No. 19-

IN THE

Supreme Court of the United States

DENNIS J. MALOUF,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Numerous federal statutes require administrative exhaustion to preserve an issue for review by an Article III court. The Securities Exchange Act ("SEA"), 15 U.S.C. § 78y(c)(1), and the Investment Advisers Act ("IAA"), 15 U.S.C. § 80b-13(a), require exhaustion but include an express exception where there were "reasonable grounds" for not urging the objection before the Securities and Exchange Commission ("SEC"). In Petitioner's case, the Tenth Circuit's decision, that there were no "reasonable grounds" to excuse Petitioner's failure to urge a valid Appointments Clause objection before the SEC, conflicts with decisions of the D.C. Circuit and the Sixth Circuit as to similar statutory exceptions to exhaustion.

Other federal statutes, like the Securities Act ("SA"), 15 U.S.C. § 77i(a), require exhaustion but do not have any express exceptions. In Petitioner's case, the Tenth Circuit concluded it "need not decide" if § 77i(a) is a "jurisdictional condition" or a "claim processing" rule because either way it lacked discretion to excuse Petitioner's failure. No court has decided the important and recurring questions whether exhaustion is a "claim-processing" rule and whether exhaustion is subject to "equitable exceptions."

The questions presented are:

1. What constitutes "reasonable grounds," as used in SEA § 78y(c)(i) and IAA § 80b-13(a), and in other federal statutes, to excuse a failure to urge before the SEC a valid Appointments Clause objection to an unconstitutionally selected administrative law judge?

2. Is an administrative exhaustion requirement like that in SA § 77i(a) without any express exceptions, and in other federal statutes, a "jurisdictional condition" to review of a valid Appointments Clause objection by an Article III court or a "claim-processing" rule?

3. Whether "equitable exceptions" may excuse non-compliance with the administrative exhaustion requirement in § 77i(a) of the SA and in other federal statutes that do not contain any express exceptions?

PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT

All parties to the proceedings are listed in the caption. There are no parties that are nongovernmental corporations.

RELATED CASES STATEMENT

- *Malouf v. Securities and Exchange Commission*, No. 16-9546, U.S. Court of Appeals for the Tenth Circuit. Judgment entered Aug. 13, 2019. Petition for rehearing denied Oct. 25, 2019.

TABLE OF CONTENTS

Table of Contents

Table of Contents

TABLE OF APPENDICES

TABLE OF CITED AUTHORITIES

Page

CONSTITUTIONAL PROVISIONS

CASES

Page

Cited Authorities

Page

Page

Cited Authorities

Page

STATUTES AND RULES

ORDERS

CITATIONS TO OPINIONS BELOW

The SEC administrative law judge's Initial Decision is located at *In re Malouf*, Release No. 766 (S.E.C. Release No.), 2015 WL 1534396 (Apr. 7, 2015).

The SEC's Final Decision is located at *In re Malouf,* Release No. 4463 (S.E.C. Release No.), 2016 WL 4035575 (Jul. 27, 2016).

The Tenth Circuit Court of Appeals' opinion is located at *Malouf v. SEC,* 933 F.3d 1248 (10th Cir. 2019).

JURISDICTION

Pursuant to the Securities Act, 15 U.S.C. § 77i(a), the Securities Exchange Act, 15 U.S.C. § 78y(a)(1), and the Investment Advisers Act, 77 U.S.C. § 80b-13(a), Petitioner filed a petition for review with the Tenth Circuit Court of Appeals. The judgment of the Tenth Circuit was entered on August 13, 2019. The timely filed petition for rehearing was denied on October 25, 2019. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The following constitutional and statutory provisions cited below are found in the Appendix:

U.S. Const., art. II, § 2, cl. 2. (Appointments Clause)

Securities Act, 15 U.S.C. § 77i(a).

Securities Exchange Act, 15 U.S.C. § 78y(c)(1).

Investment Advisers Act, 15 U.S.C. § 80b-13(a).

INTRODUCTION

Before the SEC instituted proceedings against Petitioner, Dennis J. Malouf, it had a publicly-declared position that it was not violating the Appointments Clause of the U.S. Constitution, art. II, § 2, cl. 2, by its method of selecting administrative law judges ("ALJs') to adjudicate administrative enforcement proceedings. In 2014, the SEC instituted an administrative proceeding against Petitioner to determine if he had violated the securities laws. Mr. Malouf concedes he did not urge an Appointments Clause objection before the SEC because there was no judicial support for it and the SEC was on record opposing it. The SEC found that Petitioner violated the securities laws and, among other sanctions, barred him from the industry for life.

In 2016, Mr. Malouf's petition for review of the SEC's Final Decision was pending before the Tenth Circuit Court of Appeals when it decided *Bandimere v. SEC,* 844 F.3d 1168 (10th Cir. 2016). In *Bandimere,* for the first time a court of appeals upheld an Appointments Clause objection to SEC ALJs. Petitioner immediately lodged a timely Appointments Clause objection before the Tenth Circuit. In 2018, Mr. Malouf's case was still pending on appeal when this Court decided *Lucia v. SEC,* 138 S. Ct. 2044 (2018), in accord with *Bandimere*. Despite his valid Appointments Clause objection, however, the Tenth Circuit denied Mr. Malouf's petition for review. *Malouf v. SEC,* 933 F.3d 1248 (10th Cir. 2018)(App. 1a).

As to the findings that Petitioner violated the SEA and IAA, the Tenth Circuit denied the petition for review because it concluded that there were no "reasonable grounds" (as that term is used in SEA § 78y(c)(1) and IAA § 80b-13(a)) to excuse Mr. Malouf's failure to urge an Appointments Clause objection before the agency. (App. 8a-13a) The Tenth Circuit's reasoning and application of the "reasonable grounds" exception conflicts with decisions involving similar statutory exceptions to exhaustion by the D.C. Circuit and by the Sixth Circuit. This Court should grant this petition for a writ of certiorari to resolve this conflict.

As to the findings that Petitioner violated the SA, the Tenth Circuit denied the petition because SA § 77i(a) does not contain an express exception to exhaustion. The court of appeals concluded, therefore, it lacked discretion to excuse Mr. Malouf's failure to urge an Appointments Clause objection before the agency and it "need not decide" if § 77i(a) is a "jurisdictional condition" to appellate review or a "claim-processing" rule. (App. 8a-9a, 14a-15a n.10) This Court has directed the lower courts to make that determination, however, because of its significant impact on the outcome of litigation. This Court should grant this petition for a writ of certiorari to decide if the exhaustion requirement in § 77i(a), and in other statutes without any express exceptions, is a claim-processing rule.

The Tenth Circuit also did not consider if "equitable exceptions" may excuse Petitioner's failure to urge a valid Appointments Clause objection before the SEC. On several occasions, this Court has acknowledged that there is disagreement among the lower courts as to whether equitable exceptions may excuse non-compliance with

claim-processing rules, but it reserved judgment on the question. In at least one case this Court held that a claim-processing rule was subject to the equitable exception of tolling. This Court should grant this petition for certiorari to decide if administrative exhaustion in the securities laws (and in other federal statutes) is subject to equitable exceptions; such as, futility, change in law, and miscarriage of justice.

STATEMENT OF THE CASE

A. The Public Record Shows That Before The SEC Instituted Proceedings Against Petitioner It Had a Predetermined Position on the Appointments Clause Objection

Before the SEC instituted proceedings against Petitioner, the SEC's public position was that its ALJs were not "inferior officers" of the United States and did not have to be appointed according to the Appointments Clause. The SEC's legal opinion was that this Court's decision in *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868 (1991), holding that special tax court judges were "inferior officers," did not apply to SEC ALJs, and that the D.C. Circuit's decision in *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000), holding that FDIC ALJs were not "inferior officers," controlled at the SEC. *See Hill v. SEC*, 114 F. Supp. 3d 1297, 1318 (N.D. Ga. 2015), *rev'd* 825 F.3d 1236 (11th Cir. 2016); *Timbervest, LLC v. SEC*, Case No. 15-CV-2106, SEC's Opp. to Plaintiffs' Motion for Preliminary Injunction (Dkt #18, at pp. 18-31) (N.D. Ga. Jun. 29, 2015); *Gray Financial Group, Inc. v. SEC*, Case No. 15-CV-492, Mem. of Law In Support of Def.'s Motion to Dismiss (Dkt #14-1, at pp. 2, 18-36) (N.D. Ga. Apr. 20, 2015).

The SEC made its stance known publicly in several ways. First, the Deputy Chief Operating Officer of the SEC, Jayne L. Seidman, publically defended the agency's method of selecting ALJs in her affidavit. *See Duka v. SEC*, Case No. 15-CV-357(RMB)(SN), Decision & Order (Dkt #57 at p. 5)(S.D.N.Y. Aug. 3, 2015). Second, Appointments Clause challenges were made in administrative proceedings but the ALJs ruled that they lacked authority to decide the issue. *See Hill*, 114 F. Supp. 3d at 1305 ("ALJ James F. Grimes found on May 14, 2015, that he did not have the authority to address [constitutional] issues…."). Third, in federal district courts, the SEC defended its method of selecting ALJs against collateral attacks on the administrative proceedings. The SEC prevailed on most of those challenges, but even if the SEC was unsuccessful initially, it subsequently prevailed on appeal. *See, e.g., Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016). All indications were the SEC would not change its predetermined public position without judicial intervention, which did not come until 2016.

B. The Charges Against Mr. Malouf[1]

Petitioner, Mr. Malouf, was an investment advisor and the owner of a branch office of a broker-dealer. To eliminate conflicts that might arise from those dual roles, in 2008, Mr. Malouf sold the branch office to an independent third party. As is typical, the sale was financed by periodic payments from the continuing operations of the branch.

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1. This petition for certiorari does not relate to the SEC's factual findings of violations of the securities laws by Mr. Malouf. Instead, it presents issues arising out of challenges to an unconstitutional tribunal.

After the sale, Mr. Malouf directed execution of trades for his advisory clients to that branch office. The purchaser used the branch's revenues from executing the trades to make the periodic payments to Mr. Malouf.

On June 9, 2014, the SEC issued an order instituting administrative enforcement proceedings against Mr. Malouf to determine if he violated the securities laws by not disclosing to his advisory clients on the firm's website and in its Form ADV alleged conflicts of interest arising from the above transaction and the periodic payments. (App. 149a) The payments Mr. Malouf received for the sale of the branch office totaled $1,068,084. (App. 132a) The SEC also alleged that Mr. Malouf did not obtain "best execution" for his advisory clients[2] resulting in extra charges to his clients of "roughly" $265,000 as part of trading government bonds involving millions of dollars. (App. 233a) There were no allegations that Mr. Malouf misappropriated monies invested by his advisory clients or even that his advisory clients lost money during a period when the stock market generally declined.

In his defense, Mr. Malouf explained he was not the "maker" or "disseminator" of the statements on the firm's website or its Form ADV. He had delegated responsibility for those disclosures to the firm's Chief Compliance Officer ("CCO") and he lacked actual knowledge of the specific

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2. The duty of best execution is derived from the prohibition against engaging in fraudulent or deceptive transactions in IAA, 15 U.S.C. § 80b-6(2). Part of an investment advisor's duty of loyalty includes obtaining the best price discoverable in the exercise of reasonable diligence. *In re Hughes,* Release No. 4048 (Exchange Act Release No.), 1948 WL 29537, at *5 (Feb. 18, 1948), *aff'd sub nom. Hughes v. SEC,* 174 F.2d 969, (D.C. Cir. 1949).

disclosures made. At most, Mr. Malouf "failed to correct" the CCO's misstatements, which was not sufficient to prove scheme liability under SEA, 15 U.S.C. § 10b and Rules 10b-5(a) and (c) thereunder or SA, 15 U.S.C. §§ 17(a)(1) and (3), or to prove aiding and abetting liability under IAA, 15 U.S.C. §§ 206-207 and Rules 206(4)-(1)(a)(5) thereunder.[3] Also, Mr. Malouf presented expert testimony that he obtained "best execution" according to the accepted industry practices at the time.

C. The 2015 Initial Decision by the Unconstitutionally-Selected ALJ

Mr. Malouf's case was assigned for fact-finding, adjudication, and determination of sanctions to ALJ Jason Patil. An evidentiary hearing was held in Albuquerque, New Mexico, from November 17-25, 2014. On April 7, 2015, the ALJ issued an Initial Decision finding Mr. Malouf in violation of all the securities laws and imposed sanctions. *In re Malouf*, Release No. 766 (S.E.C. Release No.), 2015 WL 1534396 (Apr. 7, 2015). (App. 145a)

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[3] While his case was pending on appeal before the Tenth Circuit, this Court decided *Lorenzo v. SEC,* 139 S. Ct. 1094 (Mar. 28, 2019), that addressed the issue of scheme liability under the securities laws. The Tenth Circuit's decision in Mr. Malouf's case arguably extends this Court's decision in *Lorenzo* because unlike Lorenzo, Mr. Malouf was not a disseminator of misstatements—he merely failed to correct misstatements "made" and "disseminated" by the CCO.

D. The SEC's Final Decision in Mr. Malouf's Case and the SEC's Continued Rejection of the Appointments Clause Challenge in Other Cases From 2014-2016

Mr. Malouf appealed the ALJ's Initial Decision to the SEC. In his opening brief, filed on September 2, 2015, Mr. Malouf did not include an Appointments Clause objection to the SEC ALJ based on the lack of judicial support and the SEC's already-stated public opposition to the challenge. Indeed, the day after Mr. Malouf filed his opening brief, the SEC denied the objection in another enforcement case. *See In re Lucia,* Release No. 4190 (S.E.C. Release No.), 2015 WL 5172953 (Sep. 3, 2015), *pet. for review denied*, *Lucia v. SEC,* 832 F. 3d 277 (D.C. Cir. 2016), *pet. reh. denied en banc* 868 F.3d 1021 (2017), *rev'd, Lucia v. SEC*, 138 S. Ct. 2044 (2018). During the next two months, the SEC denied the objection on at least two more occasions. *In re Timbervest, LLC,* Release No. 4197 (S.E.C. Release No.), 2015 WL 5472520 (Sep. 17, 2015); and *In re Bandimere,* Release No. 9972 (S.E.C. Release No.), 2015 WL 6575665 (Oct. 29, 2015), *rev'd*, *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016).

On July 27, 2016, the SEC issued its Final Decision based on findings by the unconstitutionally selected ALJ without having done any additional fact-finding. The SEC adopted all of the ALJ's findings of fact negative to Mr. Malouf but ignored certain findings of fact in his favor; such as, the duty to disclose conflicts relating to the sale of the branch office was delegated to the CCO. Except for increasing the sanctions, the SEC adopted all of the ALJ's legal conclusions that Mr. Malouf violated the securities laws. *In re Malouf,* Release No. 4463 (S.E.C. Release No.), 2016 WL 4035575 (Jul. 27, 2016). (App. 55a)

The SEC increased a seven-year bar imposed by the ALJ to a permanent bar from the securities industry. The SEC increased the disgorgement imposed by the ALJ by $562,001 on top of the $506,082 he had paid already on behalf of the firm. The SEC approved the $75,000 civil monetary penalty and the cease-and-desist order imposed by the ALJ.

On August 9, 2016, in *Lucia v. SEC,* 832 F. 3d 277 (D.C. Cir. 2016), *pet. reh. denied en banc* 868 F.3d 1021 (Jun. 26, 2017), *rev'd*, *Lucia v. SEC*, 138 S. Ct. 2044 (2018), the D.C. Circuit ruled that the SEC ALJs were not "inferior officers" and the SEC's method of selecting them did not violate the Appointment Clause.

E. *Bandimere* and *Lucia* Change the Law as to SEC ALJs, and Mr. Malouf Immediately Lodged an Appointments Clause Objection in the Court of Appeals

Mr. Malouf filed a petition for review of the SEC's Final Decision in the Tenth Circuit Court of Appeals pursuant to § 77i(a) of the SA, § 78y(a)(1) of the SEA, and § 80b-13(a) of the IAA. On November 22, 2016, Mr. Malouf filed his opening brief before the Tenth Circuit Court of Appeals on his petition for review of the SEC's Final Decision. Lacking any judicial support, Mr. Malouf did not assert an Appointments Clause objection in his opening brief.

On December 27, 2016, the Tenth Circuit issued its decision in *Bandimere v. SEC*, 884 F.3d 1168 (10th Cir. 2016), reaching a conclusion directly opposite to that reached by the D.C. Circuit in *Lucia*. For the first time,

there was judicial support for an Appointments Clause objection.[4]

On January 13, 2017, shortly after *Bandimere* was issued, Mr. Malouf moved to file a supplemental brief to urge an Appointments Clause objection. With leave of court, he filed his supplemental brief on January 27, 2017. The SEC had a full opportunity to respond in its brief filed on March 13, 2017. The SEC argued that the Tenth Circuit could not consider the Appointments Clause objection because Mr. Malouf had not urged it before the SEC. The SEC did not argue that ALJ Patel was appointed in accordance with the Appointments Clause. The focus of oral argument on September 26, 2017, was on whether the court of appeals had to ignore the unconstitutional composition of the SEC administrative tribunal because Mr. Malouf had not urged the Appointments Clause objection before the SEC. On January 16, 2018, the court of appeals *sua sponte* abated Mr. Malouf's case in light of this Court's grant of a writ of certiorari in *Lucia*.

This Court issued its decision in *Lucia v. SEC*, 138 S. Ct. 2044 (2018), on June 21, 2018, which established that the SEC's method of selecting ALJs violated the Appointment Clause not only in Mr. Lucia's case but also in Mr. Malouf's case. In response to this Court's decision in *Lucia*, on August 22, 2018, the SEC granted all respondents in administrative enforcement cases pending before an SEC ALJ or on appeal to the SEC (about 130

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4. Even after the decision in *Bandimere*, the SEC declared it was not going to change its method of selecting ALJs and it continued to consider the D.C. Circuit's decision in *Lucia* as controlling. *In re Haring Advisory LLC*, Release No. 4600 (S.E.C. Release No.) 2017 WL 66592 (Jan. 6, 2017).

respondents) the opportunity for a new administrative hearing—irrespective of whether the respondent had asserted an Appointments Clause objection. *In re Pending Administrative Proceedings*, SEC Release No. 4993, 2018 WL 4003609 (Aug. 22, 2018). (App. 44a-54a) Although each of those respondents was given an opportunity to have his case re-heard, the Order did not apply to Mr. Malouf due to the serendipitous fact that his case was pending before the Tenth Circuit which had exclusive jurisdiction.

On July 24, 2018, the Tenth Circuit ordered the parties to file supplemental briefs on the issue of whether Mr. Malouf had forfeited an Appointments Clause objection by not urging it before the SEC.

F. The Tenth Circuit Denied Mr. Malouf's Petition For Review Notwithstanding that It was the Product of an Unconstitutional Administrative Tribunal

On August 13, 2019, the Tenth Circuit issued its judgment. *Malouf v. SEC,* 933 F.3d 1248 (10th Cir. 2019). (App. 1a) Despite the unconstitutional composition of the SEC tribunal, and even though the Tenth Circuit expressly ruled that Mr. Malouf's Appointments Clause objection was timely in the court of appeals (App. 7a-8a n.4), the Tenth Circuit denied Mr. Malouf's petition for review.

As to violations by Petitioner of the SEA and the IAA, the Tenth Circuit concluded that there were no "reasonable grounds" to excuse a failure to exhaust the valid Appointments Clause objection before the agency because it would not have been "clearly useless" to have objected. (App. 10a) The Tenth Circuit's finding was

based on another serendipitous fact that the first SEC enforcement decision denying an Appointments Clause objection happened to be issued the day *after* Mr. Malouf filed his opening brief with the SEC instead of the day before he filed it. (App. 10a and 10a-11a n.7) The court of appeals also held that *Lucia* and *Bandimere* did not change the law because those cases just applied *Freytag* to SEC ALJs. (App. 12a-14a)

As to violations by Petitioner of the SA, the Tenth Circuit concluded it "lack[ed] discretion to excuse the failure to exhaust administrative remedies" because the "Securities Act does not contain an express exception to the exhaustion requirement …." (App. 9a) It further concluded that it "need not decide" whether exhaustion is a jurisdictional condition or a claim-processing requirement and it did not consider whether equitable exceptions might excuse non-compliance. (App. 8a, 14a-15a n.10) The court of appeals denied the petition for review.

G. Mr. Malouf Filed Timely Post-Decision Petitions

On September 19, 2019, Mr. Malouf filed a timely petition for panel re-hearing and/or hearing *en banc*. On October 25, 2019, the Tenth Circuit denied the petition for rehearing and the mandate was issued on November 4, 2019. This petition for certiorari follows.

REASONS FOR GRANTING THE PETITION

A. The Lower Courts Need Guidance on What Constitutes "Reasonable Grounds" and other Statutory Exceptions to Excuse Non-compliance with Exhaustion Requirements

1. The Tenth Circuit's Decision that there were No "Reasonable Grounds" Conflicts with the D.C. Circuit's and Sixth Circuit's Decisions as to Similar Statutory Exceptions in Other Statutes.

Section 78y(c)(1) of the SEA and § 80b-13(a) of the IAA state "no objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission *or unless there were reasonable grounds for failure so to do*." (Italics added.) The Tenth Circuit held that "reasonable grounds" means "clearly useless." As to the findings that Petitioner violated the SEA and the IAA, the court of appeals denied the petition for review because "Mr. Malouf has not shown that exhaustion of the challenge would have been clearly useless."[5] (App. 10a)

In *Washington Assoc. for Television and Children v. FCC*, 712 F.2d 677 (D.C. Cir. 1983), the D.C. Circuit examined a number of federal statutes that require

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5. "Clearly useless" is not the same as "reasonable grounds." It may be reasonable not to have asserted a defense because of the agency's predetermined position or a subsequent change in law supporting the objection even though, in hindsight, it turns out not to have been "clearly useless."

administrative exhaustion, some of which have an express exception for "reasonable grounds" and others have an express exception for "extraordinary circumstances." The D.C. Circuit concluded that the differences in language were not significant because in all of the statutes Congress intended merely to codify the judicial doctrine of administrative exhaustion along with its exceptions.

> Numerous statutes contain an explicit exhaustion requirement. Only some of these statutes explicitly permit exceptions, and the statutes that permit exceptions use different wording to describe the scope of the exceptions, with no apparent rhyme or reason for the differences. *Compare* Securities Act of 1933, 15 U.S.C. § 77i(a) ("no objection … shall be considered by the court unless such objection shall have urged before the Commission.") *with* Securities Exchange Act of 1934, 15 U.S.C. § 78y(c)(1) ("No objection … may be considered by the court unless it was urged before the Commission or there was **reasonable grounds** for failure to do so."); and *compare* National Labor Relations Act, 29 U.S.C. § 160(e) ("No objection that has not been urged before the Board … shall be considered by the court, unless the failure … shall be excused because of *extraordinary circumstances*.") (emphasis added) *with* Fair Labor Standards Act, 29 U.S.C. § 210(a) ("No objection … shall be considered by the court unless such objection shall have been urged before [an] industry committee or unless there were **reasonable grounds** for failure so to do.") (emphasis added).

> *See also* Public Utility Holding Company Act, 15 U.S.C. § 79x(a) (similar to Securities Exchange Act).
>
> The very senselessness of these differences in language suggests that Congress meant, in all these statutes, merely to codify the judicial doctrine of exhaustion of administrative remedies. That would explain Congress' failure to give careful attention to the nuances of language that might, in another context, connote differences in intended meaning.

Id. at 682 n.6 (bold and italics in original, underlining added).

Even though the differences in the language of the express exceptions to exhaustion are "senseless," or at least are not significant, there is no uniformity among the circuits as to what constitutes "reasonable grounds" and other similar statutory exceptions. The lower courts' decisions advance three incompatible positions as to when a failure to exhaust may be statutorily excused. A lenient view holds that the seriousness of the objection, or a constitutional infirmity of the tribunal, in and of themselves, are "extraordinary circumstances" irrespective of whether the objection could have been asserted before the agency. *Noel Canning v. NLRB,* 705 F.3d 490 (D.C. Cir. 2013), *aff'd on other grounds*, 134 S. Ct. 2550 (2014). The strictest view holds that it must have been "clearly useless" to object because the agency was bound by a judicial decision against the objection for there to be a statutory excuse. *Malouf v. SEC*, 933 F.3d 1248 (2018); *NLRB v. Relco Locomotive, Inc.*, 734 F.3d

764 (8th Cir. 2013). A middle view holds that confusion as to whether the agency can rule on the objection or the absence of a judicial decision supporting the objection are "extraordinary circumstances." *Jones v. Secretary of Labor*, 898 F.3d 669 (6th Cir. 2018). This thicket of inconsistent case law has resulted in an irreconcilable disparity of outcomes.

In *Noel Canning*, there was "no attempt by petitioner to raise the threshold issues related to the recess appointments before the [National Labor Relations] Board." 705 F.3d at 496. Nevertheless, the D.C. Circuit held that the express exception for "extraordinary circumstances" in the NLRA, 29 U.S.C. § 160(e), excused the failure to exhaust because the Recess Appointments objection goes "to the very power of the Board to act and implicate[s] fundamental separation of powers concerns." *Id.* at 497. In the D.C. Circuit's view, the seriousness of the challenge satisfies the statutory exception irrespective of whether the objection could have been made, there was binding legal precedent for or against the challenge, or the agency had a predetermined position against the objection.[6]

In contrast, in *Relco*, the Eighth Circuit reached the opposite result and concluded that "extraordinary circumstances" are strictly limited to where an agency renders a "decision 'patently … outside the orbit' of the Board's authority" or where "a new development of fact

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6. In *NLRB v. Noel Canning*, 573 U.S. 513 (2014), this Court affirmed the decision of the lower court. This Court assumed the Recess Appointments Clause objection was reviewable without addressing the meaning of "extraordinary circumstances."

or law occurs after the Board's decision or was otherwise unavailable to the party at the original hearing." *Id.* at 797. The Eighth Circuit held that forfeiture was not excused because the *Noel Canning* case was not a "new development of law." The Eighth Circuit's reasoning is the same as the Tenth Circuit's "clearly useless" reasoning in *Malouf* as to when "reasonable grounds" exist.

Finally, in *Jones*, the Sixth Circuit found that "extraordinary circumstances" excused the exhaustion requirement in the Mine Safety Act, 30 U.S.C. § 816(a)(1), because of "the absence of legal authority addressing whether the Commission could entertain the claim…." 898 F.3d at 677. Although there was existing case law from which an Appointments Clause objection could have been derived, the court of appeals said the "building blocks of today's opinion are established and weathered, but we know of no Supreme Court or court of appeals case that brings them together." *Id.* "We understand why that question may have confused Jones Brothers below…." *Id.*

Noel Canning, *Relco/Malouf*, and *Jones* are in conflict and reach irreconcilable results. Applying the D.C. Circuit's reasoning to Mr. Malouf's case, there were "reasonable grounds" based on the seriousness of an Appointments Clause objection and the constitutional infirmity of the SEC tribunal. Applying the Sixth Circuit's reasoning also results in a finding that there were "reasonable grounds" because *Bandimere* and *Lucia* changed the law even though the "building blocks" of an Appointments Clause objection were around since *Freytag*. But, applying the Eighth and Tenth Circuits' reasoning results in the conclusion that there were not "reasonable grounds." They conclude *Lucia* was not a

change because it merely applied the holding in *Freytag* to a different agency's ALJs. Further, it was not "clearly useless" to have raised the Appointment Clause objection or the SEC did not do something "clearly outside its orbit."

This Court should grant this petition because the Tenth Circuit incorrectly concluded there were no "reasonable grounds" in Petitioner's case and because its decision conflicts with the D.C. Circuit's and the Sixth Circuit's decisions on similar statutory exceptions. This Court's guidance is needed to unify the lower courts' reasoning and incompatible results.

2. The Public Record Shows there were "Reasonable Grounds" to Excuse Mr. Malouf's Non-compliance with the Exhaustion Requirement Based on the SEC's Litigation Conduct From 2014-2018.

When the Tenth Circuit concluded there were no "reasonable grounds" to excuse Mr. Malouf's failure to urge his objection it looked at only two isolated acts by the SEC. First, the court of appeals placed undue significance on the serendipitous fact that it was not until the day after Mr. Malouf filed his opening brief with the SEC that the agency rejected an Appointments Clause challenge *in an administrative proceeding* and wholly disregarded the SEC's public opposition to the constitutional objection in its multiple filings in federal district courts. (App. 10a-11a n.7) Second, the court of appeals gave controlling weight to the fact that the SEC immediately asserted the statutory exhaustion requirement when Mr. Malouf raised the Appointments Clause objection on appeal. (App. 14a-15a n.10) In assessing "reasonable grounds," however, a court should consider the "totality of circumstances" of both parties'

litigation behavior. In this case the totality of circumstances includes the parties' litigation behavior as documented in the public record from 2014-2018, changes in the law by *Bandimere* and *Lucia*, and the miscarriage of justice arising from the SEC's August 22, 2018 Order. (*See supra* Statement of the Case, Parts A, D-E.)

Even though the SEC did not issue an administrative enforcement decision rejecting an Appointments Clause challenge until the day after Mr. Malouf filed his opening brief with the SEC in September 2015, the SEC's opposition was declared in federal court and was public knowledge from 2014 on—before the SEC instituted proceedings against Mr. Malouf. At the SEC, ALJ Grimes had declined to rule on the Appointments Clause issue and the SEC Deputy Chief Operating Officer Jayne L. Seidman publicly had rejected the constitutional challenge. In the district courts, the SEC vigorously opposed collateral attacks on Appointments Clause challenges to the SEC ALJs. In short, when Petitioner filed his opening brief at the SEC there was no judicial support for an objection and all indications were that the SEC would not change its position without judicial intervention. One more objection by Petitioner added to the numerous objections by other respondents would not have caused the SEC to alter its position.

Indeed, long after Mr. Malouf filed his opening brief at the SEC, it continued to deny Appointments Clause objections in numerous administrative enforcement cases. Even after there was judicial support for the objection when *Bandimere* was decided in December 2016, the SEC refused to change its position. The SEC did not change its practices until 2018—long after jurisdiction over Mr. Malouf's case resided with the Tenth Circuit.

Contrary to the Tenth Circuit's conclusion, it was futile for Petitioner to object in September 2015 before the SEC because the agency most certainly would have denied the objection anyway. (App. 10a-12a) Mr. Malouf never received consideration of the merits of his valid constitutional objection by an Article III neutral court. To require that an Article III court ignore a valid Appointments Clause challenge just to give an errant agency that was already on notice of the legal issue one more chance to change its mind tilts the scales of justice too far in the agency's favor and against an individual's constitutional rights. *See* App. 11a-12a (to support its holding, the Tenth Circuit cites *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 37 (1952)).

Further, *Bandimere* and *Lucia* clearly did change the law. If they did not, there would have been no reason for the SEC to alter its practices in response to these cases by issuing the Order on August 22, 2018, to bring it into compliance with *Lucia.* There is something amiss if the SEC had the power to order a re-hearing of 130 pending cases irrespective of whether an Appointments Clause objection had been made, but an Article III court of appeals concluded it "cannot excuse" Mr. Malouf's failure to urge the objection before the agency even though he lodged a timely objection before the Tenth Circuit.

Finally, since all respondents whose cases were still pending at the SEC were given the opportunity for a new administrative hearing irrespective of whether they had raised an Appointments Clause objection, it is a miscarriage of justice to deny the same to Mr. Malouf. To prevent just such a miscarriage of justice, this Court

has declared that the normal rule is for court decisions to apply retroactively to all cases still on appeal. *Harper v. Virginia Dept. of Taxation,* 509 U.S. 86 (1993). Soo, too, this Court's decision in *Lucia* should apply retroactively to all cases still on appeal including Mr. Malouf's case.

If the Tenth Circuit's strict view of "reasonable grounds" is correct, no court should ever excuse a failure to exhaust an objection before a federal agency—contrary to the express exceptions in § 78y(c)(1) of the SEA and § 80b-13(a) of the IAA, and other similar statutes. This petition for writ of certiorari should be granted to provide guidance to the lower courts as to express exceptions to exhaustion in the securities laws and in other similar statutes.

B. The Court Should Decide that the Exhaustion Requirement in the Securities Act and in Other Similar Federal Statutes Is a "Claims-Processing" Rule

Section 77i(a) of the SA states "no objection … shall be considered by the court unless such objection shall have been urged before the Commission." 15 U.S.C. § 77i(a). The SA (and other federal statutes requiring exhaustion) does not contain any express exceptions, unlike the SEA and the IAA.

The Tenth Circuit stated: "The Securities Act does not contain an express exception to the exhaustion requirement, so we cannot excuse a failure" to exhaust.[7]

[7.] The D.C. Circuit has reached the opposite conclusion that a statutory exhaustion requirement is not inflexible and leaves

(App. 9a) Concluding it had no discretion, the lower court stated it "need not decide" if § 77i(a) is a claim-processing rule or a jurisdictional condition. (App. 14a-15a n.10) As to the violations of the SA by Petitioner, the Tenth Circuit denied the petition for review.

In *Arbaugh v. Y&H Corp.*, 546 U.S. 500 (2006), this Court directed lower courts to determine if a requirement is a "jurisdictional condition" or a "claim-processing" rule because of the "critical differences" between the two. *See Kontrick v. Ryan,* 540 U.S. 443, 456 (2004). If the condition is jurisdictional, a court is "deprived of all authority" to hear the matter "even if equitable considerations would support" excusing non-compliance. *United States v. Kwai Fun Wong,* 135 S. Ct. 1625, 1631-32 (2015). In contrast, enforcement of a claim-processing rule may depend on a party's litigation conduct. *Kontrick,* 540 U.S. at 456.

Arbaugh provides an approach for making that determination. The lower courts should examine the statute's text, the statutory context in which the condition is found, and the legislative history. *See Henderson v. Shinseki,* 562 U.S. 428, 438-39 (2011); *Kwai,* 135 S. Ct. at 1632-33. The most important factor is whether the text of the statute "clearly states" that a requirement is jurisdictional. *Arbaugh,* 546 U.S at 515. If not, then the requirement is a claim-processing rule. If "Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character." *Id.* at 516.

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room for judicial discretion. *Action for Children's Television vs. FCC*, 564 F.2d 458, 469 (D.C. Cir. 1977).

Applying the *Arbaugh* approach to the exhaustion requirement in the SA, the only conclusion is that the requirement is a claim-processing rule. The text of the SA does not "clearly state" that § 77i(a) is jurisdictional. The context in which the exhaustion requirement appears is in a section titled "Court Review of Orders," not in a section on jurisdiction. Although there are no express exceptions in § 77i(a) of the SA, the inclusion of express exceptions to exhaustion in all the other securities laws is compelling evidence that Congress intended the exhaustion requirement in the SA to be subject to exceptions as well. "It would be at least unusual to ascribe jurisdictional significance to a condition subject to these sorts of exceptions." *Reed Elsevier, Inc. v. Muchnick*, 559 U.S. 154, 166 (2010)(holding copyright registration requirement was not jurisdictional because it is subject to exceptions). Similarly, it would be at least unusual to conclude, as the Tenth Circuit did, that under the SEA in certain circumstances an Article III court has discretion to consider an objection even if it was forfeited, but under the SA a reviewing court has no discretion and may never consider the same objection—even though the same equitable circumstances justify the litigant's non-compliance with the same exhaustion requirement in both statutes. Accordingly, the exhaustion requirement in the SA is a claim-processing rule and not a jurisdictional condition that must be enforced by a court without any exceptions.

Contrary to this Court's direction in *Arbaugh*, the Tenth Circuit did not decide if the exhaustion requirement in § 77i(a) of the SA is a claim-processing rule or a jurisdictional condition. (App. 14a-15a n.10) Without deciding the issue, however, in effect the Tenth Circuit

treated § 77i(a) as a jurisdictional condition that deprives a court of all discretion, or at the very least the lower court failed to recognize that there are differences between a jurisdictional condition and a claim-processing rule. The lower court's decision is contrary to decisions of this Court that go to great lengths to distinguish between the two and stress "the question is not merely semantic but one of considerable practical importance for judges and litigants." *Henderson*, 562 U.S. at 434. The failure to make that determination certainly was of considerable practical importance in Mr. Malouf's case as it deprived him of consideration by an Article III court of a valid Appointments Clause challenge.

The Tenth Circuit's reasoning shows that the lower courts need additional guidance on determining whether a requirement is a claim-processing rule. As neither this Court nor any other court has ruled directly on whether the exhaustion requirement in the securities laws (and other similar federal statutes) is a jurisdictional condition or a claim-processing rule, and given the significant impact this determination has on litigation outcomes, this Court should grant certiorari to decide this important question as to the securities laws and provide guidance as to other federal statutes that require administrative exhaustion.

C. Whether "Equitable Exceptions" May Excuse non-compliance with a Claim-Processing Rule is an Important and Recurring Question that Warrants Immediate Resolution by this Court

On several occasions this Court has acknowledged there is disagreement among the lower courts as to whether claim-processing rules are subject to "equitable

exceptions." More times than not, however, it has not reached the issue. In *Kontrick,* this Court noted "[w]hether the [Federal Bankruptcy Procedural] Rules, despite their strict limitations, could be softened on equitable grounds is therefore a question we do not reach." 540 U.S. at 457. (*See also id.* at 457 n.11, noting the lower courts are "divided" on the question of whether certain Bankruptcy Rules allow equitable exceptions.) In *Henderson*, this Court noted that the "parties have not asked us to address whether the 120-day deadline in 38 U.S.C. § 7266(a) is subject to equitable tolling …." 562 U.S. at 441 n.4.[8] More recently, in *Hamer v. Neighborhood Housing Services of Chicago,* 138 S. Ct. 13 (2017), this Court said "our decision does not reach [the] issue[]…whether equitable considerations may occasion an exception" to the claim-processing time limit for filing a notice of appeal in Federal Rule Appellate Procedure 4(a)(5)(C). *Id.* at 18. Further, "[w]e have reserved whether mandatory claim-processing rules may be subject to equitable exceptions." *Id.* at 18 n.3.[9]

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8. Significantly, in *Henderson*, the government did not dispute that a non-jurisdictional time limit is subject to equitable tolling. 562 U.S. at 441 n.4.

9. The Tenth Circuit cites *Manrique v. United States,* 137 S. Ct. 1266 (2017), in support of its conclusions that it did not have to decide if § 77i(a) is a claim-processing rule and it had a duty to enforce the exhaustion requirement because the SEC promptly asserted it. Significantly, however, *Hamer* was decided after *Manrique,* yet in *Hamer* this Court notes that whether mandatory claim-processing rules may be subject to equitable exceptions is still an open question. In *Manrique*, petitioner did not argue there were equitable exceptions that excused his failure to file a second notice of appeal. He argued that filing a second notice was not required. This Court disagreed.

As shown above, the exhaustion requirement in § 77i(a) of the SA is a claim-processing rule. Even though exhaustion is not a jurisdictional condition to appellate review and as noted by this Court there is support for the position that "equitable exceptions" may excuse non-compliance with claim-processing rules, the Tenth Circuit did not consider whether Mr. Malouf's failure to urge a valid Appointments Clause objection was excused by equitable exceptions. The Tenth Circuit gave controlling weight to the fact that the SEC promptly responded to the Appointments Clause objection by asserting the exhaustion requirement in § 77i(a). "[T]the SEC promptly responded that Mr. Malouf had failed to exhaust the issue in SEC proceedings. We thus would need to enforce the statutory exhaustion requirements regardless of whether they are jurisdictional." (App. 14a-15a n.10)

But, in *Kwai,* the government also promptly "moved to dismiss the tort claim on the ground that it was filed late." 138 S. Ct. at 1629. This Court held that the time limits in the Federal Tort Claim Act, 28 U.S.C. § 2401(b), are claim processing rules and that they are subject to equitable exceptions for tolling. Despite the government's prompt response to the late-filed claims, this Court remanded for a determination of whether petitioner's non-compliance may be excused by an equitable exception based on the parties' litigation behavior. *Id.* at 1638. So too, contrary to the Tenth Circuit's ruling, an Article III court has discretion to decide whether an equitable exception excuses a failure to exhaust a valid Appointments Clause objection even if the SEC promptly raises SA § 77i(a).

This Court should grant the petition for a writ of certiorari to answer the question left open in prior cases

whether equitable exceptions may excuse non-compliance with claim-processing rules and, more specifically, to address whether the exhaustion requirement in the securities laws is subject to equitable exceptions; such as, futility, changes in law, and miscarriage of justice.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT, FILED AUGUST 13, 2019

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 16-9546

DENNIS J. MALOUF,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

August 13, 2019, Filed

Petition for Review from an Order of the
Securities & Exchange Commission
(SEC No. 3-15918)

Kenneth F. Berg, Ulmer & Berne LLP, Chicago, Illinois (Alan M. Wolper and Heidi E. VonderHeide with him on the briefs), for Petitioner.

Daniel Aguilar, Attorney, Appellate Staff, Civil Division, United States Department of Justice, Washington, D.C. and Lisa Helvin, Senior Counsel, Securities and Exchange Commission, Washington, D.C. (Chad A. Readler, Acting Assistant Attorney General, Mark R. Freeman, Attorney,

and Joshua A. Salzman, Attorney, Appellate Staff, Civil Division, United States Department of Justice, Washington, D.C.; Michael A. Conley, Solicitor, and Dominick V. Freda, Assistant General Counsel, Securities and Exchange Commission, Washington, D.C., with them on the briefs), for Respondent.

Before **BRISCOE**, **HARTZ**, and **BACHARACH**, Circuit Judges.

BACHARACH, Circuit Judge.

Mr. Dennis Malouf occupied key roles at two firms. One of the firms (UASNM, Inc.) offered investment advice; the other firm (a branch of Raymond James Financial Services) served as a broker-dealer. Raymond James viewed those dual roles as a conflict, so Mr. Malouf sold the Raymond James branch. But the structure of the sale perpetuated the conflict. Because Mr. Malouf did not disclose perpetuation of the conflict, administrative officials sought sanctions against him for violating the federal securities laws.

An administrative law judge found that Mr. Malouf had violated the Securities Exchange Act of 1934, the Securities Act of 1933, the Investment Advisers Act of 1940, Rule 10b-5, and Rule 206(4)-1. Given these findings, the judge imposed sanctions. The SEC affirmed these findings and imposed additional sanctions, including disgorgement of profits.

Mr. Malouf appeals the SEC's decision, and we affirm.

Appendix A

Background

I. Mr. Malouf sells the Raymond James branch and uses that branch to execute trades for UASNM's clients.

In 2007, Raymond James became concerned about the conflict of interest between (1) Mr. Malouf's role at its branch office and (2) his role at UASNM. These concerns led Raymond James to ask Mr. Malouf to choose between the two roles. Mr. Malouf opted to remain at UASNM and sold his Raymond James branch to Mr. Maurice Lamonde for roughly $1.1 million, to be paid in installments based on the Raymond James branch's collection of securities-related fees.[1]

To facilitate the installment payments, Mr. Malouf routed bond trades on behalf of his UASNM clients through the Raymond James branch. This way, Mr. Lamonde would receive enough in commissions to allow him to pay what he owed Mr. Malouf.[2]

While Mr. Malouf was routing bond trades to the Raymond James branch, he regularly failed to seek

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1. The written agreement does not state a specific dollar figure for the sale. The written agreement instead provides that Mr. Lamonde would pay 40% of securities-related fees that the Raymond James branch collected over a four-year period. But Mr. Malouf testified that he and Mr. Lamonde had agreed that upon payment of $1.1 million, they would consider the purchase price fully paid.

2. The Raymond James branch collected $1,074,454 in commissions on UASNM bond transactions. With these commissions, Mr. Lamonde ultimately paid Mr. Malouf $1,068,084 to buy the Raymond James branch.

competing bids for the trades. Mr. Malouf conceded that he should have sought competing bids: UASNM's compliance procedures required firm personnel to solicit bids from three different broker-dealers before placing a trade, and Mr. Malouf admitted that he probably could have received better prices for his clients through competing bids.

II. UASNM makes misstatements concerning Mr. Malouf's conflict of interest, and he does not correct these misstatements.

Mr. Malouf bore responsibility for preparing UASNM's forms to be filed with the SEC (referred to as "Forms ADV")[3] and ensuring the accuracy of the UASNM website. But UASNM delegated compliance with these responsibilities to a chief compliance officer and hired an outside consultant to review UASNM's compliance procedures and Forms ADV.

Mr. Malouf later acknowledged that his financial arrangement with Mr. Lamonde had created a conflict of interest that should have been disclosed. But Mr. Malouf did not disclose that arrangement to UASNM's chief compliance officer or the outside consultant. Because these individuals did not know the details of the Malouf-Lamonde arrangement, UASNM not only failed to disclose Mr. Malouf's conflict of interest but also boasted that (1) UASNM's employees were not receiving any commissions

3. A "Form ADV" is used by investment advisers to register with the SEC and state securities authorities. Form ADV, SEC, https://www.sec.gov/fast-answers/answersformadvhtm.html (last visited June 26, 2019).

or fees from the Raymond James branch and (2) UASNM was providing impartial advice untainted by any conflicts of interest.

While UASNM was boasting of its impartiality, Mr. Malouf was participating in deciding what UASNM would disclose. He acknowledged that he had reviewed some of the Forms ADV for what to disclose and had at least some familiarity with the contents of the website. But he took no steps to remedy UASNM's misstatements or to disclose his own conflict of interest.

III. UASNM discloses Mr. Malouf's conflict of interest.

In June 2010, UASNM's outside consultant learned that Mr. Malouf had been receiving ongoing payments from Mr. Lamonde. With this information, the consultant told Mr. Malouf and UASNM that the payments had created a conflict of interest that needed to be disclosed. UASNM disclosed the conflict roughly nine months later.

IV. The SEC finds that Mr. Malouf violated the federal securities laws.

The SEC then brought an enforcement proceeding against Mr. Malouf. Based on the evidence introduced in that proceeding, an administrative law judge found that Mr. Malouf had (1) aided and abetted UASNM's violations of the federal securities laws and (2) committed violations of his own. In the administrative appeal, the SEC agreed, finding that Mr. Malouf had violated

- § 10(b) of the Securities Exchange Act of 1934 and Rules 10b-5(a) and (c),

- §§ 17(a)(1) and 17(a)(3) of the Securities Act of 1933, and

- §§ 206(1) and 206(2) of the Investment Advisers Act of 1940.

The SEC also found that Mr. Malouf had aided and abetted UASNM's violations of §§ 206(4) and 207 of the Investment Advisers Act and Rule 206(4)-1(a)(5).

The SEC imposed four sanctions on Mr. Malouf:

1. a lifetime bar from the securities industry,

2. an order to cease and desist violations of federal securities laws,

3. an order to disgorge $562,001.26 plus prejudgment interest, and

4. an order to pay a $75,000 civil penalty.

On appeal, Mr. Malouf makes four arguments:

1. The appointment of his administrative law judge violated the Constitution's Appointments Clause.

2. The SEC misinterpreted the securities laws.

3. The SEC's findings lack substantial evidence.

4. The sanctions should be vacated.

Standard of Review

When considering these appellate arguments, we credit the SEC's factual findings if they are supported by substantial evidence. *Geman v. SEC*, 334 F.3d 1183, 1188 (10th Cir. 2003). Substantial evidence is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1433 (10th Cir. 1988) (quoting *Consol. Edison Co. of New York v. NLRB*, 305 U.S. 197, 229, 59 S.Ct. 206, 83 L.Ed. 126 (1938)).

Discussion

I. Mr. Malouf forfeited his challenge under the Appointments Clause.

Mr. Malouf contends that the administrative law judge was not validly appointed under the Constitution's Appointments Clause. But Mr. Malouf forfeited this contention by failing to present it in the SEC proceedings.[4]

4. In its response brief, the SEC argues in part that Mr. Malouf forfeited the issue by omitting it in his opening appeal brief. We reject this argument.

Before the SEC filed its response brief, Mr. Malouf had requested leave to file a supplemental brief addressing the issue under the Appointments Clause. The SEC opposed the request, contending that Mr. Malouf should have raised the issue in his

Given the forfeiture, we decline to reach the merits of this challenge.

A. Exhaustion of administrative remedies is mandatory under the pertinent statutes.

The Constitution's Appointments Clause authorizes Congress to delegate the appointment of "inferior officers" to the President, courts, and department heads. U.S. Const. art. II § 2, cl. 2. Mr. Malouf contends that his administrative law judge was an "inferior officer" who had not been appointed by the President, a court, or a department head. *See Lucia v. SEC*, 138 S.Ct. 2044, 201 L.Ed.2d 464 (2018). For this contention, the threshold issue involves exhaustion of administrative remedies.

The underlying securities laws expressly require administrative exhaustion. *See* 15 U.S.C. §§ 77i(a) (Securities Act), 78y(c) (Securities Exchange Act), 80b-13(a) (Investment Advisers Act).[5] Given the statutory

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opening appeal brief. A motions panel provisionally granted Mr. Malouf's request, leaving the final decision to the merits panel and extending the SEC's deadline to file a response brief. So the SEC obtained notice and extra time to brief the issue before filing the response brief. Given the notice and extra time, consideration of the issue would not unfairly prejudice the SEC. In light of the absence of prejudice, we grant the request to supplement and reject the SEC's argument that Mr. Malouf forfeited the issue by failing to raise it in his opening appeal brief.

5. The exhaustion requirement encompasses constitutional claims. *See C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1439 (10th Cir. 1988) (concluding that the SEC could have addressed the petitioners' "constitutional concerns" and that the opportunity for administrative review had triggered the exhaustion requirement).

requirement, courts lack discretion to excuse the failure to exhaust administrative remedies. *Ross v. Blake*, 136 S.Ct. 1850, 1856-57, 195 L.Ed.2d 117 (2016). Failure to comply with a mandatory exhaustion requirement prevents judicial review of the issue. *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 37, 73 S.Ct. 67, 97 L.Ed. 54 (1952).

B. Mr. Malouf lacks reasonable grounds to excuse his failure to exhaust.

Mr. Malouf concedes that his administrative filings did not address the Appointments Clause. We thus must decide whether Mr. Malouf satisfies an exception to the exhaustion requirement.

The Securities Act does not contain an express exception to the exhaustion requirement, so we cannot excuse a failure to satisfy the Securities Act's exhaustion requirement. 15 U.S.C. § 77i(a); *see Ross*, 136 S.Ct. at 1856-57. But the other two securities statutes (the Securities Exchange Act and Investment Advisers Act) provide an exception, allowing the claimant to avoid the exhaustion requirement upon a showing of reasonable grounds. 15 U.S.C. §§ 78y(c)(1), 80b-13(a).

Mr. Malouf argues that he had two reasonable grounds to skip the exhaustion requirement:

1. It would have been futile to raise this challenge in the SEC proceedings.

2. The law changed after the SEC had ruled.[6]

We reject both arguments.

1. Raising the challenge would not have been futile.

Mr. Malouf argues that exhausting this challenge would have been futile because the SEC would undoubtedly have denied relief. We reject this argument.

The failure to pursue administrative remedies may be excused when exhaustion would have been futile. *Gilmore v. Weatherford*, 694 F.3d 1160, 1169 (10th Cir. 2012). But the futility exception is available only when the administrative process would have been "clearly useless." *Id.* (quoting *McGraw v. Prudential Ins. Co. of Am.*, 137 F.3d 1253, 1264 (10th Cir. 1998)).

Mr. Malouf has not shown that exhaustion of this challenge would have been clearly useless. Indeed, when he filed his brief in the SEC (on September 2, 2015), the SEC had not yet addressed the applicability of the Appointments Clause to administrative law judges.[7]

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6. In two stray sentences, Mr. Malouf also states that enforcement of the exhaustion requirement would create a miscarriage of justice. But Mr. Malouf provides no explanation or support for these statements. Given the absence of explanation or support, we regard the two stray sentences as inadequate development of a distinct argument. *United States v. Martinez*, 518 F.3d 763, 768 (10th Cir. 2008).

7. The day after Mr. Malouf filed this brief, the SEC ruled for the first time that administrative law judges need not be appointed

Despite the absence of any prior SEC decisions on the issue, Mr. Malouf insists that the SEC would have rejected this challenge. He points out that attorneys for the SEC had previously argued that its administrative law judges were not inferior officers subject to the Appointments Clause. But the prior arguments by SEC attorneys do not mean that exhaustion would have been futile. *See Gilmore v. Weatherford*, 694 F.3d 1160, 1169 (10th Cir. 2012) (rejecting an argument that the agency's position had been "predetermined" based on the agency's position in three earlier cases); *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1439 (10th Cir. 1988) ("[A]lthough petitioners contend that raising [the] argument below would have been futile given the SEC's past response, that alone is not a sufficient ground for presuming futility.").

Mr. Malouf points out that after he began his administrative appeal, the SEC frequently rejected challenges under the Appointments Clause. But these decisions do not mean that the SEC necessarily would have rejected a challenge by Mr. Malouf. *See Gilmore*, 694 F.3d at 1169 ("Requiring exhaustion of [claims asserted against agency precedent or an agency's litigation position] allows agencies to take into account the specific facts of each matter, and to change course if appropriate." (internal citation omitted)). Had Mr. Malouf exhausted available administrative remedies, the SEC might have changed its position on the Appointments Clause issue; and "if it did not, the [SEC] would at least be put on notice of the

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under the Appointments Clause. *In re Lucia*, SEC Release No. 4190, 2015 SEC LEXIS 3628, 2015 WL 5172953 (Sept. 3, 2015).

accumulating risk of wholesale reversals being incurred by its persistence." *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 37, 73 S.Ct. 67, 97 L.Ed. 54 (1952).

Because Mr. Malouf has not shown that presentation of this challenge to the SEC would have been clearly useless, we do not regard exhaustion as futile.

2. No intervening change of law took place.

We also reject Mr. Malouf's reliance on an intervening change in the law.

For the sake of argument, we can assume that an intervening change in the law might constitute a reasonable ground to excuse the failure to exhaust. But the law did not change.

Mr. Malouf bases his argument largely on *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016), and *Lucia v. SEC*, 138 S.Ct. 2044, 201 L.Ed.2d 464 (2018).[8] In these cases, our court and the Supreme Court held that SEC administrative law judges are inferior officers subject to the Appointments Clause. *See Bandimere*, 844 F.3d at 1170; *Lucia*, 138 S.Ct. at 2049. The Courts decided these cases after the SEC had ruled in Mr. Malouf's case, preventing him from relying on either opinion during

8. Mr. Malouf also points to *Landry v. FDIC*, 204 F.3d 1125, 340 U.S. App. D.C. 237 (D.C. Cir. 2000). But *Landry* dealt with the Federal Deposit Insurance Corporation's administrative law judges, not the SEC's. *Landry*, 204 F.3d at 1130. Moreover, the D.C. Circuit's opinion does not control in our circuit.

his administrative appeal. But neither *Bandimere* nor *Lucia* changed the law: In both cases, the Courts merely applied the Supreme Court's 1991 opinion in *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868, 111 S.Ct. 2631, 115 L.Ed.2d 764 (1991).

In *Freytag*, the Supreme Court held that special trial judges for the Tax Court were inferior officers subject to the Appointments Clause. 501 U.S. at 881, 111 S.Ct. 2631. The Supreme Court's decision hinged on the extensive powers granted to special trial judges, which were significant enough to characterize these judges as inferior officers. *See id.* at 881-82, 111 S.Ct. 2631 (noting that special trial judges "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders"). SEC administrative law judges are "near-carbon copies" of the Tax Court's special trial judges. *Lucia*, 138 S.Ct. at 2052. So in *Bandimere* and *Lucia*, our court and the Supreme Court regarded *Freytag* as dispositive on the status of the SEC's administrative law judges. *Bandimere*, 844 F.3d at 1174 ("In our view, *Freytag* controls the result of this case."); *Lucia*, 138 S.Ct. at 2052 (concluding that *Freytag*'s analysis "necessarily decides this case").

In the SEC proceedings, Mr. Malouf could have invoked *Freytag*, just as the petitioners in *Bandimere* and *Lucia* had done. *See Island Creek Coal Co. v. Wilkerson*, 910 F.3d 254, 257 (6th Cir. 2018) (stating that no precedent would have prevented a party from bringing an Appointments Clause challenge before *Lucia*, which itself "noted that existing case law 'sa[id] everything necessary to decide this case'" (quoting *Lucia v. SEC*,

138 S.Ct. 2044, 2053, 201 L.Ed.2d 464 (2018))).[9] Thus, Mr. Malouf cannot avoid the exhaustion requirement based on an intervening change in the law. *See Saffle v. Parks*, 494 U.S. 484, 488, 110 S.Ct. 1257, 108 L.Ed.2d 415 (1990) (stating that a rule is not new if the court "would have felt compelled by existing precedent" to conclude that the rule being urged "was required by the Constitution").

* * *

Mr. Malouf failed to administratively exhaust his challenge under the Appointments Clause. We thus conclude that Mr. Malouf forfeited this challenge.[10]

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9. In *Wilkerson*, the Sixth Circuit held that a party had forfeited its Appointments Clause challenge by waiting until the reply brief to present this challenge. 910 F.3d at 256.

10. The SEC concedes that Mr. Malouf's failure to exhaust this challenge does not constitute a jurisdictional defect. Despite this concession, we would ordinarily need to decide for ourselves whether the failure to exhaust is jurisdictional. *See Hertz Corp. v. Friend*, 559 U.S. 77, 94, 130 S.Ct. 1181, 175 L.Ed.2d 1029 (2010) ("Courts have an independent obligation to determine whether subject-matter jurisdiction exists, even when no party challenges it.").

Even if the exhaustion requirement were not jurisdictional, however, it would constitute a claim-processing rule. *See Henderson ex rel. Henderson v. Shinseki*, 562 U.S. 428, 435, 131 S.Ct. 1197, 179 L.Ed.2d 159 (2011) (explaining that claim-processing rules are non-jurisdictional rules "that seek to promote the orderly progress of litigation by requiring that the parties take certain procedural steps at certain specified times"). Unlike jurisdictional requirements, claim-processing rules can be waived or forfeited. *Muskrat v. Deer Creek Pub. Sch.*, 715 F.3d 775, 783 (10th Cir. 2013).

II. The SEC reasonably found that Mr. Malouf had violated Rule 10b-5[11] and § 17(a) of the Securities Act of 1933.

The SEC found that Mr. Malouf had failed to correct material misstatements, violating

- Rule 10b-5(a) and (c) and
- the Securities Act of 1933 § 17(a)(1) and (3).

For purposes of this appeal, Mr. Malouf does not deny that he failed to correct UASNM's misstatements. But he argues that a failure to correct UASNM's misstatements does not constitute a separate violation of the securities laws. We disagree.

But the SEC has not waived or forfeited the failure to exhaust. When Mr. Malouf first raised the Appointments Clause issue, the SEC promptly responded that Mr. Malouf had failed to exhaust the issue in SEC proceedings. We thus would need to enforce the statutory exhaustion requirements regardless of whether they are jurisdictional. *See Hamer v. Neighborhood Hous. Servs. of Chicago*, 138 S.Ct. 13, 17-18, 199 L.Ed.2d 249 (2017) ("If properly invoked, mandatory claim-processing rules must be enforced, but they may be waived or forfeited."). Given the need to require exhaustion as either a claim processing rule or jurisdictional requirement, we need not decide which one applies. *See Manrique v. United States*, 137 S.Ct. 1266, 1271, 197 L.Ed.2d 599 (2017) (declining to decide whether the requirement to timely file a notice of appeal is jurisdictional because the requirement is "at least a mandatory claim-processing rule").

11. The SEC also found that Mr. Malouf had violated the Securities Exchange Act of 1934 § 10(b). But this provision simply incorporates the SEC's "rules and regulations." 15 U.S.C. § 78j(b). The rule invoked here is Rule 10b-5.

Appendix A

A. Rule 10b-5(a) and (c) and § 17(a)(1) and (3) of the Securities Act of 1933 encompass the failure to correct UASNM's false or misleading statements.

The relevant provisions ban two broad categories of conduct. The first category involves the making of a materially untrue or misleading statement. The second category involves employment of a fraudulent or deceptive scheme. Addressing the second category, the SEC found that Mr. Malouf had failed to correct UASNM's false or misleading statements, triggering liability for employment of a fraudulent or deceptive scheme.

Mr. Malouf contends that liability cannot be based on his failure to correct UASNM's misstatements because the failure to correct is inseparable from the misstatements themselves. In his view, the SEC "obliterate[d] the distinction" between the two categories of prohibited conduct. Appellant's Opening Br. at 23. We reject this argument based on *Lorenzo v. SEC*, 139 S.Ct. 1094, 203 L.Ed.2d 484 (2019).

In *Lorenzo*, the Supreme Court confronted the same two categories of prohibited conduct. The first category is enshrined in Rule 10b-5(b), which prohibits the making of a statement that is materially false or misleading. 17 C.F.R. § 240.10b-5(b). The second category is enshrined in

- Rule 10b-5(a) and the Securities Act of 1933 § 17(a)(1), which prohibit the employment of a fraudulent "device, scheme, or artifice" and

- Rule 10b-5(c), which prohibits engagement in an "act, practice, or course of business" operating as a "fraud or deceit."

15 U.S.C. § 77q(a)(1); 17 C.F.R. § 240.10b-5(a), (c).

In *Lorenzo*, the SEC found that the petitioner had disseminated another's false statement with scienter.[12] *Lorenzo*, 139 S.Ct. at 1099. The Supreme Court granted certiorari in *Lorenzo* to decide "whether someone who is not a 'maker' of a misstatement under [Rule 10b-5(b)] . . . can nevertheless be found to have violated [Rule 10b-5(a) and (c)] and related provisions of the securities laws, when the only conduct involved concerns a misstatement." *Id.* at 1100.

The Supreme Court answered "yes." *See id.* at 1100-01. In urging the opposite result, the petitioner argued that the prohibitions applicable to "makers" of false statements would be superfluous if someone could incur liability by disseminating another person's false statement. *Id.* at 1101. The Supreme Court rejected this argument based on the prohibitions' language, purpose, and overlap. *Id.* at 1102-03. Applying *Lorenzo*, we conclude that Mr. Malouf's failure to correct UASNM's misstatements could trigger liability.

The Court in *Lorenzo* applied three of the provisions that the SEC has invoked against Mr. Malouf:

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12. The *Lorenzo* Court assumed that the petitioner himself had not made a false or misleading statement. *Lorenzo*, 139 S.Ct. at 1100.

Appendix A

1. Rule 10b-5(a),

2. Rule 10b-5(c), and

3. the Securities Act of 1933 § 17(a)(1).

The Court expressly held that a person could incur liability under these provisions when the conduct involves another person's false or misleading statement. *Id.* at 1102. In reaching this holding, the Supreme Court rejected the same argument urged by Mr. Malouf (that the SEC's interpretation would render Rule 10b-5(b) superfluous). *Id.* at 1101-03.

The *Lorenzo* Court did not address a fourth provision involved here: the Securities Act of 1933 § 17(a)(3). But this provision is virtually identical to Rule 10b-5(c), which *Lorenzo* did address. Rule 10b-5(c) prohibits anyone using interstate commerce from "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit." 17 C.F.R. § 240.10b-5(c). Similarly, the Securities Act of 1933 § 17(a)(3) states that offerors or sellers of securities cannot "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a)(3).

In light of this similarity, Mr. Malouf urges us to interpret § 17(a)(3) coextensively with Rule 10b-5(c). We do so; *Lorenzo* thus controls on § 17(a)(3) as well as the other provisions.

B. Substantial evidence exists for the findings that Mr. Malouf violated Rule 10b-5(a) and (c) and the Securities Act of 1933 § 17(a)(1) and (3).

The resulting question is whether substantial evidence supports the SEC's findings that Mr. Malouf violated Rule 10b-5(a) and (c) and § 17(a)(1) and (3) of the Securities Act of 1933. Mr. Malouf argues that the findings lack substantial evidence because

- he did not engage in prohibited conduct and
- the evidence does not establish scienter.

1. The applicable provisions address prohibited conduct and scienter.

The pertinent securities laws prohibit fraudulent conduct. For example, Rule 10b-5(a) and the Securities Act of 1933 § 17(a)(1) prohibit the employment of a device, scheme, or artifice to defraud. 17 C.F.R. § 240.10b-5(a); 15 U.S.C. § 77q(a)(1). "A 'device' . . . is simply that which is devised, or formed by design; a 'scheme' is a project, plan, or program of something to be done; and an 'artifice' is an artful stratagem or trick." *Lorenzo v. SEC*, 139 S.Ct. 1094, 1101, 203 L.Ed.2d 484 (2019) (quoting *Aaron v. SEC*, 446 U.S. 680, 696 n.13, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980)). Rule 10b-5(c) bars a fraudulent or deceitful act, practice, or course of business. 17 C.F.R. § 240.10b-5(c). The Securities Act of 1933 § 17(a)(3) similarly prohibits fraudulent or deceitful transactions, practices, or courses of business. 17 U.S.C. § 77q(a)(3).

In addressing these provisions, Mr. Malouf challenges the sufficiency of the evidence on scienter, which is "a mental state embracing intent to deceive, manipulate, or defraud." *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1435 (10th Cir. 1988) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976)). This mental state can include extreme recklessness. *Id.* Conduct is extremely reckless when the petitioner knows or must have known that the conduct created a danger of misleading investors. *Id.*

Scienter is required to find a violation of Rule 10b-5(a), Rule 10b-5(c), or the Securities Act of 1933 § 17(a)(1). But scienter is not required for a violation of the Securities Act of 1933 § 17(a)(3). *Aaron v. SEC*, 446 U.S. 680, 691, 697, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980).

2. The SEC acted reasonably in finding improper conduct.

Given these definitions, we conclude that the SEC did not err in finding a fraudulent device, scheme, or artifice to defraud.

The evidence allowed the SEC to reasonably find a conflict of interest: while working at UASNM, Mr. Malouf maintained a financial arrangement with Mr. Lamonde, the purchaser of the Raymond James branch. Mr. Malouf knew not only that a conflict existed but also that UASNM was telling its clients that he was independent. Despite this knowledge, Mr. Malouf took no steps to correct UASNM's statements or to disclose his own conflict. Given

this failure to correct misstatements or to disclose his conflict, the SEC reasonably found the existence of

- an artful stratagem or plan devised to defraud investors under Rule 10b-5(a) and the Securities Act of 1933 § 17(a)(1) and

- a fraudulent or deceptive act, practice, or course of business under Rule 10b-5(c) and the Securities Act of 1933 § 17(a)(3).

3. The SEC acted reasonably in finding scienter.

Mr. Malouf also challenges the finding of scienter on the claims involving Rules 10b-5(a) and (c) and the Securities Act of 1933 § 17(a)(1).[13] We reject this challenge.

Mr. Malouf and Mr. Lamonde had a financial arrangement that resulted in payments to Mr. Malouf from bond trades that he had routed through the Raymond James branch. This arrangement gave an incentive to Mr. Malouf to route his clients' bond trades through the Raymond James branch, compromising the independence of UASNM and Mr. Malouf as investment advisers. The SEC reasonably concluded that Mr. Malouf was aware of the conflict and tried to exploit it, for UASNM's outside consultant testified that Mr. Malouf had lied and resisted disclosure of the financial arrangement with Mr. Lamonde.

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13. As noted above, § 17(a)(3) of the Securities Act of 1933 does not require scienter. *See* p. 20, above.

Mr. Malouf denies scienter, insisting that he did not know of misstatements on the Forms ADV or the UASNM website. For these misstatements, Mr. Malouf pins the blame on UASNM's chief compliance officer. For three reasons, we reject Mr. Malouf's arguments and conclude that substantial evidence supports the SEC's finding of scienter.

First, the SEC reasonably rejected Mr. Malouf's effort to shift the blame. The chief compliance officer admittedly knew that the Raymond James branch had been sold, but he denied knowing about the arrangement for installment payments.

Second, the evidence allowed the SEC to reasonably find that Mr. Malouf was familiar with the contents of UASNM's Forms ADV and its website. For example, Mr. Malouf admitted that he had periodically reviewed the Forms ADV and the website. Yet for several years, Mr. Malouf took no action to correct material misstatements on the forms or the website.

Third, the evidence suggests that Mr. Malouf dragged his feet even after being directed to disclose the conflict. This directive stemmed from the outside consultant's discovery that Mr. Malouf had been receiving installment payments from the buyer of the Raymond James branch. Upon this discovery, the consultant told Mr. Malouf and UASNM that the arrangement had created a conflict of interest that needed to be disclosed. But about nine months passed before UASNM disclosed the conflict. Mr. Malouf's contribution to that delay reasonably supports a finding of scienter.

The SEC reasonably found that Mr. Malouf had acted with scienter to (1) employ a device, scheme, or artifice to defraud and (2) engage in an act, practice, or course of business that operated as a fraud or deceit. We thus affirm the SEC's conclusion that Mr. Malouf violated Rule 10b-5(a) and (c) and the Securities Act of 1933 § 17(a)(1) and (3).

III. The SEC reasonably found violations of the Investment Advisers Act of 1940 §§ 206 and 207 and Rule 206(4)-1(a)(5).

The SEC also found that Mr. Malouf had

- violated § 206(1) and (2) of the Investment Advisers Act and
- aided and abetted UASNM's violations of §§ 206(4) and 207 of the Investment Advisers Act and Rule 206(4)-1(a)(5).

We uphold these findings.

A. The SEC reasonably found primary violations of § 206 of the Investment Advisers Act.

Under § 206 of the Investment Advisers Act, investment advisers cannot

- employ a device, scheme, or artifice to defraud a client or

- engage in a transaction, practice, or course of business that operates as a fraud or deceit upon a client.

15 U.S.C. § 80b-6(1)-(2). The SEC concluded that Mr. Malouf had violated § 206(1) and (2) of the Act in three ways:

1. by failing to correct the misstatements on UASNM's Forms ADV and website,

2. by failing to disclose his conflict of interest to his clients, and

3. by failing to seek best execution for his clients' bond trades.

Mr. Malouf argues that the SEC erred in concluding that he violated § 206(1) and (2) because

- the failure to correct UASNM's misstatements cannot support liability,

- the finding of scienter (when failing to disclose the conflict of interest) is not supported by substantial evidence, and

- he owed no duty of best execution and the finding of a violation is unsupported by the evidence.

We reject Mr. Malouf's arguments.

1. A violation could be based on Mr. Malouf's failure to correct UASNM's misstatements.

Mr. Malouf argues that he cannot incur liability under § 206(1) and (2) simply because he failed to correct UASNM's misstatements. In Part II, we addressed the same issue under

- the Securities Act of 1933 § 17(a)(1) and (3) and
- Rule 10b-5(a) and (c).

See Discussion-Part II(A), above. The language in these provisions is virtually identical to the language in the Investment Advisers Act § 206(1) and (2).[14] Given the

14. The Investment Advisers Act § 206(1) states that an investment adviser cannot "employ any device, scheme, or artifice to defraud any client or prospective client." 15 U.S.C. § 80b-6(1). Similarly, the Securities Act of 1933 § 17(a)(1) states that an offeror or seller of securities cannot "employ any device, scheme, or artifice to defraud." 15 U.S.C. § 77q(a)(1). And Rule 10b-5(a) states that no one can use interstate commerce "[t]o employ any device, scheme, or artifice to defraud." 17 C.F.R. § 240.10b-5(a).

The Investment Advisers Act § 206(2) prohibits investment advisers from "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. § 80b-6(2). The Securities Act of 1933 § 17(a)(3) similarly states that offerors or sellers of securities cannot "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

virtually identical wording, Mr. Malouf urges us to interpret the Investment Advisers Act in the same way that we interpret Rule 10b-5(a) and (c) and the Securities Act of 1933 § 17(a)(1) and (3). We do so in light of the virtually identical language in these provisions. *See SEC v. Steadman*, 967 F.2d 636, 641 n.3, 296 U.S. App. D.C. 269 (D.C. Cir. 1992) (interpreting the Investment Advisers Act § 206(1) in the same way that the Supreme Court interpreted the Securities Act of 1933 § 17(a)(1) because the statutory language is virtually identical). Given this interpretation, we conclude that Mr. Malouf's failure to correct UASNM's misstatements could create liability under the Investment Advisers Act § 206(1) and (2).

2. Substantial evidence exists for the finding of scienter based on Mr. Malouf's failure to disclose his conflict of interest.

Liability under the Investment Advisers Act § 206(1) requires proof of scienter; liability under § 206(2) requires only simple negligence. *Robare Grp., Ltd. v. SEC*, 922 F.3d 468, 472 (D.C. Cir. 2019). Scienter can encompass extreme recklessness. *See* p. 20, above.

The SEC found scienter in Mr. Malouf's failure to disclose his conflict. Mr. Malouf challenges this finding on grounds that he

- was "set-up" by UASNM's chief compliance officer and

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15 U.S.C. § 77q(a)(3). And Rule 10b-5(c) prohibits the use of interstate commerce "[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit." 17 C.F.R. § 240.10b-5(c).

- believed that the chief compliance officer had been disclosing the conflict.

But the SEC reasonably credited the chief compliance officer's testimony that he had not known about Mr. Malouf's conflict. *See* p. 22, above. We thus reject Mr. Malouf's challenge to the SEC's finding of scienter on the claim under § 206(1) of the Investment Advisers Act.

3. Mr. Malouf owed a duty of best execution, and the SEC's finding of a violation is supported by substantial evidence.

The duty of best execution requires a broker-dealer to seek the best terms reasonably available for customer orders. *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 270 (3d Cir. 1998) (en banc). Mr. Malouf argues that

- the SEC erred by finding that he owed this duty and

- the evidence was insufficient to find a violation of this duty.[15]

We reject both arguments, concluding that (1) Mr. Malouf owed a duty of best execution to his clients and (2) substantial evidence supports the finding of a violation.

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15. Mr. Malouf also suggests that the SEC erroneously ignored the administrative law judge's conclusions of law. This suggestion assumes that the administrative law judge's conclusions of law bound the SEC when it reviewed the judge's decision. Mr. Malouf supplies no authority for this assumption.

Under the duty of best execution, a fiduciary bears an obligation to seek "the most favorable terms reasonably available under the circumstances." *Geman v. SEC*, 334 F.3d 1183, 1186 (10th Cir. 2003) (quoting *Newton*, 135 F.3d at 270). This obligation requires investment advisers to seek the lowest price reasonably available for a client unless the more expensive option results in better service. *See Newton*, 135 F.3d at 270 n.2; *Securities; Brokerage and Research Services*, SEC Release No. 23170, 1986 WL 630442, at *11 (Apr. 23, 1986).[16] When an investment adviser is affiliated with the brokerage firm executing the transaction, the adviser must make a good-faith judgment that the commission charged "is at least as favorable to the [client] as that charged by other qualified brokers." *Applicability of Comm.'s Policy Statement on the Future Structure of Securities Markets to Selection of Brokers and Payment of Commissions by Institutional Managers*, SEC Release No. 318, 1972 WL 121270, at *2 (May 17, 1972). In cases of self-dealing, the investment adviser bears a "particularly heavy" burden to justify a commission rate exceeding the lowest available rate. *Id.*

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16. We defer to the SEC's reasonable interpretations of ambiguous statutory provisions in federal securities laws when the interpretations carry the "force of law." *Thomas v. Metropolitan Life Ins. Co.*, 631 F.3d 1153, 1162 (10th Cir. 2011); *see SEC v. Zandford*, 535 U.S. 813, 819-20, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002) (stating that the SEC's reasonable interpretation of an ambiguous provision of the Securities Exchange Act, issued in a formal adjudication, is entitled to deference). We otherwise consider the SEC's interpretations only for their persuasive value. *Thomas*, 631 F.3d. at 1162-63.

In citing the SEC releases, we use them only for their persuasive value. We need not decide whether the SEC releases are subject to deference.

Mr. Malouf concedes that the duty of best execution requires reasonable diligence to ensure the best price reasonably available. But Mr. Malouf argues that the duty of best execution is owed by the investment firm as a whole, not by him individually. For this argument, Mr. Malouf relies on Regulatory Notice 15-46 of the Financial Industry Regulatory Authority. This notice refers to a "firm's best execution obligation." *Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets*, FINRA Regulatory Notice 15-46, at 4 (Nov. 2015). Mr. Malouf seizes on this language in denying that the obligation applies to individual brokers like himself. We reject Mr. Malouf's argument for two reasons:

1. The duty of best execution comes from the Investment Advisers Act, not Regulatory Notice 15-46.

2. Mr. Malouf has misinterpreted Regulatory Notice 15-46.

First, the duty of best execution originated in the Investment Advisers Act rather than Notice 15-46. *See Kurz v. Fidelity Mgmt. & Research Co.*, 556 F.3d 639, 640 (7th Cir. 2009) (stating that the duty of best execution is "widely understood as a subject of regulation" under the federal securities laws, including the Investment Advisers Act). The Act prohibits investment advisers from engaging in a fraudulent or deceptive transaction, practice, or course of business. Investment Advisers Act, 15 U.S.C. § 80b-6(2). This prohibition imposes a fiduciary duty of loyalty on investment advisors, and the duty of loyalty subsumes the

duty of best execution. *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 191-92, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963) (recognizing that the Investment Advisers Act obligates investment advisers to provide "disinterested" advice); *In re Hughes*, Exchange Act Release No. 4048, 1948 SEC LEXIS 20, 1948 WL 29537, at *5 (Feb. 18, 1948) ("A corollary of the fiduciary's duty of loyalty to his principal is his duty to obtain . . . the best price discoverable in the exercise of reasonable diligence."), *aff'd sub nom. Hughes v. SEC*, 174 F.2d 969, 85 U.S. App. D.C. 56 (D.C. Cir. 1949). Thus, the Act ultimately imposes a duty of best execution on investment advisers (not just their firms). *See In re DeSano*, Advisers Act Release No. 2815, 2008 WL 5189512, at *4 (Dec. 11, 2008) ("Under Section 206 of the [Investment] Advisers Act, an investment adviser has a fiduciary duty to seek best execution for its clients' security transactions.").

Second, Mr. Malouf has misinterpreted Notice 15-46. This notice points out that the Financial Industry Regulatory Authority has codified the duty of best execution in Rule 5310 of the Financial Industry Regulatory Authority Manual. Rule 5310 provides:

> In any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with a member shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Financial Industry Regulatory Authority Manual, Rule 5310(a)(1).

Rule 5310 does not confine the duty of best execution to firms: it applies to "a member and persons associated with a member." The rule's definition of the term "member" includes "any individual, partnership, corporation or other legal entity admitted to membership" in the Financial Industry Regulatory Authority, and the term "person" includes "any natural person." *Id.*, Rule 160(b)(10) & (12). Thus, Mr. Malouf's argument is based on a misreading of Rule 5310.

But Mr. Malouf also argues that even if he owed the duty of best execution, he would avoid liability because he delegated compliance to the chief compliance officer. For this argument, Mr. Malouf identifies the administrative law judge's conclusions of law that the chief compliance officer's duties included

- review of UASNM's trade tickets to ensure that the commissions were reasonable and that the investment advisers were complying with UASNM's best-execution policy and

- review to ensure compliance with UASNM's compliance manual.

But Mr. Malouf does not identify any evidence that he delegated his own compliance with the best-execution policy.[17]

17. Even if Mr. Malouf had delegated his own compliance with the duty of best execution, he would remain liable. *See Geddes v. United Staffing Alliance Emp. Med. Plan*, 469 F.3d 919, 926 (10th Cir. 2006) (stating that when a fiduciary delegates tasks to others, the fiduciary remains "responsible for actions performed in his name").

He instead points to conclusions of law stating that the chief compliance officer's duties included policing of UASNM employees for adherence to the firm's manual. But these conclusions of law do not undermine the obligation of investment advisers (like Mr. Malouf) to comply with their own fiduciary duties to their clients. *See Commission Guidance Regarding Client Commission Practices Under Section 28(E) of the Securities Exchange Act of 1934*, Exchange Act Release, No. 54165, 2005 WL 4843294, at *2 & n.3 (July 18, 2006) (stating that investment advisers bear duties to act in their clients' best interests).

Mr. Malouf also argues that

- there is no evidence that he could have executed trades for better prices and
- he was not obligated to seek competing bids from brokers before executing bond trades.

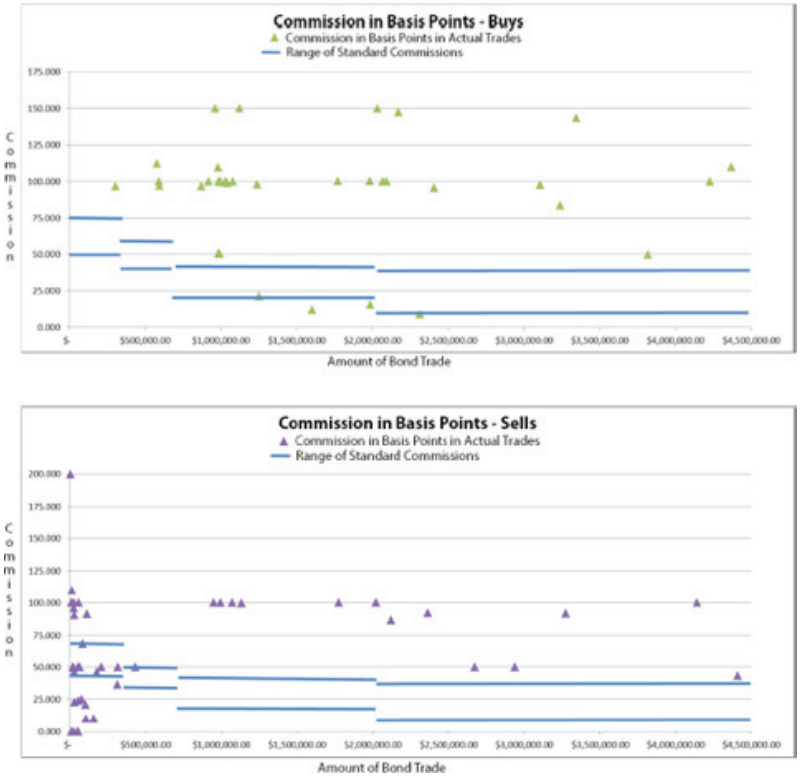
We reject both arguments.

First, Mr. Malouf denies that he could have executed bond trades for better prices than those offered by the Raymond James branch. But the SEC could reasonably arrive at a contrary finding based on (1) the testimony of an expert witness and (2) Mr. Malouf's own testimony.

An expert witness opined that Mr. Malouf's trades had resulted in commissions to the Raymond James branch substantially exceeding the industry's standard commissions. In reaching this opinion, the expert witness assumed that standard commissions range from 0.10 to 0.75 percent of the total amount of the bond transaction. He based this range

on personal experience, industry research, and consultation with other experts in the field. With this assumption, the expert witness studied the bond trades that Mr. Malouf had routed through the Raymond James branch and determined that his clients had paid commissions between $442,106 and $693,804 above the standard rate.

The expert witness presented two diagrams showing the differences between the actual commissions paid on Mr. Malouf's trades and standard commissions[18]:



18. We have slightly edited the diagrams for clarity.

The SEC credited

- the expert witness's lower figure of total excess commissions paid by Mr. Malouf's clients to the Raymond James branch ($442,106) and

- Mr. Malouf's own testimony about the percentage of UASNM bond trades that he had conducted (60%).

Based on its findings, the SEC concluded that Mr. Malouf was responsible for $265,263.60 in excess commissions paid by UASNM clients. In light of the expert witness's testimony, we conclude that the SEC reasonably found that Mr. Malouf could have executed trades for better prices.

Second, Mr. Malouf contends that the duty of best execution did not obligate him to seek multiple bids. Even without this obligation, the SEC concluded that Mr. Malouf's failure to seek multiple bids supported a finding of scienter. This conclusion was based on substantial evidence.

The expert witness testified that multiple bids provide the ideal way to satisfy the duty of best execution. Mr. Malouf agreed with this testimony and conceded that he had routinely failed to seek competing bids before routing trades through the Raymond James branch, with which he had an undisclosed financial relationship. The SEC thus reasonably found that Mr. Malouf had routed trades to the Raymond James branch in order to benefit himself to the detriment of his clients.

We conclude that the SEC reasonably found that Mr. Malouf had violated the Investment Advisers Act § 206(1) and (2) by failing to

- correct UASNM's misstatements,
- disclose a conflict of interest, and
- seek best execution.

B. The SEC also reasonably found that Mr. Malouf had aided and abetted UASNM's violations of §§ 206 and 207 of the Investment Advisers Act and Rule 206(4)-1(a)(5).

Section 206 of the Investment Advisers Act bans practices that are fraudulent, deceptive, or manipulative. 15 U.S.C. § 80b-6(4). For example, it is fraudulent, deceptive, or manipulative to publish an advertisement containing an untrue statement of material fact. 17 C.F.R. § 275.206(4)-1(a)(5). And under § 207 of the Act, an investment adviser cannot omit material facts in an SEC report (like a Form ADV). 15 U.S.C. § 80b-7.

Applying these prohibitions, the SEC found that Mr. Malouf had aided and abetted UASNM's violations of the Investment Advisers Act and Rule 206(4)-1(a)(5). According to the SEC, UASNM violated these provisions by

- stating in the Forms ADV and on the company's website that

the employees had no conflicts of interest and

- failing to disclose Mr. Malouf's conflict of interest.

The SEC also found that Mr. Malouf had aided and abetted these violations by recklessly failing to tell UASNM that he had a conflict of interest.

Mr. Malouf does not contest UASNM's commission of a primary violation. He instead argues that the SEC lacks substantial evidence for its finding that he had aided and abetted UASNM's violations. According to Mr. Malouf, evidence was lacking on

- scienter and

- substantial assistance of UASNM's violations.

Mr. Malouf also argues that by declining to charge him with aiding and abetting a violation of Rule 10b-5(b), the SEC undermined its finding that he had aided and abetted a violation of the Investment Advisers Act. We reject Mr. Malouf's arguments.

First, Mr. Malouf contests the SEC's finding of scienter. As Mr. Malouf suggests, scienter is an essential element of aiding and abetting a violation of the securities law. *See Howard v. SEC*, 376 F.3d 1136, 1143, 363 U.S. App. D.C. 100 (D.C. Cir. 2004) (stating that liability for aiding and abetting requires scienter). But we have already concluded that the SEC had reasonably found scienter

based on Mr. Malouf's failure to correct UASNM's misstatements about the absence of a conflict of interest. *See* pp. 21-23, above.[19]

Second, Mr. Malouf contests the finding on substantial assistance, stating that his failure to correct UASNM's misstatements did not facilitate its fraudulent scheme. But in finding substantial assistance, the SEC did not rely on a failure to correct UASNM's misstatements; the SEC instead relied on Mr. Malouf's failure to disclose his conflict of interest arising from Mr. Lamonde's ongoing payments. UASNM's failure to disclose this conflict of interest stemmed largely from Mr. Malouf's failure to tell other UASNM officers about the ongoing payments from Mr. Lamonde. Without this information, the other UASNM officers had no way of knowing that Mr. Malouf was personally benefiting from bond trades routed through the Raymond James branch.

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19. Mr. Malouf argues that scienter cannot be based on his failure to detect another's misconduct. To support this argument, he cites *Howard v. SEC*, 376 F.3d 1136, 363 U.S. App. D.C. 100 (D.C. Cir. 2004). There the D.C. Circuit held that the defendant had not acted with scienter when the only evidence of his intent was that he should have known about another's wrongdoing. 376 F.3d at 1143.

Howard is not analogous. The SEC reasonably found that Mr. Malouf had recognized a conflict of interest, known that he needed to disclose it, and known that he had not disclosed to UASNM that his conflict was ongoing. Given this knowledge, Mr. Malouf knew or must have known that UASNM could not fully disclose the conflict. At a minimum, the SEC had substantial evidence for its finding that Mr. Malouf had acted with extreme recklessness by facilitating UASNM's failure to disclose the conflict. *See Geman v. SEC*, 334 F.3d 1183, 1195 (10th Cir. 2003) (holding that an individual had acted with extreme recklessness when he was aware of undisclosed information and "surely knew" that it had not been adequately reported).

Finally, Mr. Malouf points to the SEC's decision not to charge him with aiding and abetting UASNM's making of a material misstatement in violation of Rule 10b-5(b). According to Mr. Malouf, the absence of such a charge must mean that the SEC did not believe that he had aided and abetted UASNM's violations. But Mr. Malouf does not provide any authority for this leap. "[A]n agency decision not to enforce often involves a complicated balancing of a number of factors which are peculiarly within its expertise. So the agency must not only assess whether a violation has occurred, but whether agency resources are best spent on this violation or another . . . ." *Heckler v. Chaney*, 470 U.S. 821, 831, 105 S.Ct. 1649, 84 L.Ed.2d 714 (1985). The SEC's decision not to bring an aiding or abetting charge under Rule 10b-5(b) does not affect the existence of substantial evidence, so we decline to disturb the SEC's findings on this basis.

IV. The SEC did not err in deciding on the sanctions to impose.

Based on Mr. Malouf's violation of the securities laws and related rules, the administrative law judge imposed three sanctions:

1. a 7-1/2 year bar from the securities industry,

2. an order to cease and desist violations of the federal securities laws, and

3. a civil penalty of $75,000.

The SEC extended the bar from 7-1/2 years to life, ordered Mr. Malouf to disgorge $562,001.26 plus prejudgment interest, and adopted the administrative law judge's other sanctions. Mr. Malouf asks us to vacate the SEC's lifetime ban and disgorgement order.[20]

We do not disturb sanctions imposed by the SEC unless they are "beyond the law, devoid of factual support, or are 'so lacking in reasonableness as to constitute an abuse of discretion.'" *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1438 (10th Cir. 1988) (quoting *Am. Power & Light Co. v. SEC*, 329 U.S. 90, 115, 67 S.Ct. 133, 91 L.Ed. 103 (1946)). In our view, the SEC did not abuse its discretion in imposing the lifetime bar or in ordering Mr. Malouf to disgorge $562,001.26 plus prejudgment interest.

A. The SEC did not abuse its discretion in ordering a lifetime bar from the securities industry.

Under the Investment Advisers Act, the SEC may bar advisers from associating with the securities industry if

- they "willfully violated" or "willfully aided [and] abetted . . . the violation" of federal securities law and

20. In his reply brief, Mr. Malouf also contends that his sanctions were disproportionate to the sanctions imposed in other cases. But Mr. Malouf did not present this contention in his opening appeal brief. Raising the issue in his reply brief was too late. *See, e.g.*, *WildEarth Guardians v. EPA*, 770 F.3d 919, 933 (10th Cir. 2014) (stating that it "was too late" to present a new issue in the petitioners' reply brief).

- the bar is in the public interest.

15 U.S.C. § 80b-3(e)(5)-(6) & (f). The SEC concluded that both conditions had been met.

Mr. Malouf argues that

- he did not act willfully,
- the SEC penalized him for defending himself, and
- the public interest did not support a lifetime bar in light of his disclosures preceding the SEC investigation and his payment of restitution and civil penalties.

We reject these arguments.

First, according to Mr. Malouf, the SEC's finding of willfulness must have been based on his failure to require disclosure from others. For this argument, Mr. Malouf insists that he delegated the duty of disclosure. We disagree. Mr. Malouf blames the chief compliance officer, but this officer could not have been expected to disclose a conflict of interest that he had not known about. *See* pp. 22, 26-27, above. The SEC thus did not abuse its discretion in determining that Mr. Malouf had acted willfully.

Second, Mr. Malouf contends that the SEC penalized him for defending himself. We disagree. The SEC reasonably considered Mr. Malouf's failure to recognize

his own wrongdoing. *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979) (noting that a defendant's admission of wrongful conduct (or lack of an admission thereof) is a factor "that [has] been deemed relevant to the issuance of an injunction" from the securities industry), *aff'd*, 450 U.S. 91, 101 S.Ct. 999, 67 L.Ed.2d 69 (1981); *ZPR Inv. Mgmt. Inc. v. SEC*, 861 F.3d 1239, 1255 (11th Cir. 2017) (upholding a bar on continued work in an industry when the SEC found that the petitioner had not genuinely acknowledged his wrongdoing). Consideration of one's acceptance of responsibility constitutes "a routine and unexceptionable feature . . . of criminal, let alone civil, punishment." *SEC v. Lipson*, 278 F.3d 656, 664 (7th Cir. 2002). And the agency record is replete with examples of Mr. Malouf's refusal to accept responsibility for his actions. The SEC thus did not abuse its discretion in considering Mr. Malouf's failure to accept responsibility.

Finally, Mr. Malouf stresses his (1) disclosures preceding the SEC's investigation and (2) prior payment of huge sums in restitution and civil penalties. But his earlier disclosures and payments do not render a lifetime bar unreasonable. Mr. Malouf waited roughly three years before making the disclosures. And for about nine months of that period, Mr. Malouf ignored an outside consultant's directions to make the disclosures. The SEC considered Mr. Malouf's delay together with his payments toward restitution and civil penalties, concluding that a lifetime bar from the securities industry was justified. The SEC's reasoning is rational and supported by the evidence.

B. The SEC did not abuse its discretion in ordering disgorgement of $562,001.26 plus prejudgment interest.

Mr. Malouf also asks us to vacate the SEC's order that he disgorge $562,001.26 plus prejudgment interest, arguing that he did not commit fraud or violate the law. For this argument, he again casts blame on the chief compliance officer for failing to disclose the financial arrangement that created a conflict of interest. But we have elsewhere rejected Mr. Malouf's effort to pin the blame on the chief compliance officer. *See* pp. 22, 26-27, 40, above.

Mr. Malouf also suggests that the SEC abused its discretion by ordering him to disgorge the funds that he had received from Mr. Lamonde. The administrative law judge had regarded those funds as legal profits that Mr. Malouf did not need to disgorge. The SEC disagreed, concluding that the payments had resulted from Mr. Malouf's violations of the securities laws. Mr. Malouf suggests that the SEC should have followed the administrative law judge's characterization of the payments.

The SEC did not abuse its discretion. Mr. Malouf knew that he was profiting when he and others at UASNM routed bond transactions through the Raymond James branch. *See* Appellant's App'x, vol. 4, at 941-42 (testimony of Mr. Malouf) (admitting that he traded through the Raymond James branch in part to get paid). Yet Mr. Malouf waited years to tell others at UASNM about his

ongoing payments from Mr. Lamonde. Given this delay in disclosing the conflict, the SEC reasonably concluded that all of the payments to Mr. Malouf were traceable to his misconduct and needed to be disgorged. *See SEC. v. Maxxon, Inc.*, 465 F.3d 1174, 1179 (10th Cir. 2006) (recognizing that the amount to be disgorged need only be a "'reasonable approximation' of illegal profits"). We thus reject Mr. Malouf's challenge to the disgorgement order.

Affirmed.

APPENDIX B — ORDER OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, DATED AUGUST 22, 2018

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10536 / August 22, 2018

SECURITIES EXCHANGE ACT OF 1934
Release No. 83907 / August 22, 2018

INVESTMENT ADVISERS ACT OF 1940
Release No. 4993 / August 22, 2018

INVESTMENT COMPANY ACT OF 1940
Release No. 33211 / August 22, 2018

In re:
PENDING ADMINISTRATIVE PROCEEDINGS

ORDER

On November 30, 2017, we ratified the appointments of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil to the office of administrative law judge in the Securities and Exchange Commission.[1] In an abundance of caution and

1. *Order*, Exchange Act Release No. 82178, 2017 WL 5969234 (Nov. 30, 2017); *see also SEC Ratifies Appointment of Administrative Law Judges*, https://www.sec.gov/news/press-release/2017-215 (Nov. 30, 2017).

for avoidance of doubt, we today reiterate our approval of their appointments as our own under the Constitution.

In light of the Supreme Court's decision in *Lucia v. SEC*,[2] we previously stayed any pending administrative proceeding initiated by an order instituting proceedings that commenced the proceeding and set it for hearing before an ALJ, including any such proceeding currently pending before the Commission.[3] We now find it prudent to allow the stay to expire effective today, August 22, 2018.

With respect to any such proceeding currently pending before an ALJ or the Commission, we order that respondents be provided with the opportunity for a new hearing before an ALJ who did not previously participate in the matter. We remand all proceedings currently pending before the Commission to the Office of Administrative Law Judges for this purpose and vacate any prior opinion we have issued in the matter. A list of matters is attached as Exhibit A. In these matters, as well as the matters currently pending before an ALJ, we direct the conduct of further proceedings consistent with this order and the Court's decision in *Lucia v. SEC*. The ALJs are directed to notify the parties in the cases pending before them of this order.

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2. 138 S. Ct. 2044 (2018).

3. *Order*, Exchange Act Release No. 83675, 2018 WL 3494802 (July 20, 2018); *Order*, Exchange Act Release No. 83495, 2018 WL 3193858 (June 21, 2018).

Appendix B

Any pending deadlines in each administrative proceeding currently pending before an ALJ or remanded to the Office of Administrative Law Judges, as described above, are hereby vacated and superseded by the procedures and deadlines set forth in this order. In each such proceeding, absent express agreement by the parties regarding alternative procedures, the Chief Administrative Law Judge shall by rotation to the extent practicable designate an ALJ who did not previously participate in the matter to be the presiding hearing officer.[4] Any agreement by the parties regarding alternative procedures shall be submitted to the Chief Administrative Law Judge by September 7, 2018. In all cases, assignments shall be made no later than September 21, 2018.

The assigned ALJ shall exercise the full powers conferred by the Commission's Rules of Practice and the Administrative Procedure Act and shall not give weight to or otherwise presume the correctness of any prior opinions, orders, or rulings issued in the matter.[5] Within 21 days of being assigned to the proceeding, the ALJ shall issue an order directing the parties to submit proposals for the conduct of further proceedings. After considering the parties' submissions, the ALJ shall hold a new hearing and prepare an initial decision; but if a party fails to submit a proposal, the ALJ may enter a default against that party pursuant to Rule of Practice 155 or impose another appropriate sanction under Rule of Practice 180.[6]

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4. 17 C.F.R. § 200.30-10(a)(2).

5. *E.g.*, Rule of Practice 111, 17 C.F.R. § 201.111; 5 U.S.C. § 556.

6. 17 C.F.R. §§ 201.155, .180.

Appendix B

The Rules of Practice as amended on July 13, 2016 shall govern all pending proceedings,[7] unless the presiding ALJ determines, after giving the parties notice and an opportunity to be heard, that application of a particular amended rule in a proceeding instituted prior to their effective date would not be just and practicable or otherwise would work a manifest injustice under the circumstances of that case, in which case the former rule applies.

This order does not preclude the Commission from assigning any proceeding to the Commission itself or to any member of the Commission at any time.

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7. In proceedings instituted before the effective date of the amended Rules of Practice, the Commission directed the ALJ to issue an initial decision within 120, 210, or 300 days of service of the OIP; for purposes of applying the amended Rules of Practice to such proceedings, they shall be deemed proceedings under the 30-, 75-, or 120-day timeframes, respectively, as specified in Rule of Practice 360(a)(2). In all proceedings, the ALJ shall compute the deadlines for scheduling a hearing and issuing an initial decision as specified in amended Rule of Practice 360(a)(2) from the date the proceeding is assigned to a hearing officer pursuant to this order, rather than the date of service of the relevant order instituting proceedings. The deadlines stated in this order confer no procedural or substantive rights on any party, and the presiding ALJ may, for good cause shown, modify any of them, including the date by which the initial decision must be issued. This grant of authority allowing the presiding ALJ to modify the deadlines stated in this order supersedes the provisions in Rule of Practice 360(a)(3)(i) and (ii) governing the circumstances under which the deadlines to issue initial decisions may be extended.

Appendix B

By the Commission.

Brent J. Fields
Secretary

Appendix B

EXHIBIT A

A.C. Simmonds, et al., File No. 3-17999
Accelerated Acquisition XVII, et al., File No. 3-18146
Aervision Holdings, Inc., et al., File No. 3-18199
Affirmative Insurance Holdings, Inc., Armada Oil, Inc., and Chuma Holdings, Inc., File No. 3-18378
AFN, Inc., et al., File No. 3-17743
Alexandre S. Clug, File No. 3-16318
Altovida Inc., et al., File No. 3-18104
American Magna Corp., et al., File No. 3-18105
American-Swiss Capital, Inc., et al., File No. 3-18156
Andrew Stitt, File No. 3-17621
Anthony C. Zufelt, File No. 3-17907
ARX Gold Corporation, File No. 3-18185
Atomic Paintball, Inc., et al., File No. 3-17991
Aurios, Inc., et al., File No. 3-18092
Axesstel, Inc., File No. 3-17941
Axiom Oil & Gas Corp., et al., File No. 3-18096
Balqon Corporation, et al., File No. 3-18095
Baltia Air Lines, Inc., Graphite Corp., and 24Holdings, Inc., File No. 3-18472
Barbara Duka, File No. 3-16349
Bioelectronics Corp., Ibex, LLC, St. John's, LLC, Andrew J. Whelan, and Kelly A. Whelan, File No. 3-17104
BioPharma Manufacturing Solutions Inc., et al., File No. 3-18148
Biovest International, Inc., et al., File No. 3-17935
Bluforest, Inc., File No. 3-17558
Bohai Pharmaceuticals Group Inc., File No. 3-18151
BOLDFACE Group, Inc., et al., File No. 3-18103
Brian Michael Berger, File No. 3-18129

Appendix B

Canso Enterprises Ltd., et al., File Nos. 3-17984, 17985, 17986, 17987, 17988, 17989
CellCyte Genetics Corp., File No. 3-18141
Century Acquisition Corp. and Eastern Acquisition Corp., File No. 3-18162
Chile Mining Technologies Inc., File No. 3-18174
China Du Kang Co., Ltd., File No. 3-18106
China Fruits Corp., et al., File No. 3-18017
China Greenstar Corporation, et al., File No. 3-18097
China Hefeng Rescue Equipment, Inc., et al., File No. 3-18179
Christopher M. Gibson, File No. 3-17184
Cibolan Gold Corporation, File No. 3-18077
Circle Star Energy Corp. and Energy Holdings International, Inc., File No. 3-18142
CNK Global, Inc. (a/k/a American Life Holding Co., Inc.), File No. 3-18082
Cono Italiano, Inc., et al., File No. 3-18177
Core Resource Management, Inc., et al., File No. 3-18079
Creator Capital Ltd., File No. 3-18189
David F. Bandimere, File No. 3-15124
Dearborn Bancorp, Inc., File No. 3-18223
dELiA*s Inc. and Global Energy, Inc., File No. 3-18037
Demitrios Hallas, File No. 3-18229
Diane Dalmy, File No. 3-16339
Digital Brand Media & Marketing Group, Inc., File No. 3-17990
e.Digital Corp., and Liberty Coal Energy Corp., File No. 3-18475
Edward M. Daspin, File No. 3-16509
Energy Edge Technologies Corp. and Focus Gold Corp., File No. 3-18038

Appendix B

Engage Eco Solutions, Inc., et al., File No. 3-18191
Evolucia, Inc. and OSL Holdings, Inc., File No. 3-18014
E-Waste Systems, Inc., File No. 3-18107
Frank Chiappone, Andrew G. Guzzetti, William F. Lex, Thomas E. Livingston, Brian T. Mayer, and Philip S. Rabinovich, File No. 3-15514
Fu Lu Cai Productions Ltd. and Heavy Earth Resources, Inc., File No. 3-18173
Gamzio Mobile, Inc., File No. 3-18170
Gary C. Snisky, File No. 3-17645
GC China Turbine Corp., File No. 3-16604
Geoglobal Resources, Inc. and USA Synthetic Fuel Corp., File No. 3-18153
Gerardo E. Reyes, File No. 3-18126
GL Capital Partners, LLC and GL Investment Services, LLC, File No. 3-17818 and 17819
GO EZ Corporation, et al., File No. 3-18204
Gregory Reyftmann, File No. 3-17959
GS Enviroservices, Inc., et al., File No. 3-17977
Guardian 8 Holdings, et al., File No. 3-18221
Hall Tees, Inc., et al., File No. 3-18155
Hampshire Group, Limited, File No. 3-18201
Hedgebrook, JayHawk Energy, Inc., and Rubicon Financial, Inc., File No. 3-18484
Hui Feng and Law Offices of Feng & Associates, P.C., File No. 3-18209
Hydrogen Future Corporation, et al., File No. 3-18220
HydroPhi Technologies Group, Inc., et al., File No. 3-18208
Ibex Advanced Mortgage Technology, Inc., File No. 3-18047
Icon Vapor, Inc., et al., File No. 3-18210
IMK GROUP, INC., et al., File No. 3-18203

Appendix B

Immunoclin Corp. et al., File No. 3-18190
Infinity Real Estate Holdings Corporation, et al., File No. 3-18217
Intellicell Biosciences, Inc., File No. 3-17990
J.S. Oliver Capital Management, L.P., File No. 3-15446
James A. Winkelmann and Blue Ocean Portfolios, File No. 3-17253
James E. Cohen and Joseph A. Corazzi, File No. 3-15974
James P. Griffin, File No. 3-17848
Jeffrey D. Smith, Joseph Carswell, and Michael W. Fullard, File No. 3-18271
Jeffrey Gainer, File No. 3-18130
Joe Lawler, File No. 3-17650
John Austin Gibson, Jr., File No. 3-17856
John J. Aesoph, CPA and Darren M. Bennett, CPA, File No. 3-15168
John Thomas Capital Management, L.P., and George R. Jarkesy, Jr., File No. 3-15255
Joseph J. Fox, File No. 3-16795
Joseph Vitale, File No. 3-18252
JuQun, Inc., et al., File No. 3-18193
KollagenX Corp., et al., File No. 3-18207
Kun De International Holdings, Inc., and Sutor Technology Group Limited, File No. 3-18169
Kung Fu Dragon Group Limited, File No. 3-18091
Laurie Bebo, File No. 3-16293
Lawrence E. Penn, III, File No. 3-18288
Louis V. Schooler, File No. 3-17115
Mackenzie Taylor Minerals, Inc., et al., File No. 3-18149
MarilynJean Interactive Inc., File No. 3-18445
Mark Megalli, File No. 3-18250
Medicus Homecare Inc., File No. 3-18081

Appendix B

Michelle L. Helterbran Cochran, CPA, File No. 3-17228
Montalvo Spirits, Inc., et al., File No. 3-18078
Neurologix, Inc., et al., File No. 3-18180
New Media Insight Group, Inc. and Pacific Sands, Inc., et al., File No. 3-18206
New Western Energy Corp. and Primco Management, Inc., File No. 3-18007
New York Sub Co., File No. 3-18038
Next Galaxy Corp. and Novamex Energy, Inc., File No. 3-18219
Patric Ken Baccam a/k/a Khanh Sengpraseuth, File No. 3-18276
Paul Edward ("Ed") Lloyd, Jr., CPA, File No. 3-16182
Penny Auction Solutions, Inc., et al., File No. 3-18202
Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr., File No. 3-15006
Retirement Surety LLC, Crescendo Financial LLC, Thomas Rose, David Leeman, and David Featherstone, File No. 3-18061
Rosalind Herman, File No. 3-17828
Roy Dekel, File No. 3-17751
Saving2Retire, LLC and Marian P. Young, File No. 3-17352
Sean P. Finn and M. Dwyer LLC, File No. 3-17693
Shervin Neman and Neman Financial, Inc., File No. 3-17699
Spring Hill Capital Markets, LLC, Spring Hill Capital Partners, LLC, Spring Hill Capital Holdings, LLC, and Kevin D. White, File No. 3-16353
StationDigital Corp., File No. 3-18004
Talman Harris and Victor Alfaya, File No. 3-17874
Timothy W. Carnahan and CYIOS Corporation, File No. 3-16386

Appendix B

Tintic Gold Mining Company, File No. 3-18157
Tod A. Ditommaso, File No. 3-17550
Vortronnix Technologies, Inc., File No. 3-18023
Warren D. Nadel, File No. 3-17883
William D. Bucci, File No. 3-17888

APPENDIX C — FINAL DECISION OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, DATED JULY 27, 2016

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 10115 / July 27, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 78429 / July 27, 2016

INVESTMENT ADVISERS ACT OF 1940
Release No. 4463 / July 27, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32194 / July 27, 2016

Admin. Proc. File No. 3-15918

In the Matter of
DENNIS J. MALOUF

OPINION OF THE COMMISSION

SECURITIES ACT PROCEEDING

EXCHANGE ACT PROCEEDING

ADVISERS ACT PROCEEDING

INVESTMENT COMPANY ACT PROCEEDING

Appendix C

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Aiding and Abetting and Causing Fraud

Failure to Seek Best Execution

Respondent, the former president and majority owner of a registered investment adviser, violated the antifraud provisions of the federal securities laws when he failed to disclose conflicts and correct misleading statements concerning ongoing payments that he received from the owner of a branch office of a broker-dealer that he had once owned. Respondent directed clients' highly liquid, AAA-rated Treasury and agency bond purchase transactions to his former broker-dealer, despite claims in registered investment adviser's Forms ADV and website that its investment advice and choice of broker-dealers were impartial and conflict-free. Respondent also failed to seek best execution for advisory clients' Treasury and agency bond trades by directing trades to his former broker-dealer without first seeking multiple competing bids, resulting in clients' payment of excessive commissions. Respondent aided and abetted and caused investment adviser's related violations. *Held,* it is in the public interest to bar the respondent from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; prohibit respondent from

serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; order the respondent to cease and desist from committing or causing any violations or future violations of the provisions violated; order disgorgement of $562,001.26, plus prejudgment interest; and assess a civil money penalty of $75,000.

APPEARANCES:

Alan M. Wolper and Heidi VonderHeide, Ulmer & Berne LLP, Chicago, IL, for Dennis J. Malouf.

Stephen C. McKenna, Dugan Bliss, and *John H. Mulhern*, for the Division of Enforcement.

Appeal filed: April 27, 2015
Last brief received: October 29, 2015

Dennis J. Malouf ("Malouf"), an investment adviser, appeals from an initial decision finding that from January 2008 to March 2011, he violated, and aided and abetted and caused UASNM, Inc.'s ("UASNM") violations of, the antifraud provisions of the federal securities laws when he failed to disclose a conflict of interest to his investment adviser clients concerning his order flow to, and receipt of payments from, a broker-dealer branch that he once owned; and failed to seek best execution for clients' bond transactions that he directed to the broker-dealer

branch.[1] The ALJ barred Malouf from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of seven-and-a-half years; prohibited him from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of seven-and-a-half years; imposed a civil money penalty of $75,000; and ordered him to cease and desist from committing or causing violations of the provisions in question. The ALJ declined to order disgorgement, finding instead that the $1,068,084 Malouf received from the owner of the broker-dealer branch is "clearly identifiable as legal profits and should not be the subject of disgorgement."[2]

The Division of Enforcement appeals the ALJ's imposition of a seven-and-a-half-year industry bar against Malouf, contending that a permanent bar is a more

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1. *Dennis J Malouf,* Initial Decision Release No. 766, 2015 WL 1534396 (Apr. 7, 2015).

2. In addition to the violations the ALJ found, the OIP in this matter charged Malouf with acting as an unregistered broker, alleging primarily that Malouf received selling compensation in the form of commissions from the broker-dealer when he was not associated with a registered broker-dealer, in violation of Exchange Act Sections 15 and 15C. 15 U.S.C. §§ 78*o*, 78*o*-5. The ALJ found that a preponderance of the evidence did not support these charges. The Division did not appeal this aspect of the ALJ's decision, and we do not review this finding on appeal.

appropriate sanction. The Division also argues that Malouf should be ordered to pay disgorgement. Malouf appeals both the ALJ's findings of violation and sanctions.

We base our findings on an independent review of the record. We find that Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act; Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder; and Sections 206(1) and 206(2) of the Advisers Act.[3] We also find that Malouf aided and abetted and caused his firm's violations of Sections 206(4) and 207 of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.[4] Based on our findings of violations and public interest determination, we impose bars without a right to reapply, order Malouf to cease and desist from committing or causing violations of the provisions listed above, and order him to pay disgorgement of $562,001.26 and a $75,000 civil penalty.

I. FACTS

A. Malouf's Ownership Interest in the Broker-Dealer and Investment Adviser Firms

Malouf purchased a branch of Raymond James Financial Services, Inc. ("RJ") in approximately February 1999 and was a registered representative and owner of the branch until the end of 2007. In September

3. 15 U.S.C. §§ 77q(a)(1) and 77q(a)(3); 78j(b); 80b-6(1) and (2); and 17 C.F.R. § 240.10b-5(a) and (c).

4. 15 U.S.C. §§ 80b-6(4) and 80b-7; and 17 C.F.R. § 206(4)-1(a)(5).

2004, Malouf and Kirk Hudson ("Hudson"), a fellow RJ registered representative, purchased UASNM from Joseph Kopczynski ("Kopczynski"), who was then Malouf's father-in-law.[5] For the next three years, Malouf owned both UASNM and the RJ branch office, and the two shared the same office space, with RJ renting a few cubicles. From 2004 to 2007, UASNM's Forms ADV disclosed Malouf's ownership of the RJ branch and noted that he might receive compensation for UASNM clients' transactions executed through the RJ branch.

B. Malouf's Sale of the RJ Branch and Receipt of Payments

In 2007, RJ became concerned about potential conflicts of interest and supervision risks resulting from Malouf's ownership of both UASNM and the RJ branch and requested that Malouf choose whether he wished to continue to associate with UASNM or RJ. Malouf decided to discontinue his association as a registered representative with RJ and, in January 2008, sold the RJ branch to Maurice Lamonde ("Lamonde"), a friend and

5. After the purchase, Malouf was the 59.5 percent owner, CEO, and president, and Hudson was the 39.5 percent owner, CFO, and Chief Investment Officer. Kopczynski maintained a one percent ownership interest and was UASNM's Chief Compliance Officer until the end of 2010. Malouf served as UASNM's CCO from January through May 2011.

Malouf and Hudson registered UASNM with the Commission on September 4, 2004. Its March 2014 Form ADV, the most recent Form ADV in the record, reported that UASNM held approximately $275 million in assets under management.

former RJ co-worker of Malouf.[6] Despite the sale, the RJ branch continued to be located in UASNM's office space.

Malouf and Lamonde agreed that Lamonde's purchase price for the RJ branch would be two times the branch's trailing revenue, for a total purchase price of approximately $1.1 million. Pursuant to the Purchase of Practice Agreement ("PPA") between Malouf and Lamonde,[7] Lamonde was to make monthly payments to Malouf over a four-year period, totaling approximately 40 percent of the branch's revenue. However, Lamonde did not make monthly payments to Malouf; instead, payments were made sporadically on no set schedule with no specific correlation to the branch's revenue, and sometimes Lamonde made more than one payment in a given month, a practice Malouf described as "prepayment." Malouf

6. Lamonde was an RJ registered representative from March 2000 until August 2011. He died in April 2014, but the ALJ admitted into the record portions of his earlier investigative testimony.

7. Although Malouf and Lamonde testified that they executed a PPA in January 2008, no witness other than Malouf and Lamonde testified to seeing the PPA until June 2010. Throughout 2009, an RJ Regional Director repeatedly pressed Lamonde for a copy of the PPA, but Lamonde failed to provide one. Lamonde finally produced a PPA in June 2010, dated January 2, 2008, but the signature page was not notarized until June 11, 2010. The RJ Regional Director testified that he felt this situation was "inappropriate." While it appears that there may, in fact, have been no executed agreement prior to June 2010, neither Malouf nor the Division disputes the general terms of the RJ branch sale (including that Lamonde was to make periodic payments to Malouf or the total amount of money that Lamonde owed Malouf).

frequently pressed Lamonde to make payments. Malouf stipulated that, on several occasions in the UASNM/RJ branch office space, he asked Lamonde "where's my check [for the RJ branch]" in the presence of other employees. And Lamonde testified that Malouf, at times, requested immediate cash payments from Lamonde, even though the PPA envisioned monthly payments. To pay Malouf, in addition to using funds from the branch's operations, Lamonde testified that he took twelve cash advances from RJ, borrowed against a personal life insurance policy, took money from his father-in-law, and took on credit card debt.

C. Malouf's Routing of Transactions to the RJ Branch

From January 2008 through March 2011, Malouf directed a substantial majority of UASNM clients' bond trades to the RJ branch for execution. Malouf had primary responsibility for UASNM's clients' bond trades (especially large-dollar-amount trades in excess of $1 million) and was considered the firm's bond expert. From 2008 to 2011, UASNM placed over 200 bond trades with the RJ branch, representing approximately 90 percent of its total bond trading. While various hearing witnesses estimated that Malouf personally placed anywhere between 60-95 percent of UASNM's total bond trades,[8] Malouf said he placed between 60-70 percent of the trades.

8. Hudson, who was in litigation against Malouf when he testified, stated that Malouf was responsible for "90-plus % of the [UASNM] bond trades," based on his review of all UASNM bond trades for the 2008-2011 period. Matthew Keller ("Keller"), a fellow UASNM representative, testified that Malouf was primarily responsible for all bond trading at the firm and that Malouf "executed 80-90% of [UASNM's bond] trades on a long-term basis."

Malouf stipulated that Hudson reviewed UASNM's clients' bond trades with broker-dealers other than RJ (roughly 10 percent of the total UASNM bond trades during this period) and determined that those trades were executed mostly by UASNM advisers other than Malouf, which demonstrates that Malouf placed few bond trades with non-RJ broker-dealers.

The transactions that Malouf directed to the RJ branch produced significant commissions for the RJ branch, which Lamonde used to pay Malouf pursuant to the PPA. According to Lamonde, he "passed along all or almost all of the commissions . . . from bond trading on behalf of UASNM back to Malouf." As Malouf agreed, he traded through the RJ branch "because then he got paid."[9] Lamonde made payments to Malouf toward his purchase of the RJ branch totaling $1,068,084, an amount almost equal to the total commissions ($1,074,454) the RJ branch earned on UASNM clients' bond trades.

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9. Malouf continued to run UASNM until May 2011, when he was terminated based on the charges that are the subject of this proceeding. Thereafter, Kopczynski and Hudson took control of UASNM, and UASNM sued Malouf in state court in New Mexico ("State Court Litigation"). As part of the settlement of the State Court Litigation, Malouf received $1.1 million for his majority ownership of UASNM. Of that amount, Malouf agreed to pay $506,083.74 to UASNM clients and another $100,000 to pay a civil penalty we imposed against UASNM in a settled enforcement action. *UASNM, Inc.,* Advisers Act Release No. 3846, 2014 WL 2568398 (June 9, 2014). Malouf currently owns New Mexico Wealth Management, LLC, an investment adviser registered with the state of New Mexico.

D. Lack of Disclosure and Assurances in UASNM's Forms ADV and Website

UASNM's Forms ADV from February 2008 through March 2011, filed with the Commission and distributed to UASNM's clients, failed to disclose Malouf's receipt of payments from Lamonde. These forms also did not contain the prior disclosures that had been included in the 2004-2007 Forms ADV regarding Malouf's ownership of the RJ branch and potential for compensation or the payment arrangement between Malouf and Lamonde. Instead, UASNM's Forms ADV from 2008 through 2011 stated that UASNM's selection of an executing broker was not based "upon any arrangement between the recommended broker and UAS[NM.]" UASNM's April 2010 Form ADV said that "employees of UASNM are not registered representatives of ... RJ ... and do not receive any commissions or fees from recommending these services."

UASNM's website also did not disclose the arrangement between Malouf and Lamonde, and asserted that UASNM provided impartial investment advice and that its brokerage recommendations were not "based upon any arrangement between the recommended broker and UASNM" and that UASNM "vigorously maintain[s its] independence to ensure absolute objectivity drives [its] decisions in managing [its] clients' portfolios." The website promised that UASNM's advice was "void of conflicts of interest."

Malouf delegated to Kopczynski the primary responsibility for preparing and filing UASNM's Forms

ADV and for ensuring that its marketing materials, including its website, were accurate and complied with applicable regulations. He nonetheless had significant involvement with the Forms ADV, the website, and their contents. Although Kopczynski was the CCO of UASNM and Hudson had certain compliance responsibilities (including signing the Forms ADV on the firm's behalf), Malouf was—in his own estimation—the "top dog."

Malouf acknowledged that, as CEO of the firm, he was at least "partially responsible" for UASNM's Forms ADV and website. To that end, Malouf reviewed some of the Forms ADV between 2008 and 2011 "focusing on disclosures relating to himself and [the RJ branch]." Malouf acknowledged that he played a key role in the "creative part of [the website]." He admitted that "[w]hile he may not have read every word of UASNM's website, he was familiar with its contents" and that he "probably read" the statements on the website in 2008 that UASNM provided independent advice and had no arrangements with broker-dealers.

Malouf and UASNM also employed the services of an outside compliance consultant, Adviser Compliance Associates, LLC ("ACA"), whose lead consultant on UASNM's account was Michael Ciambor. ACA and Ciambor reviewed UASNM's compliance procedures and Forms ADV, and it performed annual reviews in which it identified compliance deficiencies and provided advice regarding ways that the firm could improve compliance.

E. Others involved in UASNM's compliance procedures were not aware of the payments.

Malouf acknowledged that his financial arrangement with Lamonde created a conflict of interest that should have been disclosed, but thought Kopczynski, Hudson, and ACA were responsible for making such disclosures. But while Kopczynski and Hudson were aware that Malouf had sold the RJ branch to Lamonde and had at least some general awareness that Malouf received periodic payments from Lamonde, they testified they did not know the specific timing and amounts of the payments made, which was why they did not insist on disclosures of those payments.

And it is undisputed—and Malouf admitted—that ACA was not aware that Malouf had received *any* payments from Lamonde until June 2010, 2.5 years after the payments began. Ciambor testified, and Malouf does not dispute, that Malouf told him in May or June 2008 that Malouf's "relationship from that point forward with Raymond James had been effectively severed." Ciambor also testified that, when he interviewed Malouf in June 2009 as part of ACA's compliance review, Malouf did not disclose to him that he had already received over $500,000 in payments from Lamonde. Immediately after receiving that information, ACA informed UASNM that it needed to make disclosures of the arrangement in its Forms ADV and on its website. UASNM finally made such a disclosure for the first time, in its March 2011 Form ADV, at Malouf's request (as CCO) after receiving the instructions from ACA.

F. Malouf did not seek multiple competing bids for the clients' bond transactions before he directed them to the RJ branch.

UASNM's compliance procedures required the firm to attempt to obtain three bids from different broker-dealers prior to placing a trade. UASNM registered representative Matthew Keller ("Keller") regularly followed this policy with respect to his clients' bond trades. Malouf, however, conceded that he regularly failed to seek multiple bids for UASNM clients' highly-liquid, AAA-rated treasury and agency bond trades or from brokers other than RJ, and that he should have done so. He admitted that he likely could have received better prices for his clients if he had followed UASNM's policy.[10]

Malouf testified that an appropriate commission for a $1 million U.S. Treasury bond would be one percent, and for larger trades commissions should drop to 0.5 percent or even lower. Malouf and Lamonde orally agreed that one percent was the maximum commission rate RJ would charge UASNM for Treasury and agency bond trades. However, many of the large-dollar-amount trades for UASNM clients, which were primarily handled by Malouf,

10. ACA relied on interviews with UASNM personnel and documentation the firm provided to determine that UASNM followed a policy of seeking multiple competing bids before placing bond trades with a broker-dealer. UASNM did not, however, provide ACA with trade blotters that reflected the specific commission amounts of any trades, and Ciambor understood that UASNM maintained documentation supporting its multi-bid process for only a limited number of its total trades.

had commissions above one percent, with some exceeding that rate by 50 percent.[11] Numerous bond trades executed by RJ had commissions exceeding the one percent level.

II. VIOLATIONS

Based on the conduct described above, Malouf is charged with violating Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a) and 10b-5(c) thereunder, and Sections 206(1) and 206(2) of the Advisers Act. Specifically, the OIP alleges that Malouf failed to disclose the conflict that arose as a result of his "secret commission arrangement" and that, as a result, UASNM made misleading disclosures in its Forms ADV and on its website. Malouf is not charged with violating Rule 10b-5(b), which prohibits "making" a misstatement of material fact, or Section 17(a)(2), which prohibits "obtain[ing] money or property by means of" a misstatement. Malouf argues that "to prove its claims under Securities Act Section 17(a)(1) and (3), Exchange Act Section 10(b) and Rules 10b-5(a) and (c) and Advisers Act Sections 206(1) . . the Division was required to establish that [he] *made* a material misrepresentation or omission." (emphasis added). His argument and this case thus presents the following legal question: When may a respondent be held primarily liable for his conduct as part

11. Hudson testified that Malouf complained to Kopczynski and other members of the UASNM investment committee about RJ's decision to *reduce* the commission on a $3.8 million UASNM client bond trade from 1% to 0.5%, which Hudson believed was strange since he understood these commissions were being paid to RJ and Lamonde, not to Malouf.

of a fraud involving misstatements, when the respondent did not himself "make" the misstatements for purposes of Rule 10b-5(b)? We set out below our analysis of this question.[12]

A. Primary Liability Under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) of the Securities Act, and Section 206 of the Advisers Act.

Lower courts have adopted varying approaches to liability under Exchange Act Rule 10b-5 (which implements Exchange Act Section 10(b)) and Section 17(a) of the Securities Act. The Supreme Court's recent decision in *Janus Capital Group v. First Derivative Traders* resolved some of the differences among the lower courts, as it clarified—and limited—the scope of liability under Rule 10b-5(b).[13] The decision was silent, however, as to Rule 10b-5(a) and (c) and Section 17(a), each of which Malouf is charged with violating.[14] The decision also did

12. The Commission previously outlined this analysis in *John P. Flannery,* Exchange Act Release No. 73840, 2014 WL 7145625, at *9-19 (Dec. 15, 2014), *vacated on other grounds* 810 F.3d 1 (1st Cir. 2015).

13. 131 S. Ct. 2296 (2011).

14. There is a divergence of views on the scope of these provisions among federal district courts. *Compare, e.g., SEC v. Monterosso,* 768 F. Supp. 2d 1244, 1269 (S.D. Fla. 2011) (stating that "to be primarily liable for Rule 10b-5(a)'s prohibition of employment of a device, scheme, or artifice to defraud, one 'need only have made an intentionally deceptive contribution to an overall fraudulent

not address Section 206 of the Advisers Act (which Malouf is also charged with violating).

1. Primary Liability Under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5(a) and (c)

a. Section 10(b) covers conduct that is manipulative or deceptive.

Our analysis begins with the scope of Section 10(b), which prohibits the use or employment, in connection with the purchase or sale of any security, of "any manipulative or deceptive device or contrivance in contravention of Commission rules.[15] "Manipulative," the Supreme Court has explained, is "a term of art when used in connection with securities markets," referring to practices "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."[16] Although the Court has not made a similar pronouncement on the meaning of "deceptive,"

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scheme") (citation omitted) *with SEC v. Laneord,* No. 8:12CV344, 2013 WL 1943484, at *8 (D. Neb. May 9, 2013) (stating that Rule 10b-5(a) and (c) may be used only to charge conduct that is "beyond" or "distinct from" any "alleged misrepresentation or omission") *and SEC v. Kelly,* 817 F. Supp. 2d 340, 345 (S.D.N.Y. 2010) (stating that, in misstatement cases, as long as the defendant did not "make" the misstatement, even conduct "beyond" the misstatement cannot be charged under Rule 10b-5(a) or (c)).

15. 15 U.S.C. § 78j(b).

16. *Santa Fe Indus., Inc. v. Green,* 430 U.S. 462, 476 (1977).

it has consulted dictionaries in use in the 1930s to define other terms in Section 10(b);[17] those dictionaries define "deceptive" as "having power to mislead" or "[t]ending to deceive," and define "deceive" as "to impose upon; deal treacherously with; cheat" or "[t]o cause to believe the false or to disbelieve the true."[18] These definitions led one federal appeals court to conclude that "deceptive" encompasses "a wide spectrum of conduct involving cheating or trading in falsehoods."[19] Informed by these precedents, we conclude that to employ a "deceptive" device or to commit a "deceptive" act is to engage in conduct that produces a false impression.[20] Such conduct encompasses "making" a misrepresentation; it also encompasses, among other things, drafting or devising a misrepresentation.

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17. *See, e.g., Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 199 nn. 20, 21 (1976) (consulting the 1934 edition of Webster's International Dictionary to define other terms in Section 10(b)).

18. Webster's International Dictionary 679 (2d ed. 1934).

19. *SEC v. Dorozkho,* 574 F.3d 42, 50 (2d Cir. 2009) (consulting the 1934 edition of Webster's International Dictionary for the meaning of "deceptive").

20. *See Stewart v. Wyoming Cattle-Ranche Co.,* 128 U.S. 383, 388 (1888) ("The gist of the action [for deceit] is fraudulently producing a false impression upon the mind of the other party."); *United States v. Finnerty,* 533 F.3d 143, 148 (2d Cir. 2008) ("Broad as the concept of 'deception' may be, it irreducibly entails some act that gives the victim a false impression."); *see also Clark v. Capital Credit & Collection Services, Inc.,* 460 F.3d 1162, 1174 n.10 (9th Cir. 2006) ("Something is deceptive if it tends or has the power to 'give a false impression.'").

This view comports with the notion that the reach of Section 10(b) should be construed in a manner at least as protective as the common law. The Supreme Court itself has recognized that Section 10(b) was "in part designed to *add* to the protections provided investors by the common law."[21] The courts have therefore held that it would be "highly inappropriate" to construe Section 10(b) "to be more restrictive in substantive scope than its common law analogs."[22]

We find particularly persuasive case law regarding the common law offense of obtaining property by false

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21. *Basic Inc. v. Levinson,* 485 U.S. 224, 244 n.22 (1988) (citing *Herman & MacLean v. Huddleston,* 459 U.S. 375, 388-389 (1983)) ("[T]he antifraud provisions of the securities laws are not coextensive with common law doctrines of fraud. Indeed, an important purpose of the federal securities statutes was to rectify- perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securities industry.")).

22. *Sundstrand Corp. v. Sun Chemical Corp.,* 553 F.2d 1033, 1044 (7th Cir. 1977); *see also Harris v. American Inv. Co.,* 523 F.2d 220, 224 (8th Cir. 1975) (internal citation omitted) ("Although the federal securities laws in several instances offer greater protection to buyers and sellers of securities than do common law fraud concepts, common law fraud concepts underlie the securities laws and provide guidance as to their reach and application."); Louis Loss and Joel Seligman, Fundamentals of Securities Regulation 910-13 (4th ed. 2004) (noting that although "courts have repeatedly held that the fraud provisions in the SEC Acts . . . are not *limited* to circumstances that would give rise to a common law action for deceit," in light of "the legislative background it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under the statutes.").

pretenses.[23] The offense dates back to an English statute of 1757, on which many state-law criminal statutes were modeled.[24] A false representation in violation of these criminal provisions could "assume any form: [it] may be oral or written . . . or it may be implied from conduct."[25] As the Massachusetts Supreme Judicial Court explained in 1844, a person commits the offense even where he convinces someone else to act on his behalf: "[A]ll that is necessary to be proved is, that he is at the time acting in concert with [the person who ultimately delivers the misstatement] and aiding in putting forth the false pretenses . . . with his knowledge, concurrence, and direction"[26] A century later, the same court confirmed

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23. *See Frazier v. Commonwealth,* 165 S.W.2d 33, 34 (Ky. 1942) ("The gist of the offense of obtaining money or property of another by false pretenses is the fraud and deception of the perpetrator."); *accord People v. Harrington,* 267 P. 942, 945 (Cal. Dist. Ct. App. 1928); *Hicks v. State,* 215 S.W. 685, 686 (Ark. 1919); *Burney v. State,* 59 So. 306, 307 (Ala. Ct. App. 1912); *see also State v. Matthews,* 28 S.E. 469, 469 (N.C. 1897) (stating that the false pretense statutes proscribe "induc[ing] another person to believe a fact is really in existence, when it is not").

24. 30 Geo. II, c. 24 (1757); LaFave, 3 Subst. Crim. L. §§ 19.7 (2d ed.); LaFave, 3 Subst. Crim. L. §§ 19.7, 19.8; 3 Charles E. Torcia, Wharton's Criminal Law §410, at 517 (15th ed. 1993). The Model Penal Code renamed these offenses theft by deception. American Law Institute, Model Penal Code and Commentaries 180-181 (1980).

25. Wharton's Criminal Law §413, at 527; *accord* Rollin M. Perkins, Criminal Law 299 & n.19 (2d ed. 1969).

26. *Commonwealth v. Harley,* 48 Mass. (7 Met.) 462, 465-466 (1844) (stating that "if A procures B to go to C" with a false pretense and thereby obtain the goods of C then "A is guilty in the matter

that a defendant may be held liable even if there are "no false statements attributable to" the defendant, so long as the misrepresentations to the defrauded parties "are based upon and substantiated by [the defendant's] false statements."[27] Thus, as these cases and others make clear, false-pretenses liability does not require "that the defendant himself make the false representation."[28] In

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of obtaining these goods by false pretenses"); *see also Cowen v. People,* 14 Ill. 348, 352 (1853) ("[I]f the false representations were made in pursuance of a mutual agreement between the defendants, it was immaterial which actually made them; both were equally liable."); *cf. Commonwealth v. Call,* 38 Mass. (21 Pick.) 515, 523 (1839) ("A false representation, made to the agent of Parker and by him communicated to Parker upon which he acted was, in legal contemplation, a false representation made to Parker himself. It was designed to influence him, and whether communicated to him directly, or through the intervention of an agent, can make no difference. It was intended to reach and operate upon his mind. It did reach it and produced the desired effect upon it, viz. the payment of the money. And it is immaterial whether it passed through a direct or circuitous channel.").

27. *Commonwealth v. Hamblen,* 225 N.E.2d 911, 915 (Mass. 1967) (involving fraud on a corporation).

28. Wharton's Criminal Law §415, at 530; *see also Commonwealth v. Camelio,* 295 N.E.2d 902, 905 (Mass. App. Ct. 1973) ("[T]he "paradigm of a number of cases resulting in conviction" for false pretenses is a "joint venture to defraud in which the defendant furnished his accomplice with false reports, the accomplice submitted them to the [defrauded parties,] and the defendant received moneys as a result."); *cf. e.g., Brackett v. Griswold,* 20 N.E. 376, 379 (N.Y. 1889) (stating that to maintain an common law action for fraud or deceit based on false pretenses it is "not necessary that the false representation should have been made by the defendant

our view, a modern understanding of what conduct may be deemed "deceptive" should not be any narrower than this historical approach.[29]

b. Rule 10b-5(a) and (c) proscribe employing any manipulative or deceptive device, scheme, or artifice to defraud or engaging in any manipulative or deceptive act, practice, or course of business.

Rule 10b-5 implements the Commission's authority under Section 10(b).[30] Rule 10b-5(a) prohibits "employ[ing] any device, scheme, or artifice to defraud."[31] Rule 10b-5(b) prohibits "mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[32] And Rule 10b-5(c) prohibits "engag[ing] in any act, practice, or course of business which operates or would operate as

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personally" and that if "he authorized and caused it to be made, it is the same as though he made it himself").

29. *See Cady, Roberts & Co.,* 40 S.E.C. 907, 1961 WL 60638, at *3 (Nov. 8, 1961) (recognizing that Section 10(b) and Rule 10b-5 "are broad remedial provisions aimed at reaching misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit").

30. *See United States v. Zandford,* 535 U.S. 813, 816 n.1 (2002).

31. 17 C.F.R. § 240.10b-5(a).

32. *Id. §* 240.10b-5(b).

a fraud or deceit upon any person."[33] Liability under all three subsections requires a showing of scienter.[34]

Malouf is charged with violating Rule 10b-5(a) and (c). Whereas Rule 10b-5(b) (which Malouf is *not* charged with violating) is limited to liability for making false statements and omissions, Rule 10b-5(a) and (c) "are not so restricted."[35] The use in Rule 10b-5(a) and (c) of the terms "'fraud; 'deceit,' and 'device, scheme, or artifice' provide a broad linguistic frame within which a large number

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33. *Id. §* 240.10b-5(c).

34. *Hochfelder,* 425 U.S. at 194. Scienter is an "intent to deceive, manipulate, or defraud." *Id.* at 193 & n.12. It may be established through a heightened showing of recklessness. *Rockies Fund, Inc. v. SEC,* 428 F.3d 1088, 1093 (D.C. Cir. 2005); *C.E. Carlson v. SEC,* 859 F.2d 1429, 1435 (10th Cir. 1988); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551* U.S. 308, 319 n.3 (2007) (noting that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly" but that standards vary). "Extreme recklessness is an 'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Rockies Fund,* 428 F.3d at 1093 (quoting *SEC v. Steadman,* 967 F.2d 636, 641 (D.C. Cir. 1992)); *accord C .E. Carlson,* 859 F.2d at 1435.

35. *Affiliated Ute Citizens of Utah v. United States,* 406 U.S. 128, 152 (1972) (finding it irrelevant that the defendants "may have *made* no positive representation" because only Rule 10b-5(b) "specifies the making of an untrue statement of a material fact") (emphasis added).

of practices may fit."[36] Indeed, we have explained that Rule 10b-5 is "designed to encompass the infinite variety of devices that are alien to the climate of fair dealing . . . that Congress sought to create and maintain."[37] The Supreme Court, too, has recognized that Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any' are obviously meant to be inclusive."[38] The Court therefore has instructed that they "must be read flexibly, not technically or restrictively" in order to achieve their remedial purposes.[39]

Nonetheless, liability under Rule 10b-5 cannot "extend beyond conduct encompassed by Section 10(b)'s prohibition."[40] And the "language of Section 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."[41] Because a plaintiff "may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of Section 10(b)," only conduct that is itself manipulative or deceptive violates Rule 10b-5.[42]

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36. *SEC v. Clark,* 915 F.2d 439, 448 (9th Cir. 1990) (noting the breadth of the terms "'fraud,' 'deceit,' and 'device, scheme, or artifice'").

37. *Collins Sec. Corp.,* 46 SEC 20, 33 (1975) (internal quotation marks omitted).

38. *Affiliated Ute,* 406 U.S. at 151.

39. *See, e.g., Santa Fe,* 430 U.S. at 475-76.

40. *United States v. O'Hagan,* 521 U.S. 642, 651 (1997).

41. *Santa Fe,* 430 U.S. at 473.

42. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 173, 177-78 (1994); *accord Robert W.*

In our view, therefore, primary liability under Rule 10b-5(a) and (c) extends to anyone who (with scienter, and in connection with the purchase or sale of securities) employs *any* manipulative or deceptive device, scheme, or artifice to defraud or engages in *any* manipulative or deceptive act, practice, or course of business that operates as a fraud. In particular, as discussed above, we understand the statutory term "deceptive" to connote a broad proscription against conduct that deceives or misleads another, and nothing in the text, history, or our prior interpretations of the rule suggest that subsections (a) and (c) in any way limit that understanding.

Thus, the courts to consider the issue agree, as do we, that the prohibitions in subsections (a) and (c) encompass the falsification of financial records to misstate a company's performance.[43] Those prohibitions also encompass the orchestration of sham transactions designed to give the false appearance of business operations.[44] But contrary

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Armstrong III, Exchange Act Release No. 51920, 58 SEC 542, 2005 WL 1498425, at *6 (June 24, 2005); *Leslie A. Arouh,* Exchange Act Release No. 50889, 57 SEC 1099, 2004 WL 2964652, at *5 (Dec. 20, 2004).

43. *E.g., Monterosso,* 756 F.3d at 1334-36 (holding that falsification of financial records can suffice for primary liability under Rule 10b-5(a)); *SEC v. Familant,* 910 F. Supp. 2d 83, 86-88, 93-97 (D.D.C. 2012) (agreeing that such conduct suffices for primary liability under both Rule 10b-5(a) and (c)); *Langford,* 2013 WL 1943484, at *8 (same); *Sells,* 2012 WL 3242551, at *6-7 (same); *Mercury Interactive,* 2011 WL 5871020, at *2 (same).

44. *E.g., In re Parmalat Sec. Litig.,* 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (holding that banks could be liable under Rule 10b-5(a) and (c) for engaging in transactions with issuer that lacked

to the view expressed by some courts that Rule 10b-5(a) and (c) are limited to conduct "beyond mere misstatements and omissions,"[45] we conclude that subsections (a) and (c) also proscribe making, drafting, or devising a material misstatement. Furthermore, because nondisclosure in violation of a fiduciary duty involves "feigning fidelity" to the person to whom the duty is owed and is therefore deceptive,[46] we find that failing to correct a material misstatement in violation of a fiduciary duty to do so also falls within the prohibitions of Rule 10b-5(a) and (c).

These actions, in our view, constitute employing a deceptive "device" or engaging in a deceptive "act."[47] Indeed, the Supreme Court recently indicated that it agreed with this understanding—at least with regard to Rule 10b-5(a) encompassing the "making" of a material misrepresentation or a similar omission.[48] And, Section

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economic substance and allowed the issuer to misstate its financial condition); *In re Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004) (holding that auditor could be liable under Rule 10b-5(a) and (c) for masterminding sham swap transactions that were used to circumvent GAAP and inflate and misstate company's revenue); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173-74 (D. Mass. 2003) (holding that companies that created and financed sham entities that entered into bogus transactions with another company to inflate and misstate that company's profits could be liable under Rule 10b-5(a) and (c)).

45. *E.g., Familant,* 910 F. Supp. 2d at 97.

46. *See O'Hagan,* 521 U.S. at 655.

47. 17 C.F.R. § 240.10b-5(a), (c).

48. *Chadbourne & Parke LLP v. Troice,* 134 S. Ct. 1058, 1063 (2014) (stating that Rule 10b-5 "forbids the use of any 'device,

10(b) and Rule 10b-5 "are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing.'"[49]

In sum, primary liability under Rule 10b-5(a) and (c) extends to any defendant whose "challenged conduct in relation to a fraudulent scheme constitutes the use of a deceptive device or contrivance," even if a misstatement "made" by another person for purposes of Rule 10b-5(b) "creates the nexus between the scheme and the securities markets."[50] A defendant who employs a deceptive device or engages in a deceptive act cannot escape primary liability under Rule 10b-5(a) and (c) by arguing that his deceptive device or act involved misstatements and another person "made" the misstatements for purposes of Rule 10b-5 as construed by *Janus*.[51]

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scheme, or artifice to defraud' *(including* the making of 'any untrue statement of a material fact' or any similar 'omi[ssion]') 'in connection with the purchase or sale of any security'" (alterations in original; emphasis added)).

49. *United States v. Charnay,* 537 F.2d 341, 349 (9th Cir. 1976) (citation omitted).

50. *Parmalat,* 376 F. Supp. 2d at 502-03 (citing *Lernout & Hauspie,* 236 F. Supp. 2d at 173-74).

51. *See SEC v. Strebinger,* 114 F. Supp. 3d 1321, 1329-1331 (N.D. Ga. 2015) (despite defendant's argument that the Commission "fail[ed] to allege that [he] *made* the misstatements within the" reports, finding sufficient for liability under Rule 10b-5(a) and (c) the allegations that defendant "contributed to the contents" of reports

c. Primary liability under Rule 10b-5(a) and (c) is not limited to deceptive conduct "beyond" misstatements or omissions.

Given our reading of Section 10(b) and Rule 10b-5(a) and (c), we necessarily disagree that a "defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rule 10b-5(a) or (c) when the scheme also encompasses conduct *beyond* those misrepresentations or omissions."[52] Such a conclusion contravenes the plain text of the rule. Rule 10b-5(a) proscribes deceptive "device[s]," "scheme[s]," and "artifice[s] to defraud," and Rule 10b-5(c) proscribes, among other things, deceptive "act[s]." It would be arbitrary to read those terms as *excluding* the making, drafting, or devising of a misstatement or omission.[53] And,

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that contained misstatements, "edited, and otherwise provided information for," the reports that contained misstatements, and "arrange[d] the dissemination of the" reports knowing that they contained misstatements).

52. *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.,* 655 F.3d 1039, 1057-58 (9th Cir. 2011) (emphasis added) (collecting cases); *accord Public Pension Fund Grp. v. KV Pharm. Co.,* 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg); see also Lentell v. Merrill Lynch & Co.,* 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

53. If a deceptive device that is "beyond" a misstatement suffices for liability, then a deceptive device that is not "beyond" a misstatement also should suffice. Falsifying an invoice as part of a fraud involving revenue misstatements has been considered a deceptive device "beyond" the misstatements. *See, e.g., Familant,* 910 F. Supp. 2d at 92-93, 97. The conversion of those false invoices into a

as noted, the Supreme Court has recently indicated that it would reject such a narrow reading of subsections (a) and (c).[54]

The three subsections of Rule 10b-5 need not be read exclusively, such that conduct that falls within the purview of one—e.g., misstatements or omissions, within subsection (b)—cannot also fall within another. To the contrary, we have advised that the subsections of the rule are "mutually supporting rather than mutually exclusive."[55] Reading the subsections of Rule 10b-5 to

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misstatement about revenue—i.e., drafting the misstatement—also should be viewed as a deceptive device. The latter is no less deceptive than the former. For purposes of primary liability, it should not matter whether the deceptive act could be considered "beyond the misstatement."

54. *See Troice,* 134 S. Ct. at 1063.

55. *Cady, Roberts & Co.,* 1961 WL 60638, at *4. And in *SEC v. Capital Gains Research Bureau,* 375 U.S. 180, 197-98 (1963), the Supreme Court explained that because the Securities Act of 1933 was "the first experiment in federal regulation of the securities industry," it "was understandable" that Congress "include[d] both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure." Because Rule 10b-5 was modeled on Section 17(a) of the Securities Act, we find the same logic applicable to Rule 10b-5. It is thus reasonable to construe Rule 10b-5(a) and (c) as encompassing "all acts within the purview of Rule 10b-5[(b)]." *See* Arnold S. Jacobs, *Disclosure and Remedies under the Securities Laws §* 6:22 (citing *Capital Gains); accord* 1 Alan R. Bromberg et al., *Bromberg & Lowenfels on Securities Fraud §* 2:181 (2d ed.); *see also Troice,* 134 S. Ct. at 1063.

overlap ensures that investors are appropriately protected from manipulative or deceptive conduct in connection with the purchase or sale of securities.

In addition, the "beyond a misstatement" formulation has arisen from a misunderstanding of the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver.*[56] In *Central Bank,* the Court explained that only defendants who themselves employ a manipulative or deceptive device or make a material misstatement may be primarily liable under Rule 10b-5; others are, at most, secondarily liable as aiders and abettors and "a private plaintiff may not maintain an aiding and abetting suit under Section 10(b)."[57] The Court found that the defendant bank could not be primarily liable merely for having facilitated the fraudulent scheme by agreeing to delay an appraisal.[58] Lower courts have appropriately read *Central Bank* to require that, in cases involving fraudulent misstatements, defendants cannot be primarily liable under Rule 10b-5(a) or (c) merely for having "assisted" an alleged scheme to make a fraudulent misstatement (without engaging in conduct that is manipulative or deceptive).[59] But some courts have

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56. 511 U.S. 164.

57. *Id.* at 191.

58. *Id* at 168-69, 191.

59. *E.g., Great Neck Capital Appreciation Inv. P'ship, L.P. v. Pricewaterhouse Coopers, L.L.P.,* 137 F. Supp. 2d 1114, 1121 (E.D. Wis. 2001) (finding allegations that accounting firm "assisted with the press release by reviewing it and advising [company] that

articulated this "more than mere assistance" standard imprecisely, stating that primary liability under Rule 10b-5(a) and (c) must require proof not just of manipulative or deceptive conduct, but of particular deceptive conduct "beyond" the alleged misstatements.[60]

This construction of our rule is neither consistent with nor dictated by *Central Bank*. *Central Bank* does not hold that primary liability under Rule 10b-5(a) and (c) turns on whether a defendant's conduct is "beyond" a misstatement. Instead, *Central Bank* stands for the proposition that any defendant whose conduct is manipulative or deceptive may be liable as a primary violator under Rule 10b-5.[61]

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it conformed to GAAP" insufficient to support primary liability because plaintiffs did not allege that accounting firm "drafted the release, publicly adopted it, or allowed its name to be associated with it").

60. *E.g., In re Alstom SA,* 406 F. Supp. 2d 433, 475-76 (S.D.N.Y. 2005).

61. 511 U.S. at 177-78, 191. We believe our approach appropriately distinguishes between primary and secondary liability, as *Central Bank* requires. Defendants who merely obtain or transmit legitimate documents knowing that they would later be falsified in order to misstate a company's financial condition would not be primarily liable under Rule 10b-5(a) and (c), but could be liable for aiding and abetting. Similarly, defendants who engage in legitimate, rather than sham, transactions generally would not be primarily liable under Rule 10b-5(a) and (c), even if they "knew or intended that another party would manipulate the transaction to effectuate a fraud." *See, e.g., Simpson v. AOL Time Warner Inc.,* 452 F.3d 1040, 1047-50 (9th Cir. 2006), *vacated on other grounds sub nom. Avis Budget Group, Inc. v. Cat Stat Teachers' Ret. Sys.,* 552 U.S. 1162

Additionally, *Janus* does not independently justify such a test.[62] In *Janus,* the Court construed only the term "make" in Rule 10b-5(b), which does not appear in subsections (a) and (c); the decision did not mention or construe the broader text of those provisions.[63] The Court did not suggest that because the "maker" of a false statement is primarily liable under subsection (b), that person cannot *also* be liable under subsections (a) and (c). Nor did the Court indicate that a defendant's failure to "make" a misstatement for purposes of subsection (b) precludes primary liability under the other provisions.

(2008). And defendants who have no fiduciary duty of disclosure but who are aware of a fraud and have the potential to benefit from it but take no action to stop it also would be aiders and abettors of a Rule 10b-5 violation rather than primary violators themselves. *See SEC v. Aragon Cap. Advisors, LLC,* 2011 WL 3278907, at *17-18 (S.D.N.Y. July 26, 2011) (finding that defendants who were aware that their brother was trading based on material non-public information in accounts in their names aided and abetted the fraud by their inaction because they stood to benefit from the fraud and thus their inaction was intentionally designed to aid the fraud). In these situations, the defendants are aiders and abettors rather than primary violators because their own conduct was not deceptive.

62. *See, e.g., Monterosso,* 756 F.3d at 1334 (stating that "*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b-5(b), and did not concern . . . Rule 10b-5(a) or (c)"); Jacobs, *Disclosure and Remedies under the Securities Laws §* 12:113.99 (agreeing that *Janus* "does not control any suit under" Rule 10b-5(a) or (c)). *But see, e.g., SEC v. Benger,* No. 09 C 676, 2013 WL 1150587, at *5 (N.D. Ill. Mar. 21, 2013) *("Janus* cannot be skirted simply by artful pleading and rechristening a 10b-5(b) claim as a claim under 10b-5(a) and (c).").

63. *See generally Janus,* 131 S. Ct. 2296.

Janus thus provides no support for the notion that primary liability under those provisions is limited to deceptive acts "beyond" misstatements.[64]

Indeed, our view of primary liability under Rule 10b-5(a) and (c) is consistent with the rationales on which *Janus* rests. The Court first emphasized the textual basis for its holding, concluding that one who merely "prepares" a statement necessarily is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.[65] Our approach does not conflict with that logic: Accepting that a drafter, for example, may not be primarily liable under Rule 10b-5(b) if he did not "make"

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64. As we reject the "beyond a misstatement" approach, we necessarily also reject the reading of Rule 10b-5(a) and (c) adopted in *Kelly,* 817 F. Supp. 2d at 344. *See supra* note 13. There, the court concluded that, in any case involving misstatements, *Janus* precludes primary liability under Rule 10b-5(a) and (c) for all defendants who do not themselves "make" the misstatements, regardless of whether they engaged in deceptive conduct "beyond" the misstatements. That reading of *Janus* mistakenly assumes both that the Court intended to construe provisions that it never mentioned and that the Court intended to give primacy to Rule 10b-5(b) at the expense of subsections (a) and (c). Indeed, as one court observed, "*Kelly* cast subsection (b) in Rule 10b-5's lead role and then crippled subsections (a) and (c) to ensure that they would never overshadow the star." *Familant,* 910 F. Supp. 2d at 95. A number of district court have disagreed with *Kelly's* reading of *Janus. E.g., Strebinger,* 114 F. Supp. 3d. at 1331 n.9; *Sells,* 2012 WL 3242551, at *6-7; *Langford,* 2013 WL 1943484, at *8; *Garber,* 2013 WL 1732571, at *4; *SEC v. Geswein,* 2011 WL 4541308, at *17 n.3 (N.D. Ohio Aug. 2, 2011), *adopted in relevant part,* 2011 WL 4565861 (N.D. Ohio Sept. 29, 2011).

65. *Janus,* 131 S. Ct. at 2302.

the misstatement, our position is that the drafter instead could be primarily liable under subsections *(a)* and *(c)* for employing a deceptive "device" and engaging in a deceptive "act." At least one court of appeals has agreed with that view.[66] Indeed, this textual reading of Rule 10b-5(a) and (c) is consistent with the *Janus* Court's own emphasis on adhering to the text of the rule.[67]

Our approach is also consistent with the second rationale in *Janus*—that a drafter's, as opposed to a "maker's," conduct is too remote to satisfy the element of reliance in private actions arising under Rule 10b-5. Investors, the Court explained, cannot be said to have relied on "undisclosed act[s]," such as drafting a misstatement, that "preced[e] the decision of an independent entity to make a public statement."[68] Again, our analysis fully comports with that logic. Indeed, as *Janus* recognizes, if the private plaintiffs' claims in *Janus* had arisen under Rule 10b-5(a) or (c), those plaintiffs may not have been able to show reliance on the drafters' conduct. Thus, our interpretation does not expand the "narrow scope" the Supreme Court "give[s to] the implied private right of action."[69] In contrast to private parties, however, the Commission need not show reliance as an element of its

66. *Big Apple Consulting,* 783 F.3d at 796.

67. *Janus,* 131 S. Ct. at 2302-04.

68. *Id* at 2303-04 (citing *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 161 (2008)).

69. *Id.* at 2303.

claims.[70] Thus, even if *Janus* precludes liability in private actions for those who commit "undisclosed" deceptive acts, it does not preclude liability in Commission enforcement actions under Rule 10b-5(a) and (c) against those same individuals.

2. Primary Liability Under Sections 17(a)(1) and (a)(3) of the Securities Act

a. Section 17(a) does not require conduct that is itself manipulative or deceptive.

Section 17(a) of the Securities Act makes it unlawful, in the offer or sale of any security, "(1) to employ any device, scheme, or artifice to defraud"; (2) "to obtain money or property by means of any untrue statement of a material fact or any [material] omission"; or (3) "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[71] Absent from these provisions is the language of Section 10(b) requiring that the proscribed conduct be "manipulative or deceptive."[72] There is therefore no textual basis for concluding that Rule 10b-5's requirement that the defendant's violative conduct itself be "manipulative or deceptive" also applies to Section 17(a).[73]

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70. *See, e.g., SEC v. Morgan Keegan & Co.,* 678 F.3d 1233, 1244 (11th Cir. 2012) (noting that reliance is not an element of a Commission enforcement action).

71. 15 U.S.C. § 77q(a).

72. *See id.* § 78j(b).

73. Some commenters have recognized that Section 17(a) may cover conduct that is not itself manipulative or deceptive because

Appendix C

As the Court explained in *Aaron,* Section 17(a)(1) requires a showing of scienter, or deceptive *intent*,[74] but we find that mental-state requirement distinct from the need to show, under Exchange Act Section 10(b) that

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it does not contain the language of Section 10(b). *E.g.,* 4 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation §* 12.22 ("Section 17(a) does not contain the phrase 'manipulative or deceptive device' that is found in Section 10(b) of the Exchange Act and has formed a basis of the scienter and deception requirements."); Donald C. Langevoort, *Fraud and Deception by Securities Professionals,* 61 Tex. L. Rev. 1247, 1293 (1983) ("Aside from [S]ection 10(b), [S]ection 17(a) of the Securities Act of 1933 is the broadest section prohibiting fraud 'in the offer or sale' of any security. It is not limited to deception or manipulation . . . ."). Nevertheless, some courts have, without meaningful analysis, described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *E.g., Landry v. All Am. Assurance Co.,* 688 F.2d 381, 386 (5th Cir. 1982).

74. *Aaron v. SEC,* 446 U.S. 680, 695-697 (1980). A showing of negligence suffices under subsections (a)(2) and (a)(3). *Id.* at 697. Negligence requires a showing that the defendant failed to exercise reasonable care. *Ira Weiss,* Exchange Act Release No. 52875, 58 SEC 977, 2005 WL 3273381, at *12 (Dec. 2, 2005) (citing *SEC v. Hughes Capital Corp.,* 124 F.3d 449, 453-54 (3d Cir. 1997)), *pet. denied, Weiss v. SEC,* 468 F.3d 849 (D.C. Cir. 2006). The Supreme Court in *Aaron* makes clear that negligence is sufficient for liability under Sections 17(a)(2) and (a)(3), *e.g., SEC v. Smart,* 678 F.3d 850, 857 (10th Cir. 2012); *Weiss,* 468 F.3d at 855, though the Court has never addressed whether negligence is *necessary* to prove a violation of those provisions. *See Aaron,* 446 U.S. at 696-97 (noting that the focus of Section 17(a)(3), at least, is on the "effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible" for the conduct"); *see also United States Tagliaferri,* __ F.3d __, 2016 WL 2342677, at *5 (2d Cir. May 4, 2016) (relying on this language from *Aaron*).

the defendant's violative conduct is itself deceptive (or manipulative).[75] Moreover, reading Section 17(a) not to impose such a requirement ensures that investors are appropriately protected from conduct in the offer or sale of securities that is not itself manipulative or deceptive—but nevertheless would operate as a fraud on those investors.

b. Section 17(a)(1), like Rule 10b-5(a) and (c), encompasses fraudulent conduct involving misstatements.

Like Rule 10b-5(a) and (c), we read the language of Section 17(a)(1) to encompass all fraudulent conduct undertaken with scienter—including conduct undertaken as part of a fraud involving misstatements.[76] Indeed, Section 17(a)(1) is identical to Rule 10b-5(a) in prohibiting

75. *Accord Klamberg v. Roth,* 473 F. Supp. 544, 556 (S.D.N.Y. 1979) (noting that because Section 17(a) "is in many respects broader than [S]ection 10(b)," the Section 17(a) claims could survive even absent deceptive conduct by the defendant himself). We can conceive of a number of ways that a defendant might contribute to a fraud through conduct that is not itself deceptive or manipulative. For example, if a defendant company executed legitimate transactions with another entity knowing that the other entity would use the transactions to misstate its revenue, the defendant company would not be liable under Section 10(b) because the transactions were not themselves deceptive, but would still be liable under Section 17(a). *See, e.g., Simpson,* 452 F.3d at 1050.

76. In our analysis of Sections 17(a)(1) and (a)(3), we find irrelevant the case law requiring conduct "beyond" a misstatement for claims arising under Rule 10b-5(a) and (c). As discussed above, that authority is unpersuasive even in the context of Rule 10b-5(a) and (c). And, in any case, those cases only involve Section 10(b) and Rule 10b-5, not Section 17(a).

the "employ[ment]" of a "device," "scheme," or "artifice to defraud."[77] And, as explained above, a misstatement or omission of a material fact is undoubtedly a "device" or "artifice" to defraud.[78]

Thus, one who (with scienter) makes a material misstatement or omission of a material fact in the offer or sale of a security has violated Section 17(a)(1) because such conduct constitutes "employ[ing]" a "device, scheme, or artifice to defraud." Futhermore, anyone (acting with scienter) who, for example, drafts or devises a misstatement of a material fact, uses a misstatement of a material fact made by others to defraud investors, or fails to correct a misstatement of a material fact despite a fiduciary duty to do so likewise has "employ[ed]" a "device" or "artifice to defraud" and therefore, violated Section 17(a)(1).[79]

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77. 15 U.S.C. § 77q(a)(1).

78. *See Troice,* 134 S. Ct. at 1063.

79. *See, e.g., Big Apple Consulting,* 798 F.3d at 792, 795-798 (upholding jury verdict finding defendants liable for violating Sections 17(a)(1), (2), and (3) where they, among other things, "conceived, drafted, edited, or reviewed numerous press releases" containing materially misleading statements); *Monterosso,* 756 F.3d at 1334 (holding that falsification of financial records can be sufficient for liability under Section 17(a)(1)); *Strebinger,* 114 F. Supp. 3d at 1332 (finding allegations that defendant "contributed to the contents" of reports that contained misstatements, "edited, and otherwise provided information for," the reports, and "arrange[d] the dissemination of the" reports knowing that they contained misstatements sufficient for liability under Section 17(a)(1)-(3)). *See generally United States v. Naftalin,* 441 U.S. 768, 772 (1979) (recognizing that a defendant who "falsely represented that he owned the stock he sold" violated Section 17(a)(1)).

We thus reject any suggestion that the reach of Section 17(a)(1) is limited because Section 17(a)(2) expressly prohibits certain negligent misstatements.[80] Section 17(a)(1) and (a)(2) address very different types of conduct—Section 17(a)(1) proscribes all scienter-based fraud, whereas Section 17(a)(2) prohibits negligent misrepresentations that deprive investors of money or property. And we have recognized that the subsections of Section 17(a) are "mutually supporting rather than mutually exclusive."[81] As the Supreme Court has observed, "[e]ach succeeding prohibition [in Section 17(a)] is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections."[82] Reading the provisions as

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80. *See, e.g., Kelly,* 817 F. Supp. 2d at 345-46. Nothing in *Janus* is inconsistent with our understanding of Section 17(a)(1). Nearly all courts to consider the issue agree that *Janus* has no bearing on Section 17(a). *E.g., Big Apple Consulting,* 783 F.3d at 798 (stating that Sections 17(a)(1) and (a)(3) "are in no way directly or indirectly affected by the *Janus* decision"); *Monterosso,* 756 F.3d at 1334 (stating that *Janus* addressed only "what it means to 'make' a statement for purposes of Rule 10b-5(b), and did not concern 17(a)(1) or (3)"); *Sentinel Mgmt. Group,* 2012 WL 1079961, at *14-15; *Stoker,* 865 F. Supp. 2d at 465-66 (collecting cases); *Sells,* 2012 WL 3242551, at *7 (collecting cases); 5 *Bromberg & Lowenfels on Securities Fraud* § 7:306.58 (collecting cases); *see also Disclosure and Remedies under the Securities Laws* § 12:113.99 (concurring that *Janus* does not affect the scope of liability under Section 17(a)).

81. *Cady, Roberts & Co.,* 1961 WL 60638, at *4.

82. *Naftalin,* 441 U.S. at 774. Reading Section 17(a)(1) to encompass misstatements does not cause Section 17(a)(2) to be wholly subsumed by Section 17(a)(1), because Section 17(a)(2) permits liability for negligence, whereas Section 17(a)(1) requires a showing of scienter. *See Aaron,* 446 U.S. at 695-97.

mutually exclusive could also limit our ability to protect investors from fraudulent misstatements in the offer or sale of securities where the misstatements did not involve obtaining money or property.

c. Section 17(a)(3) encompasses fraudulent conduct involving misstatements to the extent the fraudulent conduct can be considered a transaction, practice, or course of business.

Section 17(a)(3) prohibits all "transaction[s]," "practice[s]," and "course[s] of business" that "operate[] or would operate as a fraud."[83] Although this language closely resembles Rule 10b-5(c), Section 17(a)(3) uses the term "transaction" rather than the broader term "act." For purposes of determining whether misstatement-related conduct comes within the purview of Section 17(a)(3), we find that difference significant: While a misstatement or omission (or related activity) may fairly be characterized as an "act," a misstatement or omission is not a "transaction."[84] As a result, whereas Rule 10b-5(a) and (c) and Section 17(a)(1) all proscribe even a single act of, for example, making or drafting a materially misleading

83. 15 U.S.C. § 77q(a)(3).

84. *Compare* Webster's New International Dictionary 25 (def. 1) (2d ed. 1934) (defining "act" broadly as "[t]hat which is done or doing; the exercise of power, or the effect whose cause is power exerted; a performance; a deed") *with id.* 2688 (def. 2a) (defining "transaction" as "[a] business deal; an act involving buying and selling").

statement to investors, Section 17(a)(3) would not proscribe a single act unless that single act may be considered a "transaction," "practice," or "course of business." That said, *repeated* acts, such as repeatedly making or drafting materially misleading statements over a period of time, may be considered a fraudulent "practice" or "course of business."[85] Accordingly, we read Section 17(a)(3) to be narrower than Rule 10b-5(c) in this respect—*i.e.*, Section 17(a)(3) does not encompass those "acts" proscribed by Rule 10b-5(c) that are not "transactions," "practices" or "courses of business."[86]

Despite being narrower than Rule 10b-5(c) in some respects, Section 17(a)(3) is broader than Rule 10b-5(c) (and Section 17(a)(1)) in others. As discussed above, unlike Rule 10b-5(c), 17(a)(3) does not require that the defendant have engaged in conduct that is itself deceptive (or manipulative). Nor does Section 17(a)(3) require a showing of scienter. *Aaron* instructs that "the language of [Section] 17(a)(3)] . . . quite plainly focuses upon the effect of particular conduct on members of the investing

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85. *See id.* at 1937 (def. 1b) (defining "practice," when used as a noun, in terms suggesting repeated conduct engaged in over time: "often, repeated or customary action; usage; habit; custom; . . . the usual mode or method of doing something"); *id.* 610 (def. 5) (defining "course," when used in phrases like "course of conduct," to mean "a succession of acts or practices" or "[a] series of motions or acts"). We note that "transaction" is also an operative term in the statute—a transaction, such as a trade, that itself operated or would operate as a fraud could serve as the basis for primary liability, as well.

86. *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 3:248 (suggesting that "the word 'transaction' in Section [17(a)(3)] is less broad than 'act' in [Rule 10b-5(c)]").

public, rather than upon the culpability of the person responsible."[87] Section 17(a)(3)'s prohibition thus applies, for example, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also applies, for example, where, as a result of a defendant's negligent conduct, prospective investors are prevented from learning material information about a securities offering.[88] This reading of the statute ensures that investors protected from are potentially harmful courses of conduct in the offer and sale of securities.

3. Primary liability under Section 206 of the Advisers Act.

Section 206(1) of the Advisers Act makes it unlawful for "any investment adviser" to "employ any device, scheme,

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87. *Aaron,* 446 U.S. at 697 (emphasis omitted); *accord Tagliaferri,* 2016 WL 2342677, at *5.

88. *See, e.g., Weiss v. SEC,* 468 F.3d 849, 855 (D.C. Cir. 2006) (denying petition for review where Commission found a school district's bond counsel liable under Section 17(a)(3) for having "fail[ed] to look for even minimal objective "support for school district's statements in bond prospectus when approving prospectus and issuing opinion letters); *Johnny Clifton,* Securities Act Release No. 9417, 2013 WL 3487076, at *10 (July 12, 2013) (finding a Section 17(a)(3) violation because defendant "conceal[ed] material adverse information" from "sales representatives" and "ensure[d] that sales representatives who learned such information also withheld it from prospective investors"); *see also Byron G. Borgardt,* 56 S.E.C. 999, 2003 WL 22016313, at *13 (Aug. 25, 2003) (finding respondents liable under Section 17(a)(3) for failing to provide appropriate disclosures in registration statements).

or artifice to defraud any client or prospective client."[89] Section 206(2) makes it unlawful for the investment adviser to "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[90] Scienter is required to establish a violation of Advisers Act Section 206(1); a showing of negligence is sufficient for a violation of Section 206(2).[91] As is true of Exchange Act Rule 10b-5(a) and (c) and Securities Act Sections 17(a)(1) and (3), Sections 206(1) and 206(2) "lack any reference to *making* statements."[92] As a result, investment advisers may be held primarily liable under these provisions for their fraudulent conduct regardless of whether they "made" misstatements.[93]

These proscriptions apply to "any investment adviser."[94] Section 202(a)(11) defines an investment adviser as "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities."[95] This definition "does not include

89. 15 U.S.C. 80b-6(1).

90. 15 U.S.C. 80b-6(2).

91. *SEC v. Washington Inv. Network,* 475 F.3d 392, 396-397 (D.C. Cir. 2007) (citing *SEC v. Steadman,* 967 F.2d 636, 641, 643 (D.C. Cir. 1992) (quoting *Hochfelder,* 425 U.S. at 194 n.12)).

92. *Donald L. Koch,* Advisers Act Release No. 3836, 2014 WL 1998524, at *18 (May 16, 2014) (emphasis added), *aff'd,* 793 F.3d 147 (D.C. Cir. 2015).

93. *Id.*

94. 15 U.S.C. 80b-6(1), (2).

95. 15 U.S.C. 80b-2(a)(11).

whether one is registered or not with the SEC."[96] An individual may be primarily liable under the Section 206(1) and (2), therefore, irrespective of registration with the Commission."[97] Accordingly, anyone whose activities "fall[] under the broad definition of 'investment adviser' in the Act" may be "liable as a primary violator under Advisers Act Sections 206(1) and 206(2)."[98]

Primary liability for a violation of Rule 206(4)-1 under the Advisers Act, which implements Section 206(4), is narrower in scope. Section 206(4) provides that it shall be unlawful for an investment advisor "to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and that the Commission shall, for purposes of this section, define "such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."[99] Rule 206(4)-1 provides in turn that certain conduct "shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser *registered or required to be registered* under section 203 of the Act."[100]

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96. *Koch v. SEC*, 793 F.3d 147, 157 (D.C. Cir. 2015).

97. *Id.*

98. *Koch*, 2014 WL 1998524, at *18 (citing 15 U.S.C. 80b-2(a)(11) and collecting cases).

99. 15 U.S.C. 80b-6(4).

100. 17 C.F.R. 15 U.S.C. § 275.206(4)-1 (emphasis added). *See infra* Part II.B.5.

B. Malouf Violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) of the Securities Act, and Section 206 of the Advisers Act.

We find that Malouf violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5(a) and (c), Sections 17(a)(1) and 17(a)(3) of the Securities Act, and Sections 206(1) and 206(2) of the Advisers Act. Although Malouf may not have "made" the material misstatements in UASNM's Forms ADV and on its website regarding UASNM's independence, he failed to correct those misstatements despite having a fiduciary duty to do so, and he acted with scienter.[101] As discussed below, we conclude that through his misconduct Malouf employed a deceptive device and artifice to defraud, and he engaged in a deceptive act, practice, and course of business that operated as a fraud in violation of those provisions.[102] We

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101. From the record, it is clear that Malouf was, as he himself described his role, the "top dog" at UASNM and he admitted he was at least "partially responsible" for its disclosures in its Forms ADV and on its website. This evidence might support a finding that Malouf had "ultimate authority" over those statements for purposes of assessing liability under Rule 10b-5(b); however, we do not reach the issue since Malouf was not charged under that provision.

102. It is undisputed that the highly liquid, AAA-rated Treasury and agency bonds that UASNM's clients purchased through RJ between 2008 and 2011 were securities, that Malouf used instrumentalities of interstate commerce to offer and sell them, and that the statements in the Forms ADV and on UASNM's website were made in connection with offers and sales of securities. We thus find a preponderance of the evidence that these elements of the charged violations are satisfied.

also find that Malouf violated Sections 206(1) and 206(2) of the Advisers Act by failing to seek best execution for his clients. Finally, we find that Malouf aided and abetted UASNM's violated of the Advisers Act.

1. Malouf violated Exchange Act Section 10(b) and Rule 10b-5(a) and (c) by failing to correct the material misstatements on UASNM's Forms ADV and website.

a. Malouf employed a deceptive device and artifice to defraud and engaged in a deceptive act, practice, and course of business by failing to correct the material misstatements in UASNM's Forms ADV and on its website in violation of his fiduciary duty to do so.

UASNM's Forms ADV and website contained numerous material misstatements:

- UASNM'S Forms ADV from 2008 to 2011 represented that UASNM's selection of an executing broker was not based "upon any arrangement between the recommended broker and UAS[NM.]"

- UASNM's April 2010 Form ADV also stated that "employees of UASNM are not registered representatives of . . . RJ . . . and do not receive any commissions or fees from recommending these services."

- UASNM's website claimed that UASNM provided impartial investment advice, that its brokerage recommendations were not "based upon any arrangement between the recommended broker and UASNM" and that UASNM "vigorously maintain[s its] independence" and that its advice was "void of conflicts of interest."

In none of these communications did UASNM disclose that in fact Malouf had an arrangement with Lamonde whereby Lamonde paid him an amount equal (or almost equal) to the commissions that Lamonde received on the trades Malouf directed to Lamonde's RJ branch.

Malouf acknowledged that, as UASNM's CEO, he was at least "partially responsible" for UASNM's Forms ADV and website. He also admitted that he reviewed some of the Forms ADV between 2008 and 2011, "focusing on disclosures relating to himself and [the RJ branch]." Malouf also admitted "[w]hile he may not have read every word of UASNM's website, he was familiar with its contents in the 2008, 2009, and 2010 time frame" and that he "probably read" the statements on the website in 2008 to the effect that UASNM provided independent advice and had no arrangements with broker-dealers.

We find that Malouf acted deceptively in failing to correct the misstatements noted above. As an investment adviser, Malouf had a fiduciary obligation to provide "'full and fair disclosure of all material facts,'"[103] as well as an

103. *Geman v. SEC,* 334 F.3d 1183, 1189 (10th Cir. 2003) (quoting *Capital Gains,* 375 U.S. at 194); *accord SEC v. DiBella,* 587 F.3d 553, 563 (2d Cir. 2009).

"affirmative obligation to avoid misleading [his] clients."[104] He also had "a duty to disclose any potential conflicts of interest accurately and completely."[105] Separately, Malouf acknowledged that his agreement with Lamonde created a conflict of interest: He had an incentive to send UASNM clients' bond transactions to RJ so that Lamonde would be able to pay Malouf the amounts he owed him for the branch ($1,068,084). By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties as an investment adviser. Because it is well established that "nondisclosure in breach of a fiduciary duty 'satisfies section 10(b)'s requirement . . . [of] a 'deceptive device or contrivance,'"[106] we find that Malouf acted deceptively.[107]

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104. *SEC v. Washington Inv. Network,* 475 F.3d 392, 395 (D.C. Cir. 2007) (quoting *Capital Gains,* 375 U.S. at 194); *accord SEC v. Blavin,* 760 F.2d 706, 711-712 (6th Cir. 1985); see also *DiBella,* 587 F.3d at 568 ("The 'legislative history [of the Advisers Act] leaves no doubt that Congress intended to impose enforceable fiduciary obligations' on investment advisers."). An associated person of an investment adviser is also a fiduciary. *See, e.g., Christopher A. Lowry,* Investment Advisers Act Release No. 2052, 2002 WL 1997959, at *5 (Aug. 30, 2002), *aff'd,* 340 F.3d 501 (8th Cir. 2003).

105. *Vernazza v. SEC,* 327 F.3d 851, 860 (9th Cir. 2003).

106. *Dorozkho,* 574 F.3d at 49 (alteration and omission in original) (quoting *O'Hagan,* 521 U.S. at 653); *see also Finnerty,* 533 F.3d at 148 (holding that deception "irreducibly entails some act that gives the victim a false impression" such as "a false statement, breach of a duty to disclose, or deceptive communicative conduct"). *See generally Stoneridge,* 128 S. Ct. at 769 ("Conduct itself can be deceptive.").

107. *See* Model Penal Code §223.3 (theft by deception) (stating that a "person deceives if he purposely: (1) creates or reinforces a

Appendix C

Having found that Malouf acted deceptively, we also find that he employed a device and artifice to defraud in violation of Rule 10b-5(a) and engaged in an act, practice, and course of business that operated as a fraud in violation of Rule 10b-5(c). Malouf's failure to correct the misstatements on UASNM's website and in its Forms ADV left clients with the false impression that UASNM received no commissions from its brokerage recommendations, provided independent and impartial investment advice, and had no arrangements with broker-dealers. Several of UASNM's clients testified that they would have wanted to know about Malouf's potential conflict, confirming that the information was material to their decision to select UASNM as an investment adviser. Because Malouf's conduct deprived his clients of this information, his failure to correct the misrepresentations operated as a "device" and "artifice" to defraud and an "act," "practice," and "course of business" that misled his clients.[108]

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false impression . . . or (3) fails to correct a false impression which the deceiver previously created or reinforced, or which the deceiver knows to be influencing another to whom he stands in a fiduciary or confidential relationship").

108. *See, e.g., SEC v. Shattuck Denn Mining Corp.* 297 F. Supp. 470, 476 (S.D.N.Y. 1968) (finding the "failure to correct the 'misleading impression left by statements already made,' by one with a duty to do so, "constituted a fraud") (citing *Cochran v. Channing Corp.,* 211 F. Supp. 239, 243 (S.D.N.Y. 1962) (stating that the "fact that the defendants did not make any statements at all does not, in and of itself, deprive plaintiff of relief," that the "three subsections of Rule 10b-5 are in the disjunctive, and while subsection (2) seems to require a statement of some sort, subsections (1) and (3) do not,"

Malouf argues that in order to prove its claims under Exchange Act Section 10(b) and Rule 10b-5(a) and (c) (and Securities Act Section 17(a) and Advisers Act Section 206) "the Division was required to establish that [he] made a material misrepresentation or omission." As discussed above, we reject that view of primary liability under the antifraud provisions. Malouf's employment of a deceptive device and artifice to defraud and a deceptive act, practice, and course of business as part of the fraud suffices for liability so long as he acted with scienter.

b. Malouf acted with scienter.

We find that Malouf acted, at a minimum, with extreme recklessness in failing to promptly correct the material omissions in the Forms ADV and on the website. Malouf has acknowledged that he was familiar with the contents of UASNM's Forms ADV and website throughout the applicable period. Given this awareness and his admitted periodic reviews of the disclosures, we find that Malouf must have been aware that his conflict had not been disclosed to UASNM's clients.

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and that "[f]raud may be accomplished by false statements, a failure to correct a misleading impression left by statements already made or, as in the instant case, by not stating anything at all when there is a duty to come forward and speak"); *see also Bristol Myers Squibb Co. Secs. Litig.,* 586 F. Supp. 2d 148, 169-170 (S.D.N.Y. 2008) (finding defendant's "failure to correct [CEO's] and the Company's material misstatements despite his duties as a senior executive" deceptive even though he "made no public statements himself).

Furthermore, the risk of misleading investors as to the true reason why their bond trades were directed to RJ was so obvious that Malouf must have been aware of it; indeed, the circumstances suggest that Malouf may have declined to correct the misleading disclosures precisely *because* he wanted to convey an incorrect impression about the reason he selected RJ for the trades. Malouf acknowledges that in June 2010 he disclosed to ACA his receipt of payments from Lamonde—at which point ACA immediately instructed UASNM to disclose this arrangement—but did not add corresponding disclosures to the Forms ADV and website until March 2011. Thus, while the evidence strongly suggests that Malouf was aware of the missing disclosures for many years, even the most favorable reading of Malouf's testimony makes clear that he was aware of the omissions for at least nine months before correcting them. Allowing such misleading communications to persist for such a long period of time demonstrates, at a minimum, a reckless disregard of the risk of misleading investors.

While clients believed that their trades were directed to RJ because it provided them with the best execution of their trades in the view of an impartial adviser, they very well may have reached a different conclusion had they known about the significant payments Malouf received from Lamonde.[109] Indeed, because the payments

109. *See Curshen,* 372 F. App'x at 882 (finding scienter based on the "logical conclusion" that one who knew he was being compensated for promoting a stock also knew that the failure to disclose this compensation would mislead those reading his internet postings by making his opinions seem objective); *see also Gebben,* 225 F. Supp. 2d

Malouf received were almost identical to the commissions RJ received on the trades Malouf directed to the RJ branch, and those trades were the source of the funds Malouf received from Lamonde as payment for Malouf's interest in the RJ branch, it would have been difficult *not* to conclude that Malouf's recommendations could be influenced by his personal financial interests.

Malouf claims that he did not act recklessly because he reasonably believed that Kopczynski, Hudson, and ACA were aware of his receipt of the payments from Lamonde and did not tell Malouf to disclose them. But both Kopczynski and Hudson testified that they were *not* aware of the arrangement, and the ALJ credited their testimony over Malouf's.[110] And it is undisputed that ACA was not aware of any payments until June 2010. Even had Kopczynski, Hudson, Ciambor, and ACA known about Malouf's arrangement with Lamonde, this would not defeat a finding of scienter. Malouf admitted that investment advisers have a duty to disclose a conflict of

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at 927 (internet poster who "knew that investors . . . would wrongly believe that his opinions represented independent research, rather than merely a recitation of what Issuers paid [his employing firm] to say" acted with scienter).

110. We generally defer to an ALJ's demeanor-based credibility determinations, absent a showing that the substantial weight of the evidence warrants a different finding. *See Steven Altman,* Exchange Act Release No. 63306, 2010 WL 5092725, at *4 n.10 (Nov. 10, 2010) (citing *Anthony Tricarico,* Exchange Act Release No. 32356, 1993 WL 1836786, at *3 (May 24, 1993)), *petition denied,* 666 F.3d 1322 (D.C. Cir. 2011). The weight of the evidence does not warrant a different finding here.

interest that might cause them to render self-interested investment advice. Thus, regardless of what others may have thought, Malouf, an experienced securities professional, had an independent obligation to disclose his conflict, understood that obligation, and must have known that clients would be misled by his failure to correct the representation that no conflict existed.[111]

Likewise, we do not find convincing Malouf's claims that his efforts as CCO to correct the misleading omissions in March 2011 demonstrate a lack of scienter. Malouf corrected the communications at issue only after they had existed in their misleading form for several years—and only after ACA identified the critical omissions and warned that they would be cited in its annual compliance review.

Because we find that Malouf acted with scienter in employing a deceptive device and artifice to defraud and engaging in a deceptive act, practice, and course of business, we find that he violated Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c).

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111. *See Orlando Joseph Jett,* Exchange Act Release No. 49366, 2004 WL 2809317, at *20 (Mar. 5, 2004) (rejecting applicant's claim that he lacked scienter because, among other reasons, even if applicant's "supervisors and co-workers knew about his fraud on the firm—indeed even if they ordered him to commit it—that would not relieve Jett of responsibility for what he knew or was reckless in not knowing and for what he did").

2. Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3) by failing to correct the material misstatements on UASNM's Forms ADV and website.

Based on our analysis above, we also find that Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act.[112] Malouf's employment of a deceptive device and artifice to defraud with scienter establishes that he violated Section 17(a)(1). And Malouf admitted that he reviewed UASNM's disclosures on its Forms ADV and website periodically. That he repeatedly and continually failed to correct the disclosures that falsely stated UASNM had no conflicts of interest constituted a "practice" and "course of business" that operated as a fraud. Malouf's conduct was plainly unreasonable as it violated well-established professional and fiduciary standards. We therefore find that he also violated Section 17(a)(3).

3. Malouf violated Advisers Act Sections 206(1) and 206(2) by failing to correct the material misstatements on UASNM's Forms ADV and website and by failing to disclose his conflict of interest to his clients.

Malouf violated Section 206(1) and 206(2) by failing to correct the misstatements in UASNM's Form ADVs and on its website. "Facts showing a violation of Section

112. As discussed above, a violation of Section 17(a)(1) requires a showing of scienter, but negligence is sufficient for a violation of Section 17(a)(3). *See supra* note 73.

17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violation."[113] Therefore, given our determination that Malouf is liable under Section 10(b) and Section 17(a) for his conduct with respect to the misleading statements disseminated to his clients, we find that the same conduct renders him liable under Sections 206(1) and 206(2).[114]

We also find that Malouf violated Sections 206(1) and 206(2) by failing to disclose his conflict of interest with RJ to his clients. The Advisers Act "reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser . . . to render advice which was not disinterested."[115] The Act imposes this heightened standard of disclosure on investment advisers based on their "fiduciary status . . . in relation to their clients," as well as "Congress's general policy of promoting 'full disclosure' in the securities industry."[116]

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113. *E.g., SEC v. Haligiannis,* 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007).

114. *Cf. Montford and Co., Inc.,* Advisers Act Release No. 3829, 2014 WL 1744130 at *14, 16 (May 2, 2014) (finding registered investment adviser and its president and sole owner liable under Sections 206(1) and 206(2) for making material misrepresentations regarding registered investment adviser's independence on Forms ADV that president signed and on firm's website that were attributed to president), *aff'd,* 793 F.3d 76 (D.C. Cir. 2015).

115. *Capital Gains,* 375 U.S. at 191-92.

116. *Id.*

Accordingly, we have "long stated that advisers owe their clients 'a duty to render disinterested advice . . . and to disclose information that would expose any conflicts of interest,' including . . . even a potential conflict."[117] Malouf's extremely reckless failure to do so violates Section 206(1) of the Advisers Act, and his negligent failure to do so violates Section 206(2).[118]

As previously discussed, the information Malouf failed to disclose was material: Malouf's clients would have wanted to know about his arrangement with Lamonde before accepting his recommendation that RJ execute their transactions. His conduct was both reckless and negligent for all the reasons previously discussed. Accordingly, we find that by failing to disclose his conflict of interest, Malouf violated Sections 206(1) and 206(2).[119]

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117. *Montford and Co.,* 2014 WL 1744130 at *13 (citing *Capital Gains,* 375 U.S. at 201).

118. *See id.* at *13-14, 16.

119. Although we find Malouf liable under the Advisers Act but not the Securities Act or the Exchange Act for his failure to disclose material information, that does not mean that liability under Rule 10b-5(a) and (c) (or Sections 17(a)(1) and (3)) may not arise solely from such nondisclosure. Indeed, the Supreme Court's statement in *Capital Gains,* 375 U.S. at 198-199, that a fiduciary's "nondisclosure" is "one variety of fraud or deceit" suggests that it could. Because in this case Malouf failed to disclose his conflict of interest but also failed to correct the misrepresentations that UASNM had no conflicts of interest, we need not determine in what circumstances a respondent may be held liable under Rule 10b-5(a) and (c) (or Sections 17(a)(1) and (3)) simply for failing to disclose material information despite a duty to do so.

Finally, we note that we find Malouf primarily, rather than secondarily, liable under Sections 206(1) and 206(2) because, as UASNM's CEO and President, he received compensation in connection with giving investment advice and therefore falls under the broad definition of "investment adviser" in the Advisers Act.[120]

4. Malouf violated Advisers Act Sections 206(1) and 206(2) by failing to seek best execution for his clients' bond trades.

An investment adviser's fiduciary duty "includes the obligation to seek 'best execution' of clients' transactions under the circumstances of the particular transaction."[121] The duty of best execution requires an investment adviser to "execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances."[122] Those circumstances include the "full range and quality of a broker's services in placing brokerage

120. *Koch,* 2014 WL 1998524, at *18 (citing 15 U.S.C. 80b-2(a)(11) and collecting cases).

121. *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934,* Exchange Act Release No. 54165, 2005 WL 4843294, at *2 & n.3 (July 18, 2006); *see also* Advisers Act Rule 206(3)-2(c), 17 C.F.R. § 206(3)-2(c) (acknowledging adviser's duty of best execution of client transactions); Amendments to Form ADV, Investment Advisers Act Release No. 3060, 2010 WL 2957506, at *16 (Aug. 12, 2010).

122. Exchange Act Release No. 23170, 1986 WL 630442, at *11 (Apr. 23, 1986).

including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager."[123] The "determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account."[124] Thus, although "the duty to obtain the best security price remains, in selecting a broker to secure such price an adviser is not required to seek the service which carries the lowest cost so long as the difference in cost is reasonably justified by the quality of the service offered."[125]

Nonetheless, we have long held that the "selection of a broker and the determination of the rate to be paid should . . . never be influenced by the adviser's self-interest in any manner."[126] Where "the adviser is affiliated with or has a relationship with the brokerage firm executing the transaction," the adviser "must make the good faith judgment that such broker is qualified to obtain the best price on the particular transaction and that the commission in respect of such transaction is at least as favorable to the

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123. *Id.*

124. *Id.*

125. *Applicability of Commission's Policy Statement on the Future Structure of Securities Markets to Selection of Brokers and Payment of Commissions by Institutional Managers,* Exchange Act Release No. 9598, 1972 WL 121270, at *2 (May 17, 1972).

126. *Id.* at *1.

company as that charged by other qualified brokers."[127] In essence, in "a case of self-dealing, the burden of justifying paying a commission rate in excess of the lowest rate available is particularly heavy."[128]

We have also explained that although an adviser "has no duty or obligation to seek competitive bidding for the most favorable negotiated commission rate applicable to such transaction, it should consider such 'posted' commission rates, if any as may be applicable to the transaction, as well as any other information available at the time as to the level of commissions known to be charged on comparable transactions by other qualified brokerage firms. . . ."[129] Here, the Division's expert witness testified that because of their high liquidity and AAA rating, fulfilling the duty of best execution for transactions in the Treasury and agency bonds at issue was primarily a matter of finding the lowest available cost for the trade *(i.e.,* the commission paid), rather than any other factors related to trade execution, such as research. While acknowledging that it may be appropriate to execute a bond transaction without first seeking multiple bids in certain rare circumstances, the Division's expert opined that, because the commission cost is the driving factor in achieving best execution for these bonds, the best general practice was to seek multiple competing bids.

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127. *Id.* at *2.

128. *Id.*

129. *Id.*

Malouf agreed that the best approach to an adviser's best execution responsibilities was to seek multiple competing bids for client transactions. He also acknowledged that Keller, on a few occasions during the applicable period, was able to convince the RJ branch to lower proposed commission amounts after he shopped his client bond trades to other brokers for competing bids. Nonetheless, Malouf conceded that he routinely failed to seek competing bids before directing bond trades to Lamonde's RJ branch.

The Division's expert also evaluated all of UASNM's client bond trades through the RJ branch during the applicable period and determined that dozens of such transactions involved commissions that were significantly higher than industry norms. He assumed that an appropriate commission level was 0.10-0.75 percent of the total dollar amount of the trade for highly-liquid, AAA-rated Treasury and agency bond transactions, a conclusion he reached from personal experience trading this type of security, as well as industry research and consultation with other experts.[130] Based on his analysis, he determined

130. The expert, in his analysis, did not attribute any specific transaction to Malouf, but rather evaluated all of UASNM's bond trades through RJ during the period. The Division's expert also testified, and Malouf's expert agreed, that the best execution responsibilities of an adviser such as UASNM, which owes a fiduciary duty to its clients, are different from those of a broker-dealer, such as RJ, which does not. Therefore, as Malouf conceded, an adviser cannot rely on the broker-dealer to satisfy the adviser's own best execution responsibilities. Neither of the two expert witnesses who testified on behalf of Malouf offered a contrary estimate of the

that UASNM's clients paid between $442,106 and $693,804 of commissions on 81 such bond trades in excess of what they would have paid if they had paid prevailing market commission rates.

Malouf effectively concedes that these commissions were excessive. He stipulated that there were approximately 81 bond trades exceeding $1 million executed by UASNM during the applicable period, that "for a $1 million Treasury bond an appropriate commission would be one percent, would drop to 0.5 percent above that then goes down from there," and that he and Lamonde had an oral agreement that RJ would not charge commissions exceeding one percent for such trades. Malouf does not dispute the expert witness's calculations with respect to UASNM's total bond trades used to calculate the excess commissions Malouf's clients paid.[131]

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appropriate commissions to be charged on highly-liquid, AAA-rated Treasury and agency bond transactions. We, like the ALJ, rely on the testimony of the Division's expert witness in the absence of other evidence in the record, but our findings on the appropriate commissions to be charged on highly liquid agency bonds are limited to this matter. Determining the appropriate commission on a particular trade is a circumstance-specific inquiry. *See supra* notes 119-123 and accompanying text.

131. Although Malouf claims that he made reasonable efforts to obtain best execution because he used RJ's BondDesk platform to research market prices, he offers no evidence showing how BondDesk's information regarding bid and ask spreads would inform Malouf as to the appropriate commission he should pay to a broker-dealer.

Malouf fails to meet his "heavy" burden of justifying paying a commission rate in excess of the lowest rate available. Even in cases where "there is no self-dealing," we have stated that "where commission rates reflect services furnished to the managed account in addition to the cost of execution, managers must stand ready to demonstrate that such expenditures were bona fide."[132] Malouf admitted that, when using BondDesk, he "would not know the precise commission that Lamonde was going to charge for the trade."[133] Malouf could not establish that the RJ branch actually provided lower costs for his clients than those of other brokers, and he fails to explain what services or efforts RJ provided that any other broker would not have for such routine, highly-liquid, AAA-rated Treasury and agency bond transactions.[134] Malouf's failure to justify the excess commissions his clients paid is especially problematic in light of his arrangement with Lamonde.

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132. Exchange Act Release No. 9598, 1972 WL 121270, at *2.

133. Malouf also claims that he relied on his own experience trading bonds over many years to evaluate the fairness of a price, but he does not demonstrate how his years of experience could substitute for actual knowledge of commissions being charged in the market for particular trades.

134. *See Mark David Anderson,* Exchange Act Release No. 48352, 2003 WL 21953883, at *8 (Aug. 15, 2003) (finding that Treasury and agency bonds, such as those at issue here, are highly liquid and therefore a broker's efforts to execute trades in them are "in no way extraordinary").

Appendix C

Malouf attempts to avoid liability by arguing that the Division has not introduced evidence connecting him to a specific bond transaction on which excessive commissions were charged and that therefore he cannot be held liable for excessive commissions, or related best execution violations, on any trades whatsoever. We reject Malouf's argument on several grounds. Testimony and documentary evidence shows that Malouf was responsible for UASNM's large-dollar-amount bond trades and that his clients were the parties to the bond transactions on which excessive commissions were paid. Malouf himself conceded that he executed anywhere from 60-70 percent of all of UASNM's bond trades. And as discussed above, 81 large-dollar-amount bond trades placed through the RJ branch, which the Division's expert witness reviewed, involved commissions exceeding the appropriate levels the expert set forth, and Malouf did not dispute the appropriate levels of commissions the Division's expert witness set forth.

Furthermore, using the highest rate that the expert witness testified might be acceptable (0.75 percent), the expert witness calculated that UASNM clients paid a total of $442,106 in excess commissions paid on all bond trades that were directed to the RJ branch during the period. Based on this calculation, the ALJ then used the lowest end of Malouf's own range of trades attributable to him (60 percent) to conclude that Malouf was personally responsible for at least $265,263.60 of those excessive commissions. We find that the ALJ's calculation was reasonable, and Malouf points to no evidence that would suggest using the assumptions for this calculation would

be inappropriate. Given that several witnesses testified that the percentage of UASNM's bond trades that Malouf directed was likely much higher than 60 percent, and that Malouf was responsible for all large-dollar-amount UASNM client bond trades, the ALJ's calculations were a conservative estimate of the total excess commissions.

Malouf also argues that ACA bore some responsibility for monitoring UASNM's best execution compliance. Since, among other things, ACA did not identify a deficiency in those practices and ACA was aware that a significant percentage of UASNM's client bond trades were directed to the RJ branch, Malouf contends that he "conclude[d], reasonably, that [UASNM] met its best execution guidelines." Ciambor, however, testified that Malouf and others at UASNM told him that UASNM always followed a multiple bid process when executing client trades. Malouf also acknowledges that ACA did not review full trade blotters reflecting all UASNM client trades during this period, instead reviewing only a sample. Malouf admits that ACA was not aware until June 2010 of the payments Malouf received from Lamonde and that this was crucial information for ACA's evaluation of UASNM's best execution practices because Lamonde's ongoing payments provided Malouf with an incentive to allow his clients to pay RJ's higher commissions. Finally, Malouf stipulated that "ACA does not assume any of the fiduciary duties its clients are subject to as supervised persons under the Investment Advisers Act" and that "ACA does not undertake a duty to root out fraud on behalf of its clients." For these reasons, Malouf's claim that he understood that ACA had approved UASNM's best execution practices is unpersuasive.

We find that Malouf violated his duty to seek best execution for his clients. The result of Malouf's conduct was that his clients paid at least $265,263.60 in excess commissions to Lamonde's RJ branch. Lamonde paid Malouf an amount almost equal to the amount of the commissions Lamonde received on Malouf's clients' trades. Malouf admitted that he directed trades to the RJ branch because "then I got paid." Malouf benefitted at his clients' expense. He thus employed a device and artifice to defraud his clients and engaged in a practice and course of business that operated as a fraud or deceit upon his clients. And he did so with scienter. Malouf knew that he had an arrangement with Lamonde, that the best approach to UASNM's best execution responsibilities was to seek multiple competing bids, and that appropriate commissions on the trades of highly-liquid, AAA-rated Treasury and agency bond of over $1 million were not more than one percent. Malouf could have lowered his clients' costs if he had sought multiple competing bids from other brokers or insisted that the commissions on the trades stayed below one percent. His failure to do either, in light of his knowledge, evinces a reckless disregard for the risk that his clients would not receive best execution but would instead pay excess commissions to the RJ branch, which Lamonde would use to pay him. Accordingly, Malouf's failure to seek best execution for his clients violated Advisers Act Sections 206(1) and 206(2).[135]

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135. *See Delaware Management Co.,* 43 S.E.C. 392, 1967 WL 88897, at *4 (July 19, 1967) (finding that an investment adviser's sale of stock through a broker at a lower price than that offered by another broker in order to compensate the broker for research services performed for the adviser, where the adviser

5. Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1 thereunder and Section 207.

To establish aiding and abetting liability, we must show: "(1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor had the necessary scienter."[136] The level of scienter required for such a showing is "extreme recklessness."[137] An individual who aids and abets a violation of the Advisers Act is also a cause of that violation.[138]

Advisers Act Section 206(4) prohibits a registered investment adviser from engaging in "any act, practice,

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was contractually obligated to provide such services and received advisory fees for them, benefited the adviser at the expense of its client, was incompatible with the adviser's duty to obtain the best prices for its client, and constituted a fraud upon the client); *cf. Interpretations of Section 28(e) of the Securities Exchange Act of 1934; Use of Commission Payments by Fiduciaries,* Exchange Act Release No. 12251, 1976 WL 185942, at *1-2 (Mar. 24, 1976) (stating that investment advisers' practice of asking a broker, "retained to effect a transaction for the account of a beneficiary, to 'give up' part of the commission negotiated by the broker and the fiduciary to another broker designated by the fiduciary" may "constitute fraudulent acts and practices by fiduciaries" in violation of the antifraud provisions).

136. *Graham v. SEC,* 222 F.3d 994, 1000 (D.C. Cir. 2000).

137. *Howard v. SEC,* 376 F.3d 1136, 1143 (D.C. Cir. 2004).

138. *Zion Capital Mgmt, LLC,* Advisers Act Release No. 2200, 2003 WL 22926822, at *7 & n. 36 (Dec. 11, 2003).

or course of business which is fraudulent, deceptive, or manipulative."[139] A primary violation of Section 206(4) requires neither a showing of scienter nor client harm.[140] Advisers Act Rule 206(4)-1(a)(5) prohibits a registered investment adviser from publishing, circulating, or distributing advertisements, including the contents of its website, containing untrue statements of material facts, or that otherwise are false or misleading.[141]

Based on our findings above, we find that UASNM violated these provisions by claiming on its website that its advice was impartial and conflict-free, while failing to disclose Malouf's receipt of $1,068,084 in payments from Lamonde, the owner of the RJ branch to which Malouf directed the overwhelming majority of UASNM's clients' bond trades. As we found above, Malouf recklessly failed to disclose this clear conflict of interest. Thus, he substantially assisted UASNM's violations. We therefore find that Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1(a)(5).

Advisers Act Section 207 prohibits, among other things, the making of any omission of a material fact required to be stated in a report filed with the

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139. 15 U.S.C. § 80b-6(4).

140. *SEC v. C.R. Richmond & Co.,* 565 F.2d 1101, 1105 (9th Cir. 1977) (citing *Capital Gains,* 375 U.S. at 195).

141. 15 U.S.C. § 275.206(4)-1(a)(5).

Commission, including Form ADV.[142] Advisers Act Section 207 does not require a showing of scienter.[143] Item 12.B of Form ADV Part II requires an investment adviser to describe all factors considered in selecting broker-dealers for execution of client trades and for determining the reasonableness of their commissions. UASNM's Forms ADV failed to disclose Malouf's receipt of $1,068,084 in payments from the owner of the broker-dealer to which Malouf directed the overwhelming majority of UASNM clients' bond trades as a factor it considered in selecting RJ as a broker-dealer for client trades. Thus, UASNM violated Advisers Act Rule 207 by failing to disclose this factor in its choice of broker-dealers. Malouf recklessly provided substantial assistance to UASNM's violation by failing to insist that the Forms ADV be changed to correct this omission, despite regularly reviewing the Forms ADV during the applicable period and recognizing the importance of disclosing this conflict. For these reasons, we find that Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 207.

III. SANCTIONS

The ALJ barred Malouf from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of seven-and-a-half years; prohibited Malouf from serving or acting as an employee, officer, director, member of

142. 15 U.S.C. § 80b-7.

143. *Montford & Co.,* 2014 WL 1744130, at *16 & n.134.

an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of seven-and-a-half years; ordered Malouf to cease and desist from committing or causing violations, and any future violations, of Securities Act Sections 17(a)(1) and (a)(3), Exchange Act Section 10(b), Exchange Act Rules 10b-5(a) and (c), Advisers Act Sections 206(1), (2), and (4) and 207, and Advisers Act Rule 206(4)-1(a)(5); and imposed a third-tier civil penalty of $75,000. On appeal, the Division requests that we impose a permanent industry bar and order Malouf to pay disgorgement in the amount of $1,068,084; and Malouf requests that we vacate all sanctions ordered by the ALJ. Based on our consideration of the relevant factors, we impose a bar from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; impose a cease-and-desist order; prohibit Malouf from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; order Malouf to pay disgorgement of $562,001.26; and order Malouf to pay a single, third-tier civil penalty of $75,000.

Appendix C

A. Industry Bar

Advisers Act Section 203(f) authorizes us to bar any person who, at the time of the misconduct, was associated with an investment adviser, from "being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" if we find "on the record after notice and opportunity for a hearing" that the person willfully violated the securities laws and the sanction is in the public interest.[144]

The Division appealed the ALJ's imposition of a seven-and-a-half-year industry bar, contending that a permanent bar is a more appropriate sanction for Malouf's violations. Malouf appealed the imposition of any sanction and argued that no bar is warranted. As discussed below, we find that a bar without time limitation or a right to reapply is in the public interest.

1. Maloufs violations of the securities laws were willful.

Advisers Act Section 203(f) authorizes us to bar persons associated with investment advisers for willful violations of the securities laws. In this context, willfulness is shown where a person intends to commit the act that constitutes the violation; there is no requirement that the person also be aware that his actions violate any statutes or regulations.[145] Malouf does not dispute

144. 15 U.S.C. § 80b-3(f).

145. *Wonsover v. SEC,* 205 F.3d 408, 414 (D.C. Cir. 2000).

that he knew that he was committing the acts involved in directing the transactions to the RJ branch and then receiving funds back from Lamonde, who owned the RJ branch. Rather, he claims that he did not act "willfully" in failing to make the required disclosure because he relied on Kopczynski, Hudson, and others and, therefore, "reasonably believed that the disclosure had been made." Malouf's argument equates "willfulness" with scienter. But, to find willfulness, Malouf need only to have known he was directing clients' transactions to the RJ branch and receiving payments from Lamonde, and that he neither made the required disclosures nor required anyone else to make the required disclosures. In any event, as stated above, we find that Malouf acted with scienter in violating the antifraud provisions. Therefore, Malouf not only intended to commit the acts; he committed them with fraudulent intent.

2. Barring Malouf is in the public interest.

When determining what, if any, sanctions are in the public interest, we consider, among other things, (i) the egregiousness of the respondent's actions; (ii) the degree of scienter involved; (iii) the isolated or recurrent nature of the infraction; (iv) the respondent's recognition of the wrongful nature of his or her conduct; (v) the sincerity of any assurances against future violations; and (vi) the likelihood that the respondent's occupation will present opportunities for future violations.[146] We also consider

146. *Steadman v. SEC,* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 91 (1981).

whether the sanctions will have a deterrent effect.[147] Our inquiry is flexible, and no single factor is dispositive.[148]

After considering these factors, we find that an industry bar is in the public interest. Malouf's betrayal of his clients' trust involved a core tenet of his responsibility as an investment adviser—his duty to disclose material facts, including his conflict of interest, to his clients. Malouf's failure to seek best execution also betrayed his clients' trust. Over a three-year period, Malouf directed hundreds of bond transactions to (and received payments from the owner of) the RJ branch, and had a secret arrangement under which he would receive for himself $1,068,084, an amount nearly equal to the commissions his clients were being charged by the RJ branch. For approximately 48-77 highly-liquid, AAA-rated Treasury and agency bond transactions, as a result of Malouf's directing the transactions to the RJ branch, his advisory clients paid more than $250,000 in excessive commissions. The violations and the deception were repeated and ongoing.[149]

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147. *See Toby G. Scammell,* Investment Advisers Act Release No. 3961, 2014 WL 5493265, at *5 (Oct. 29, 2014) (citing additional authority).

148. *David Henry Disraeli,* Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007), *petition denied,* 334 F. App'x 334 (D.C. Cir. 2009) (per curiam).

149. Malouf objects to the fact that in his sanctions analysis, the ALJ cited hearing testimony of an expert witness who stated that in 44 years in the securities industry, he had "never seen a million dollars conflict of interest like this before." Malouf claims that this

Malouf shows virtually no recognition of the wrongfulness of his conduct. He argues that responsibility for the misleading statements and omissions in the Forms ADV and on UASNM's website rests with others, including Kopczynski, Hudson, and ACA. Likewise, Malouf claims that he did not act recklessly, but as explained above, we find that he acted with scienter.

We also find that there is a significant likelihood that Malouf will be presented with the opportunity to violate the securities laws in the future. Malouf continues to own and operate a state-registered investment adviser. His continued work as an investment adviser, combined with his apparent lack of understanding of the seriousness of his misconduct demonstrates that a bar is necessary to protect investors.

Given Malouf's egregious and repeated misconduct, and failure to acknowledge his wrongdoing or to understand the role he played in misleading his advisory clients, we believe that the ALJ erred in imposing a time-limited bar.[150] The ALJ cited Malouf's age (55) and

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"was testimony presented in a separate state court proceeding between Mr. Malouf and Mr. Kopczynski." We have not relied on this testimony in determining that a bar is in the public interest.

150. The law judge barred Malouf "for a period of seven-and-one-half years." This departs from our usual practice in situations in which we find that a bar of limited duration may be appropriate. Typically, a so-called "time-limited" bar takes the form of a bar with a right to reapply after a certain period of time. *See, e.g., Eric J. Brown,* Exchange Act Release No. 66469, 2012 WL 625874, at *13 (Feb. 27, 2012) (barring respondent from associating with a

assumed that, because Malouf would be over 62 by the time the bar expired, Malouf may not return to the securities industry, and if he did, he would retire soon after. In effect, the ALJ assumed that the seven-and-a-half year bar was enough to protect the public because, for all practical purposes, the bar was likely to extend until Malouf retired. We make no such assumptions. Instead of relying on Malouf's potential future retirement to protect the public interest, we impose a bar without time limitation.[151] Accordingly, Malouf is barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. Similarly, we prohibit, without time limitation, Malouf from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser,

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broker, dealer, or investment adviser, with a right to reapply in non-supervisory capacity after two years), *petition denied sub nom., Collins v. SEC,* 736 F.3d 521 (D.C. Cir. 2013); *Robert Rodano,* Advisers Act Release No. 2750, 2008 WL 2574440, at *8 (June 30, 2008) (barring respondent from associating with an investment adviser, but providing for a right to reapply after five years).

151. Even under the bar that we impose, Malouf may seek consent from a relevant self-regulatory organization ("SRO") to associate with one of that SRO's member firms. Alternatively, Rule 193(a) of our Rules of Practice provides a process by which barred individuals can apply to the Commission for consent to become associated with an entity that is not a member of an SRO, *e.g.,* an investment adviser, an investment company, or a transfer agent. 17 C.F.R. § 201.193(a).

depositor, or principal underwriter, pursuant to Section 9(b) of the Investment Company Act.[152]

B. Cease-and-Desist Order

Section 8A(a) of the Securities Act, Section 21C(a) of the Exchange Act, and Section 203(k) of the Advisers Act authorize us to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" those Acts or any rule promulgated thereunder.[153] In determining whether a cease-and-desist order is warranted, we consider not only the public interest factors discussed above, but also "'whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.'"[154] We also consider whether there is a reasonable likelihood of future violations, although

152. The ALJ barred Malouf from these activities for 7.5 years. Unlike the Exchange Act, Securities Act, and Advisers Act provisions at issue in this proceeding, Section 9(b) provides for time-limited prohibitions. Although the Division did not appeal this aspect of the ALJs decision, we have determined to review this aspect of the ALJ's decision on our own initiative. For the same reasons as discussed in our imposition of the other bars against Malouf, we find that a bar, without time limitation, pursuant to Section 9(b) is in the public interest.

153. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k).

154. *Koch,* 2014 WL, 1998524, at *21 (citing *KPMG Peat Marwick, LLP,* Exchange Act Release No. 43862, 2001 WL 47245, at *24-26 (Jan. 19, 2001)).

the required showing of a risk of future violations in the context of a cease-and-desist order is significantly less than that required for an injunction, and "in the ordinary case, a finding of a past violation is sufficient to demonstrate a risk of future ones."[155] Our inquiry is flexible, and no single factor is dispositive.[156]

The discussion of the public interest factors in connection with the bar militates in favor of a cease-and-desist order. The additional factors relevant to cease-and-desist orders further support imposition of such an order here. Malouf's violations are relatively recent. Malouf's conduct was harmful to investors. Malouf argues that "there is no customer harm" because he paid UASNM's customers $506,083.74 as part of the settlement of the State Court Litigation. When determining whether a cease-and-desist order is appropriate, we consider whether the violation *caused* harm to investors, not whether investors were later made whole. For all of the above reasons, we impose a cease-and-desist order in the public interest.

C. Disgorgement

In a cease-and-desist proceeding we "may enter an order requiring accounting and disgorgement, including reasonable interest."[157] Disgorgement is an equitable

155. *KPMG Peat Marwick, LLP,* 2001 WL 47245, at *26.

156. *Id.*

157. 15 U.S.C. §§ 77h-1(e), 78u-3(e).

remedy that requires the violator to give up wrongfully obtained profits causally related to the wrongdoing at issue.[158] Because disgorgement is designed to return the violator to where he or she would have been absent the violative conduct,[159] disgorgement should include all of the gains that flow from the illegal activity.[160] The Division, in seeking disgorgement, must present a reasonable approximation of profits causally connected to the violation.[161] Once the Division has presented such a reasonable approximation, any risk of uncertainty in calculating the disgorgement amount then falls on the wrongdoer, whose misconduct created the need for disgorgement.[162]

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158. *SEC v. First City Fin. Corp., Ltd.,* 890 F.2d 1215, 1230 (2d Cir. 1989) (citing additional authority). Ordering disgorgement may also deter others from violating the law. *Id.*

159. *Zacharias v. SEC,* 569 F.3d at 471 ("[D]isgorgement restores the *status quo ante* by depriving violators of ill-gotten profits.").

160. *Koch,* 2014 WL 1998524, at *22 (citing *SEC v. JT Wallenbrock & Assocs.,* 440 F.3d 1109, 1113-14 (9th Cir. 2006)).

161. *Id.* (citing *Laurie Jones Canady,* Exchange Act Release No. 41250, 1999 WL 183600, at *10 n.35 (Apr. 5, 1999), *petition denied,* 230 F.3d 362 (D.C. Cir. 2000)).

162. *See First City,* 890 F.2d at 1232 (finding that, once Commission has shown that its disgorgement figure "reasonably approximates the amount of unjust enrichment," the burden then shifts to respondents "to demonstrate that the disgorgement figure was not a reasonable approximation"); *Koch,* 2014 WL 1998524, at *22 & n.234.

Appendix C

In the proceeding below, the Division sought an order of disgorgement in the amount of $1,068,084, the amount of money Malouf received from Lamonde in undisclosed payments for the sale of the RJ branch. The ALJ found that this money constituted "legal profits" to Malouf for the sale of the RJ branch and was therefore not subject to disgorgement. The ALJ found that only the amount of excessive commissions that UASNM clients paid on their bond transactions (which the ALJ calculated to be $265,263.60) was subject to a disgorgement order, but declined to order Malouf to disgorge the excessive commissions in light of payments made by Malouf to clients in connection with the State Court Litigation.

We disagree with the law judge's disgorgement analysis. The $1,068,084 was not received through an untainted transaction immune from disgorgement. It was in no sense "legal profits." Malouf only received payment by sending UASNM clients' bond transactions to RJ so that Lamonde would be able to pay Malouf the amounts due under the sales contract. Once UASNM's client investments were directed to RJ, Lamonde paid back to Malouf the commissions RJ earned, nearly dollar for dollar. Malouf admitted the bond transactions were sent to the RJ branch "because then he got paid."[163] Yet he did not disclose this conflict of interest to his clients. Absent this fraudulent channeling of transactions, he would not

163. Even with the commissions RJ received from Malouf-directed trades, Lamonde was able to meet his other expenses only by taking on significant debt, providing further support for the conclusion that Malouf's directing trades to RJ was essential to the payments Lamonde made to Malouf.

have received the $1,068,084.[164] For these reasons, the full $1,068,084 paid by Lamonde to Malouf is causally connected to his violations and a reasonable approximation of Malouf's ill-gotten gains.

Malouf bears the burden of presenting evidence that the Division's approximation of his ill-gotten gains, with which we concur, is not reasonable. Malouf offers no alternative method of calculating the proper disgorgement amount, and the record is devoid of evidence of possible alternative measures of Malouf's ill-gotten gains. Malouf relies solely on the ALJ's finding that Lamonde's payments to Malouf were not "transaction-based" commissions, a finding the ALJ made in the context of determining that Malouf had not acted as an unregistered broker.[165] But the ALJ's finding regarding whether Malouf received

164. *See Montford,* 2014 WL 1744130, at *22 & n.194 (finding that investment adviser must disgorge full amount of payments received from an investment manager because respondent advisers "fraudulently misled clients to believe they were independent and did not take any money from investment managers at the same time they were arranging for and receiving substantial payments from such an investment manager" and citing investor testimony that they would not have paid respondents the moneys at issue because they would not have retained them as their advisers and would not have made the investments in question); *see also Edgar R. Page and PageOne Financial Inc.,* Exchange Act Release No. 32131, 2016 WL 3030845, at *13 & n.75 (May 27, 2016) (finding that, where respondent's clients would not have invested in certain funds if respondent had disclosed his conflict of interest to them—and "therefore could not have received the . . . payments [at issue]"—those payments were causally connected to his violations and thus subject to disgorgement).

165. *See supra* note 2.

"transaction-based compensation" is a separate question from the issue of whether the monies Malouf received were ill-gotten gains causally related to his fraudulent conduct.

We order that Malouf disgorge the full $1,068,084 he received from Lamonde, minus $506,083.74 that he has already paid to UASNM clients in the State Court Litigation, resulting in a disgorgement order of $562,001.26, plus prejudgment interest.

D. Civil Money Penalty

Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act (the "Acts") authorize the Commission to impose penalties for violations of the Acts if it is in the public interest to do so. In considering whether a penalty is in the public interest, the Commission may consider:[166] (A) "whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; (B) "the harm to other persons resulting either directly or indirectly from such act or omission"; (C) "the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior"; (D) specified prior findings of misconduct; and (E) "the need to deter such person and other persons from committing such

166. 15 U.S.C. § 78u-2(3); 15 U.S.C. § 80b-3(i)(3); 15 U.S.C. § 80a-9(d)(3); *see also Collins v. SEC,* 736 F.3d 521, 524-25 (D.C. Cir. 2013) (recognizing that "Congress guides the Commission's discretion by pointing to . . . factors" in penalty statute).

acts or omissions."[167] Congress also specified that we may consider "such other matters as justice may require."[168]

The Acts specify that penalties can be imposed "for each act or omission" in violation of the federal securities laws. For each such "act or omission," the Commission may impose a penalty under one of three tiers, depending on the nature of the violation: first-tier penalties for violations of the securities laws; second-tier penalties for violations of the securities laws that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;" or third-tier penalties for violations that satisfy the requirement for a second-tier penalty and "resulted in substantial losses or created significant risk of substantial losses to other persons or resulted in substantial pecuniary gain." For violations occurring between February 15, 2005 and March 3, 2009, the maximum penalty per act or omission for a natural person is $130,000 for a third-tier penalty; for violations occurring between March 4, 2009 and March 5, 2013, the maximum penalty per act or omission for such a violation is $150,000.[169]

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167. *Id.*

168. *Id.*

169. *See* 17 C.F.R. §§ 201.1003, Table III (setting forth penalties for conduct occurring after February 14, 2005); 201.1004, Table IV (setting forth penalties for conduct occurring after March 3, 2009); 201.1005, Table V (setting forth penalties for conduct occurring after March 5, 2013).

The Division requests that, like the ALJ, we impose a single $75,000 third-tier penalty on Malouf for his misconduct.[170] Third-tier penalties are appropriate because Malouf engaged in fraud, which resulted in substantial losses of $265,263.60 to his advisory clients and a substantial pecuniary gain to himself of $1,068,084. The factors we discussed in support of our decision to impose a bar on Malouf also weigh heavily in favor of a penalty in the public interest. Although Malouf has no disciplinary history, his misconduct was serious and grossly breached his fiduciary duty to his advisory clients by failing to disclose an obvious conflict of interest that influenced his investment advice.

We also find that there is a need for a civil penalty to deter Malouf and others from similar failures to disclose significant conflicts of interest to advisory clients. Congress recognized that penalties are especially warranted "if the violation is of a type that is difficult to detect."[171] Malouf's advisory clients had no reason to expect that he was receiving over $1 million from the owner of the branch office of a broker-dealer to which

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170. The ALJ based his penalty amount only on Malouf's failure to disclose to his clients Lamonde's payments and not based on Malouf's best execution violations, treating the repeated failure over three years as a single course of misconduct. The Division did not appeal this aspect of the ALJ's decision.

171. H.R. Rep. No. 101-616, at 21; *see also* S. Rep. No. 101-337, at 15 ("The Committee believes it is appropriate to enable the SEC to impose a higher penalty if the violation is of a type that is difficult to detect.").

he directed their trades, making his fraud difficult to detect.[172] A civil penalty is important to deter Malouf (notwithstanding the bar) and others from engaging in such conduct in the future.

Neither party attempts to calculate a precise number of violative acts or omissions committed by Malouf, but UASNM filed with the Commission eight Forms ADV during the applicable period, none of which disclosed Malouf's conflict of interest, and the firm's website consistently and incorrectly claimed, over three years, that UASNM representatives received no compensation from any broker to whom they directed clients' trades and stated that UASNM's advice was conflict-free. Although a higher penalty could be calculated on the basis of several discrete violations, the Division seeks a single, third-tier penalty, and although the violations were serious, the Division seeks a penalty lower than the maximum amount available.

Malouf argues that no civil penalty is warranted because he claims that he committed no violations. As discussed above, we reject that claim. Malouf does not specifically challenge the ALJ's method of calculating the penalty amount except regarding his claimed inability to pay. Malouf claims that his liabilities exceed his assets by approximately $634,000. Malouf argues that, in assessing Malouf's ability to pay, the ALJ "arbitrarily"

172. Although Malouf is barred from association with a Commission-registered investment adviser, he continues to be associated with a state-registered adviser, as discussed above, and many of the applicable statutory provisions apply to all types of advisers. *See* Advisers Act Section 206, 15 U.S.C. § 80b-6 (making it "unlawful for any investment adviser" to engage in specified acts).

assigned a value of $300,000 to Malouf's current state-registered investment advisory business, as opposed to Malouf's proposed $100,000 valuation. He asserts that, if he is barred from the securities industry, the value of the business would be limited to approximately $7,500 (the value of its tangible assets), since the business would then be foreclosed from earning any revenues. Malouf also claims that the assets he possesses are illiquid, and that he has little income left after payment of monthly expenses. He further disputes the ALJ's finding that he is "an individual of aptitude and shrewdness who will undoubtedly find work in some other business profession," noting that the securities business is the only business in which he has ever worked. Malouf also claims that any civil penalty he is ordered to pay should be offset by his payment of $506,083.74 to UASNM clients and the $100,000 civil penalty that he paid on behalf of UASNM in a separate settled Commission administrative proceeding.[173]

The Division counters that Malouf repeatedly cited differing values for the state-registered investment advisory business, ranging from $0 to $100,000, and the Division argues, "Malouf's contradictory assertions of value should be given no weight." The Division argues that the ALJ adopted an acceptable method of valuing investment advisory businesses (at twice their annual trailing revenue) to come up with his valuation of $300,000. While Malouf himself would not be able to continue to earn revenues from the business if he is barred, the Division observes that "he could simply sell the business as has been done in the past, valued at twice its annual trailing revenue."

173. *UASNM,* 2014 WL 2568398, at *8.

We note that we have the discretion to impose penalties notwithstanding a respondent's financial circurnstances.[174] We also find the Division's arguments concerning the value of the state-registered investment advisory business to be more persuasive than Malouf's. While we believe the record supports some mitigation of the penalty based on ability to pay and (as the ALJ found) because of Malouf's payment of UASNM's $100,000 civil penalty and of $506,083.74 to UASNM clients in the State Court Litigation,[175] we do not believe that it would be appropriate to impose no penalty here. We find that, in light of Malouf's fraudulent misconduct, which resulted in substantial losses to his advisory clients and pecuniary gain to him, a $75,000 civil penalty is warranted. In light of the higher number of violative acts and omissions established by the record, and the permissible penalty range of up to $150,000 per act or omission, a single third-tier penalty of $75,000 is conservative.[176]

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174. *See Gregory O. Trautman,* Exchange Act Release No. 61167A, 2009 WL 6761741, at *24 (Dec. 15, 2009) ("Even when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, . . . particularly when the misconduct is sufficiently egregious") (quoting *Philip A. Lehman,* Exchange Act Release No. 54660, 2006 WL 3054584, at *4 (Oct. 27, 2006) and declining to reduce penalty in light of egregiousness of respondent's actions).

175. *See supra* note 9. We note that we offset Malouf's disgorgement by the amount of his payment to UASNM clients as part of the State Court Litigation.

176. The OIP in this proceeding was filed on June 9, 2014, and as discussed above, Malouf's fraudulent misconduct extended into March 2011. We considered only the conduct that fell within the five-year statute of limitations for the purposes of determining

An appropriate order will issue.[177]

By the Commission (Chair WHITE and Commissioner STEIN; Commissioner PIWOWAR, concurring separately).

Brent J. Fields
Secretary

/s/ Lynn M. Powalski
By: Lynn M. Powalski
Deputy Secretary

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the civil penalty. *See* 28 U.S.C. § 2462 (setting five-year statute of limitations); *Gabelli v. SEC,* 133 S. Ct. 1216, 1220-24 (holding that statute of limitations under § 2462 begins to run when the violation occurs, not when it is discovered).

The Division requested oral argument; Malouf did not. In light of our determination of the case, we find that oral argument is unnecessary to aid our decisional process, and we hereby deny the Division's request for oral argument.

177. We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

Appendix C

Commissioner PIWOWAR, concurring:

Commissioner Piwowar concurs with the opinion, which concludes, among other things, that Dennis Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rules 10b-5(a) and (c), based on failures to correct misstatements made to clients.

Several courts have found that misrepresentations and omissions alone are not sufficient to give rise to scheme liability.[1] In this case, however, there is no need to determine whether the holdings of those cases apply. Although not specifically described in the majority opinion as a basis for liability, Malouf engaged in activities beyond his failure to correct the misstatements. In particular, he admitted that he directed his clients' trades to the branch office he sold because then he got paid. In routing client transactions to the branch office he also failed to seek best execution, which resulted in clients' payment of excessive commissions. The excess commissions generated were then used to pay Malouf.

Because Malouf acted deceptively, employed deceptive devices and artifices to defraud, and engaged in deceptive acts, practices, and a course of business that operated as a fraud beyond his failure to correct misstatements,

1. *See, e.g., WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.,* 655 F.3d 1039, 1057-58 (9th Cir. 2011) (collecting cases); *Public Pension Fund Grp. v. KV Pharm. Co.,* 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg); Lentell v. Merrill Lynch & Co.,* 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

there is no need to address whether his failure to correct those misstatements alone is sufficient to find violations of Section 17(a)(1) and (a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rules 10b-5(a) and (c).

Appendix C

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10115 / July 27, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 78429 / July 27, 2016

INVESTMENT ADVISERS ACT OF 1940
Release No. 4463 / July 27, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32194 / July 27, 2016

Admin. Proc. File No. 3-15918

In the Matter of
DENNIS J. MALOUF

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Dennis J. Malouf be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from serving or acting as an employee, officer, director, member of an advisory board, investment

adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, and it is further

ORDERED that Dennis J. Malouf be prohibited, permanently, from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, and it is further

ORDERED that Malouf cease and desist from committing or causing any violations or future violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933, Sections 10(b) Securities Exchange Act of 1934 and Rules 10b-5(a) and (c) thereunder, and Sections 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act of 1940 and Rule 206(4)-1(a)(5) thereunder; and it is further

ORDERED that Malouf disgorge $562,001.26, plus prejudgment interest of $764,300.14, such prejudgment interest calculated beginning from January 1, 2008, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Malouf pay a civil money penalty of $75,000.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States

postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

/s/ Lynn M. Powalski
By: Lynn M. Powalski
Deputy Secretary

APPENDIX D — INITIAL DECISION OF THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, DATED APRIL 7, 2015

UNITED STATES OF AMERICA
BEFORE THE SECURITIES
AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

INITIAL DECISION RELEASE NO. 766
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15918

INITIAL DECISION

IN THE MATTER OF

DENNIS J. MALOUF.

April 7, 2015

APPEARANCES: Stephen C. McKenna, Dugan Bliss, and John H. Mulhern for the Division of Enforcement, Securities and Exchange Commission Burton W. Wiand, Robert K. Jamieson, and Peter B. King of Wiand, Guerra King P.L. for Respondent Dennis J. Malouf

SUMMARY

This Initial Decision finds that Respondent Dennis J. Malouf (Malouf) violated Sections 206(1) and 206(2), and aided and abetted and caused violations of Sections 206(4) and 207 and Rule 206(4)-1(a)(5), of the Investment Advisers Act of 1940 (Advisers Act); violated Sections 17(a)(1) and

17(a)(3) of the Securities Act of 1933 (Securities Act); and violated Section 10(b) and Rules 10b-5(a) and 10b-5(c) of the Securities Exchange Act of 1934 (Exchange Act). This Initial Decision orders Malouf to cease and desist from causing further violations of these securities laws, bars Malouf from participating in the securities industry for a period of seven-and-one-half years, and orders Malouf to pay a civil money penalty of $75,000.

I. INTRODUCTION

The Securities and Exchange Commission (Commission or SEC) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on June 9, 2014, pursuant to Section 8A of the Securities Act, Sections 15(b), 15C(c), and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). Malouf filed his Answer on July 21, 2014. A hearing was held in Albuquerque, New Mexico, from November 17 through November 25, 2014. The admitted exhibits are listed in the Record Index issued by the Secretary of the Commission on March 20, 2015. The Division of Enforcement (Division) and Malouf filed post-hearing briefs and post-hearing reply briefs, proposed findings of fact and conclusions of law and responses, and briefs regarding Malouf's inability to pay disgorgement or penalties.[1]

1. Citations to the hearing transcript are noted as "Tr. __." Citations to the Division's exhibits and Malouf's exhibits are noted as "Div. Ex. ___" and Resp. Ex. ___," respectively. I will use similar designations in citations to the post-hearing filings. Citations to the parties' prehearing joint stipulations are noted as "JS No. ___." Citations to the parties' post-hearing stipulated findings of fact are

The OIP alleges the existence of a secret agreement between Malouf and a branch manager of a broker-dealer between 2008 and 2011, where Malouf directed UASNM, Inc.'s (UASNM) investment advisory client trades to the branch office of the broker-dealer, which he had previously owned, and the branch manager forwarded to Malouf substantially all of the resulting commissions. OIP at 2. According to the OIP, Malouf earned approximately $1.1 million from the scheme and did not disclose this arrangement to his clients. *Id.* Additionally, as a result of this secret agreement, the OIP alleges that (1) Malouf caused UASNM's website to make false or misleading statements, (2) Malouf failed to seek best execution on client bond trades, and (3) Malouf acted as an unregistered broker-dealer. *Id.*

Malouf denies these allegations, claiming that this action was orchestrated by Joseph Kopczynski (Kopczynski), UASNM's former owner, Chairman, and Chief Compliance Officer (CCO) and Malouf's former father-in-law, as a result of Malouf's decision to divorce Kopczynski's daughter. Answer at 1-6. Malouf also asserts a statute of limitations defense for any activity that forms the basis of the Division's allegations that occurred more than five years before the issuance of the OIP. *Id.* at 16.

II. FINDINGS OF FACT

I base the following findings of fact and conclusions on the entire record and the demeanor of the witnesses who

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noted as "Stipulated FOF No. ___" and conclusions of law are noted as "Stipulated COL No. ___." *See Dennis J. Malouf*, Admin. Proc. Rulings Release No. 2189, 2015 SEC LEXIS 73 (Jan. 8, 2015)

testified at the hearing, applying preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 100-04 (1981). All arguments and proposed findings and conclusions that are inconsistent with this decision are rejected. I find the following facts to be true.

A. Relevant People and Entities

1. Dennis J. Malouf

Malouf, age fifty-five, was the chief executive officer, president, and majority owner of UASNM from September 2004 until May 13, 2011, when he was terminated. Stipulated FOF Nos. 1, 14, 286; JS No. 6. During 2008 to May 2011, Malouf was UASNM's advisory representative. Stipulated FOF No. 286; JS No. 6. When Malouf was CEO of UASNM, he was "top dog" and Kopczynski and Hudson worked for him. Stipulated FOF No. 197.

He is currently the sole owner and president of NM Wealth Management, LLC, an investment adviser registered with the State of New Mexico with approximately $26 million in assets under management.[2] Stipulated FOF Nos. 1, 14, 194. Malouf was a registered representative associated with Raymond James Financial Services (RJFS) from February 1999 through December 2007 and the owner of RJFS Branch 4GE (Branch 4GE). Stipulated FOF No. 14; Tr. 912, 914. From 2008 to May 2011, Malouf was not registered with the Commission as a broker or dealer and he was not associated with a broker or dealer. Stipulated FOF Nos. 46, 292; JS No. 12.

2. Since the parties stipulated to these facts, it became clear that the amount of assets under management is less than $20 million.

In thirty-one years in the financial industry Malouf has never had a securities license suspended, has never had any discipline taken against his securities license, has never been fined for any securities related conduct, and has never been sued by a customer. Tr. 1009-10.

2. UASNM, Inc.

UASNM is a New Mexico corporation located in Albuquerque, New Mexico, that registered as an investment adviser with the Commission on September 4, 2004. Stipulated FOF Nos. 2, 15. UASNM, formerly known as "Universal Advisory Services" (UAS), provides discretionary advisory services primarily to individuals, charitable organizations, and employee benefit plans. Stipulated FOF Nos. 2, 15. UASNM's most recent Form ADV reported approximately $275 million in assets under management. Stipulated FOF Nos. 2, 15. UASNM is named as a respondent in a separate administrative proceeding. Stipulated FOF No. 2; *UASNM, Inc.*, Advisers Act Release No. 3846, 2014 WL 2568398 (June 9, 2014). Under a settlement in that proceeding, UASNM agreed to pay $506,083.74 to customers for purportedly excessive commissions and a $100,000 civil money penalty. Tr. 1274, 1371; *UASNM, Inc.*, 2014 WL 2568398, at *6, 8. Pursuant to a state court settlement between UASNM and Malouf, UASNM used Malouf's money to pay that $606,083.74. Stipulated FOF No. 371.

a. Joseph Kopczynski

Kopczynski, age sixty-five, is currently the chairman of UASNM's board of directors and its CCO. Stipulated

FOF No. 16. He started the UASNM business and sold the firm to Malouf, his then son-in-law, and Kirk Hudson (Hudson), in September of 2004, but maintained a one-percent ownership interest. *Id.* Kopczynski was UASNM's CCO from 2004 to 2010, relinquished that position to Malouf in January of 2011, and resumed the position in June 2011, after Malouf was terminated. *Id.*; Stipulated FOF No. 302. During the time that Kopczynski was CCO, Malouf relied upon him to carry out all responsibilities of the compliance program at UASNM. Tr. 1062. Prior to 2011, Malouf relied on Kopczynski as CCO to ensure the firm was complying with its best execution obligation. Stipulated FOF 98. From 2008 to 2010 it was Kopczynski's responsibility as CCO to review the arrangements between UASNM and third party providers such as RJFS. Tr. 787-788; Div. Ex. 15 at 99. Kopczynski claims he reviewed and approved the content posted on UASNM's website and other marketing materials and that it was his responsibility to ensure the accuracy of the firm's Forms ADV. Tr. 1323, 1325, 1354; Stipulated FOF Nos. 57-58; *see* Div. Ex. 15 at 53; Stipulated FOF Nos. 55-56.

b. Kirk Hudson

Hudson, age fifty-two, held a minority ownership interest in UASNM from August 2004 to 2011, and is currently UASNM's chief financial officer and chief investment officer. Stipulated FOF No. 17. Hudson did bond trading for a significant number of his clients at UASNM, and was the secondary trader that would step in if Malouf was unavailable. Tr. 731-32. Hudson placed a significant number of bond trades for UASNM customers through Branch 4GE prior to 2008. Tr. 772.

c. Other Relevant UASNM Personnel

Matthew Keller (Keller) is a minority shareholder of UASNM. Stipulated FOF No. 90. During 2008 through 2011, Keller was an investment adviser with UASNM. Stipulated FOF No. 296. Keller placed 50-60% of the bond trades he directed through RJFS. Tr. 1165-66.

Paula Calhoun (Calhoun), UASNM's bookkeeper, is an employee at will. Stipulated FOF Nos. 91, 254, 299. Beginning in late 2007 or early 2008, through 2011, Calhoun performed bookkeeping services for Malouf personally. Stipulated FOF Nos. 195, 254, 299. Calhoun performed personal bookkeeping services for Malouf because those were his instructions in his capacity as UASNM's President. Stipulated FOF No. 256. Calhoun is a workplace friend of Aubrey Kopczynski, daughter of Kopczynski and Malouf's ex-wife. Stipulated FOF No. 92.

3. Raymond James Financial Services, Inc.

RJFS is a Florida corporation formed in 1999. Stipulated FOF No. 15. RJFS, through a predecessor, has been registered with the Commission as a broker-dealer since 1974, and is a member of FINRA. *Id.*

a. Maurice Lamonde

Maurice Lamonde (Lamonde) was a registered representative associated with RJFS from March 2000 until August 2011, and, from January 2008 through August 2011, he owned an Albuquerque office of RJFS, Branch

4GE. Stipulated FOF No. 15. He died unexpectedly on April 4, 2014, at age sixty-five.[3] *Id.*; Stipulated FOF No. 308.

b. Kirk Bell

From 2007-2011, Kirk Bell (Bell) was Assistant Regional Director at RJFS. Stipulated FOF No. 219. Bell supervised the 4GE Branch owned by Lamonde from 2008-2011, with which Malouf was previously affiliated. Stipulated FOF No. 220.

4. Adviser Compliance Associates, LLC

UASNM engaged Adviser Compliance Associates, LLC (ACA), a compliance consulting firm that provides advice and guidance to registered investment advisers, at various times beginning in 2002 through 2011. Stipulated FOF Nos. 139, 303. ACA contracted with UASNM to provide mock SEC compliance audits annually and used that process to recommend potential updates or changes to UASNM's Form ADV. Stipulated FOF Nos. 35, 93, 304, 346. In 2010 ACA would have normally charged $50,000 per year for the type of service provided to UASNM, but ACA only charged UASNM $15,000. Tr. 790. ACA does not undertake a duty to root out fraud on behalf of its clients. Stipulated FOF No. 155.

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3. I admitted the prior sworn statement of Lamonde on September 23, 2014, after briefing by the parties. *Dennis J. Malouf*, Admin. Proc. Rulings Release No. 1831, 2014 SEC LEXIS 3533. During the hearing, the Division and Respondent read relevant sections of Lamonde's investigative testimony into the record. Tr. 854-85, 1593-1616.

Appendix D

Michael Ciambor (Ciambor) started at ACA in the spring of 2003. Stipulated FOF No. 144. Ciambor was a consultant at ACA from 2006 to 2009 and a principal consultant from 2009 to 2012. Stipulated FOF No. 392. Ciambor took over the lead role with respect to ACA's annual examinations of UASNM in or around 2006. Stipulated FOF Nos. 144, 393. Ciambor worked primarily with Hudson and Kopczynski on matters relating to UASNM's engagement of ACA. Stipulated FOF No. 274. Ciambor primarily interacted with them rather than Malouf. Tr. 790. Malouf reasonably believed that Kopczynski, Hudson, and Ciambor were all sufficiently experienced and qualified for their positions and the attendant duties. Tr. 1018, 1062-63, 1127.

Ciambor was not a former securities regulator, although many of ACA's founding employees were. Tr. 718, 757, 761. Ciambor did not undergo any formal training for his position at ACA with respect to best execution or identifying conflicts of interest or continuing commission payments. Tr. 757-58; Stipulated FOF No. 143.

ACA conducted mock SEC inspections of UASNM by using the current document request list utilized in inspections by the SEC at that time as a baseline, and then submitting supplemental document requests as warranted. Stipulated FOF No. 382. ACA also prepared UASNM's compliance manual, which was intended to keep UASNM in compliance with SEC regulations. Stipulated FOF No. 350. ACA's annual review of UASNM included testing to ensure that UASNM's practices were consistent with the procedures set forth in its written compliance manual. Tr. 780.

B. Background

In 2004, Malouf purchased a majority interest in UASNM, and Hudson purchased a minority interest in UASNM, and registered the firm as an investment adviser with the Commission. Stipulated FOF Nos. 3, 18, 114. At that time, Malouf was also associated as a registered representative and owned a branch of a broker-dealer, RJFS. Stipulated FOF Nos. 3, 18. The RJFS branch owned by Malouf subleased and occupied a portion of UASNM's office space. Stipulated FOF Nos. 3, 18.

In 2007, RJFS became concerned about potential conflicts of interest and supervision risks, among other issues, arising from Malouf's work at UASNM, and asked him to choose between associating with UASNM or RJFS. Stipulated FOF Nos. 4, 19. Malouf decided to continue his advisory work at UASNM and to terminate his association as a registered representative and owner of a branch office of RJFS. Stipulated FOF Nos. 4, 19. Prior to RJFS approaching him, Malouf had not contemplated selling his profitable RJFS branch. Stipulated FOF No. 163. He considered Branch 4GE to be a substantial asset that he wanted to protect. Stipulated FOF No. 387.

As a result, at the end of 2007, Malouf terminated his registration with RJFS and he transferred his broker-dealer customers either to UASNM or to the new branch manager, Lamonde. Stipulated FOF Nos. 5, 19. Lamonde continued to operate Branch 4GE within UASNM's office space until June 2011. Stipulated FOF Nos. 5, 19.

As a broker, Lamonde had the power and authority to set the commission on trades placed through Branch 4GE, subject to a maximum commission rate designated by RJFS. Tr. 669-70, 709-10, 1614; *see* Div. Ex. 127.

Malouf was considered the person with the most experience with bonds within UASNM, based upon his prior experience in trading bonds. Stipulated FOF No. 6. As a result, he handled most of the bond trading on behalf of UASNM clients. *Id.* From 2008 to 2011, Malouf selected Lamonde and RJFS to execute the majority of bond transactions that he directed on behalf of UASNM clients. *Id.* Between January 2008 and May 2011, UASNM placed over 200 bond trades through RJFS, representing approximately ninety percent of its bond trading in this period. *Id.* During this period, Malouf, through UASNM, effected transactions in securities, including U.S. Treasuries, federal agency bonds, and municipal bonds. *Id.* From 2008 to May 2011, Malouf was one of several investment advisers at UASNM who provided advice regarding investments on behalf of UASNM customers, and transactions were carried out on behalf of UASNM customers pursuant to the advice of Malouf and other UASNM advisers. Stipulated FOF Nos. 37, 284; JS No. 4. In providing investment advice to UASNM customers, Malouf and other UASNM advisers utilized instruments of interstate commerce, such as telephones, email, and regular mail. Stipulated FOF No. 285; JS No. 5. During 2008 to May 2011, Malouf solicited clients on behalf of UASNM. Stipulated FOF Nos. 43-2, 287; JS No. 7. Malouf was primarily the person at UASNM who identified which bonds should be purchased for UASNM customers. Stipulated FOF No. 288; JS No. 8.

On May 13, 2011, Kopczynski and Hudson voted to terminate Malouf as CEO of UASNM and locked him out of the office. Stipulated FOF No. 309. On May 27, 2011, Kopczynski, Hudson, and UASNM filed a lawsuit against Malouf in the Second Judicial District Court, Bernalillo County, New Mexico, seeking injunctive relief and a declaratory judgment. Stipulated FOF No. 310. Malouf was paid $1.1 million for his interest in UASNM as part of a settlement agreement; $350,000 was paid directly to Malouf and $850,000 was held back in an account. Stipulated FOF No. 371. $506,000 of the $850,000 that was held back was paid to UASNM customers, and another $100,000 from that account was used to pay UASNM's civil penalty. *Id.*

C. Malouf's Sale of RJFS Branch 4GE to Lamonde

1. Timing

On approximately January 1, 2008, Malouf sold the RJFS broker-dealer branch that he founded in 1999 to his then branch manager Lamonde. Stipulated FOF No. 293; JS No. 13. Kopczynski, Hudson, and Keller knew Branch 4GE had been sold to Lamonde at the beginning of 2008. Stipulated FOF No. 50.

Although the sale was supposedly effective on January 2, 2008, the first time that Lamonde or Malouf disclosed a written agreement was almost two-and-a-half years later, in response to requests by Bell to Lamonde. In May 2009, RJFS intercepted an email between Lamonde and his wife, referencing financial problems and the lack of the

written agreement with Malouf. Stipulated FOF No. 223; Tr. 639-40. As a result, Bell requested a copy of the written buy/sell agreement between Malouf and Lamonde. *Id.* Lamonde indicated that he and Malouf were still working on it, and did not provide a signed copy. Div. Exs. 60, 94; Stipulated FOF No. 27. Lamonde told Bell that Lamonde and Malouf were working on a buy/sell agreement, but that no sale had yet taken place; Lamonde did not tell Bell that Lamonde was already making payments to Malouf. Stipulated FOF No. 224.

During 2009, Bell requested a copy of the buy/sell agreement on multiple occasions but the agreement was not provided. Stipulated FOF No. 225. Lamonde responded to email requests for the agreement as follows: "I'M WORKING ON THE PURCHASE AGREEMENT" (on May 15, 2009) and "I AM STILL WORKING ON THE AGREEMENT AND WILL SEND IT AS SOON AS WE FINISH IT" (on June 4, 2009). *Id.*; Stipulated FOF No. 27. Bell understood there was no sale or agreement at that time. Stipulated FOF No. 225.

Bell ultimately received a copy of the purported Purchase of Practice Agreement (PPA) on June 10, 2010. Div. Ex. 97; Stipulated FOF No. 227. The front page of the agreement was dated January 2, 2008, but the signature page and notary were dated June 11, 2010. Div. Ex. 97; Stipulated FOF No. 227. Bell was concerned about the date discrepancy and thought it did not make sense and was inappropriate. Stipulated FOF No. 227.

No witness other than Malouf or Lamonde claimed to have seen a written PPA prior to June 10, 2010. Prior

to that date, Hudson, Kopczynski, and Keller had not seen a written PPA, and Hudson and Kopczynski had not asked to see a written PPA, regarding Malouf's sale of his RJFS branch to Lamonde. Stipulated FOF Nos. 52, 62, 126. Although Malouf told Ciambor that he had sold the branch during ACA's 2008 on-site review, Ciambor was not provided with the agreement in 2008. Tr. 736; Stipulated FOF No. 149. However, at that time Ciambor did not ask Malouf for a copy of the PPA and did not ask what the terms of the sale of Branch 4GE were. Tr. 736, 774; Stipulated FOF No. 49.

Neither Hudson nor Kopczynski ever disclosed to Ciambor that they knew Malouf was receiving payments from Lamonde. Stipulated FOF No. 385. Ciambor discovered that Malouf had been receiving payments from Lamonde for the sale of his RJFS branch no later than the June 2010 on site review. Stipulated FOF No. 150. In 2010, Ciambor's understanding of the payments made by Lamonde to Malouf is that they were payments for the sale of Branch 4GE and not commission-based compensation. Tr. 799. Don Miller (Miller), Malouf's accountant, first saw a copy of the written PPA in May of 2011. Stipulated FOF No. 325.

Malouf has been unable to produce any copy of Exhibit A to the PPA, which purportedly set forth the clients Malouf was transferring to Lamonde. Tr. 921-22; Stipulated FOF No. 128; *see* Div. Ex. 97. While Malouf has been unable to locate a copy, clients were indisputably transferred from Malouf to Lamonde via a list that was in RJFS's possession on or around December 31, 2007.

Stipulated FOF No. 69. This list of customers was attached to email communications between RJFS and Malouf on January 2, 2008. Stipulated FOF No. 70. Steven McGinnis (McGinnis) never asked Malouf or RJFS for a copy of Exhibit A.[4] Tr. 460-61. Bell testified that the account transfer could have occurred without Lamonde or Malouf providing a list of accounts; RJFS could have transferred the accounts using the individual representative numbers associate with Lamonde and Malouf. Tr. 635. Bell did not testify that the transfer in fact occurred without Lamonde or Malouf providing a list of accounts. In fact, the evidence showed that a list was provided. *See* Div. Exs. 82, 83; Resp. Exs. 514, 515 (indicating Malouf sent a list to RJFS); Tr. 681-82.

Lamonde changed his testimony about entering into a written agreement with Malouf in late 2007 or early 2008 after being confronted with e-mails indicating that there was no written agreement until 2010, and acknowledged that he and Malouf did not create a written, signed agreement until June of 2010. Resp. Ex. 308 at 70-71; Div. Ex. 239 at 285-86.

2. Terms

The PPA between Malouf and Lamonde stated that Lamonde would pay Malouf continuing commissions pursuant to IM-2420-2, the FINRA (formerly NASD) rule

4. McGinnis is a consultant to Capital Forensics, which was hired by UASNM in its lawsuit against Malouf to evaluate the evidence related to UASNM's bond trading and opine as to what would be UASNM's compliance response. Stipulated FOF Nos. 40, 209-10, 355.

on "Continuing Commissions Policy" (NASD 2420-2). Div. Ex. 97 at RJFS-SEC-UASNM-000163; *see* Div. Ex. 234. Malouf learned about or was directed to NASD 2420-2 by RJFS. Tr. 1043. Malouf read information regarding NASD 2420-2 on the RJFS intranet, and he reviewed the plain language of the rule on FINRA's website. Tr. 1041.

The process for the sale of an RJFS branch typically involves RJFS providing the registered representatives with a sample agreement, getting a list of client accounts that would be part of the buy-sell agreement, and then moving the accounts according to that list. Tr. 633.

Malouf testified that he and Lamonde agreed that the price for the branch would be two times trailing revenue of approximately $500,000 to $550,000, or approximately $1.1 million. Tr. 924-25. This is same formula that Malouf had employed for his purchase of UASNM. Tr. 924, 1056. Lamonde made installment payments for his purchase of Branch 4GE. *See* Stipulated FOF Nos. 293, 294.

The sale agreement between Malouf and Lamonde required Lamonde to make periodic payments to Malouf for the purchase of the branch. Tr. 924. Malouf testified that payment for the branch was to be 40% of branch revenue over a four-year production period. Stipulated FOF No. 166. The PPA stated that the production period was to be five years, from January 2, 2008, to December 31, 2012. Stipulated FOF No. 167. Malouf is not sure why if everything is based on four years, the contract contemplates five. Stipulated FOF No. 168.

3. Payments

From 2008-2011, Malouf did the majority of his bond trades on behalf of UASNM clients through RJFS. Stipulated FOF No. 173. RJFS's trade blotter (Div. Ex. 29) shows that from January 2008 to May 2011 UASNM traded $140,819,708.15 in bonds through RJFS. Stipulated FOF No. 23. A summary of UASNM's bond trades prepared by Hudson shows that between January 2008 and May 2011, UASNM traded only $16,789,390.30 in bonds through other brokers. Div. Exs. 30, 207; Tr.101-03.[5] Thus, 89% of UASNM's bond trades were made through RJFS during the relevant period. Div. Ex. 207; Tr. 108, 357.

Malouf testified that when he used RJFS's bond desk to purchase bonds Lamonde was paid a commission and then had money to pay Malouf under their agreement. Stipulated FOF No. 175. Malouf used RJFS to trade bonds, among other reasons, because he was paid for those bond transactions, and he was not ashamed of receiving the approximately $1.1 million of payments for the sale of his branch because he thought he had done a good job. Tr. 941-42; Stipulated FOF Nos. 176, 177; Div. Ex. 231 at 259-60. Malouf said that if he could get the same bond at the same price from either RJFS or another broker, he was not obligated to direct a trade to the other broker simply because he might benefit in some way if the trade went through RJFS. Div. Ex. 231 at 259-60.

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5. Division Exhibit 207 is a chart prepared by summary witness John Schmalzer (Schmalzer), a financial analyst who works for the Commission on a contract basis and who testified for the Division. Tr. 345-46, 355-56.

Appendix D

From 2008 into 2011, Lamonde made a series of ongoing payments to Malouf for the RJFS branch. Stipulated FOF No. 294; JS No. 14. During that time period, Lamonde earned $1,074,454 in commissions from RJFS on UASNM bond trades and paid $1,068,084 to Malouf. Stipulated FOF Nos. 7, 20.

Beginning with his purchase of Branch 4GE in January 2008, Lamonde did not make payments to Malouf on a monthly basis as provided for in the PPA. Div. Ex. 97 at RJFS-SEC-UASNM-000162; *see* Stipulated FOF Nos. 258, 323; Div. Ex. 201.[6] The payments were not made on a set schedule and oftentimes more than one payment would be made each month. Div. Ex. 201. According to Malouf, Lamonde was simply prepaying what he owed for the branch. Stipulated FOF No. 28.

Lamonde admitted in investigative testimony that he and Malouf did not follow the terms of the PPA and that he paid Malouf more than the terms of the PPA required. Div. Ex. 239 at 178-79. Lamonde also testified that Malouf repeatedly demanded immediate cash payments for the entire commission that had been earned from particular UASNM bond trades (which was contrary to the terms of the PPA that provided for monthly payments). *Id.* at 274-75; Stipulated FOF No. 21. Malouf sometimes asked Lamonde, "where is my check" in the presence of at least Hudson or Calhoun. Stipulated FOF Nos. 21, 60. Lamonde espoused the opinion that that Malouf acted as if the

6. Division Exhibit 201 is a chart prepared by Schmalzer. Tr. 347.

commissions Lamonde made on bond trades referred by Malouf were Malouf's money, though Lamonde did not testify that Malouf told him that he felt that way. Div. Ex. 239. at 195.

Lamonde sought at least twelve cash advances from RJFS in pertinent part to pay Malouf. Stipulated FOF No. 214; Div. Exs. 101, 102. Two of these cash advances indicate "FBO" Peter Lehrman, indicating that they were to pay Peter Lehrman and not Malouf. Div. Ex. 101.

For Lamonde to pre-pay what he owed Malouf for the branch, he borrowed against a life insurance policy, took money from his father-in-law's bank account, and took on new credit card debt without telling his wife. Div. Ex. 89; Div. Ex. 239 at 127-28; *see* Stipulated FOF No. 223.

Often, Lamonde's payments to Malouf appeared to be related to commissions earned on the UASNM bond trades Malouf made through Branch 4GE. Tr. 142; Div. Ex. 203; *see* Stipulated FOF No. 196.[7] According to Lamonde, under the agreement, Lamonde passed along almost all of the commissions he made from RJFS bond trading on behalf of UASNM clients back to Malouf. Div. Ex. 239 at 205. Lamonde's payments to Malouf totaled $1,068,084.13, which equaled 99.4% of Lamonde's commissions. Div. Ex. 203; *see* Stipulated FOF No. 71. On a quarterly basis in 2008 and 2009, the amounts of the payments by Lamonde to Malouf at times exceeded the amount of commissions

7. Division Exhibit 203 is a chart prepared by Schmalzer. Tr. 351-53.

received by Lamonde, and on a quarterly basis in 2010, the amount of payments by Lamonde to Malouf are at times less than the amount of commissions received by Lamonde. Stipulated FOF Nos. 72, 72-2. Jerry DeNigris (DeNigris), an expert witness for Malouf, calculated that Lamonde paid Malouf 57.35% of the net branch revenues and 44.59% of the gross commission earned by the branch. Resp. Ex. 583 at Exhibit 4.

Lamonde gave inexplicably contradictory testimony regarding whether payments to Malouf were based, on the one hand, on bond-trade commissions from the accounts that Malouf sold to Lamonde (44Y5), or, on the other hand, that the payments were based on gross commissions for the whole branch, not just accounts transferred to 44Y5. Div. Ex. 239 at 184; Stipulated FOF No. 221; Tr. 1595-96.

Lamonde referred to the payments he made to Malouf as "commissions" on his 2008, 2009, and 2010 tax returns. Stipulated FOF No. 44; Div. Exs. 76, 77, 78. Lamonde provided Malouf with IRS Forms 1099 for the payments. Stipulated FOF No. 44. At Malouf's instruction, from 2008 through the first quarter of 2011, Calhoun performed bookkeeping services for Lamonde's Ltd. Stipulated FOF Nos. 259, 301. Calhoun prepared Forms 1099 for Lamonde's Ltd., including a 1099 to Malouf for 2010 that listed amounts he was paid as nonemployee compensation, but not as proceeds from the sale of a business.[8] Stipulated

8. I do not find credible Calhoun's hearing testimony that Lamonde told her that the checks from Lamonde to Malouf were commissions from RJFS. Tr. 1243-45. During her investigative testimony, Calhoun testified that when she started working at

FOF No. 260. Miller, an experienced CPA, testified that Lamonde did not report the payments correctly and issued the 1099s in error. Tr. 1577-78.

Kopczynski believed the sale of Branch 4GE could have involved payments over time from Lamonde to Malouf, similar to the terms of his sale of UAS to Malouf and Hudson in 2004. Tr. 1331-1332; Stipulated FOF No. 51. Additionally, the payments to Lamonde were broadcast openly throughout the office on those occasions when Malouf would ask Lamonde about the status of payments, resulting in at least one or two open arguments about the payments. Div. Ex. 229 at 104-05. The fact that Lamonde was making payments to Malouf, according to Hudson, "wasn't a hidden thing," and Hudson assumed the payments were for the purchase of Branch 4GE. *Id.* at 106-07; Stipulated FOF Nos. 34, 347. Hudson did not object to Malouf receiving money from RJFS because it meant him borrowing less from UASNM. *Id.* at 106. Hudson did not ask about or investigate the agreement

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UASNM in 2004 – Malouf still owned Branch 4GE at that time and was registered with RJFS – Malouf received commission checks. Div. Ex. 227 at 19-20. At the hearing she testified there was no reason for her to think any different later on when Malouf had sold Branch 4GE. Tr. 1256. She did not testify that Lamonde told her they were commissions during her investigative testimony, but that she would ask about the memo that Lamonde would allegedly put on the checks – "commission." Div. Ex. 227 at 20. When confronted with the checks at the hearing, Calhoun admitted that contrary to her statement about the memo line, none of them actually contained the memo "commission." Tr. 1257-58; *see* Stipulated FOF No. 61. She never testified during the investigation that Lamonde told her they were commissions.

between Malouf and Lamonde because he did not think it was part of his role or any of his business. Tr. 140-41.

According to UASNM's independent compliance consultant, Ciambor, Malouf told him that with the sale of his RJFS branch to Lamonde, his relationship with RJFS was effectively severed, though Ciambor could not recall whether Malouf actually used the phrase "severed ties" in discussing the matter with him. Tr. 736-37, 773-76. Prior to June 2010, Malouf did not tell Ciambor that he was receiving ongoing payments from Lamonde from the RJFS branch. Tr. 737; Stipulated FOF No. 36. When asked if Malouf told him when he interviewed Malouf in June of 2009 that he had received in the last year and a half over forty payments from Lamonde totaling over half a million dollars based upon trades that had been run through Malouf's former RJFS branch, Ciambor testified "absolutely not," but if that were the case Malouf should have told Ciambor about it. Stipulated FOF No. 156. Ciambor testified that based upon what he knows now, he thinks Malouf lied to him. Tr. 852.

D. UASNM Forms ADV

Malouf, Kopczynski, Hudson, and outside compliance consultant ACA each were involved to varying degrees in preparing or reviewing UASNM's Forms ADV from 2008 through May 2011. Stipulated FOF No. 32. ACA reviewed Parts I and II of UASNM's Forms ADV annually and made recommendations to UASNM regarding updates it thought were necessary. Stipulated FOF No. 384. Ciambor primarily worked with Kopczynski and Hudson to update

UASNM's Forms ADV. Tr. 751. Ciambor personally reviewed Part II of UASNM's Forms ADV on at least an annual basis. Tr. 820.

Hudson signed or authorized ACA to sign his name to every Form ADV filed by UASNM. Tr. 291-92; Stipulated FOF No. 54. By doing so, he and the investment adviser both certified, under penalty of perjury under the laws of the United States of America, that the information and statements made therein, including exhibits and any other information submitted, were true and correct. Tr. 291-92.

Malouf performed at least a cursory review of some Forms ADV focusing on disclosures relating to himself and RJFS. Stipulated FOF No. 33. Malouf had a responsibility to make full and accurate disclosure in the Forms ADV regarding his ongoing relationship with RJFS. Tr. 995. Malouf, as CEO, president, and majority shareholder of UASNM, had final and ultimate responsibility for UASNM's Forms ADV between 2006 and the end of 2010. Tr. 993-95.

At least some of UASNM's ADVs between 2008 and 2011 did not disclose that Malouf sold his RJFS branch to Lamonde and was receiving ongoing payments from Lamonde in connection with that sale. Stipulated FOF No. 8.[9],[10]

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9. The Division does not dispute that the conflict with Branch 4GE was disclosed from 2004 through August 2008, and again in March 2011 in UASNM's Forms ADV.

10. At times between 2008 and May 2011, UASNM's Forms ADV and website stated that Malouf had a Bachelor of Science

Appendix D

Items 8 and 9 of UASNM's Forms ADV Part II, dated February 4, 2008, August 20, 2008, and December 1, 2008, disclosed that employees of UASNM were or may be registered representatives of RJFS and could receive commissions. Stipulated FOF No. 29.

Items 8 and 9 of UASNM's Forms ADV Part II, dated October 1, 2009, January 1, 2010, and April 12, 2010, removed the prior disclosure regarding the UASNM employees' status as registered representatives of RJFS but were otherwise the same as the prior versions. Stipulated FOF No. 30.

Item 12 of UASNM's Form ADV Part II, dated April 12, 2010, affirmatively represented that "employees of UASNM are not registered representatives of Schwab, [RJFS] or Fidelity, and do not receive any commissions or fees from recommending these services." Stipulated FOF No. 10.

Item 12 of UASNM's Form ADV Part II, dated April 12, 2010, disclosed that the broker recommended by UASNM was not "based upon any arrangement between the recommended broker and UASNM," and, instead, was

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in Finance degree from the University of Northern Colorado at Greeley. Stipulated FOF No. 335. Malouf did not receive a Bachelor of Science in Finance degree from the University of Northern Colorado. Stipulated FOF No. 336. Malouf was not initially aware that the disclosure was incorrect. He became aware that he had not successfully received his degree and immediately took steps to ensure that the disclosure on the Form ADV was corrected. Stipulated FOF No. 83

> dependent upon a number of factors including the following: Trade execution, custodial services, trust services, recordkeeping and research, and/or ability to access a wide variety of securities. UASNM reviews, on a periodic and systematic basis, its third-party relationships to ensure it is fulfilling its fiduciary duty to seek best execution on client transactions.

Stipulated FOF No. 9.

Items 10 and 12 of UASNM's Form ADV Part 2A, dated March 2011, disclosed that Malouf had sold his interest in an RJFS branch in exchange for a series of payments, and that an incentive may exist for UASNM to utilize RJFS to generate revenue that may be utilized to make payments to Malouf. Stipulated Finding of Fact Nos. 11, 31.

All or most of UASNM's Forms ADV created between October 1, 2009, and April 12, 2010, portions of which are reflected in Exhibit 193, were provided to UASNM clients.[11] Tr. 1377-78, 906. Malouf's conflict of interest related to Lamonde's payments to Malouf from UASNM bond trades placed through RJFS was not specifically disclosed to the testifying UASNM investors. Stipulated FOF Nos. 328, 330. The testifying UASNM investors would have wanted to know that Malouf would receive

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11. Division Exhibit 193 is a demonstrative exhibit containing a summary of UASNM's Forms ADV Part II Items 8.C and 9.B.E disclosures dated July 17, 2006-April 12, 2010. Tr. 187; Div. Ex. 193.

payments related to bond trades placed through RJFS. Stipulated FOF Nos. 329, 331.

Malouf testified that "without a doubt," disclosure regarding the ongoing payments he was receiving from Lamonde should have been in all the relevant ADV disclosures. Stipulated FOF No. 193; Tr. 1001. Hudson viewed Malouf's arrangement with Lamonde as a potential conflict of interest. Stipulated FOF No. 127. When Ciambor learned in June of 2010 that Malouf had been receiving payments from Lamonde as a result of UASNM bond trades through the RJFS branch he believed that was a clear conflict of interest. Stipulated FOF No. 151. Ciambor believes that disclosure of the financial incentive for UASNM to route trades through RJFS, which was ultimately made in March 2011, should have been disclosed in all Forms ADV ever since Malouf's arrangement with Lamonde in 2008. Stipulated FOF No. 154. Malouf agrees that the ongoing payment arrangement with Lamonde created a clear conflict of interest ever since he entered into the arrangement with Lamonde in early 2008. Stipulated FOF No. 178. McGinnis testified that in his forty-four years in the securities industry, he has "never seen a million dollars conflict of interest like this before." Tr. 421-22; Stipulated FOF No. 213.

E. UASNM Website

According to Hudson, as CEO and head of UASNM's marketing efforts, Malouf had some responsibility for ensuring that the information on UASNM's website was accurate. Tr. 156-57. Malouf was the lead salesman for

UASNM, and he was familiar with at least some of the contents of its website. Stipulated FOF No. 13. Malouf assisted in creating the website content. Tr. 157, 1137-38. Malouf's understanding was that what is on the UASNM website for the public to consume is what is important. Stipulated FOF No. 190. While Malouf testified that he may not have read every word of UASNM's website, he was familiar with its contents in the 2008, 2009, and 2010 time frame. Stipulated FOF No. 189. Malouf previously testified that he "probably read" statements on UASNM's website in 2008 about UASNM being independent and not charging commissions. Stipulated FOF No. 191.

The primary compliance responsibility for the website was assigned to Kopczynski as CCO by UASNM's compliance manual; he acknowledged he was responsible for representations on the website and he actually reviewed the website. Resp. Ex. 346 at 72; Tr. 1354-57. Malouf delegated all compliance functions to Kopczynski as CCO, including the website content, consistent with UASNM's written compliance procedures, and reasonably relied on Kopczynski to ensure the information was compliant; Kopczynski described his duties as follows: "My responsibility as chief compliance officer was to take procedures and protocols that were established in an effort to keep UASNM in compliance with the Commission's regulations, and effectively work with the consultant to make sure anything that was required along those lines would be taken care of." Tr. at 1287.

At times, between 2008 and 2011, UASNM's website, memorialized in Division Exhibits 66, 68, and 69, made the following statements:

Appendix D

> We do not accept commissions and we vigorously maintain our independence to ensure absolute objectivity drives our decisions in managing our clients' portfolios.
>
> * * *
>
> Uncompromised Objectivity Through Independence
>
> UAS[NM] is not owned by any "product" company nor compensated by any commissions. This allows us to provide investment advice void of conflicts of interest. UAS[NM] may place trades through multiple sources, ensuring that the best cost/service/execution mix is met for its clients.

Div. Exs. 66, 68-69; Stipulated FOF Nos. 12, 131. These statements were very common statements UASNM would use in marketing. Stipulated FOF No. 131.

ACA advised UASNM in its September 2007 and December 2009 annual reports that the language in its marketing materials "void of conflicts of interest" was potentially misleading, and recommended removing it. Stipulated FOF Nos. 85, 86. The "void of conflicts of interest" language continued to appear on the UASNM website and in marketing materials in 2008-2010. Stipulated FOF No. 87. Kopczynski claims to have reviewed the UASNM website and believed it to be accurate in 2008. Tr. 1356-57. Neither Hudson nor

Kopczysnki took any action to remove language from the UASNM website regarding UASNM being "void of conflicts of interest" until 2012, despite being specifically advised by ACA in its 2007 and 2009 annual reports that such language was problematic. Tr. 1363, 1369.

Similar to the website, UASNM's other marketing materials informed clients that brokers would be recommended "based on the broker's cost, skill, reputation, dependability, and compatibility with Clients, and not upon any arrangement between the recommended broker and [UASNM]." Div. Ex. 24 at MaloufSEC000559. Kopczynski admitted it was also his obligation to review UASNM's marketing materials before they were disseminated. Tr. 1289, 1356.

F. Best Execution

From 2008 to 2011, RJFS had written policies and procedures pertaining to best execution duties of a broker-dealer, rather than of an investment adviser. Tr. 710-11; Stipulated FOF No. 267. RJFS maintained a policy requiring the price on all bond trades to be fair and reasonable. Tr. 669; Div. Ex. 127 at RJFS-SEC-UASNM-004167. If a bond trade is placed through RJFS with a commission or markup that exceeds the RJFS commission/markup grid, then that trade will be rejected by RJFS. Tr. 710; *see* Stipulated FOF Nos. 232, 265. Part of the reason RJFS reviews the markups/commissions charged on bond trades is to ensure that its customers are getting best execution. Tr. 710; Div. Ex. 126. From 2008-2011, Malouf was not governed by RJFS's markup/

markdown policy. Stipulated FOF No. 252. Malouf admitted that there is a different best execution duty for a broker-dealer than there is for an investment adviser. Tr. 1147-48.

An investment adviser may not rely solely on a broker's trading platform, such as BondDesk, to fulfill his fiduciary duty of best execution. Tr. 1147; Div. Ex. 243 at 28-29. However, BondDesk is a tool that can assist in achieving best execution, and the Division's expert agreed it was a good place to find bond bids/asks. *See* Stipulated FOF No. 263. BondDesk allows users to see what the best asks and best bids are from approximately 160 broker-dealers at any given time for particular bonds. Tr. 541; Stipulated FOF No. 374.

To seek best execution, an investment adviser generally must obtain competing bid or ask prices from more than one broker-dealer. Div. Ex. 20; Div. Ex. 243 at 21; Tr. 935; *see* Stipulated FOF Nos. 133, 145. Obtaining multiple bids is not an absolute requirement and the Division's expert acknowledged that whether multiple bids were necessary depends upon the circumstances. *See* Stipulated FOF No. 381; Tr. 548-49, 552. Best execution is based upon a number of qualitative and quantitative factors that may not require multiple bids. Stipulated FOF No. 381; Tr. 548-49, 552.

Malouf told others that he sought multiple bids for his bond trades. Tr. 169, 726-27, 1203. However, Malouf generally did not shop around for bids from competing brokers when executing bond trades on behalf of UASNM

clients. Div. Ex. 243 at 4; Stipulated FOF No. 174. Malouf's own expert witness acknowledges that Malouf's practice was not to obtain competitive quotes every time he placed bond trades through RJFS. Resp. Ex. 579 at 8; Tr. 1462-63.

The evidence shows that in at least some cases, shopping bond trades among brokers resulted in a broker offering a better price than RJFS. Div. Ex. 218; Stipulated FOF No. 204. By shopping bond trades with other brokers, Keller was at times able to get RJFS to come down to meet a lower price. Resp. Ex. 341. Malouf was one of the people who told Keller about the practice of obtaining multiple bids from broker-dealers when purchasing bonds. Tr. 1201. Even Malouf acknowledged that he should have gotten multiple bids and that had he shopped around among brokers for lower bids on bond sales it is possible that he could have gotten a lower bid for his clients. Stipulated FOF Nos. 174, 334.

McGinnis advised that UASNM had a best execution problem because there were excessive markups, and possibly an unregistered broker-dealer issue, and said that UASNM needed to self-report the issue, quickly. Stipulated FOF No. 137. McGinnis never independently verified whether any of the conduct at issue was actually attributable to Malouf, instead relying on what Hudson and Kopczynski told him. Tr. 446-47; *see* Stipulated FOF No. 111.

A commission of over one percent on a U.S. Treasury or agency bond trade of $1,000,000 or more is excessive.

In the 2008-2011 time period, Malouf understood that Lamonde would charge at most a one percent commission on a bond trade, or less if RJFS's institutional grid suggested it. Stipulated FOF No. 184. Malouf and Lamonde also both testified that they would never charge more than a hundred basis points on a bond trade, yet some bond trades run through RJFS were subject to commissions in excess of one percent. Stipulated FOF No. 43.

For a U.S. Treasury bond trade of over $1 million, an appropriate commission would start at one-half of one percent and go down from there. Malouf did not dispute his prior testimony that for a $1 million U.S. Treasury bond an appropriate commission would be 1%, would drop to 0.5% above that then go down from there. Stipulated Finding of Fact No. 186. The evidence shows many UASNM bond trades of $1 million or more where the commissions charged were in excess of the 0.5% that Malouf testified was reasonable for trades of that size. A commission of approximately 1% was paid to the RJFS branch on the $3 million federal agency loan reflected in Respondent Exhibit 339. Stipulated FOF No. 321. As another example, a $5,500 commission was paid on the $522,825 bond trade (1.052%) reflected in Exhibit 553 and another trade was for $1,537,829 and involved a $15,212.90 commission (0.99%). Stipulated FOF No. 322; Resp. Ex. 582, Tab 1 at 1-2.

A September 17, 2010, email exchange between Bell and Eva Skibicki (Skibicki), a manager in Trading and Retail Sales at RJFS, reflects that a 1% commission on a

$3.8 million bond trade was reduced to fifty basis points based on a discussion between Bell and Skibicki. Div. Ex. 65; Tr. 147-48. Hudson became concerned about Malouf's receipt of payments from Lamonde in the fall of 2010 when he learned that Malouf had questioned RJFS's decision to write down the commission charged on a particular bond trade. Tr. 147-48. Hudson thought it was odd that Malouf would be concerned about a commission write down because that money was going to Lamonde. Tr. 148-49.

The payments from Lamonde and Malouf's incentive to execute bond trades through RJFS created a best execution issue in Ciambor's mind. Stipulated FOF No. 153. However, Kopczynski convinced Ciambor to remove the "high" risk level rating that ACA assigned to UASNM's best execution practices in its 2011 annual review a week before the Commission conducted its examination of UASNM. Stipulated FOF 386.

The Commission conducted examinations of UASNM in 2002 and 2006. *See* Resp. Exs. 391, 558. Neither examination resulted in UASNM being advised that any issues existed with respect to whether UASNM was satisfying its best execution obligations. Tr. 1125-26; Resp. Exs. 391, 558. UASNM's bond trading practices and procedures were generally unchanged from 2000 through May 2011. Tr. 1126. ACA never advised Malouf at any time from 2002 to 2010 that there was any issue with respect to UASNM's best execution. Tr. 1128.

The scope of ACA's engagement included best execution. Stipulated FOF No. 96. Each year ACA

performed a periodic and systematic evaluation of the execution quality of UASNM's client trades with respect to equities and fixed income. Tr. 725-26. The written semi-annual reviews of best execution that ACA provided to UASNM did not state that they were limited to equities. Tr. 793. Kopczynski sent UASNM trade blotters to ACA quarterly. Tr. 1291. ACA reviewed UASNM's trade confirms during ACA's annual reviews. Tr. 1303. However, the confirmations that UASNM received for bond trades did not reflect the specific amount of any markups. Tr. 1308.

Ciambor was advised that UASNM would seek bids from multiple brokers to achieve best execution on bond trades, and he was provided documentation which evidenced that process. Tr. 728. Based upon interviews with various UASNM personnel and his review of documents, Ciambor's understanding was that a multi-bid process for bond transactions was used fairly consistently for the majority of trades, but that only a sample of the documentation evidencing that process was being maintained. Tr. 729, 763; Stipulated FOF No. 145. Ciambor told Kopczynski that Malouf had shown him evidence of bids regarding bond transactions. Tr. 837. Ciambor saw evidence during ACA's annual mock audits that UASNM was seeking best execution on fixed income investments. Tr. 726.

Prior to June 2010, ACA advised UASNM and Malouf each year that UASNM was complying with its best execution obligation and never advised UASNM of any deficiencies in best execution. Stipulated FOF No.

100. Hudson believed ACA was conducting a periodic and systematic review of UASNM's best execution, that ACA had the resources available to conduct a proper best execution review, and that they were looking at commission levels in connection with their best execution review. Stipulated FOF No. 359. When ACA did not advise UASNM of any issues with respect to its best execution, Hudson believed that the firm, in fact, did not have any issues. *Id.* Hudson relied upon ACA to conduct UASNM's periodic and systematic review of best execution. Stipulated FOF No. 360. Likewise, Kopczynski relied on ACA to assist UASNM with complying with its best execution obligation. Stipulated FOF No. 97. Prior to 2011, Malouf relied on ACA to assist Kopczynski to ensure the firm was complying with its best execution obligation and prior to May 2011, Kopczynski never advised Malouf of any deficiencies in best execution. Stipulated FOF Nos. 99, 101; Tr. 947. Kopczynski was responsible for supervising Malouf's bond trading. Tr. 1311. However, supervision of Malouf's bond trading was limited to analysis and/or review performed by ACA. Stipulated FOF No. 342. ACA never advised UASNM or Malouf that it was not examining UASNM's fixed income trades for excessive markups or commissions. Stipulated FOF No. 383.

G. Expert Witness Testimony

The parties agreed that experts' reports would be incorporated, by reference, into their direct testimony for the sake of efficiency. *See Dennis J. Malouf*, Admin. Proc. Ruling Release No. 1971, 2014 SEC LEXIS 4123 (Nov. 3, 2014); Tr. 470-71.

Appendix D

1. Dr. Gary Gibbons

Dr. Gary Gibbons (Dr. Gibbons), the Division's expert, is a visiting professor of entrepreneurship at Thunderbird School of Global Management, focusing on securities investing and corporate finance.[12] Div. Ex. 243 at 1. He is also a Principal with The Coleridge Group, an investment advisory firm. *Id.* From 2007-2011, Dr. Gibbons was an active investment adviser and traded an average of $45 million of bonds per year on behalf of his clients. *Id*. at 2.

At the request of the Division, Dr. Gibbons offered opinions on the duties of investment advisers with respect to clients, bond trading, best execution, and whether Malouf fulfilled his duties to clients. Div. Exs. 243-44.

Dr. Gibbons concluded that investment advisers have a number of obligations with respect to their position as a fiduciary, including: not making any misrepresentations to clients; not engaging in any scheme that perpetrates a fraud; avoiding all avoidable conflicts of interest; disclosing all actual and potential conflicts of interest; providing independent advice free of pecuniary motives not related to the payment of the fee charged to the client; being knowledgeable and mindful of the law; being knowledgeable of industry practices and competent in applying industry practice to the construction of client

12. Dr. Gibbons earned a BS in Business Administration from the University of Arizona, Tucson; a master of science in Business Administration from California State University, Dominguez Hills; and a doctor of philosophy in Business Administration from The Claremont Graduate University. Div. Ex. 243 at 53.

portfolios and the selection of securities; and providing best execution and having procedures in place to determine if best execution is being provided. Div. Ex. 243 at 9-10.

Dr. Gibbons testified that bonds are different from equities because their theoretical value is determined in a very specific matter, their price is a function of a negotiated exchange between the buyer and seller, and most bonds do not trade on exchanges or in an auction outcry market. Div. Ex. 243 at 19. He believes that investment advisers should view broker-dealers as counterparties when buying and selling bonds for their clients. *Id.* Dr. Gibbons testified that the factors that impact bond prices, such as liquidity, credit quality, issuer, trade size, and maturity, are unique and specific. *Id.* According to Dr. Gibbons, markets play a distinct role in setting the ultimate trading price of a bond and commissions have a very large impact on the final trade price of a bond and the ultimate return to the investor. *Id.*

With respect to best execution, Dr. Gibbons testified that the minimum standard for investment advisers to achieve best execution involves identifying qualified broker-dealers, getting alternative bids or asks for the security, and having a clear procedure in place to document the process. Div. Ex. 243 at 29. He noted that investment advisers should be particularly focused on price. *Id.*

Dr. Gibbons explained that an investment adviser's fiduciary duty of best execution is different from a broker-

dealer's lesser duty. Div. Ex. 243 at 20-23. According to Dr. Gibbons, simply trading through a broker, such as RJFS, does not satisfy an investment adviser's fiduciary duty of best execution. *Id.* at 28-29. In a similar vein, Dr. Gibbons explained that an investment adviser may not rely solely on a broker's trading platform, such as BondDesk, to fulfill a fiduciary duty of best execution. *Id.* Instead, according to Dr. Gibbons, to seek best execution an investment adviser generally must obtain competing bid or ask prices from more than one broker-dealer. *Id.* at 21-22. Dr. Gibbons conceded that multiple bids may not need to be sought on every single trade to achieve best execution. Tr. 551-52.

Dr. Gibbons identified eighty-one UASNM trades in U.S. Treasury and federal agency bonds during the period in question that represented $95,954,806 in principal amount and generated $833,798 in commissions, which, on a dollar weighted average basis, is 87.28 basis points, or 0.8728%. Stipulated FOF No. 39. Dr. Gibbons relied on his experience and other sources to opine that U.S. Treasury and agency bond trades such as these should have been subject to commissions in the range of ten to seventy-five basis points. *Id.* Dr. Gibbons testified that his ranges of "acceptable" markups/markdowns are not absolute. Tr. 555; Stipulated FOF No. 112. He testified that there is no publication setting forth a fixed acceptable range of commissions on bond trades. Tr. 525-26; Stipulated FOF Nos. 80, 378.

Dr. Gibbons found that UASNM clients were charged excess commissions of between $442,106 and $693,804 on the eighty-one bond trades he analyzed. Div. Ex. 243 at 36.

Dr. Gibbons also opined that Malouf engaged in several repetitive short-term bond trades that lost money for his clients. *Id.* at 4-5.

Dr. Gibbons rebutted the contention of one of Malouf's experts, Alan Wolper (Wolper), that neither "Mr. Malouf nor UASNM had an obligation on a real-time, trade-by-trade basis to ensure that the executions he was getting from RJFS constituted" best execution, as follows:

> 1. Mr. Malouf has a fiduciary duty to his clients which includes the duty of diligence, prudence, the duty to be knowledgeable and to act in the client's best interest. Without a doubt this means when trades are being done not at some later time. Points 2 and 3 below follow from this duty[,]
>
> 2. The duty to get alternative bids and asks on a contemporary basis (this duty is described in UASNM's brochure),
>
> 3. The duty Mr. Malouf has to trade at the lowest commissions or mark-ups or mark-downs when available within the constraints of the market and the broker-dealer.

Div. Ex. 244 at 3 (formatting altered); Stipulated FOF No. 81.

Dr. Gibbons's Report acknowledges that he refers to the eighty-one trades as "Malouf's trades" but was unable

to confirm whether Malouf directed any specific bond trade at issue. Div. Ex. 243 at 3; Tr. 508. Malouf directed no more than forty-eight to seventy-seven of these eighty-one trades (60% and 95%). Stipulated FOF No. 77.[13]

Dr. Gibbons did not review or consider any of the trade tickets for the trades at issue in preparing his expert report or forming any of his opinions. Tr. 542. Dr. Gibbons was unable to find and did not consider any studies regarding markups or commissions on bond trades. Tr. 544. There is no data available to compare the actual markups and commissions charged on UASNM's bond trades against other markups or commissions that were being charged on the same bonds at the same time. Tr. 558. Dr. Gibbons did not consider any misconduct by ACA or Kopczynski as CCO in his expert report. Tr. 511.

2. Jerry DeNigris

DeNigris is a broker-dealer professional with substantial experience in fixed income trading, mark-up analysis, and reviews.[14] Resp. Amended Witness List and Good Faith Identification of Exhibits at Ex. C; Tr. 1518-22. At the request of Malouf, he offered opinions regarding the bond trading at issue and the payments received by Malouf from Lamonde. Resp. Ex. 581 at 1.

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13. I have found, for reasons set forth below, that Malouf was responsible for at least sixty percent of these trades.

14. DeNigris earned a BA in Economics from Rutgers University and has held Series 4, 7, 15, and 63 licenses at one time. Resp. Amended Witness List and Good Faith Identification of Exhibits, Ex. C at 2; Tr. 1518.

DeNigris found that UASNM customers' bond trades incurred an average commission of 81.8 basis points. Stipulated FOF No. 41. He identified multiple bond trades made through RJFS that exceeded 100 basis points, including three trades with commissions of approximately 150 basis points. Stipulated FOF No. 43.

DeNigris did not offer any opinion as to what a reasonable commission would be on the bond trades at issue or whether UASNM customers paid excessive commissions. Stipulated FOF Nos. 41, 248. DeNigris testified that that Malouf is not governed by RJFS's markup/markdown policy. Stipulated FOF No. 252.

DeNigris compared the actual yield on bonds purchased by UASNM, as determined by the price and reported to the customer with the yield that would have been achieved if a hypothetical forty basis point commission was assumed on every transaction. Resp. Ex. 582 at 3. He found that the average effect of the commissions on bond yields in question was 0.14%. Resp. Ex. 582 at 3, Tab 3.

DeNigris found that when the payments from Lamonde to Malouf are extrapolated over four years they would have ultimately constituted approximately 46.97% of the revenues earned by Branch 4GE. Resp. Ex. 582 at 4, Tab 4a.

3. Alan Wolper

Wolper was previously Director of NASD's Atlanta District Office, where he oversaw hundreds of member

firms and thousands of branch offices.[15] Resp. Ex. 579 at 2. He also served as a member of the NASD's Department of Enforcement, where he had responsibility for prosecuting hundreds of formal disciplinary actions. *See* Tr. 1394; Resp. Ex. 579 at 1-2. At Malouf's request, Wolper opined on the allegations that Malouf failed to seek best execution for UASNM clients and received commission payments from RJFS even after resigning from the broker-dealer. Resp. Ex. 579 at 1.

Wolper testified that there are important and clear differences between the manner in which equity and debt securities are sold, including the fact that debt securities are not offered for sale on national exchanges and in order for a buyer to compare among sellers the types and prices of bonds, it can be necessary to contact multiple sellers separately. Resp. Ex. 579 at 3-4. He noted that some vendors offer a service that compiles the available inventories of many broker-dealer sellers of bonds in a single location, allowing subscribers to see thousands of debt offerings at once and conduct a quick and efficient review of available bonds and prices. *Id.* at 4. BondDesk is one such service. *Id.*

Wolper testified that one of an investment adviser's fiduciary obligations is to obtain best execution on trades effected for customers. Resp. Ex. 579 at 4. He explained that determining best execution requires a review of

15. Wolper earned a BA in English from Rutgers University and a JD from the University of North Carolina, Chapel Hill. Resp. Amended Witness List and Good Faith Identification of Exhibits, Ex. B; Resp. Ex. 579 at 1.

a combination of a number of both quantitative and qualitative factors and involves more than just obtaining the lowest possible commission on a particular trade. *Id.* at 5. Factors that should be evaluated include the price of the security, the costs of the transaction, the speed of execution, the size of the transaction, and the liquidity of the security. *Id.* He added that best execution also involves an analysis of the executing broker-dealer's abilities. *Id.*

Wolper opined that a trade-by-trade, real-time comparison and analysis is not necessary to achieve best execution and that best execution should be determined based at least in part on a periodic and systematic evaluation. Resp. Ex. 579 at 5-6; Resp. Ex. 580 at 3; Tr. 1409; Stipulated FOF No. 82. Wolper does not believe there is a difference between the fiduciary duty applied to broker-dealers versus investment advisers as to best execution, but admitted that RJFS satisfying its duty of best execution does not mean that Malouf satisfied his. Stipulated FOF Nos. 242-43. However, he testified that the record reflects that Malouf's decision to use RJFS was reasonable and could be accurately characterized as an effort to obtain best execution. Resp. Ex. 579 at 6. Wolper cited Malouf's justifications that: RJFS gave him access to BondDesk; based on his years in the business he was aware that all broker-dealers in that space charged basically the same commissions for the types of bonds he was trading; Malouf instructed Lamonde to limit commissions to no more than one point; Malouf spot checked the competitiveness of RJFS's prices; Malouf read research on a daily basis on the bonds he was trading for customers, allowing him to gauge the competitiveness

of the prices he was getting from RJFS; and Malouf's experience trading bonds using Fidelity and Schwab taught him that those firms could not offer the same inventory he could see on BondDesk and they charged prices that were generally higher than those he could get from RJFS. *Id.* at 7-8. Wolper opined that Malouf was not required to obtain competitive quotes from three different broker-dealers each time he placed an order for execution with RJFS. *Id.* at 8. Wolper did not offer an opinion on appropriate commission range or whether particular commissions were reasonable. Stipulated FOF No. 241.

Wolper opined that Malouf appropriately delegated the compliance function to Kopczynski and relied upon him to properly carry out his duties. Resp. Ex. 579 at 9-11; Resp. Ex. 580 at 4-6. Wolper based that opinion on his understanding that a president/CEO of a broker-dealer may delegate responsibility for the functions of a firm to other qualified individuals, whereupon the delegate assumes ultimate responsibility, not the CEO. Resp. Ex. 580 at 5. Wolper agreed that this principle was decided in the broker-dealer context (as opposed to the investment adviser context), and that such delegation requires reasonable follow-up and review of delegation, which there was no evidence of in this case. *Id.*; Tr. 1488-89; Stipulated FOF No. 246.

Wolper never provided legal advice to investment advisers on best execution issues, provided expert opinions regarding investment adviser best execution, held any securities licenses, worked as a regulator of an investment adviser or as an investment adviser, traded

bond funds for a client, or managed a bond fund. Stipulated FOF Nos. 233, 235-39.

According to Wolper, NASD 2420-2 requires only that the agreement be "bona fide," not that it be written. Tr. 1421-22; Resp. Ex. 579 at 8-9. Generally, Wolper agreed that Commission staff no-action letters provide persuasive authority and guidance that are relied upon in the securities industry. Tr. 1498. Wolper thinks that retiring from the securities industry does not mean one has to stop selling securities, but rather just leave the broker-dealer industry; one may still be an investment adviser. Stipulated FOF No. 245.

III. CONCLUSIONS OF LAW

Malouf contends that he finds himself in his current predicament because Kopczynski turned on him days after Malouf revealed his intent to divorce Kopczynski's daughter. Resp. Br. at 1-3. In the absence of that precipitating incident, it is possible that the ensuing events leading to UASNM's self-reporting to the Commission may not have taken place. While, from Malouf's perspective, it seems palpably unfair that neither Kopczynski nor Hudson were charged in administrative proceedings, the Commission's decision not to pursue charges against them is an unreviewable exercise of prosecutorial discretion. *See Greer v. Chao*, 492 F.3d 962, 964 (8th Cir. 2007).[16] Many

16. As that Court explained, *Heckler v. Chaney*, 470 U.S. 821 (1985), "held that when an agency declines to initiate enforcement proceedings, that decision is not presumptively reviewable. This is true because when an agency decides to seek enforcement actions (or

factors inform that exercise. *See Wayte v. United States*, 470 U.S. 598, 607 (1985) ("Such factors as the strength of the case, the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan are not readily susceptible to the kind of analysis the courts are competent to undertake."); *Dirks v. SEC*, 463 U.S. 646, 678 n.16 (1983) (Blackmun, J., dissenting) (noting that passing on "information to regulatory authorities . . . may be the reason . . . the SEC, in an exercise of prosecutorial discretion, did not charge [the tipper of insider information] under Rule 10b-5"). Thus, even if Kopczynski and Hudson committed misconduct similar to Malouf's – such as failure to disclose conflicts of interest – it would make no difference with respect to Malouf's liability. *See, e.g.*, *United States v. Foster*, 754 F.3d 1186, 1193 (10th Cir. 2014) ("[A] prosecutor exercises prosecutorial discretion in determining whether to file charges against some individuals but not others, even when the individuals in question committed sufficiently similar conduct" but once charged, a defendant's guilt is determined by reference to statute, not others' conduct.).

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declines to seek enforcement actions), it is entitled to the same type of discretion that a prosecutor is afforded in bringing (or not bringing) criminal charges." *Greer*, 492 F.3d at 964 (internal citations omitted) (citing 470 U.S. at 831 ("[A]n agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion.")); *see Drake v. FAA*, 291 F.3d 59, 71 (D.C. Cir. 2002) (citing *Block v. SEC*, 50 F.3d 1078, 1082 (D.C. Cir. 1995)).

Appendix D

A. Exchange Act Sections 15(a)(1) and 15C(a)(1)(A)

Exchange Act Section 15(a)(1) makes it "unlawful for any [unregistered or unaffiliated] broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security . . .) unless such broker or dealer is registered" with the Commission in accordance with Section 15(b) of the Exchange Act. 15 U.S.C. § 78*o*(a)(1). Scienter is not required for a violation of this provision. *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003). Similarly, Section 15C(a)(1)(A) of the Exchange Act makes it unlawful for any unregistered broker to effect any transaction in any government security and does not require scienter. 15 U.S.C. § 78*o*-5(a)(1)(A).

Exchange Act Section 3(a)(4) defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others."[17] 15 U.S.C. §78c(a)(4). The phrase "engaged in the business" connotes "a certain regularity of participation in securities transactions at key points in the chain of distribution." *Mass. Fin. Servs., Inc. v. Sec. Investor Protection Corp.*, 411 F. Supp. 411, 415 (D. Mass. 1976); *see also SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011). Broker activity can be evidenced by such things as regular participation in securities transactions, receiving transaction-based compensation

17. It is not disputed that the bond trades at issue were securities and that U.S. Treasury bonds are government securities. The use of interstate commerce is also not disputed.

or commissions (as opposed to salary), a history of selling the securities of other issuers, and involvement in advice to investors and active recruitment of investors. *See, e.g.*, *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 12-13 (D.D.C. 1998).

Receipt of commissions is a "hallmark" of a being broker. *Kramer*, 778 F. Supp. 2d at 1334-35 (citing *Cornhusker Energy Lexington, LLC v. Prospect St. Ventures*, No. 8:04cv586, 2006 U.S. Dist. LEXIS 68959, at *20 (D. Neb. Sept. 12, 2006)). Yet, transaction-based compensation is not a prerequisite to finding liability for acting as an unregistered broker-dealer. *David F. Bandimere*, Initial Decision Release No. 507, 2013 WL 5553898, at *52, 82 (Oct. 8, 2013) (finding that "[e]ven assuming [Respondent] did not receive transaction-based compensation, the evidence that he acted as an unregistered broker is overwhelming").[18]

Malouf voluntarily gave up his broker-dealer registration on December 31, 2007. He elected to focus on UASNM, the investment adviser, instead of transferring his registration to another broker-dealer to continue doing business as a broker. *See* Stipulated FOF Nos. 5-6. Malouf had sold Branch 4GE to Lamonde when he gave up his registration. The broker-dealer for all the transactions at issue in this case was Lamonde, who was registered and

18. Although *David F. Bandimere* is an Initial Decision and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it, but does distinguish its application based on the facts. Div. Proposed Additional FOF and COL at 66; Resp. Response to Div. Proposed Additional FOF and COL at 102-03.

associated with broker-dealer RJFS. By contrast, Malouf, and other officials at UASNM, such as Hudson and Keller, who directed business to Lamonde, were investment advisers. Malouf's actions, like that of Hudson and Keller, were consistent and typical with those of a registered investment adviser. An investment adviser is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." 15 U.S.C. § 80b-2(a)(11).

As a preliminary matter, before addressing the issues of whether or not Malouf, as opposed to Lamonde, received commissions, or whether it was permissible for him to do so, I consider the Division's argument, relying on *David F. Bandimere*, that Malouf acted as an unregistered broker dealer. Div. Br. at 18-19.

Unlike Malouf, Bandimere directly sold unregistered investments related to Ponzi schemes. Bandimere enticed investors based on accounts of his own success with such investments. *David F. Bandimere*, 2013 WL 5553898, at *51. He handled the paperwork necessary for investors to make a direct investment, obtained their signatures, took their money and transferred it to the companies' accounts, and sent out returns. *Id.* By contrast, Malouf's conduct as an investment adviser, which involved managing client portfolios, recommending investments, and utilizing a broker (Lamonde) to effect transactions in

customer accounts, does not present a sufficient parallel to Bandimere's misconduct.

I am also not persuaded that Malouf is an unregistered broker-dealer based on the Division's allegations that he received commissions. Malouf testified that he and Lamonde agreed that the price for the branch would be two times trailing revenue of approximately $500,000 to $550,000, or approximately $1.1 million. Tr. 924-25. This is same formula that Malouf had employed for his purchase of UASNM. Tr. 924, 1056. Lamonde made installment payments for his purchase of Branch 4GE. *See* Stipulated FOF Nos. 293, 294. If Lamonde did not have the money upfront to purchase the branch outright, logically those payments would come from Branch 4GE's revenue – particularly Lamonde's commissions – since that seemed to be Lamonde's principal source of income.[19] However, in addition to the Branch 4GE revenue, the Division acknowledges that Lamonde also used money from other sources to pay Malouf for the branch, such as borrowing against a life insurance policy, withdrawing money from a family member's bank account, and taking on credit card debt. Div. Ex. 89; *see* Div. Proposed Additional FOF and COL at 38. I find that Lamonde's payments to Malouf, based on the profitability of the branch, and other sources, do not meet the definition of transaction-based compensation.[20] Because of Lamonde's untimely,

19. Another likely option for Lamonde to purchase Branch 4GE would have been a bank loan, which would have had its own set of transaction costs.

20. The CPA for Malouf and UASNM opined that, for federal income tax purposes, Lamonde's payments to Malouf for the sale of

unexpected demise, and the malleable investigative testimony that he provided, I find that Malouf's testimony – notwithstanding his self-interest – is the best evidence regarding the agreement that he entered into with Lamonde at the time he sold the branch.

The Division's claim that Malouf received commissions is challenged by the fact that, among several dozen transactions at issue, the hearing evidence does not clearly tie particular payments made to Malouf, by Lamonde, to specific trades that Malouf was involved in – as opposed to other UASNM investment advisers.[21] There is a range of conflicting estimates as to the percentage of bond trades directed by Malouf, as opposed to Hudson and Keller.[22]

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the RJFS branch represented capital gains, not ordinary income, as commissions would be classified. Tr. 1578-79. While there is spirited discussion between the parties as to how payments are classified on draft tax returns and other tax-related documents, I am unpersuaded by the significance of those indications, because they appear to be a hold-over from the years that Malouf owned the RJFS branch and served as a broker-dealer, but were not updated. I found the testimony of the CPA much more reliable than non-final or inaccurate tax documents.

21. The Division, to its credit, did attempt to tie Malouf to a few isolated trades, but, the evidence that they were his, as opposed to another UASNM investment adviser, is not clear. *See* Stipulated FOF No. 199; *compare, e.g.*, Resp. Ex. 553, *and* Tr. 122, *with* Tr. 1141-42, 1211-12.

22. While the estimates of the individuals involved is evidence, I note that Hudson's understanding of the total amount of bond trading was inaccurate, which in turn may indicate that his estimate ascribing almost all bond trades to Malouf as similarly inaccurate. Tr. 150.

Keller confirmed that there was no document that would identify trades entered by each adviser at UASNM. Tr. 1187.

Because the Division could not validate its commission theory based on specific trades, it instead attempted to prove that Malouf received commissions based upon the similarity between the total payments, on the one hand, and the total commissions, on the other, generated over three years. However, measured quarterly, the payments to Malouf vary significantly from the commissions generated and appear inconsistent with an agreement to pass all the commissions along. Div. Ex. 203. Although the Division accurately notes that "Malouf's own Exhibit A to his Brief shows that payments to Malouf were within 5% of Lamonde's commissions for the first six months of the agreement," they did not match up in that fashion afterwards. Div. Reply at 7. From 2008 through the second quarter of 2011 (fourteen quarters), there are only three quarters during which the payments made by Lamonde to Malouf are within 5% of the commissions earned. *See* Div. Ex. 203. The average variance between the payments and commissions over the entire time frame is about 26%. *See id.* Another challenge for the Division is that while the overall amounts of payments and commissions are quite similar, this is also similar to the amount that Malouf testified that Lamonde agreed to pay for Branch 4GE. Malouf's explanation for that purchase price seems sensible, as it was based on a similar sale Malouf was involved in a few years earlier. So, when Lamonde received commissions from his broker activity related to UASNM, and then used them to make payments for Branch 4GE,

those would be commissions received by Lamonde, not Malouf; and in my mind, installment payments for the sale of a business as they were made to Malouf. Malouf was also paid from other sources than Branch 4GE, which were clearly not commissions. Yet, Lamonde is presumably permitted to spend his commissions as he sees fit, such as satisfying outstanding payments for his purchase of the broker-dealer branch.

Assuming, for the sake of argument, that the payments by Lamonde to Malouf represent Malouf's "commissions" and are therefore evidence of broker-dealer conduct by Malouf, I find that Lamonde's payments to Malouf were made pursuant to the plain language of NASD 2420-2, which contemplates the permissible payment of commissions to an individual after they cease being a broker, where: (1) a "bona fide contract" calls for such payment; (2) the selling broker does not undertake any "solicitation of new business or the opening of new accounts;" and (3) no payments are made to anyone ineligible for FINRA membership or anyone disqualified from being associated with a member. Div. Ex. 234 at 4.

It appears, from their conduct, that Malouf and Lamonde had a bona fide contract for the sale of the branch.[23] It appears highly implausible that, unless Malouf

23. The Division argues that there was in fact no contract and that the signed PPA was a sham. Div. Br. at 6-9. I find this implausible because it would be illogical for two parties to create a sham contract with obvious issues on its face, such as the fact that the contract was dated as of January 2, 2008, but notarized in June 2010. I find it more likely that if this contract were a sham, the signature and notary page would likely be backdated to 2008.

and Lamonde had a meeting of the minds, that Malouf would give up something so valuable and Lamonde would pay so much money in exchange for nothing of value. The essential agreement was that Malouf would sell his branch, Lamonde would service all transferred accounts, Lamonde would make payments based on branch revenues for a period of time to satisfy the purchase price, and would then no longer be obligated to pay Malouf. The parties' conduct was consistent with such an agreement beginning in January 2008. Whether the agreement was reduced to writing is irrelevant because, as Malouf's expert and former NASD regulator Wolper testified, NASD 2420-2 requires only that the agreement be "bona fide," not that it be written. *See* Div. Ex. 234 at 4; Tr. 1421-22. Although it appears that RJFS had an internal requirement that its representatives provide a written contract, NASD 2420-2 contains no such requirement. Whether or not Lamonde met RJFS's internal supervisory rules for sale agreements does not disprove the bona fide nature of an agreement. It is also irrelevant if Lamonde did not precisely follow subsequently memorialized written terms by choosing to pre-pay additional amounts as "a written contract may be modified, rescinded or discharged by subsequent oral agreement." *Medina v. Sunstate Realty, Inc.*, 889 P.2d 171, 174 (N.M. 1995) (quoting 4 Samuel Williston & Walter H.E. Jaeger, *A Treatise on the Law of*

The Division did not raise the argument that the contract was invalid under New Mexico state law. Whether the statute of frauds would require this contract to be in writing to be enforced is not a matter for my consideration as both Malouf and Lamonde believed themselves to be, and their actions suggest that they were, subject to an enforceable contract.

Contracts, § 591, at 203 (3d ed. 1961) (parties to a written contract may modify that contract by express or implied agreement as shown by the words and conduct)). The written agreement, which may have been provided simply as a way to placate RJFS's requests for a writing, is not invalid because "Exhibit A" cannot be located. I note that a document with a virtually identical function to Exhibit A existed and was relied upon by RJFS to transfer accounts in connection with the sale of the branch. Tr. 680-82; *see* Resp. Ex. 515. RJFS transferred clients from Malouf to Lamonde pursuant to a list existing on December 31, 2007. Stipulated FOF Nos. 69, 70. That list was either Exhibit A, or contained information from Exhibit A. The transfer of accounts was consistent with usual methods by which branches were sold. Tr. 633; *see Medina*, 889 P.2d at 174.

Malouf otherwise complied with the terms of NASD 2420-2. No evidence was presented that Malouf solicited new business or opened accounts for Branch 4GE after 2007. NASD 2420-2's plain language does not require retirement from the securities industry, as indicated by a no-action letter issued in November 2008 by the Commission's Division of Trading and Markets. *See* Div. Ex. 235. This no-action letter relied upon by the Division (which is similar to a handful that preceded it) states that "[t]his staff position concerns enforcement action only and does not represent a legal conclusion regarding the applicability of the statutory or regulatory provisions of the federal securities laws." *Id.* at 1. The letter also only applies to a specific set of circumstances, and the Commission staff member states that ". . . any different facts or circumstances might require a different response."

Id. Although the no-action letter suggests that Malouf would have to retire, completely, to receive "continuing commissions" – the rule on its face does not.[24] As no-

24. On December 30, 2014, the Commission approved a proposed rule change by FINRA to streamline provisions of several NASD and New York Stock Exchange Rules, including NASD 2420-2. Order Approving FINRA Proposed Rule Changes to FINRA Rules 0190 and 2040 and Amending FINRA Rule 8311, 80 Fed. Reg. 553 (Dec. 30, 2014). Among other things, new FINRA Rule 2040(b) will allow FINRA members to pay continuing commissions to retiring registered representatives as long as (1) a bona fide contract exists between the member and the retiring registered representative that prohibits the representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments, and (2) the arrangement complies with applicable federal securities laws and Exchange Act rules and regulations. *Id.* at 555. Under the Rule, "retiring registered representative" means "an individual who retires from a member (including as a result of total disability) and leaves the securities industry." *Id.* In its initial proposal, FINRA included the requirement that the arrangement must comply with "published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations"; however, this language was deleted from the final version based on concerns raised by commenters. Notice of Filing of a Proposed Rule Change to Adopt FINRA Rules 0910 and 2040 and Amend FINRA Rule 8311, 79 Fed. Reg. 59322, 59328 (Oct. 1, 2014). Although it appears that under the new rule a retiring registered representative in a situation similar to Malouf would be prohibited from receiving continuing commissions, the new rule is not yet in effect and has no bearing on my interpretation of the old rule. *See* FINRA Manual, Recently Approved Rule Changes Pending Determination of Effective Date, SR-FINRA-2014-037, Rule 2040, *available at* http://finra.complinet.com/(stating that the "effective date for this rule has not yet been determined") (website last accessed March 31, 2015).

action letters "constitute neither agency rule-making nor adjudication," they are "entitled to no deference beyond whatever persuasive value they might have." *Gryl ex rel. Shire Pharms. Group PLC v. Shire Pharms. Group PLC*, 298 F.3d 136, 145 (2d Cir. 2002). Malouf substantially complied with the rule, and thus, I find that even if one was to consider the payments "Malouf's commissions" (which I do not), his conduct would nonetheless be appropriate, and I would not find that he was acting as an unregistered broker-dealer in violation of Sections 15(a)(1) and 15C(a)(1)(A) of the Exchange Act.

B. Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2)

Malouf is charged with violating the antifraud provisions of Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2). OIP at 6. The conduct violating one of the antifraud provisions may also violate other provisions, as they proscribe similar misconduct. *See United States v. Naftalin*, 441 U.S. 768, 773 n.4, 778 (1979); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363 n.4 (9th Cir. 1993); *SEC v. Berger*, 244 F. Supp. 2d 180, 192 (S.D.N.Y. 2001); *SEC v. Blavin*, 557 F. Supp. 1304, 1315 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985).

Securities Act Sections 17(a)(1) and 17(a)(3) prohibit employing a fraudulent device, scheme, or artifice to

defraud or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit in the offer or sale of a security. 15 U.S.C. § 77q(a)(1), (3). Exchange Act Section 10(b) and Rule 10b-5 subsections (a) and (c) prohibit any person from employing any device, scheme, or artifice to defraud and engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of a security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(a), (c). Primary liability under Securities Act Section 17(a)(1) and Exchange Act Rule 10b-5 subsections (a) and (c) proscribe even a single act of making or drafting a material misstatement to investors and constitutes the employment of a deceptive device or act. *John P. Flannery*, Securities Act Release No. 9689, 2014 SEC LEXIS 4981, at *42, *62 (Dec. 15, 2014). Repeatedly making or drafting such misstatements over a period of time could constitute engaging in any fraudulent transaction, practice, or course of business as prohibited under Securities Act Section 17(a)(3). *Id.* at *62-63.

Sections 206(1) and 206(2) of the Advisers Act prohibit an investment adviser from using instruments of interstate commerce to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Stipulated COL No. 8. Advisers Act Section 206 establishes a federal fiduciary standard for investment advisers, including the obligations to exercise the utmost good faith in dealing with their clients, to disclose to their clients all material facts, and to employ reasonable care to avoid misleading their clients.

Stipulated COL No. 9. Investment advisers have a duty "to eliminate, or at least to expose, all conflicts of interest which might incline [them] – consciously or unconsciously – to render advice which was not disinterested." Stipulated COL No. 10. Malouf had an obligation to disclose conflicts of interest that existed at UASNM that he was aware of. Stipulated COL No. 25.

Malouf was the CEO and President of UASNM, a registered investment adviser, and he was an advisory representative for UASNM. Stipulated FOF No. 286. As such, he is a primary violator under Advisers Act Section 206 because he received compensation in connection with giving investment advice and thus comes within the broad statutory definition of an investment adviser as defined by Section 202(a)(11) of the Advisers Act: a "person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." *See* 15 U.S.C. § 80b-2(a)(11); *Abrahamson v. Fleschner*, 568 F.2d 862, 870 (2d Cir. 1977) (general partners of investment adviser considered investment advisers under Advisers Act Section 202(a)(11)); *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *73-74 & n.196 (May 16, 2014) (investment adviser's principal and owner liable as a primary violator under Advisers Act Sections 206(1) and 206(2)).

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1); a showing of negligence is sufficient to establish violations

of Securities Act Section 17(a)(3) and Advisers Act Section 206(2). Stipulated COL Nos. 8, 14; *Aaron v. SEC*, 446 U.S. 680, 695-97, 701-02 (1980); *SEC v. Steadman*, 967 F.2d 636, 641 & n.3, 643 & n.5, 647 (D.C. Cir. 1992). Scienter is defined as a mental state consisting of intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter may be proven by showing extreme recklessness. *SEC v. Steadman*, 967 F.2d at 641-42. Recklessness is an "extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Steadman*, 967 F.2d at 641-42 (ellipses in original) (quoting *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

Material misstatements and omissions violate the antifraud provisions; information is "material" if there is a substantial likelihood that a reasonable person would consider the information important. Stipulated COL No. 11; *see Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Specifically, the existence of a conflict of interest is a material fact that an investment adviser, as a fiduciary, must disclose to a client. Stipulated COL No. 12.

"To be liable for a scheme to defraud, a defendant must have 'committed a manipulative or deceptive act in furtherance of the scheme.'" *SEC v. Fraser*, No. CV-09-00443-PHX-GMS, 2010 U.S. Dist. LEXIS 7038, at *23 (D. Ariz. Jan. 28, 2010) (quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997)). The defendant "must have

engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), *vacated on other grounds*, *Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008).

Based on my analysis below, I find that Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2).

1. Misstatements and Scheme

Malouf's agreement with Lamonde created a conflict of interest for Malouf because Malouf was incentivized to send UASNM bond transactions through Branch 4GE so that Lamonde would be able to pay what he owed for the business. Malouf did not explicitly and completely disclose his conflict of interest in submitting bond trades through Branch 4GE, resulting in misleading disclosures in UASNM's Forms ADV and on its website.

Malouf did not tell anyone at UASNM or ACA the details of his agreement to receive payments from Lamonde. I have previously accepted that, based on Malouf's own description, key terms of the agreement were oral, rather than written. Just as it took effort for me to understand the nature of the agreement, so too, without exposition, it would have been difficult for anyone else to understand without the specifics. Malouf's receipt of payments from Lamonde created a conflict

of interest. Stipulated FOF No. 178. Yet, the conflict created by Malouf's receipt of payments from Lamonde was not disclosed on UASNM's Forms ADV between 2008 and 2011 or on its website. Stipulated FOF No. 8; *see* Div. Exs. 66, 68-69. Given this crucial omission, the website's statements about independence and freedom from conflicts of interest, and the lack of disclosure of Malouf's continuing relationship with the RJFS branch on UASNM's Forms ADV were materially misleading to UASNM clients. All Forms ADV distributed between 2008 and 2011 were materially misleading by failing to disclose Malouf's arrangement with Lamonde.

Prior to 2008, the "void of conflicts of interest" language was at least countered by the disclosure that Malouf owned the Branch 4GE and that he and other registered representatives might receive compensation for transactions executed through that branch; after that language was removed the "free of conflicts of interest" language and other statements disclaiming compensation from commissions and proclaiming "[u]ncompromised objectivity through independence" on UASNM's Forms ADV and website were misleading. *See* Stipulated FOF No. 12.

Malouf's argument that Kopczynski's tiny ownership interests in Secured Partners and National Advisors Trust Company (NATC) was inconsistent with the "devoid of conflicts of interest" language on UASNM's website (but was disclosed on the Form ADV) does not excuse Malouf's failure to disclose his receipt of over one million dollars in payments from Lamonde. Tr. 1383. Similarly,

the collective failure to list RJFS as a broker through which UASNM did business in its October 2009 Form ADV does not excuse the failure to disclose Malouf's conflict of interest.

Malouf's principal response is that other UASNM officials knew or should have known that he was receiving payments from Lamonde and that he relied on them to make the disclosures. Resp. Br. at 22-23. However, even if all the relevant officials at UASNM, RJFS, and ACA knew all about Lamonde and Malouf's agreement, and the payments, it would not excuse Malouf's recklessness. The parties previously agreed, and I have found, investment advisers have a duty "to eliminate, or at least to expose, all conflicts of interest which might incline [them] – consciously or unconsciously – to render advice which was not disinterested." Stipulated COL No. 10. Thus, regardless of what Hudson, Kopczynski, Keller, Bell, or Ciambor knew, UASNM's customers were not told about Malouf's conflict of interest and thus, Malouf was reckless in allowing material omissions on the Forms ADV and misrepresentations on the website.

Malouf's reliance-on-others defense requires him to show that he made full disclosure to those upon whom he relied.[25] *See Provenz v. Miller*, 102 F.3d 1478, 1491 (9th Cir. 1996), *citing C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988) (finding that "[i]f it

25. Malouf's own reliance on *SEC v. Huff*, 758 F. Supp. 2d 1288, 1351-52 (S.D. Fla. 2010), fails to address the fact that Huff's reliance-on-others defense failed because Huff never disclosed critical facts to his accountant. *See* Resp. Prehearing Br. at 19-20.

is true that defendants withheld material information from their accountants, defendants will not be able to rely on their accountant's advice as proof of good faith"). Malouf claims, without support, that "Kopczynski was aware or should have been aware of the nature of the sale of Branch 4GE." Resp. Br. at 22. However, Malouf stipulated that Kopczynski and Hudson understood that Malouf had sold Branch 4GE to Lamonde, but they were not aware of the specific terms of that sale. Stipulated FOF No. 34. Moreover, the claim that Kopczynski should have been aware is not defense to Malouf's own failure to disclose. Likewise, his claimed reliance on UASNM's outside consultant is misplaced where he failed to disclose his payments from Lamonde for over two years and misrepresented that he had severed all ties with RJFS. Tr. 736-37, 773-76.

Ultimately, because Malouf was the only one who knew the details of his conflict of interest, regardless of whether others were reckless, or merely negligent, in investigating the nature and extent of Malouf's conflict, I conclude that Malouf's failure to disclose, for years, any details of the payments, to be extremely reckless. Indeed, even when the PPA was disclosed in 2010, because its terms were not the terms that Lamonde and Malouf had agreed to, his failure to disclose the details of the oral agreement at that time – which he and Lamonde abided by, as opposed to the PPA – evidence continuing reckless behavior.

Malouf had a direct role with regard to reviewing the Forms ADV, especially as they related to his own conflicts of interest, and had a greater role with regard to

UASNM's marketing materials, particularly those present on the website. Malouf also had the best knowledge of his ongoing financial relationship with Lamonde. Malouf was the best-suited official to apprehend his conflict, and ensure that appropriate disclosures were made and inconsistent language was corrected. Though Malouf, to his credit, ultimately corrected language in the Forms ADV in 2011 (but not language on the website and in marketing materials), that does not excuse his highly reckless behavior with respect to his own conflicts of interest for years before then.

I disagree with Malouf's contention that the "Division has not offered sufficient evidence to establish whether the Forms ADV introduced at the hearing were final or were drafts that were never filed with the SEC or disseminated to clients." Resp. Br. at 30. The Division established at the hearing that: (1) UASNM did not update its Form ADV to specifically reflect the payments by Lamonde to Malouf for the sale of the RJFS branch until March 2011, Stipulated FOF No. 307; (2) at least some of UASNM's Forms ADV between 2008 and 2011 did not disclose that Malouf sold his RJFS branch to Lamonde and was receiving ongoing payments from Lamonde in connection with that sale, Stipulated FOF No. 8; (3) Judith Owens, a UASNM client, signed an investment management services agreement acknowledging that she had received and read Part II of the February 4, 2008, UASNM Form ADV, Stipulated FOF No. 63; and (4) all or most of the Forms ADV created between October 1, 2009, and April 12, 2010, portions of which are reflected in Division Exhibit 193, were provided to UASNM clients. Div. Ex. 193; Tr. 906, 1377-78. For the foregoing reasons,

I find that a preponderance of evidence establishes that the Forms ADV were either filed with the Commission or disseminated to clients.

Based on the above, I find that Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Securities Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2).

2. Failure to Seek Best Execution

I find that Malouf violated his fiduciary duty by failing to seek best execution for UASNM's clients with regard to the majority of U.S. Treasury and federal agency bond trades routed through RJFS between 2008 and 2011. One of an investment adviser's "basic duties" under Advisers Act Section 206 is to ensure that its clients' transactions are executed "in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances." *Kidder, Peabody & Co.*, Advisers Act Release No. 232, 1968 SEC LEXIS 251, at *10-11 (Oct. 16, 1968)[26]; *see Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *70-72 & n.189 (May 16, 2014). Failure to seek best execution or to conduct best execution review constitutes a violation of Section 206(2) of the Advisers Act. *Jamison, Eaton & Wood, Inc.*, Advisers Act Release No. 2129, 2003 SEC LEXIS 1174, at *3 (May

26. Although the *Kidder, Peabody & Co.* release is a settled enforcement action and thus nonprecedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 68; Resp. Response to Div. Proposed Additional FOF and COL at 106.

15, 2003) ("By failing to disclose its potential conflict of interest and other brokerage options, and by failing to seek to obtain best execution, Jamison violated Section 206(2) of the Advisers Act.").[27,28]

The Division argues that an adviser's failure to seek best execution for clients can be established by showing that clients paid higher commissions with no apparent corresponding benefit, citing a settled enforcement action. Div. Proposed Additional FOF and COL at 69; *see Jamison, Eaton & Wood, Inc.*, 2003 SEC LEXIS 1174, at *16 ("Taking into consideration the higher commissions paid by some of Jamison's clients, and the lack of any apparent corresponding benefit such as better trading prices, Jamison failed to seek to obtain best execution for these clients."). Malouf disputes this additional proposed conclusion of law, noting that while

27. Although the *Jamison, Eaton & Wood, Inc.*, release is a settled enforcement action and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 68; Resp. Response to Div. Proposed Additional FOF and COL at 106.

28. Malouf contends that the only specific requirement for ensuring compliance with best execution is "periodic and systematic review" of the procedures employed for best execution. Resp. Br. at 27. In support, Malouf cites to *Jamison, Eaton & Wood*, where the firm "did not periodically and systematically review its brokerage arrangements" and "thereby failed to seek to obtain best execution for these clients." 2003 LEXIS 1174, at *16; Resp. Response to Div. Additional FOF and COL at 107. However, as set forth below, an investment adviser can fail to satisfy a duty of best execution through other actions or omissions.

the "language from *Jamison* is accurately quoted," it "does not support the proposed conclusion of law," citing a Commission interpretive release. Resp. Response to Div. Proposed Additional FOF and COL at 107; *see* Resp. Ex. 578. The release states that a "money manager should consider the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager." Resp. Ex. 578 at 15. It also notes that "the determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account. *Id.* An investment adviser must consider a number of qualitative and quantitative factors when trying to achieve best execution, not just the amount of commission. Stipulated COL No. 23.

However, when the other factors are equal, cost may be of principal concern in determining best execution. As Dr. Gibbons explained, for U.S. Treasury and agency bond trades – the ones at issue here – the other factors are largely irrelevant due to the highly liquid and transparent nature of the bonds and other factors. Tr. 553-54; s*ee* Div. Ex. 243 at 16, 18, 30; Tr. 476-77, 532. Multiple witnesses, including Hudson, Keller, Ciambor, Dr. Gibbons, McGinnis, and even Malouf himself, testified that in seeking best execution an investment adviser should shop trades to multiple brokers. Div. Ex. 20; Div. Ex. 243 at 21-22; Tr. 935; Stipulated FOF Nos. 133, 145; Tr. 168-69, 172-73, 453; Resp. Ex. 559. Malouf has admitted that he often did not do that. Stipulated FOF No. 174; Div. Ex. 243

at 4; Resp. Ex. 579 at 8; Tr. 935-37. By contrast, another UASNM advisor, Keller, was able to get lower bond prices from other brokers or have RJFS lower its price to meet prices offered by other brokers. Stipulated FOF No. 204; Div. Ex. 218; Resp. Ex. 341.

Instead, between 2008 and 2011, Malouf generally selected Lamonde's branch of RJFS to execute bond trades on behalf of UASNM clients.[29] Stipulated FOF No. 38. Malouf's failure to obtain competing bids caused UASNM's clients to pay markups/markdowns that were significantly higher than industry norms on dozens of U.S. Treasury and federal agency bond trades. Div. Ex. 243 at 32-34. Dr. Gibbons concluded that UASNM failed to seek best execution for its U.S. Treasury and federal agency bond trades, and has estimated that this failure caused UASNM clients to pay between $442,106 and $693,804 in excess commissions. *Id.* at 36. Dr. Gibbons and McGinnis (who previously performed a similar calculation in the state court litigation involving UASNM and Malouf) both found that commissions charged on UASNM bond trades were excessive.[30] Dr. Gibbons's range – ten to

29. Malouf did open accounts at UBS, Smith Barney, and Morgan Stanley, and used existing accounts at Griffin Kubiak, Stevens and Thompson, and Crews & Associates to buy bonds and check prices. Stipulated FOF No. 353. However, evidence that Malouf actually sought competing bids is sparse, and it is clear that the substantial majority of UASNM's bond trades were done with RJFS.

30. Malouf objected to the introduction of McGinnis's analysis done for the state court litigation because he believed it to be expert testimony (and the Division did not offer McGinnis as an expert witness). Tr. 403-04. I allowed in the testimony, noting that

seventy-five basis points (bps) – was slightly broader than McGinnis's range – twenty to fifty bps – but both have similar averages of thirty-five (McGinnis) and 42.5 bps (Dr. Gibbons). Stipulated FOF No. 39; Div. Ex. 44 at Ex. 5. Dr. Gibbons's range is thirty-five bps more favorable to Malouf than the range applied in the state court litigation in that it provides a wider range of acceptable commission rates. In addition, Dr. Gibbons's seventy-five bps upper limit is much closer to the 100 bps maximum commission than McGinnis's fifty bps upper limit that Lamonde and Malouf agreed should ever be charged on such trades.

In *Mark David Anderson*, an expert testifying regarding trades in U.S. Treasury securities noted, as Dr. Gibbons did here, that markups and markdowns on such securities are "driven by th[e] bid-ask spread." Exchange Act Release No. 48352, 2003 WL 21953883, at *4 (Aug. 15, 2003) (alteration in original). That expert further testified that after "doubling what was custom and practice in the industry," an appropriate commission on the U.S. Treasury notes at issue, which as here were extremely

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I would not base any part of the ruling on McGinnis's opinions to the detriment of Malouf and would not rely on his opinions to shore up the Division's expert testimony. Tr. 404, 408. My ruling during the hearing remains unchanged; I am not relying on McGinnis's opinions in any way, only noting that Dr. Gibbons's opinions are more favorable to Malouf than McGinnis's opinions, which were the subject of the state court litigation and considered when entering into the settlement agreement, including holding $850,000 in escrow to cover potential liability resulting from UASNM's plan to report possible best execution failures to the Commission. *See* Resp. Ex. 312 at 3; Resp. Ex. 479, Ex. 1 at 3, Ex. 2 at 3, 7.

liquid and carried an implied rating of AAA, would be between twenty-five and fifty bps. *Id*. This range coincides with the ranges set forth by Dr. Gibbons and McGinnis. In *Mark David Anderson*, the Commission found that:

> The Division introduced expert testimony which supported its contention that Anderson's pricing was "well above what professionals in the business would generally charge for the transactions in question" and not warranted by any extraordinary circumstances.

Id. at *7 (internal footnote omitted). I find that Dr. Gibbons's testimony reliably serves the same function as the expert opinion in *Mark David Anderson*. *Id.* at *7 n.40 (noting that "expert testimony is generally very helpful when the question to be resolved is the proper pricing of debt securities"). Malouf offered no expert opinion to the contrary. Stipulated FOF No. 241.

Dr. Gibbons's testimony did not attempt to attribute any specific trade to Malouf. *See* Stipulated FOF No. 372. Malouf, Hudson, Keller, and Kopczynski have roughly estimated that Malouf directed somewhere between 60% to 95% of UASNM's bond trades. Stipulated FOF Nos. 6, 76. As noted, there has been no reliable evidence showing that Malouf directed any particular trade. The evidence shows only that from 2008 to 2011, Malouf directed certain bond trades for UASNM clients to RJFS but no evidence indicating *which* bond trades he directed there. Stipulated FOF No. 38.

I am unconvinced that the high point of the preceding range, which is based primarily on Hudson's testimony, is reliable. First, when Hudson initially attempted to determine the trades that Malouf directed, he was in the process of suing Malouf and had no small self-interest in avoiding regulatory liability. Tr. 100-01. One could reasonably expect that Hudson would give himself, and others, the benefit of the doubt in his calculation to Malouf's detriment. Second, although Hudson claimed he only occasionally directed bond trades, Ciambor testified that Hudson did a "significant" amount of bond trading. Tr. 731-32. Third, when Hudson testified about UASNM's bond trading, he was off by tens of millions of dollars with regard to the annual value of trades, suggesting his estimates regarding bond trading are not the most reliable. Tr. 149-50. Fourth, Keller admitted to directing 50% to 60% of his own trades through RJFS. Tr. 1165-66.

In the absence of the Division proving any particular trade was directed by Malouf, and the deficiencies with the highest estimates, I am confident that a preponderance of the evidence nonetheless established that Malouf directed sixty percent of trades to RJFS. While sixty percent of the trades does not necessarily equate to sixty percent of the value of the trades, because it is the lowest estimate of Malouf's trade in the range for which estimates were offered, and Malouf was often the principal investment adviser on large-scale institutional trades, more likely than not, the value of at least sixty percent of the bond trades can be attributed to Malouf. It is of course possible that Malouf could have been responsible for more than sixty percent. To prove that, the Division could have

inquired of witnesses as to each trade, using all the documentary evidence available. However, such evidence was not presented by the Division. In the absence of such evidence, given the uncertainties, I am unable to declare that by a preponderance of the evidence Malouf directed more of the trades, and, more particularly, that he directed more than sixty percent of the trades on which there were commissions in excess of what should reasonably have been paid.

Based on Dr. Gibbons's opinion that the failure to seek best execution resulted in an actual cost to UASNM customers of at least $442,106, and my preceding determination that Malouf is culpable for at least sixty percent of the underlying trades, I find that Malouf's failure to seek best execution on bond trades resulted in $265,263.60 of unnecessary cost and expense to UASNM customers.[31]

In addition to this tangible, adverse result, the fact that Malouf was not actually seeking and achieving best execution, recklessly, further demonstrates how the statements in the website and Forms ADV to the contrary were misleading, and hence violations of Advisers Act Section 206(1) and (2).

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31. While UASNM's settlement with the Commission involved the repayment of a greater amount of money to its customers, that settlement was targeted to satisfy all of UASNM's best execution failures – not just those of Malouf; and was based on McGinnis's analysis of customer losses, which, as noted previously, found a greater amount of loss than the Division's expert Dr. Gibbons.

C. Aiding and Abetting Liability

To establish aiding and abetting liability, the Commission must show: "(1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor had the necessary 'scienter' – i.e. that she rendered such assistance knowingly or recklessly." *Graham v. S.E.C.*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *see also First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891, 898 (10th Cir. 1992), *rev'd on other grounds*, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).[32] The Tenth Circuit applies a "recklessness" standard for aiding and abetting liability and the D.C. Circuit requires a showing that the aider and abettor acted with "extreme recklessness." *First Interstate Bank*, 969 F.2d at 903 ("We hold that in an aiding-and-abetting case based on

32. This test has also been formulated as: "(1) a primary or independent securities law violation by an independent violator; (2) the aider and abettor's knowing and substantial assistance to the primary securities law violator; and (3) awareness or knowledge by the aider and abettor that his role was part of an activity that was improper." *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 184 (D.R.I. 2004); *see Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980). The requirement of "awareness or knowledge by the aider and abettor that his role was part of an activity that was improper" has been reformulated under the scienter requirement under more recent case law. *See Howard v. SEC*, 376 F.3d 1136, 1142-43 (D.C. Cir. 2004); *Graham*, 222 F.3d at 1000 (explaining that the aiding and abetting test has been "variously formulated" and citing *Investors Research*, among other circuit precedent, for the D.C. Circuit's more recent articulation of the test).

assistance by action, the scienter element is satisfied by recklessness."); *Howard*, 376 F.3d at 1143 (citing *Graham*, 222 F.3d at 1004; *SEC v. Steadman,* 967 F.2d at 641).

A respondent who aids and abets a violation is a cause of the violation. *See Zion Capital Mgmt. LLC*, Securities Act Release No. 8345, 2003 SEC LEXIS 2939, at *28 (Dec. 11, 2003).

1. Advisers Act Section 206(4) and Rule 206(4)-1(a)(5)

Malouf is charged with aiding and abetting and causing UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1(a)(5). Advisers Act Section 206(4) prohibits a registered investment adviser from engaging "in any act, practice, or course of business which is fraudulent, deceptive, or manipulative[,]" including those defined by the Commission. 15 U.S.C. § 80b-6(4). Neither scienter nor proof of client harm is required. *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1105 (9th Cir. 1977) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

Rule 206(4)-1(a)(5) prohibits a registered investment adviser from publishing, circulating, or distributing advertisements containing untrue statements of material facts, or that are otherwise false or misleading. 17 C.F.R. § 275.206(4)-1(a)(5). A website can be considered an advertisement for purposes of the rule. *Anthony Fields, CPA*, Initial Decision Release No. 474, 2012 WL 6042354, at *12 (Dec. 5, 2012) ("Fields's misrepresentations on

Platinum's website violated Securities Act Section 17(a), and his misrepresentations on the AFA website and in AFA's Form ADV and brochure violated Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5).").[33]

Based on preceding findings, I have determined that UASNM violated Rule 206(4)-1(a)(5) by making statements about independence, freedom from conflicts of interest, and best execution that were materially misleading as a result of Malouf's agreement with Lamonde. *See supra* pp. 30-32, 36. Malouf provided substantial assistance by recklessly failing to disclose to others at UASNM his conflict of interest with respect to RJFS. Therefore, I find that Malouf aided and abetted and caused UASNM's false and misleading website statements by failing to disclose his receipt of payments from Lamonde, as detailed above.

2. Advisers Act Section 207

Malouf is charged with violating, or in the alternative, aiding and abetting and causing UASNM's violations of, Advisers Act Section 207. I do not find that Malouf was a primary violator because he delegated responsibility for the Forms ADV to Kopczynski and Hudson and Hudson ultimately was the person who signed them. Advisers Act Section 207 makes it unlawful for any person willfully to

33. Although the *Anthony Fields, CPA* release is an initial decision and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 72; Resp. Response to Div. Proposed Additional FOF and COL at 110.

make any untrue statement of a material fact or omit to state any material fact required to be stated in a report filed with the Commission, including Form ADV.[34] 15 U.S.C. § 80b-7; *Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003). The materiality standard for Advisers Act Section 207 claims is essentially the same as for violations of Advisers Act Section 206. *Id*. Advisers Act Section 207 does not require a showing of scienter. *Montford and Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *68 (May 2, 2014).

Item 12.B of Form ADV Part II (and Item 12.A of the new Part 2A) requires an investment adviser to describe the factors considered in selecting broker-dealers and determining the reasonableness of their commissions. *See, e.g.*, Div. Ex. 24 at UASNM0442. Thus, an investment adviser violates Advisers Act Section 207 by failing to disclose those factors. The disclosures in UASNM's Forms ADV between 2008 and 2011, willfully omitted required information.

UASNM violated Advisers Act Section 207. Malouf substantially assisted this violation. The UASNM Compliance Manual provided that its "employees" (including Malouf, as CEO) should bring to the CCO's attention disclosures that may require amendment to the Form ADV: "Employees are encouraged to review UASNM's disclosure documents and bring to the CCO's

34. A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976).

attention any disclosures that may require amendment/updating." Stipulated FOF No. 55. Instead of following this guidance, Malouf failed to disclose to others at UASNM the full extent of his conflict of interest and did not tell Kopczynski that the Form ADV needed to be revised. Malouf acted knowingly as he testified that "[w]ithout a doubt," disclosures regarding the ongoing payments Malouf was receiving from Lamonde should have been in all the relevant ADV disclosures. Stipulated FOF No. 193; Tr. 1001.

For the foregoing reasons, I find that Malouf aided and abetted and caused UASNM's violation of Advisers Act Section 207.

IV. SANCTIONS

A. Willfulness

Some of the requested sanctions are only appropriate if Malouf's violations were willful. *See* 15 U.S.C. § 78*o*(b)(4)(A), (D), (E), (6)(A)(i), 78*o*-5(c), 78u-2(a), 80a-9(b)(2), (3), (d), 80b-3(e)(1), (5), (6), (f), (i). Malouf's actions were unquestionably willful because he did not adequately and fully disclose his conflict of interest to UASNM and its clients and he was responsible for the false and misleading misstatements that appeared in UASNM's Forms ADV and on its website.

B. Statute of Limitations

Malouf asserts the five year statute of limitations set forth in 28 U.S.C. § 2462 as an affirmative defense. Resp.

Br. at 39-40; Resp. Reply at 20-21. The Division's equitable and remedial claims are not barred by that or any other applicable statute of limitations. By its express wording, Section 2462 applies only where the Commission seeks relief that a court deems punitive – "any civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462. Section 2462 does not limit the time for the Commission to file claims seeking equitable or remedial relief such as disgorgement or cease-and-desist orders. *Riordan v. SEC*, 627 F.3d 1230, 1234-35 (D.C. Cir. 2010) (disgorgement and cease-and-desist order not subject to five year statute of limitations); *Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009) ("[A]n 'order to disgorge is not a punitive measure; it is intended primarily to prevent unjust enrichment.'") (citations omitted); *Johnson v. SEC*, 87 F.3d 484, 491 (D.C. Cir. 1996) (citing cases); *SEC v. Kelly,* 663 F. Supp. 2d 276, 286 (S.D.N.Y. 2009) (citing cases); *see Gabelli v. SEC*, 133 S. Ct. 1216, 1219, 1220 n.1 (2013).

I disagree with Respondent's contention that the five-year statute of limitations contained in 28 U.S.C. § 2462 applies to all forms of relief sought by the Division. Respondent cites the non-precedential opinion of *SEC v. Graham*, 21 F. Supp. 3d 1300, 1307-11 (S.D. Fla. 2014), for the proposition that injunctive relief and disgorgement claims are subject to the five-year statute of limitations. That non-binding opinion does provide "persuasive" authority for Respondent's contention. At present I am not persuaded by that opinion's reasoning that the longstanding precedents on the pertinent limitations period were swept aside, in effect, by the Supreme Court's decision in *Gabelli*, which specifically noted that its holding

did not extend to injunctive relief and disgorgement claims. 133 S. Ct. at 1220 n.1; s*ee SEC. v. LeCroy*, Civil Action No. 2:09-cv-2238-AKK, 2014 U.S. Dist. LEXIS 126836, at *2-5 n.1 (N.D. Ala. Sept. 5, 2014) (collecting cases inconsistent with *Graham*).

As to the Division's request for a civil penalty, I disagree, in part, that the statute of limitations is tolled by the continuing violation doctrine. *See* Div. Br. at 28; Div. Reply at 25. Under that doctrine, if the alleged unlawful practice continues into the limitations period, the complaint is timely if filed within the required limitations period measured from the end of that practice. *See Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380-81 (1982); *SEC v. Kovzan*, 807 F. Supp. 2d 1024, 1035-36 (D. Kan. 2011); *see also SEC v. Geswein*, Case No. 5:10CV1235, 2011 U.S. Dist. LEXIS 111893, *7 (N.D. Ohio Sept. 29, 2011) (equitable tolling includes the continuing violations doctrine); *Huff*, 758 F. Supp. 2d at 1340 ("[W]here the appropriate facts exist, the 'continuing violations' doctrine may apply to the statute of limitations in SEC enforcement actions."); *Kelly*, 663 F. Supp. 2d at 288 (rejecting motion to dismiss Commission's claim for penalties on statute of limitations grounds because continuing violation doctrine in combination with a tolling agreement made the claims timely filed); *but cf. SEC v. Caserta*, 75 F. Supp. 2d 79, 89 (E.D.N.Y. 1999) ("[I]t is not at all certain that the continuing violation doctrine applies in securities fraud litigation."); *SEC v. Jones*, No. 05 Civ. 7044 (RCC), 2006 WL 1084276, *4-5 (S.D.N.Y. Apr. 25, 2006).

Here, however, I find that the continuing violation doctrine generally does not apply to the false and

misleading Forms ADV because the violations relate to separate and discrete acts of filing and providing Part II to clients. *See National R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 114-15 (2002) (finding a plaintiff could not recover for discrete violations occurring outside the applicable time period and rejecting application of the continuing violations doctrine); *CSC Holdings, Inc. v. Redisi*, 309 F.3d 988, 992 (7th Cir. 2002) (refusing to apply the continuing violation doctrine to violations arising from sales constituting separate and discrete statutory violations). Repeatedly violating a statute does not convert multiple individual violations into a continuing wrong. *Redisi*, 309 F.3d at 992. Elsewhere, the Division's position is clearly that this case involves separate violations, i.e. "[e]ach of the 74 commission payments Malouf received . . . was a separate violation, as was each misleading disclosure on UASNM's Forms ADV and website." *See* Div. Br. at 33. By contrast, the misleading statements and omissions on the website represent a continuing wrong. As a result, except with respect to the website, claims based on violations occurring prior to June 9, 2009, are barred by the statute of limitations. Thus, for the purpose of civil penalties, I limit my consideration to violations from then until May 2011, when Malouf was terminated from UASNM.

C. Cease and Desist Order

The Division requests findings of liability for the violations alleged and an order to cease and desist from violating Section 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), (2), and (4) and 207 of the Advisers

Act. Div. Br. at 28. Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) provide that, if the Commission finds that any person has violated or caused a violation of the Securities Act, Exchange Act, or Advisers Act, respectively, or any rule or regulation thereunder, the Commission may enter an order requiring any person that was a cause of the violation to cease and desist from committing or causing any future violation of the same provision, rule, or regulation. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k)(1).

In deciding whether to issue a cease-and-desist order, the Commission must consider whether there is a reasonable likelihood of future securities violations. *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *101 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002). The Division asserts that "a past violation suffices to establish a risk of future violations." Division Proposed Additional FOF and COL at 76 (citing *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *102). Malouf disputes this contention as incomplete. Resp. Response to Div. Proposed Additional FOF and COL at 115-16. The D.C. Circuit qualified this notion in *WHX Corp. v. SEC,* 362 F.3d 854 (D.C. Cir. 2004):

> Under this view, apparently, the "risk of future violation" element is satisfied if (1) a party has committed a violation of a rule, and (2) that party has not exited the market or in some other way disabled itself from recommission of the offense. Given that the first condition is satisfied in every case where the Commission seeks

> a cease-and-desist order on the basis of past conduct, and the second condition is satisfied in almost every such case, this can hardly be a significant factor in determining when a cease-and-desist order is warranted. The Commission itself has disclaimed any notion that a cease-and-desist order is "automatic" on the basis of such an almost inevitably inferred risk of future violation.

362 F.3d at 859 (citing *KPMG, LLP v. SEC*, 289 F.3d 109, 124-25 (D.C. Cir. 2002)). The court in *WHX Corp.* went on to find that "[t]he 'risk of future violation' cannot be the sole basis for its imposition of the [cease and desist] order, as the SEC's standard for finding such a risk is so weak that it would be met in (almost) every case." *Id.* at 861.

In deciding whether to issue a cease-and-desist order, the court may consider several factors including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, the respondent's opportunity to commit future violations, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings. *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *116. This inquiry is a flexible one and no one factor is dispositive. *Id.* It is undertaken not to determine whether

there is a "reasonable likelihood" of future violations but to guide the court's discretion. *Id.*

I find that a cease-and-desist order associated with the violations is appropriate. The violations were relatively serious and lasted for more than three years. Malouf was extremely reckless, and has provided little meaningful assurance against future violations or recognition of wrongdoing; in fact he mostly places blame for his misconduct on others. To the extent Malouf is not barred from practice as an investment adviser, there is a decided opportunity to commit future violations. McGinnis testified that in his forty-four years in the securities industry, he had "never seen a million dollars conflict of interest like this before." While it is difficult to assess the impact to the investors, or the market, of such a conflict; in this case, where Malouf's failure to seek best execution was apparently borne out of the conflict of interest, my calculation establishes a loss of more than a quarter-million dollars to investors.

D. Collateral and Associational Bar

Exchange Act Section 15(b) provides that the Commission shall censure, limit, suspend, or bar any person acting as a broker from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, or from participating in an offering of penny stock, if the Commission finds that such censure, limitation, suspension, or bar is in the public interest and that person has (1) willfully made or caused

to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated or willfully aided and abetted violations of, certain provisions of the securities laws.[35] 15 U.S.C. § 78*o*(b)(4)(A), (D), (E), (6)(A)(i).

Advisers Act Section 203(f) provides that the Commission shall censure, limit, suspend, or bar any associated person of a registered investment adviser from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, if the Commission finds that such censure, limitation, suspension, or bar is in the public interest and that person has (1) willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated or willfully aided and abetted violations of, certain provisions of the securities laws. 15 U.S.C. § 80b-3(e)(1), (5), (6), (f).

Investment Company Act Section 9(b) authorizes the Commission to prohibit, conditionally or unconditionally and either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a

35. Exchange Act Section 15C(c) provides for a similar censure, limitation, suspension, or bar from acting as an associated person of a government securities broker or dealer. 15 U.S.C. § 78*o*-5(c).

registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter if such person has willfully violated or willfully aided and abetted violations of certain provisions of the securities laws. 15 U.S.C. § 80a-9(b)(2), (3).

In determining the public interest the Commission has considered the following factors: the 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 his or her conduct, the likelihood that the respondent's occupation will present opportunities for future violations, the age of the violation, the degree of harm to investors and the marketplace resulting from the violation, and, in conjunction with other factors, the extent to which the sanction will have a deterrent effect. *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at * 6 (Feb. 13, 2009) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)); *see also Ralph W. LeBlanc*, Exchange Act Release No. 48254, 2003 WL 21755845, at * 6 (July 30, 2003); *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *11 n.72 (Dec. 12, 2013). The "inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive." *Gary M. Kornman,* 2009 WL 367635, at * 6 (quoting *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at * 15 (Dec. 21, 2007)).

For the aforementioned reasons, a collateral bar under the Advisers Act and an associational bar under

the Investment Company Act are justified.[36] Malouf was associated with UASNM, a registered investment adviser, and I previously found that he violated Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c); Securities Act Sections 17(a)(1) and 17(a)(3); and Advisers Act Sections 206(1) and 206(2); and aided and abetted violations of Advisers Act Sections 206(4) and 207 and Rule 206(4)-1(a)(5). In making that determination, I note that in the Commission-approved settlement for UASNM, none of the other officials who were responsible for the materially misleading Forms ADV and website materials during the pertinent period, the CCO and CFO, were even suspended. *See UASNM, Inc.*, 2014 WL 2568398. However, the firm was subjected to heightened surveillance for two years, and credit must undeniably be given to UASNM's decision to report themselves and Malouf to the Commission. In addition, I do find that Malouf's conduct was more problematic because the most significant conflict of interest was his own, and he bore the ultimate responsibility to disclose it. On the other hand, I recognize that the circumstances that gave rise to the conflict and problems with best execution – the sale of Malouf's RJFS branch – have now passed, and are unlikely to recur. Given Malouf's age of fifty-five, a bar of seven-and-one-half years may mean that he will never return to the industry. Even if he does return to such work in his sixties, he would be near retirement. Because he works as an investment adviser, this bar will deprive him of his entire livelihood, and force him into

36. Malouf cannot be sanctioned under Exchange Act Sections 15(b) and 15C(c) because I did not find that Malouf was acting as a broker.

another profession. As an individual who worked for over thirty years in the industry, first as a broker-dealer, and then as an investment adviser, this will be a substantial professional and personal blow given his age and career prospects. However, I find that the severity of such a bar is necessary to serve the public interest.

E. Disgorgement and Prejudgment Interest

Securities Act Section 8A(e), Exchange Act Section 21C(e), and Advisers Act Section 203(k)(5) authorize disgorgement, including reasonable interest, in cease-and-desist proceedings. 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80b-3(k)(5). Exchange Act Section 21B(e), Investment Company Act Section 9(e), and Advisers Act Section 203(j) authorize disgorgement in proceedings in which a penalty may be imposed. 15 U.S.C. §§ 78u-2(e), 80a-9(e), 80b-3(j). "Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989).

Because of the difficultly in many cases to separate "legal from illegal profit . . . it is proper to assume that all profits gained while defendants were in violation of the law constituted ill-gotten gains." *SEC v Bilzerian*, 814 F. Supp. 116, 121 (D.D.C. 1993) (internal citations omitted); *see also SEC v. Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587, 611-12 (S.D.N.Y. 1993), *aff'd*, *SEC v. Posner*, 16 F.3d 520 (2d Cir. 1994). "[T]he well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that

uncertainty." *Zacharias*, 569 F.3d at 473. Here, however, the monies constituting fair value for the sale of Branch 4GE are clearly identifiable as legal profits, and should not be the subject of disgorgement.

By contrast, the monies received from excessive commissions, attributable to Malouf, should be disgorged. For the reasons set forth above, I find that this figure is roughly $265,000. However, as the Division agreed that any disgorgement awarded may be "offset by the $506,083.74 already reimbursed to investors from [Malouf's] settlement with UASNM[,]" my order will not require Malouf to pay any additional money for disgorgement purposes.[37] Div. Br. at 31.

F. Civil Penalties

Based on the willful violations and conduct set forth above, Respondent should be ordered to pay a civil penalty pursuant to Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act. Exchange Act Section 21B(a), Advisers Act Section 203(i), and Investment Company Act Section 9(d) authorize the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person (1) has willfully violated, or aided and abetted violations of, certain provisions of

37. Because no further disgorgement is required, I do not address the issue of prejudgment interest.

the securities laws or rules or regulations; or (2) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission. 15 U.S.C. §§ 78u-2(a), 80a-9(d), 80b-3(i). Securities Act Section 8A(g) authorizes the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person has violated or caused the violation of any provision of the Securities Act or its rules and regulations. 15 U.S.C. § 77h-1(g).

To determine whether a penalty is in the public interest, Exchange Act Section 21B, Advisers Act Section 203(i), and Investment Company Act Section 9(d) call for consideration of: (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm caused to others; (3) unjust enrichment, taking into account restitution made; (4) prior violations; (5) deterrence; and (6) such other matters as just may require. 15 U.S.C. §§ 78u-2(c), 80a-9(d)(3), 80b-3(i)(3). The statutes also allow a respondent to present evidence of the ability of the respondent to pay such penalty. 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d), 80a-9(d)(4), 80b-3(i)(4); *see* 17 C.F.R. § 201.630; *see also SEC v. Tourre*, 4 F. Supp. 3d 579, 593 (S.D.N.Y. 2014) (citations omitted); *SEC v. Opulentica, LLC*, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007); *SEC v. Lybrand*, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), *aff'd*, *SEC v. Kern*, 425 F.3d 143 (2d Cir. 2005); *SEC v. Coates*, 137 F. Supp. 2d 413, 429 (S.D.N.Y. 2001).

Malouf argues that a "defendant's net worth and corresponding ability to pay has proven to be one of the most important factors that district courts consider when determining how much of a civil penalty to assess." Resp. Response to Div. Proposed Additional FOF and COL at 123 (citing *SEC v. Gunn*, Civ. Action No. 3:08-cv-1013-G, 2010 WL 3359465, at *10 (N.D. Tex. Aug. 25, 2010); *SEC v. Svoboda*, 409 F. Supp. 2d 331, 347-48 (S.D.N.Y. 2006) (rejecting request to impose maximum penalty where defendants "perpetrated a fraud involving repeated securities law violations, considerable profits, and a high degree of scienter" because the maximum penalty "would be inappropriate given each defendant's financial situation"); *SEC v. Mohn*, No. 02-74634, 2005 WL 2179340, at *9 (E.D. Mich. Sept. 9, 2005) (waiving civil penalties against defendant where the court found it unlikely the Commission could collect any civil penalties given defendant's net worth and his speculative and uncertain future income potential); *SEC v. Rubin*, No. 91 CIV 6531 (MBM), 1993 WL 405428, at *7 (S.D.N.Y. Oct. 8, 1993) (imposing $1,000 penalty against impecunious defendant due to "the distinction between an ordinary debt that arises from a particular and definable liability, and a penalty that is designed to punish and is imposed based on an exercise of discretion")). The Commission has found that "ability to pay may be considered, but it is only one factor" and "[c]onsidering it is also discretionary." *Johnny Clifton*, Securities Act Release No. 9417, 2013 SEC LEXIS 2022, at *66 (July 12, 2013); *see Gregory O. Trautman*, Securities Act Release No. 9088, 2009 SEC LEXIS 4173, at *93 & n.115 (Dec. 15, 2009). When a respondent's conduct is egregious, ability to pay may be disregarded.

Johnny Clifton, 2013 SEC LEXIS 2022, at *66; *Gregory O. Trautman*, 2009 SEC LEXIS 4173, at *93.

Securities Act Section 8A, Exchange Act Section 21B, Advisers Act Section 203(i), and Investment Company Act Section 9(d) set out a three-tiered system for determining the maximum civil penalty for each violation. A maximum third-tier penalty is permitted if (1) the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (2) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission. 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3), 80a-9(d)(2)(C), 80b-3(i)(2)(C). The maximum third-tier penalty for conduct occurring after March 3, 2009, and on or before March 5, 2013, is $150,000 per violation. 17 C.F.R. § 201.1004, Subpt. E, Table IV.

I have considered "evidence concerning [Malouf's] ability to pay in determining whether disgorgement, interest or a penalty is in the public interest." 17 C.F.R. § 201.630(a); *see* 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d), 80b-3(i)(4); *Gunn*, 2010 WL 3359465, at *10. Malouf affirmed his first Statement of Financial Condition on January 12, 2015. *See* Resp. Br. at Ex. B. On January 14, 2015, I set a briefing schedule to allow the parties to file briefs setting forth their respective positions on Malouf's inability to pay any potential disgorgement, interest, or penalties that might be ordered. *Dennis J. Malouf*, Admin. Proc. Rulings Release No. 2219, 2015 SEC LEXIS 149. On February

27, 2015, the parties submitted briefs and documentary evidence on this issue (Div. Position and Resp. Position), including Malouf's second, revised Statement of Financial Condition, affirmed by Malouf on February 25, 2015. *See* Resp. Position at Ex. A. The revised statement contains supplementary detail, including additional assets and income that were previously undisclosed. I do not draw an adverse inference from Malouf's inclusion of this additional information, because the initial statement was prepared with comparatively limited information under challenging time constraints.

According to Malouf, his liabilities exceed his assets by an estimated $634,000. *See* Resp. Position at 2-9, Exs. A-I. His "regularly monthly personal expenses are approximately $4,600," including "$1,500 for rent, $850 for health insurance for himself and his children, food, utilit[ies], medical and automobile expenses" and "$550 per month in child support to his exwife." *Id.* at 9. The Division claims that Malouf's withdrawals from a NM Wealth Management bank account demonstrate that he received more than $3,000 to $6,000 per month of draws from the company, but, many such withdrawals, including cash withdrawals, could be business expenses, as opposed to personal ones. Div. Position at 4-5, Ex. D.

I disagree with Malouf's estimated value of his home and mortgages. Malouf's statement of financial condition does not include the value of his home, though Malouf notes in his position that the value was inadvertently omitted and his estimated value, based on public records, is $274,000, and the statement lists mortgages of $360,749

and a second mortgage of $164,122. Resp. Position at 2 n.1, Ex. A. Malouf's credit report, dated January 21, 2015, lists a mortgage account balance with Seterus, Inc., of $360,749 as of January 2015 and a home equity loan with US Bank with a balance as of December 2014 of $164,122.[38] *Id.* at Ex. H. The Division notes that on January 14, 2015, Malouf's property was sold at auction to CITIMORTGAGE, Inc., for $355,009.71. Div. Position at 5, Ex. G at 2. Taking into account the sale, it is more likely that Malouf's net liability involving his home is $169,861.29, instead of $250,871.

I disagree with Malouf's estimate, that his investment advisory firm, with almost $20 million under management, has a value of only $100,000. Resp. Position at 3. At the hearing it was established that with respect to two similar circumstances, the sale of investment adviser firm UAS by Kopczynski to Malouf, and the sale of broker-dealer Branch 4GE by Malouf to Lamonde, that Malouf valued each business for sale at twice its annual trailing revenue. *See* Resp. Supplemented Proposed FOF No. 73. Employing that same rule of thumb, the value of Malouf's current investment advisory firm should be at least $292,500.[39] Thus taking into account my revised mortgage

38. The Division notes that in an earlier statement of financial condition Malouf listed a mortgage liability of $458,250 and $159,250 for a second mortgage. Div. Position at 5, Ex. C at 2. Upon questioning Malouf's counsel, the Division was told that Malouf double-counted his second mortgage; Malouf then provided a corrected statement of financial condition. *Id.* at 5, Ex. F.

39. Malouf charges his clients on a quarterly basis an annual fee of 1.20% on assets under management (AUM) of up to $1,000,000; 1.00% on AUM of between $1,000,000 and $2,000,000; and 0.75% on

liability and investment advisory firm value estimates, while Malouf's liabilities exceed his assets, they do so by only $360,752.29.

For purposes of determining whether his ability to pay is in the public interest, I will not consider, in Malouf's favor, either the $286,000 of his estimated tax liability to the IRS for 2005 to 2011, nor his $68,103 state tax lien. Malouf's failure to file and pay taxes is his own fault; and allowing him to profit from his refusal to keep current with his taxes by offsetting any pecuniary remedy would negatively affect the public interest. Because I will not consider these elements to his benefit, I find that, for purposes of his ability to pay, his liabilities exceed his assets by $6,649.29. However, the mere fact that liabilities exceed assets does not establish an inability to pay, or that excusing him from paying anything would be in the public interest. Unlike someone who was destitute, and lacked the ability to work, Malouf has considerable assets (though he also has considerable obligations), and although he will not be able to work as an investment adviser going forward, he is nonetheless an individual of aptitude and shrewdness who will undoubtedly work in some other business profession. I acknowledge that for someone whose liabilities exceed their assets on Malouf's score, any civil penalty would be much more significant, in its punitive and deterrent effect on that individual, than it would be for someone in better financial circumstances. I will consider that duly in deciding any penalty in this case.

AUM over $2,000,000. Div. Position at 2, Ex. B at 3. Based on the firm's AUM, it could earn anywhere between $146,250 and $234,000. *See* Resp. Position at 8.

Third-tier penalties are appropriate because Malouf recklessly disregarded his fiduciary duties and disclosure requirements and thereby created a significant risk of substantial losses to his advisory clients. Dr. Gibbons calculated those losses, at a minimum, as $442,106, with Malouf's personal culpability exceeding a quarter-million dollars. It is undisputed that Malouf's money was used by UASNM to pay roughly twice the amount to its customers that I found Malouf was personally responsible for. I also note that Malouf already paid the $100,000 civil penalty on behalf of UASNM, and has made a convincing showing that, given his present financial status, he has dramatically less ability to pay any more substantial sums of money. The collateral bar I have ordered will deprive him of his ability to work in his chosen profession and his liabilities exceed his available assets. Balancing the aforementioned seriousness of his misconduct, with those mitigating factors of paying UASNM's penalty and his projected inability to pay, I find that a civil penalty consisting of one violation of $75,000 is appropriate to serve the public interest.[40]

V. RECORD CERTIFICATION

Pursuant to Rule of Practice 351(b), 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on March 20, 2015.

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40. Although one could parse Malouf's conduct, over time, into particular violations, the underlying violative conduct that supports a civil penalty is that he never adequately disclosed the essential terms of his agreement to sell Branch 4GE to Lamonde to anyone else.

Appendix D

VI. ORDER

I ORDER that, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 203(k) of the Investment Advisers Act of 1940:

> Dennis J. Malouf shall cease and desist from committing or causing violations, and any future violations, of Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rules 10b-5(a) and 10b-5(c); and Sections 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act and Advisers Act Rule 206(4)-1(a)(5).

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act:

> Dennis J. Malouf is barred for a period of seven-and-one-half years from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

I FURTHER ORDER that, pursuant to Section 8A(g) of the Securities Act of 1933, Section 21B(a) of the Securities Exchange Act of 1934, Section 9(d) of the Investment Company Act of 1940, and Section 203(i) of the Investment Advisers Act of 1940:

> Dennis J. Malouf shall pay a civil monetary penalty in the amount of $75,000.

Payment of civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the Commission website at *http://www.sec.gov/about/offices/ofm.htm*; or (3) by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order shall include a cover letter identifying the Respondent and Administrative Proceeding No. 3-15918, and shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule of Practice 360, 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 of Practice 111, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a 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 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.

/s/_____
Jason S. Patil
Administrative Law Judge

APPENDIX E — DENIAL OF REHEARING OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT, FILED OCTOBER 25, 2019

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 16-9546

DENNIS J. MALOUF,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

FILED
October 25, 2019

ORDER

Before B**RISCOE, HARTZ**, and **BACHARACH**, Circuit Judges

Petitioner's petition for rehearing is denied.

The petition for rehearing en banc was transmitted to all of the judges of the court who are in regular active service. As no member of the panel and no judge in regular

active service on the court requested that the court be polled, that petition is also denied.

Entered for the Court

ELISABETH A. SHUMAKER, Clerk

APPENDIX F — RELEVANT CONSTITUTIONAL PROVISIONS

U.S. CONSTITUTION

ARTICLE II

Section 1.

Section 2.

Clause 1….

Clause 2….

[The President] shall have power, by and with the advice and consent of the Senate, to make treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the advice and consent of the Senate, shall appoint ambassadors, other public ministers and consuls, judges of the Supreme Court, and all other officers of the United States, whose appointments are not herein otherwise provided for, and which shall be established by law: but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments.

APPENDIX G — RELEVANT STATUTORY PROVISIONS

15 U.S. CODE § 77i. COURT REVIEW OF ORDERS

(a) Any person aggrieved by an order of the Commission may obtain a review of such order in the court of appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such Court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or be set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by

evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The jurisdiction of the court shall be exclusive and its judgment and decree, affirming, modifying, or setting aside, in whole or in part, any order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

* * *

Appendix G

15 U.S. CODE § 78y. COURT REVIEW OF ORDERS AND RULES

(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence.

(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

* * *

(c) Objections not urged before Commission; stay of orders and rules; transfer of enforcement or review proceedings.

(1) No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so.

* * *

Appendix G

15 U.S. CODE § 80b-13. COURT REVIEW OF ORDERS

(a) Petition; jurisdiction; findings of Commission; additional evidence; finality.

Any person or party aggrieved by an order issued by the Commission under this subchapter may obtain a review of such order in the United States Court of appeals within any circuit wherein such person resides or has his principal office or place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, or any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence

is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

* * *