendant-*  
3 *Appellant.*

4 KEARSE, *Circuit Judge*:

5 In this appeal, which was reinstated following a remand for final resolution of pending  
6 claims, *see SEC v. Frohling*, 614 F. App'x 14 (2d Cir. 2015), defendant-cross-claimant-cross-  
7 defendant-appellant John B. Frohling *pro se* appeals from a November 25, 2015 Superseding Final  
8 Judgment of the United States District Court for the Southern District of New York, Miriam G.  
9 Cedarbaum, *Judge*, in this enforcement action brought by the Securities and Exchange Commission  
10 ("SEC") in connection with public offerings of unregistered shares of stock of defendant Greenstone  
11 Holdings, Inc. ("Greenstone"). The district court granted a motion by the SEC for summary judgment  
12 on issues of liability, holding Frohling--who as Greenstone's securities counsel in 2006-2008 wrote,  
13 approved, or concurred in 11 opinion letters relating to all of the relevant offerings--liable for violating  
14 § 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a); § 5 of the Securities Act,  
15 15 U.S.C. § 77e; and § 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C.  
16 § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. The Superseding Final Judgment orders  
17 Frohling to pay a total of \$204,161.86 as a civil penalty, disgorgement, and prejudgment interest, and  
18 permanently bars him from participating in so-called "penny stock" offerings, *i.e.*, offerings of "any  
19 equity security that has a price of less than five dollars, except as provided in Rule 3a51-1 under the  
20 Exchange Act," Superseding Final Judgment at 4.

21 On appeal, Frohling contends principally that he had no knowledge that the opinion  
22 letters he issued, approved, or concurred in were false, nor any knowledge of facts to alert him that

1 the opinion letters were false, and that the district court erred in ruling that there was no genuine issue  
2 to be tried as to his knowledge. For the reasons that follow, we find no basis for reversal. We assume  
3 the parties' familiarity with the underlying facts and procedural history of the case.

4 *A. Liability*

5 Section 5 of the Securities Act makes it unlawful, directly or indirectly, to publicly  
6 offer or sell unregistered stock, *see* 15 U.S.C. § 77e, unless the offering is covered by an exemption.  
7 The stock certificate for unregistered shares not covered by an exemption--"restricted" stock--normally  
8 bears a legend stating that the shares have not been registered and cannot lawfully be sold until they  
9 are registered. The pertinent exemption in this case, as it existed at the relevant time, allowed stock  
10 to be issued without the restricted-stock legend if the recipients were persons unaffiliated with the  
11 stock's issuer at the time of the sale or during the preceding three months, and if at least two years had  
12 elapsed since the shares were owned by the issuer or a person affiliated with the issuer, *see* SEC Rule  
13 144(k), 17 C.F.R. § 230.144(k) (2005) ("Rule 144(k) exemption"). The two-year requirement was  
14 satisfied if unaffiliated persons acquired the shares in exchange for "consideration consisting *solely*  
15 of other securities of the same issuer" that had been received at least two years earlier, as the shares  
16 were deemed to have been acquired from the issuer at the time the surrendered securities had been  
17 acquired. *Id.* § 230.144(d)(3)(ii) (2005) (emphasis added). "To state a cause of action under Section  
18 5, one must show '(1) lack of a [required] registration statement as to the subject securities; (2) the  
19 offer or sale of the securities; and (3) the use of interstate transportation or communication and the  
20 mails in connection with the offer or sale.'" *SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006)  
21 (quoting *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 124  
22 n.4 (2d Cir. 1998)). A person not directly engaged in transferring title of the security can be held

1 liable under § 5 if he or she "engaged in steps necessary to the distribution of [unregistered] security  
2 issues." *SEC v. Chinese Consolidated Benevolent Ass'n*, 120 F.2d 738, 741 (2d Cir. 1941).

3 Section 10(b) of the Exchange Act and Rule 10b-5, which prohibit fraud in the  
4 purchase or sale of a security, are violated if a person has "(1) made a material misrepresentation or  
5 a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter;  
6 (3) in connection with the purchase or sale of securities." *SEC v. Pentagon Capital Management*  
7 *PLC*, 725 F.3d 279, 285 (2d Cir. 2013) (quoting *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308  
8 (2d Cir. 1999)), *cert. denied*, 134 S. Ct. 2896 (2014). A false statement was made with the requisite  
9 scienter if it was made with the "intent to deceive, manipulate, or defraud." *SEC v. Obus*, 693 F.3d  
10 276, 286 (2d Cir. 2012) (internal quotation marks omitted). "[S]cienter may be established through  
11 a showing of reckless disregard for the truth, that is, conduct which is highly unreasonable and which  
12 represents an extreme departure from the standards of ordinary care." *Id.* (internal quotation marks  
13 omitted).

14 The elements of a claim under § 17(a) of the Securities Act, which prohibits fraud in  
15 the "offer or sale" of a security, 15 U.S.C. § 77q(a), are "[e]ssentially the same" as the elements of  
16 claims under § 10(b) and Rule 10b-5. *SEC v. Monarch Funding Corp.*, 192 F.3d at 308.

17 Summary judgment may be granted "if the movant shows that there is no genuine  
18 dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ.  
19 P. 56(a). A genuine dispute exists when the evidence is such that, if the party against whom summary  
20 judgment is sought is given the benefit of all permissible inferences and all credibility assessments,  
21 a rational factfinder could resolve all material factual issues in favor of that party. *See, e.g., Anderson*  
22 *v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). Summary judgment is appropriate when "there can  
23 be but one reasonable conclusion as to the verdict," *id.* at 250, *i.e.*, "it is quite clear what the truth is,"

1 *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 467 (1962) (internal quotation marks  
2 omitted), and no rational factfinder could find in favor of the nonmovant. We review the district  
3 court's grant of summary judgment *de novo*, applying the same standards that govern the district  
4 court's consideration of the motion. *See, e.g., Aulicino v. New York City Department of Homeless*  
5 *Services*, 580 F.3d 73, 79 (2d Cir. 2009).

6           It is undisputed that the Greenstone shares in question were not registered. It is  
7 undisputed that Frohling wrote, approved, or concurred in 11 opinion letters relying explicitly or  
8 implicitly on the Rule 144(k) exemption, stating that the shares could lawfully be transferred to the  
9 recipients as unrestricted shares on the ground that they were acquired by persons unaffiliated with  
10 Greenstone solely in exchange for other Greenstone securities they had received more than two years  
11 earlier. The record shows that Frohling himself wrote eight of these letters; six of the eight expressly  
12 cited the Rule 144(k) exemption; and Frohling subsequently wrote a letter revising the other two to  
13 invoke the Rule 144(k) exemption expressly. It is undisputed that those statements were untrue. For  
14 example, certain owners--the "Morelli Group"--which purported to be receiving the to-be-offered  
15 shares from Greenstone in exchange for old convertible promissory notes agreed that at least half of  
16 the proceeds from the sale of the shares would be paid to Greenstone, thus making it false to represent  
17 that the Morelli Group was acquiring the to-be-offered shares "solely" in exchange for the promissory  
18 notes. Frohling nonetheless wrote or approved opinion letters stating, *inter alia*, that the unregistered  
19 Greenstone shares "may be issued without restriction" (Frohling letter dated August 31, 2006) and  
20 without a legend identifying them as restricted shares. Public offerings of the shares ensued, and the  
21 district court concluded that Frohling's participation in those unlawful offerings was substantial  
22 because without those opinion letters, Greenstone's transfer agent "would not have issued any  
23 unregistered shares." *SEC v. Greenstone Holdings, Inc.*, No. 10 Civ. 1302, 2012 WL 1038570, at \*11

1 (S.D.N.Y. Mar. 28, 2012) ("*Greenstone I*"). Frohling has provided no basis for disturbing that  
2 conclusion. We affirm the ruling that Frohling violated § 5 substantially for the reasons stated by the  
3 district court in *Greenstone I*.

4 With respect to the SEC's fraud claims against Frohling under § 17(a), § 10(b), and  
5 Rule 10b-5, Frohling challenges the propriety of summary judgment, arguing, as he did below, that  
6 he did not know the 11 opinion letters' representations--that Greenstone shares to be offered to the  
7 public were exempt under Rule 144(k) from the registration requirement--were false and that his  
8 knowledge could not be determined as a matter of law. The district court concluded that no rational  
9 factfinder could fail to find that Frohling knew of, *inter alia*, the Morelli Group's agreement to share  
10 the proceeds of the offerings with Greenstone:

11 [A]s to the letters Frohling wrote, the record contains numerous *e-mails sent*  
12 *by Miwa* [defendant Hisao Sal Miwa, Greenstone's founder and chief officer]  
13 *to Frohling* in which *Miwa discusses the Morelli Group's plan to sell shares*  
14 *to the public and remit the proceeds to Greenstone*. Miwa explicitly states that  
15 portions of the shares were to be used for "funding the company," that is, in  
16 exchange for new consideration. Furthermore, *Frohling admitted at his*  
17 *deposition that he knew of the Morelli Group's commitment to transfer to*  
18 *Greenstone at least half of the proceeds of the public sale of the unregistered*  
19 *shares*. Thus, he knew that the shares were being improperly sold for new  
20 consideration.

21 *Greenstone I*, 2012 WL 1038570, at \*6 (emphases added).

22 In addition, Frohling wrote two of his false opinion letters to receive unrestricted shares  
23 himself, in exchange for a promissory note. Frohling opined that the Rule 144(k) exemption applied,  
24 despite knowing that it did not because, *inter alia*, he had received the note less than the required two  
25 years earlier. *See id.* at \*4. As to one such letter, "[t]he undisputed facts show that Frohling received  
26 10 million Greenstone shares as a result of th[e] opinion letter and shortly thereafter sold at least 2.9  
27 million of those shares." *Id.* at \*7.

1           The court also found that Frohling fraudulently approved of a January 11, 2006 opinion  
2 letter by defendant Virginia K. Sourlis ("Sourlis Letter") leading to the issuance of more than 6 million  
3 Greenstone shares as unrestricted stock. *See id.* at \*3. Sourlis opined that the shares could lawfully  
4 be issued as unrestricted shares because the recipients were acquiring them in exchange for certain  
5 convertible notes. *See id.* In her letter, Sourlis stated that she was relying on "information and  
6 representations furnished by . . . the Original Note Holders to me," and that "I have been informed by  
7 the Original Note Holders" that none of them were affiliated with the issuer and that the Original Note  
8 Holders had owned the notes for at least two years. (Sourlis Letter at 2.) The record established,  
9 however, that "the convertible notes described by Sourlis did not even exist." *SEC v. Greenstone*  
10 *Holdings, Inc.*, 954 F.Supp.2d 211, 213 (S.D.N.Y. 2013) ("*Greenstone II*"). Frohling concurred in the  
11 Sourlis Letter, and 6,150,000 shares were issued as unrestricted shares under the claim of a Rule  
12 144(k) exemption for convertible promissory notes that in fact did not exist, allowing the shares to be  
13 sold to the public although unregistered. Because the notes did not exist, many of the statements in  
14 the Sourlis Letter were necessarily false. *See id.* The district court found that "Frohling adopted  
15 Sourlis's statement[s] in full[,] . . . even though he knew the true facts." *Greenstone I*, 2012 WL  
16 1038570, at \*3.

17           Although Frohling argues that there was a fact issue to be tried because he testified in  
18 deposition that he did not know the opinion letters he wrote, approved, or concurred in were false in  
19 their statements that the Rule 144(k) exemption applied, it is indisputable that he also admitted in that  
20 deposition that he knew that the Morelli Group had agreed to share the proceeds of the offerings with  
21 Greenstone. Given that admission, together with the documentary evidence consisting of emails sent  
22 to him stating that Greenstone was to receive part of the proceeds of the offerings, we see no error in  
23 the district court's conclusion that Frohling's later testimony that he did not know that fact did not



1 create an issue that was genuine.

2 We conclude that the record was ample to support the district court's determination that  
3 there was no genuine issue to be tried as to Frohling's knowledge that the representations as to the  
4 applicability of the Rule 144(k) exemption were false, and to support its conclusion that Frohling  
5 violated § 17(a) of the Securities Act, § 10(b) of the Exchange Act, and Rule 10b-5 because the  
6 opinion letters he wrote, approved, or concurred in "all falsely claimed registration exemptions under  
7 Rule 144(k)," *Greenstone I*, 2012 WL 1038570, at \*6.

8 B. *Relief*

9 Finally, we reject Frohling's challenges to the relief ordered by the district court, *i.e.*,  
10 disgorgement, prejudgment interest, civil penalties, and injunctive relief. "Once the district court has  
11 found federal securities law violations, it has broad equitable power to fashion appropriate remedies  
12 . . . ." *SEC v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996) ("*First Jersey*"), *cert.*  
13 *denied*, 522 U.S. 812 (1997).

14 "The primary purpose of disgorgement as a remedy for violation of the securities laws  
15 is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those  
16 laws." *Id.* Prejudgment interest may be awarded on sums ordered disgorged in order to fully  
17 compensate the wronged party for actual damages suffered. *See, e.g., id.* at 1476. Civil monetary  
18 penalties are authorized by the Securities Act and the Exchange Act for both deterrent and punitive  
19 purposes. *See, e.g., SEC v. Razmilovic*, 738 F.3d 14, 38-39 (2d Cir. 2013). And injunctive relief is

20 particularly within the court's discretion where a violation was founded on  
21 systematic wrongdoing, rather than an isolated occurrence, . . . and where the  
22 court views the defendant's degree of culpability and *continued protestations*  
23 *of innocence* as indications that injunctive relief is warranted, since "*persistent*  
24 *refusals to admit any wrongdoing ma[k]e it rather dubious that [the offenders]*

