APPENDIX

United States Court of Appeals for the Fifth Circuit

United States Court of Appeals
Fifth Circuit

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Lyle W. Cayce
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No. 20-61007

George R. Jarkesy, Jr.; Patriot28, L.L.C.,

Petitioners,

versus

Securities and Exchange Commission,

Respondent.

Petition for Review of an Order of
the United States Securities and Exchange Commission
No. 3-15255

Before Davis, Elrod, and Oldham, *Circuit Judges*.

Jennifer Walker Elrod, *Circuit Judge*:

Congress has given the Securities and Exchange Commission substantial power to enforce the nation's securities laws. It often acts as both prosecutor and judge, and its decisions have broad consequences for personal liberty and property. But the Constitution constrains the SEC's powers by protecting individual rights and the prerogatives of the other branches of government. This case is about the nature and extent of those constraints in securities fraud cases in which the SEC seeks penalties.

The SEC brought an enforcement action within the agency against Petitioners for securities fraud. An SEC administrative law judge adjudged Petitioners liable and ordered various remedies, and the SEC affirmed on appeal over several constitutional arguments that Petitioners raised. Petitioners raise those same arguments before this court. We hold that: (1) the SEC's in-house adjudication of Petitioners' case violated their Seventh Amendment right to a jury trial; (2) Congress unconstitutionally delegated legislative power to the SEC by failing to provide an intelligible principle by which the SEC would exercise the delegated power, in violation of Article I's vesting of "all" legislative power in Congress; and (3) statutory removal restrictions on SEC ALJs violate the Take Care Clause of Article II. Because the agency proceedings below were unconstitutional, we GRANT the petition for review, VACATE the decision of the SEC, and REMAND for further proceedings consistent with this opinion.

I.

Petitioner Jarkesy established two hedge funds and selected Petitioner Patriot28 as the investment adviser. The funds brought in over 100 investors and held about $24 million in assets. In 2011, the SEC launched an investigation into Petitioners' investing activities, and a couple of years later the SEC chose to bring an action within the agency, alleging that Petitioners (along with some former co-parties) committed fraud under the Securities Act, the Securities Exchange Act, and the Advisers Act. Specifically, the agency charged that Petitioners: (1) misrepresented who served as the prime broker and as the auditor; (2) misrepresented the funds' investment parameters and safeguards; and (3) overvalued the funds' assets to increase the fees that they could charge investors.

Petitioners sued in the U.S. District Court for the District of Columbia to enjoin the agency proceedings, arguing that the proceedings infringed on various constitutional rights. But the district court, and later the U.S. Court of Appeals for the D.C. Circuit, refused to issue an injunction, deciding that the district court had no jurisdiction and that Petitioners had to continue with the agency proceedings and petition the court of appeals to review any adverse final order. *See Jarkesy v. SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014), *aff'd*, 803 F.3d 9, 12 (D.C. Cir. 2015).

Petitioners' proceedings moved forward. The ALJ held an evidentiary hearing and concluded that Petitioners committed securities fraud. Petitioners then sought review by the Commission. While their petition for Commission review was pending, the Supreme Court held that SEC ALJs had not been properly appointed under the Constitution. *Lucia v. SEC*, 138 S. Ct. 2044, 2054–55 (2018). In accordance with that decision, the SEC assigned Petitioners' proceeding to an ALJ who was properly appointed. But Petitioners chose to waive their right to a new hearing and continued under their original petition to the Commission.

The Commission affirmed that Petitioners committed various forms of securities fraud. It ordered Petitioners to cease and desist from committing further violations and to pay a civil penalty of $300,000, and it ordered Patriot28 to disgorge nearly $685,000 in ill-gotten gains. The Commission also barred Jarkesy from various securities industry activities: associating with brokers, dealers, and advisers; offering penny stocks; and serving as an officer or director of an advisory board or as an investment adviser.

Critical to this case, the Commission rejected several constitutional arguments Petitioners raised. It determined that: (1) the ALJ was not biased against Petitioners; (2) the Commission did not inappropriately prejudge the case; (3) the Commission did not use unconstitutionally delegated legislative power—or violate Petitioners' equal protection rights—when it decided to pursue the case within the agency instead of in an Article III court; (4) the removal restrictions on SEC ALJs did not violate Article II and separation-of-powers principles; and (5) the proceedings did not violate Petitioners' Seventh Amendment right to a jury trial. Petitioners then filed a petition for review in this court.

II.

Petitioners raise several constitutional challenges to the SEC enforcement proceedings.[1] We agree with Petitioners that the proceedings suffered from three independent constitutional defects: (1) Petitioners were deprived of their constitutional right to a jury trial; (2) Congress unconstitutionally delegated legislative power to the SEC by failing to provide it with an intelligible principle by which to exercise the delegated power; and (3) statutory removal restrictions on SEC ALJs violate Article II.

A.

Petitioners challenge the agency's rejection of their constitutional arguments. We review such issues *de novo*. *See Emp. Sols. Staffing Grp. II, L.L.C. v. Off. of Chief Admin. Hearing Officer*, 833 F.3d 480, 484 (5th Cir. 2016); *Trinity Marine Prods., Inc. v. Chao*, 512 F.3d 198, 201 (5th Cir. 2007).

B.

Petitioners argue that they were deprived of their Seventh Amendment right to a jury trial. The SEC responds that the legal interests at issue in this case vindicate distinctly public rights, and that Congress therefore appropriately allowed such actions to be brought in agency

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[1] Multiple *amici* have filed briefs with this court as well: the Cato Institute, Phillip Goldstein, Mark Cuban, Nelson Obus, and the New Civil Liberties Alliance. Each argues that the SEC proceedings exceeded constitutional limitations for reasons that Petitioners raise.

proceedings without juries. We agree with Petitioners. The Seventh Amendment guarantees Petitioners a jury trial because the SEC's enforcement action is akin to traditional actions at law to which the jury-trial right attaches. And Congress, or an agency acting pursuant to congressional authorization, cannot assign the adjudication of such claims to an agency because such claims do not concern public rights alone.

1.

Thomas Jefferson identified the jury "as the only anchor, ever yet imagined by man, by which a government can be held to the principles of its constitution." Letter from Thomas Jefferson to Thomas Paine (July 11, 1789), *in* The Papers of Thomas Jefferson 267 (Julian P. Boyd ed., 1958). And John Adams called trial by jury (along with popular elections) "the heart and lungs of liberty." The Revolutionary Writings of John Adams 55 (C. Bradley Thompson ed., 2000); *see also* Jennifer W. Elrod, *Is the Jury Still Out?: A Case for the Continued Viability of the American Jury*, 44 Tex. Tech L. Rev. 303, 303–04 (2012) (explaining that the jury is "as central to the American conception of the consent of the governed as an elected legislature or the independent judiciary").[2]

[2] Veneration of the jury as safeguard of liberty predates the American Founding. Our inherited English common-law tradition has long extolled the jury as an institution. William Blackstone said that trial by jury is "the glory of the English law" and "the most transcendent privilege which any subject can enjoy or wish for, that he cannot be affected, either in his property, his liberty, or his person, but by the unanimous consent of twelve of his neighbors and equals." *Mitchell v. Harmony*, 54 U.S. 115, 142–43 (1851) (quoting 4 William Blackstone, Commentaries on the Laws of England 227–29 (Oxford, Clarendon Pr. 1992) (1765)); *see also* Jennifer W. Elrod, *W(h)ither The Jury? The Diminishing Role of the Jury Trial in Our Legal System*, 68 Wash. & Lee L. Rev. 3, 7 (2011). Indeed, King George III's attempts to strip colonists of their right to trial by jury was one of the chief grievances aired against him and was a catalyst for declaring independence. The Declaration of Independence para. 20 (U.S. 1776).

Civil juries in particular have long served as a critical check on government power. So precious were civil juries at the time of the Founding that the Constitution likely would not have been ratified absent assurance that the institution would be protected expressly by amendment. 2 The Debate on the Constitution 549, 551, 555, 560, 567 (Bernard Bailyn ed. 1993) (collecting various state ratification convention documents calling for the adoption of a civil jury trial amendment); The Federalist No. 83 (Alexander Hamilton) ("The objection to the plan of the convention, which has met with most success in this State [i.e., New York], and perhaps in several of the other States, is that relative to the want of a constitutional provision for the trial by jury in civil cases."); Mercy Otis Warren, Observations on the Constitution (1788), *in* 2 The Debate on the Constitution 290 (Bernard Bailyn ed. 1993) (worrying that the unamended Constitution would lead to "[t]he abolition of trial by jury in civil causes"); *Parsons v. Bedford*, 28 U.S. (3 Pet.) 433, 446 (1830) ("One of the strongest objections originally taken against the constitution of the United States, was the want of an express provision securing the right of trial by jury in civil cases.").[3]

Trial by jury therefore is a "fundamental" component of our legal system "and remains one of our most vital barriers to governmental arbitrariness." *Reid v. Covert*, 354 U.S. 1, 9–10 (1957). "Indeed, '[t]he right to trial by jury was probably the only one universally secured by the first American state constitutions . . . .'" *Parklane Hosiery Co., Inc. v. Shore*, 439

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[3] *See also* Kenneth Klein, *The Validity of The Public Rights Doctrine in Light of the Historical Rationale of the Seventh Amendment*, 21 Hastings Const. L.Q. 1013, 1015 (1994) ("At the time the Constitution was proposed, the people of the United States greatly distrusted government, and saw the absence of a guaranteed civil jury right as a reason, standing alone, to reject adoption of the Constitution; only by promising the Seventh Amendment did the Federalists secure adoption of the Constitution in several of the state ratification debates.").

U.S. 322, 341 (1979) (Rehnquist, J., dissenting) (quoting Leonard Levy, Legacy of Suppression: Freedom of Speech and Press in Early American History 281 (1960)). Because "[m]aintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence[,] . . . any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care." *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935).

The Seventh Amendment protects that right. It provides that "[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law." U.S. Const. amend. VII. The Supreme Court has interpreted "Suits at common law" to include all actions akin to those brought at common law as those actions were understood at the time of the Seventh Amendment's adoption. *Tull v. United States*, 481 U.S. 412, 417 (1987). The term can include suits brought under a statute as long as the suit seeks common-law-like legal remedies. *Id.* at 418–19. And the Court has specifically held that, under this standard, the Seventh Amendment jury-trial right applies to suits brought under a statute seeking civil penalties. *Id.* at 418–24.

That is not to say, however, that Congress may never assign adjudications to agency processes that exclude a jury. *See Atlas Roofing Co. v. Occupational Safety & Health Rev. Comm'n*, 430 U.S. 442, 455 (1977). "[W]hen Congress properly assigns a matter to adjudication in a non-Article III tribunal, the Seventh Amendment poses no independent bar to the adjudication of that action by a nonjury factfinder." *Oil States Energy Servs., LLC v. Greene's Energy Grp., LLC*, 138 S. Ct. 1365, 1379 (2018) (internal quotations omitted).

Whether Congress may properly assign an action to administrative adjudication depends on whether the proceedings center on "public rights." *Atlas Roofing*, 430 U.S. at 450. "[I]n cases in which 'public rights' are being litigated[,] e.g., cases in which the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact[,] the Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be incompatible." *Id.* Describing proper assignments, the Supreme Court identified situations "where the Government is involved in its sovereign capacity under an otherwise valid statute creating enforceable public rights. Wholly private tort, contract, and property cases, [and] a vast range of other cases as well are not at all implicated." *Id.* at 458.

The Supreme Court refined the public-right concept as it relates to the Seventh Amendment in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989). There, the Court clarified that Congress cannot circumvent the Seventh Amendment jury-trial right simply by passing a statute that assigns "traditional legal claims" to an administrative tribunal. *Id.* at 52. Public rights, the Court explained, arise when Congress passes a statute under its constitutional authority that creates a right so closely integrated with a comprehensive regulatory scheme that the right is appropriate for agency resolution. *Id.* at 54.

The analysis thus moves in two stages. First, a court must determine whether an action's claims arise "at common law" under the Seventh Amendment. *See Tull*, 481 U.S. at 417. Second, if the action involves common-law claims, a court must determine whether the Supreme Court's public-rights cases nonetheless permit Congress to assign it to agency adjudication without a jury trial. *See Granfinanciera*, 492 U.S. at 54; *Atlas Roofing*, 430 U.S. at 455. Here, the relevant considerations include:

(1) whether "Congress 'creat[ed] a new cause of action, and remedies therefor, unknown to the common law,' because traditional rights and remedies were inadequate to cope with a manifest public problem"; and (2) whether jury trials would "go far to dismantle the statutory scheme" or "impede swift resolution" of the claims created by statute. *Granfinanciera*, 492 U.S. at 60–63 (quoting *Atlas Roofing*, 430 U.S. at 454 n.11, 461 (first and second quotations)).

2.

The rights that the SEC sought to vindicate in its enforcement action here arise "at common law" under the Seventh Amendment. Fraud prosecutions were regularly brought in English courts at common law. *See* 3 William Blackstone, Commentaries on the Laws of England *42 (explaining the common-law courts' jurisdiction over "actions on the case which allege any falsity or fraud; all of which savour of a criminal nature, although the action is brought for a civil remedy; and make the defendant liable in strictness to pay a fine to the king, as well as damages to the injured party"). And even more pointedly, the Supreme Court has held that actions seeking civil penalties are akin to special types of actions in debt from early in our nation's history which were distinctly legal claims. *Tull*, 481 U.S. at 418–19. Thus, "[a] civil penalty was a type of remedy at common law that could only be enforced in courts of law." *Id.* at 422.

Applying that principle, the Court in *Tull* held that the right to a jury trial applied to an action brought by an agency seeking civil penalties for violations of the Clean Water Act. *Id.* at 425. Likewise here, the actions the SEC brought seeking civil penalties under securities statutes are akin to those same traditional actions in debt. Under the Seventh Amendment, both as originally understood and as interpreted by the Supreme Court, the jury-trial right applies to the penalties action the SEC brought in this case.

That conclusion harmonizes with the holdings of other courts applying *Tull*. The Seventh Circuit followed the Supreme Court's lead in that case and has specifically said that when the SEC brings an enforcement action to obtain civil penalties under a statute, the subject of the action has the right to a jury trial. *SEC v. Lipson*, 278 F.3d 656, 662 (7th Cir. 2002) ("Because the SEC was seeking both legal and equitable relief (the former under the Insider Trading Sanctions Act, 15 U.S.C. § 78u–1, which (in subsection (a)(1)) authorizes the imposition of civil penalties for insider trading at the suit of the SEC[)] . . . [the defendant] was entitled to and received a jury trial."); *see also id.* (explaining that another circuit was wrong to tacitly assume "that civil penalties in SEC cases are not a form of legal relief"[4]). Some district courts have applied *Tull* similarly. *See, e.g.*, *SEC v. Badian*, 822 F. Supp. 2d 352, 365 (S.D.N.Y. 2011) (explaining that "whether the facts are such that the defendants can be subjected to a civil penalty . . . is a question for the jury, [and] the determination of the severity of the civil penalty to be imposed . . . is a question for the Court, once liability is established"); *SEC v. Solow*, 554 F. Supp. 2d 1356, 1367 (S.D. Fla. 2008) (applying *Tull* for the proposition that civil penalties are "legal, as opposed to equitable, in nature," and that it therefore "was [the defendant's] constitutional right to have a jury determine his liability, with [the court] thereafter determining the amount of penalty, if any").

Other elements of the action brought by the SEC against Petitioners are more equitable in nature, but that fact does not invalidate the jury-trial right that attaches because of the civil penalties sought. The Supreme Court has held that the Seventh Amendment applies to proceedings that involve a mix of legal and equitable claims—the facts relevant to the legal claims

[4] The Seventh Circuit was referring to the Ninth Circuit's opinion in *SEC v. Clark*, 915 F.2d 439, 442 (9th Cir. 1990). *Clark* did not address the issue whatsoever.

should be adjudicated by a jury, even if those facts relate to equitable claims too. *See Ross v. Bernhard*, 396 U.S. 531, 537–38 (1970); *see also Lipson*, 278 F.3d at 662 (noting that the defendant was entitled to a jury trial because the SEC sought legal relief in the form of penalties, even though the SEC also sought equitable relief). Here, the SEC sought to ban Jarkesy from participation in securities industry activities and to require Patriot28 to disgorge ill-gotten gains—both equitable remedies. Even so, the penalty facet of the action suffices for the jury-trial right to apply to an adjudication of the underlying facts supporting fraud liability.

3.

Next, the action the SEC brought against Petitioners is not the sort that may be properly assigned to agency adjudication under the public-rights doctrine. Securities fraud actions are not new actions unknown to the common law. Jury trials in securities fraud suits would not "dismantle the statutory scheme" addressing securities fraud or "impede swift resolution" of the SEC's fraud prosecutions. And such suits are not uniquely suited for agency adjudication.

Common-law courts have heard fraud actions for centuries, even actions brought by the government for fines. *See* Blackstone, *supra* at *42; *see also Tull*, 481 U.S. at 422 ("A civil penalty was a type of remedy at common law that could only be enforced in courts of law."). Naturally, then, the securities statutes at play in this case created causes of action that reflect common-law fraud actions. The traditional elements of common-law fraud are (1) a knowing or reckless material misrepresentation, (2) that the tortfeasor intended to act on, and (3) that harmed the plaintiff. *In re Deepwater Horizon*, 857 F.3d 246, 249 (5th Cir. 2017). The statutes under which the SEC brought securities fraud actions use terms like "fraud" and "untrue statement[s] of material fact" to describe the prohibited conduct.

See 15 U.S.C. §§ 77a–77aa, 78j(b), 80b-6. When "Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322 (1992) (quoting *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989)); *see also* Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 537 (1947) (explaining that "if a word is obviously transplanted from another legal source, whether the common law or other legislation, it brings the old soil with it").

Accordingly, the Supreme Court has often looked to common-law principles to interpret fraud and misrepresentation under securities statutes. *See, e.g*, *Omnicare, Inc. v. Laborers Dist. Council Indus. Pension Fund*, 575 U.S. 175, 191 (2015) (considering the Restatement (Second) of Torts to determine whether material omissions are actionable under a securities statute); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 343–44 (2005) (relying on "the common-law roots of the securities fraud action" in "common-law deceit and misrepresentation actions" to interpret the statutory securities-fraud action); *SEC v. Cap. Gains Rsch. Bureau*, 375 U.S. 180, 192–95 (1963) (considering the principles of common-law fraud to determine the requirements of fraud under the Advisers Act). Thus, fraud actions under the securities statutes echo actions that historically have been available under the common law.

Next, jury trials would not "go far to dismantle the statutory scheme" or "impede swift resolution" of the statutory claims. *See Granfinanciera*, 492 U.S. at 60–63. For one, the statutory scheme itself allows the SEC to bring enforcement actions either in-house or in Article III courts, where the jury-trial right would apply. *See* Dodd–Frank Act § 929P(a), 15 U.S.C. § 78u-2(a). If Congress has not prevented the SEC from bringing claims in Article III courts with juries as often as it sees fit to do so, and if the SEC has in fact brought many such actions to jury trial over the years,[5] then it is difficult to see how jury trials could "dismantle the statutory scheme." Congress could have purported to assign such proceedings *solely* to administrative tribunals, but it did not. And there also is no evidence that jury trials would impede swift resolution of the claims.[6] In this case, for example, the SEC took seven years to dispose of Petitioners' case and makes no argument that proceedings with a jury trial would have been less efficient.

Relatedly, securities-fraud enforcement actions are not the sort that are uniquely suited for agency adjudication. Again, Congress has not limited the SEC's ability to bring enforcement actions in Article III courts. Consider the statutory scheme in *Atlas Roofing* for contrast. The statutes in that case were new and somewhat unusual. They provided elaborate enforcement mechanisms for the sorts of claims that likely could not have been brought in legal actions before that point. *See Atlas Roofing*, 430 U.S. at 445 (describing how the statutes required factfinders to undertake detailed assessments of workplace safety conditions and to make unsafe-conditions findings even if no injury had occurred). But the federal courts have dealt with actions under

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[5] Indeed, the SEC regularly brings securities-fraud actions in Article III courts and adjudicates them through jury trials. *See, e.g.*, *SEC v. Fowler*, 6 F.4th 255, 258–60 (2d Cir. 2021); *SEC v. Johnston*, 986 F.3d 63, 71 (1st Cir. 2021); *SEC v. Life Partners Holdings, Inc.*, 854 F.3d 765, 772 (5th Cir. 2017); *SEC v. Quan*, 817 F.3d 583, 587 (8th Cir. 2016); *SEC v. Miller*, 808 F.3d 623, 626 (2d Cir. 2015); *SEC v. Jasper*, 678 F.3d 1116, 1119, 1121–22 (9th Cir. 2012); *SEC v. Seghers*, 298 F. App'x 319, 321 (5th Cir. 2008).

[6] The dissenting opinion contends that these considerations are "not decisive" (that the SEC has for decades sued in Article III courts under securities statutes) or "not determinative" (that those same suits are not unique to agency adjudication). To disregard these facts is to ignore the Supreme Court's explanation for what public rights are made of. And in any event, though the facts may not in isolation make up a private right, they together establish (along with the other considerations discussed above) that the right being vindicated here is a private right, not a public one.

the securities statutes for many decades, and there is no reason to believe that such courts are suddenly incapable of continuing that work just because an agency may now share some of the workload. In fact, for the first decades of the SEC's existence, securities-fraud actions against nonregistered parties could be brought *only* in Article III courts. Thomas Glassman, *Ice Skating Uphill: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. Bus. & Sec. L. 47, 50–52 (2015).[7]

The SEC counters that the securities statutes are designed to protect the public at large, and that some circuits have identified SEC enforcement actions as vindicating rights on behalf of the public. Indeed, the SEC says, the statutes allow for enforcement proceedings based on theories broader than actions like fraud that existed at common law.

Those facts do not convert the SEC's action into one focused on public rights. Surely Congress believes that the securities statutes it passes serve the public interest and the U.S. economy overall, not just individual parties. Yet Congress cannot convert any sort of action into a "public right" simply by finding a public purpose for it and codifying it in federal statutory law. *See Granfinanciera*, 492 U.S. at 61 (explaining that "Congress cannot eliminate a party's Seventh Amendment right to a jury trial merely by relabeling the cause of action to which it attaches and placing exclusive jurisdiction in an administrative agency or a specialized court of equity"). Purely private suits for securities fraud likely would have a similar public purpose—they too would serve to discourage and remedy fraudulent

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[7] Moreover, the Supreme Court has noted that agency adjudicators generally do not have special expertise to address structural constitutional claims—precisely the issues central to this case. *Carr v. Saul*, 141 S. Ct. 1352, 1360 (2021) ("[T]his Court has often observed that agency adjudications are generally ill suited to address structural constitutional challenges, which usually fall outside the adjudicators' areas of technical expertise.").

behavior in securities markets. That does not mean such suits concern public rights at their core. Granted, some actions provided for by the securities statutes may be new and not rooted in any common-law corollary. The fact remains, though, that the enforcement action seeking penalties in this case was one for securities fraud, which is nothing new and nothing foreign to Article III tribunals and juries.

That being so, Petitioners had the right for a jury to adjudicate the facts underlying any potential fraud liability that justifies penalties. And because those facts would potentially support not only the civil penalties sought by the SEC, but the injunctive remedies as well, Petitioners had a Seventh Amendment right to a jury trial for the liability-determination portion of their case.

4.

The dissenting opinion cannot define a "public right" without using the term itself in the definition. That leads to a good bit of question-begging. It says at times that the "SEC's enforcement action" is itself "a 'public right' because it is a case 'in which the Government sues in its sovereign capacity to enforce public rights." *Post* at 37. So the action is a public right because (1) the SEC is the government, and (2) it is vindicating a public right. And what is that public right being vindicated? The dissenting opinion does not say. In reality, the dissenting opinion's rule is satisfied by the first step alone: The action is itself a "public right" because the SEC is the government. And the not-so-far-removed consequences that flow from that conclusion: When the federal government sues, no jury is required. This is perhaps a runner-up in the competition for the "Nine Most Terrifying

Words in the English Language."[8] But fear not, the dissenting opinion's proposal runs headlong into *Granfinanciera*: "Congress cannot eliminate a party's Seventh Amendment right to a jury trial merely by relabeling the cause of action to which it attaches and placing exclusive jurisdiction in an administrative agency or a specialized court of equity" 492 U.S. at 61. With that limit in place, the dissenting opinion's bright-line rule burns out. Congress cannot change the nature of a right, thereby circumventing the Seventh Amendment, by simply giving the keys to the SEC to do the vindicating.

In this light, this approach treats the government's involvement as a sufficient condition for converting "private rights" into public ones. But from 1856 to 1989, the government's involvement in a suit was only a necessary condition, *not* a sufficient condition, for determining whether a suit vindicated public rights. *See Granfinanciera*, 492 U.S. at 65–66, 68–69 (Scalia, J., concurring in part) (referring to *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 U.S. (How.) 272, 283 (1856), and *N. Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 68–69 (1982) (plurality op.)); *cf. N. Pipeline Constr. Co.*, 458 U.S. at 69 n.23 ("It is thus clear that the presence of the United States as a proper party to the proceeding is a necessary but not sufficient means of distinguishing 'private rights' from 'public rights.'"). Then *Granfinanciera* said that a dispute between two private parties could still vindicate "public rights," such that the government was no longer a *necessary* condition for such suits. *See* 492 U.S. at 53–55. The dissenting opinion thus says that, after *Granfinanciera*, the government is no longer a necessary condition, but it is now a *sufficient* condition. That is at odds with *Granfinanciera* and does not follow from any of the Court's previous

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[8] *Cf.* Ronald Reagan, Presidential News Conference (Aug. 12, 1986), https://www.presidency.ucsb.edu/documents/the-presidents-news-conference-957.

decisions, which stressed that the government's involvement alone does not convert a suit about private rights into one about public rights.

The question is not just whether the government is a party, but also whether the right being vindicated is public or private, and how it is being vindicated. Tracing the roots of, and justification for, the public-rights doctrine, the Supreme Court has explained "that certain prerogatives were [historically] reserved to the political Branches of Government." *N. Pipeline Constr. Co.*, 458 U.S. at 67. Specifically, "[t]he public-rights doctrine is grounded in a historically recognized distinction between matters that could be conclusively determined by the Executive and Legislative Branches and matters that are 'inherently . . . judicial.'" *Id.* at 68 (quoting *Ex parte Bakelite Corp.*, 279 U.S. 438, 458 (1929)).

The inquiry is thus inherently historical. The dissenting opinion tries to avoid the history by again emphasizing that *Granfinanciera* dealt with private parties, not the government. But again, if the right being vindicated is a private one, it is not enough that the government is doing the suing. That means we must consider whether the form of the action—whether brought by the government or by a private entity—is historically judicial, or if it reflects the sorts of issues which courts of law did not traditionally decide.

As discussed in Part II.B.2, history demonstrates that fraud claims like these are "traditional legal claims" that arose at common law. Even aside from post-*Atlas Roofing* refinements of the "public rights" doctrine, this fact, among others, distinguishes that case. In *Atlas Roofing*, OSHA empowered the government to pursue civil penalties and abatement orders whether or not any employees were "actually injured or killed as a result of the [unsafe working] condition." 430 U.S. at 445; *see also id.* at 461 ("[Congress] created a new cause of action, and remedies therefor, unknown to the common law

. . . ."). The government's right to relief was exclusively a creature of statute and was therefore distinctly public in nature.

In contrast, fraud claims, including the securities-fraud claims here, are quintessentially about the redress of private harms. Indeed, the government alleges that Petitioners defrauded particular investors. *Cf.* 15 U.S.C. §§ 77q(a), 78j(b), 80b-6. As explained above, these fraud claims and civil penalties are analogous to traditional fraud claims at common law in a way that the "new" claims and remedies in *Atlas Roofing* were not. *See Atlas Roofing*, 430 U.S. at 461.

That being so, *Granfinanciera*'s considerations about whether Congress created a new action unfamiliar to the common law, and whether jury trial rights are incompatible with the statutory scheme, are appropriate for us to address even if the suit involves the federal government. And as discussed above: (1) this type of action was commonplace at common law, (2) jury trial rights are consistent and compatible with the statutory scheme, and (3) such actions are commonly considered by federal courts with or without the federal government's involvement. Thus, the agency proceedings below violated Petitioners' Seventh Amendment rights, and the SEC's decision must be vacated.

C.

Petitioners next argue that Congress unconstitutionally delegated legislative power to the SEC when it gave the SEC the unfettered authority to choose whether to bring enforcement actions in Article III courts or within the agency. Because Congress gave the SEC a significant legislative power by failing to provide it with an intelligible principle to guide its use of the delegated power, we agree with Petitioners.[9]

"We the People" are the fountainhead of all government power. Through the Constitution, the People delegated some of that power to the federal government so that it would protect rights and promote the common good. *See* The Federalist No. 10 (James Madison) (explaining that one of the defining features of a republic is "the delegation of the government . . . to a small number of citizens elected by the rest"). But, in keeping with the Founding principles that (1) men are not angels, and (2) "[a]mbition must be made to counteract ambition," *see* The Federalist No. 51 (James Madison), the People did not vest all governmental power in one person or entity. It separated the power among the legislative, executive, and judicial branches. *See* The Federalist No. 47 (James Madison) ("The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny."). The legislative power is the greatest of these powers, and, of course, it was given to Congress. U.S. Const. art. I, § 1.

The Constitution, in turn, provides strict rules to ensure that Congress exercises the legislative power in a way that comports with the People's will. Every member of Congress is accountable to his or her constituents through regular popular elections. U.S. Const. art I, §§ 2, 3; *id.* amend. XVII, cl. 1. And a duly elected Congress may exercise the legislative power only through the assent of two separately constituted chambers

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[9] This is an alternative holding that provides ground for vacating the SEC's judgment. "This circuit follows the rule that alternative holdings are binding precedent and not obiter dictum." *Texas v. United States*, 809 F.3d 134, 178 n.158 (5th Cir. 2015) (quoting *United States v. Potts*, 644 F.3d 233, 237 n.3 (5th Cir. 2011)).

(bicameralism) and the approval of the President (presentment). U.S. Const. art. I, § 7. This process, cumbersome though it may often seem to eager onlookers,[10] ensures that the People can be heard and that their representatives have deliberated before the strong hand of the federal government raises to change the rights and responsibilities attendant to our public life. *Cf.* Rachel E. Barkow, *Separation of Powers and the Criminal Law*, 58 Stan. L. Rev. 989, 1017 (2006). ("[T]he Framers weighed the need for federal government efficiency against the potential for abuse and came out heavily in favor of limiting federal government power over crime.").

But that accountability evaporates if a person or entity other than Congress exercises legislative power. *See Gundy v. United States*, 139 S. Ct. 2116, 2134 (2019) (Gorsuch, J., dissenting) ("[B]y directing that legislating be done only by elected representatives in a public process, the Constitution sought to ensure that the lines of accountability would be clear: The sovereign people would know, without ambiguity, whom to hold accountable for the laws they would have to follow."). Thus, sequestering that power within the halls of Congress was essential to the Framers. As John Locke—

[10] Indeed, President Woodrow Wilson, the original instigator of the agency that became the SEC, believed agencies like that one could solve the "problem" of congressional gridlock and the burden of popular accountability. *See Cochran v. SEC*, 20 F.4th 194, 218 (5th Cir. 2021) (Oldham, J., concurring) ("Wilson's 'new constitution' would ditch the Founders' tripartite system and their checks and balances for a 'more efficient separation of politics and administration, which w[ould] enable the bureaucracy to tend to the details of administering progress without being encumbered by the inefficiencies of politics.'" (quoting Ronald J. Pestritto, Woodrow Wilson and the Roots of Modern Liberalism 227 (2005))), *cert. granted sub nom.*, *SEC v. Cochran*, 21-1239, 2022 WL 1528373 (U.S. May 16, 2022); *see also id.* ("Wilson's goal was to completely separate 'the province of constitutional law' from 'the province of administrative function.'" (quoting Philip Hamburger, Is Administrative Law Unlawful? 464 (2014))).

a particularly influential thinker at the Founding—explained, not even the legislative branch itself may give the power away:

> The legislative cannot transfer the power of making laws to any other hands; for it being but a delegated power from the people, they who have it cannot pass it over to others. The people alone can appoint the form of the commonwealth, which is by constituting the legislative, and appointing in whose hands that shall be. And when the people have said we will submit to rules, and be governed by laws made by such men, and in such forms, nobody else can say other men shall make laws for them; nor can the people be bound by any laws but such as are enacted by those whom they have chosen and authorised to make laws for them.

Id. at 2133–34 (quoting John Locke, The Second Treatise of Civil Government and a Letter Concerning Toleration § 141, p. 71 (1947)).[11]

Article I of the Constitution thus provides that "[*a*]*ll* legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. art. I, § 1 (emphasis added). In keeping with Founding conceptions of separation of powers,[12] the Supreme Court has made clear that Congress cannot "delegate to the Courts, or to any other tribunals, powers which are strictly and exclusively legislative." *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 42 (1825); *see also A.L.A. Schechter Poultry Corp. v.*

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[11] Locke's perspective on the legislature's delegation of its power was influential in the United States around the time of the framing of the Constitution. *See* Hamburger, *supra* at 384.

[12] Principles of non-delegation had even taken hold in England before the American Founding. *See* Hamburger, *supra* at 381 (explaining that "even under [King] James I, the judges recognized that the king's prerogative power came from his subjects—that he was exercising a power delegated by the people" and, as a result, he could not transfer the royal powers to anyone else); *see also id.* ("[P]arliamentary subdelegations were widely understood to be unlawful.").

United States, 295 U.S. 495, 529 (1935) ("Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested."). According to the Supreme Court's more recent formulations of that longstanding rule,[13] Congress may grant regulatory power to another entity only if it provides an "intelligible principle" by which the recipient of the power can exercise it. *Mistretta v. United States*, 488 U.S. 361, 372 (1989) (quoting *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928)). The two questions we must address, then, are (1) whether Congress has delegated power to the agency that would be legislative power but-for an intelligible principle to guide its use and, if it has, (2) whether it has provided an intelligible principle such that the agency exercises only executive power.[14]

We first conclude that Congress has delegated to the SEC what would be legislative power absent a guiding intelligible principle. Government actions are "legislative" if they have "the purpose and effect of altering the legal rights, duties and relations of persons . . . outside the legislative branch." *INS v. Chadha*, 462 U.S. 919, 952 (1983). The Supreme Court has noted that the power to assign disputes to agency adjudication is "peculiarly

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[13] Some contemporary academics have argued that the non-delegation doctrine lacks a sound historical basis. *See* Julian Davis Mortenson & Nicholas Bagley, *Delegation at the Founding*, 121 Colum. L. Rev. 277 (2021); *but see* Ilan Wurman, *Nondelegation at the Founding*, 130 Yale L.J. 1490 (2021) (arguing that the doctrine was present at the Founding); Philip Hamburger, *Delegating or Divesting?*, 115 Nw. U. L. Rev. Online 88 (2020) (similar). Of course, our role as an inferior court is to faithfully apply Supreme Court precedent, so we do not reach the proper historical scope of the non-delegation doctrine. *See Morrow v. Meachum*, 917 F.3d 870, 874 n.4 (5th Cir. 2019).

[14] Adrian Vermeule, *No*, 93 Tex. L. Rev. 1547, 1558 (2015) ("[T]here is [no] delegation of legislative power at all so long as the legislature has supplied an 'intelligible principle' to guide the exercise of delegated discretion. Where there is such a principle, the delegatee is exercising executive power, not legislative power." (emphasis and footnote omitted)).

within the authority of the legislative department." *Oceanic Steam Navigation Co. v. Stranahan*, 214 U.S. 320, 339 (1909).[15] And, as discussed above, in some special circumstances *Congress* has the power to assign to agency adjudication matters traditionally at home in Article III courts. *Atlas Roofing*, 430 U.S. at 455. Through Dodd–Frank § 929P(a), Congress gave *the SEC* the power to bring securities fraud actions for monetary penalties within the agency instead of in an Article III court whenever the SEC in its unfettered discretion decides to do so. *See* 15 U.S.C. § 78u-2(a). Thus, it gave the SEC the ability to determine which subjects of its enforcement actions are entitled to Article III proceedings with a jury trial, and which are not. That was a delegation of legislative power. As the Court said in *Crowell v. Benson*, "the mode of determining" which cases are assigned to administrative tribunals "is completely within congressional control." 285 U.S. 22, 50 (1932) (quoting *Ex parte Bakelite Corp.*, 279 U.S. at 451).

The SEC argues that by choosing whether to bring an action in an agency tribunal instead of in an Article III court it merely exercises a form of prosecutorial discretion—an executive, not legislative, power. That position reflects a misunderstanding of the nature of the delegated power. Congress did not, for example, merely give the SEC the power to decide whether to bring enforcement actions in the first place, or to choose where to bring a case among those district courts that might have proper jurisdiction. It instead effectively gave the SEC the power to decide which defendants should

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[15] Moreover, at the Virginia Ratifying Convention in 1788, then-delegate John Marshall suggested that it is proper to the legislative power to determine the expedience of assigning particular matters for jury trial. *See* John Marshall on the Fairness and Jurisdiction of the Federal Courts, *in* 2 The Debate on the Constitution 740 (Bernard Bailyn ed. 1993) ("The Legislature of Virginia does not give a trial by jury where it is not necessary. But gives it wherever it is thought expedient. The Federal Legislature will do so too, as it is formed on the same principles.").

receive *certain legal processes* (those accompanying Article III proceedings) and which should not. Such a decision—to assign certain actions to agency adjudication—is a power that Congress uniquely possesses. *See id.*

Next, Congress did not provide the SEC with an intelligible principle by which to exercise that power. We recognize that the Supreme Court has not in the past several decades held that Congress failed to provide a requisite intelligible principle. *Cf. Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 474–75 (2001) (cataloguing the various congressional directives that the Court has found to be "intelligible principle[s]"). But neither in the last eighty years has the Supreme Court considered the issue when Congress offered *no guidance* whatsoever. The last time it did consider such an open-ended delegation of legislative power, it concluded that Congress had acted unconstitutionally: In *Panama Refining Co. v. Ryan*, 293 U.S. 388, 405–06 (1935), the Court considered a statutory provision granting the President the authority to prohibit the transportation in interstate commerce of petroleum and related products. The Court scoured the statute for directives to guide the President's use of that authority, but it found none. *Id.* at 414–20. It therefore explained:

> [I]n every case in which the question has been raised, the Court has recognized that there are limits of delegation which there is no constitutional authority to transcend. We think that section 9(c) goes beyond those limits. As to the transportation of oil production in excess of state permission, the Congress has declared no policy, has established no standard, has laid down no rule.

Id. at 430.

Congress's grant of authority to the SEC here is similarly open-ended. Even the SEC agrees that Congress has given it exclusive authority and absolute discretion to decide whether to bring securities fraud enforcement actions within the agency instead of in an Article III court. Congress has said nothing at all indicating how the SEC should make that call in any given case. If the intelligible principle standard means anything, it must mean that a total absence of guidance is impermissible under the Constitution.[16] *See Gundy*, 139 S. Ct. at 2123 (Kagan, J., plurality op.) (noting that "we *would* face a nondelegation question" if the statutory provision at issue had "grant[ed] the Attorney General plenary power to determine SORNA's applicability to pre-Act offenders—to require them to register, or not, as she sees fit, and to change her policy for any reason and at any time" (emphasis added)). We therefore vacate the SEC's judgment on this ground as well.

D.

The SEC proceedings below suffered from another constitutional infirmity: the statutory removal restrictions for SEC ALJs are unconstitutional.[17] SEC ALJs perform substantial executive functions. The President therefore must have sufficient control over the performance of their functions, and, by implication, he must be able to choose who holds the

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[16] As a member of this court aptly noted just last year, the fact that the modern administrative state is real and robust does not mean courts are never called to declare its limits. *See Cochran*, 20 F.4th at 222 (Oldham, J., concurring) ("If administrative agencies 'are permitted gradually to extend their powers by encroachments—even petty encroachments—upon the fundamental rights, privileges and immunities of the people,' the Court warned that 'we shall in the end, while avoiding the fatal consequences of a supreme autocracy, become submerged by a multitude of minor invasions of personal rights, less destructive but no less violative of constitutional guaranties.'" (quoting *Jones v. SEC*, 298 U.S. 1, 24–25 (1936))).

[17] Because we vacate the SEC's judgment on various other grounds, we do not decide whether vacating would be the appropriate remedy based on this error alone. *See Collins v. Yellen*, 27 F.4th 1068, 1069 (5th Cir. 2022) (remanding to the district court to determine what remedy, if any, is appropriate in light of the Supreme Court's holding that removal restrictions applicable to the Director of the Federal Housing Finance Agency were unconstitutional).

positions. Two layers of for-cause protection impede that control; Supreme Court precedent forbids such impediment.

Article II provides that the President must "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 3. The Supreme Court has held that this provision guarantees the President a certain degree of control over executive officers; the President must have adequate power over officers' appointment and removal.[18] *Myers v. United States*, 272 U.S. 52, 117 (1926). Only then can the People, to whom the President is directly accountable, vicariously exercise authority over high-ranking executive officials. *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 498 (2010). Yet not all removal restrictions are constitutionally problematic. "Inferior officers" may retain some amount of for-cause protection from firing. *See, e.g.*, *Morrison v. Olson*, 487 U.S. 654, 691–92 (1988). Likewise, even principal officers may retain for-cause protection when they act as part of an expert board. *Seila Law LLC v. CFPB*, 140 S. Ct. 2183, 2192 (2020).

But a problem arises when both of those protections act in concert. In *Free Enterprise Fund*, the Supreme Court considered the constitutionality of two layers of for-cause protection for members of the Public Company Accounting Oversight Board (PCAOB). 561 U.S. at 492. The members of the board answered to the SEC Commissioners. But the SEC could remove them only for "willful violations of the [Sarbanes–Oxley] Act, Board rules, or the securities laws; willful abuse of authority; or unreasonable failure to enforce compliance—as determined in a formal Commission order, rendered on the record and after notice and an opportunity for a hearing." *Id.* at 503.

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[18] Of course, the President's authority over appointments derives from the Appointments Clause as well. *See* U.S. Const. art. II, § 2, cl. 2.

On top of that, the President could only remove SEC Commissioners for "inefficiency, neglect of duty, or malfeasance in office." *Id.* at 486–87, 502. The Supreme Court held that this extensive system insulating PCAOB members from removal deprived the President of the ability to adequately oversee the Board's actions. *Id.* at 492, 496.

The question here is whether SEC ALJs serve sufficiently important executive functions, and whether the restrictions on their removal are sufficiently onerous, that the President has lost the ability to take care that the laws are faithfully executed. Petitioners' argument on this point is straightforward: SEC ALJs are inferior officers; they can only be removed by the SEC Commissioners if good cause is found by the Merits Systems Protection Board; SEC Commissioners and MSPB members can only be removed by the President for cause; so, SEC ALJs are insulated from the President by at least two layers of for-cause protection from removal, which is unconstitutional under *Free Enterprise Fund*. The SEC responds that this case is not like *Free Enterprise Fund*. First, it contends that SEC ALJs primarily serve an adjudicatory role. Second, it asserts that the for-cause protections for ALJs are not as stringent as those which applied to PCAOB members at the time of *Free Enterprise Fund*—or, at least, that this court should read the removal protections for ALJs that way to avoid constitutional problems.

We agree with Petitioners and hold that the removal restrictions are unconstitutional. The Supreme Court decided in *Lucia* that SEC ALJs are "inferior officers" under the Appointments Clause because they have substantial authority within SEC enforcement actions. *Lucia v. SEC*, 138 S. Ct. 2044, 2053 (2018). And in *Free Enterprise Fund* it explained that the President must have adequate control over officers and how they carry out their functions. 561 U.S. at 492, 496. If principal officers cannot intervene in their inferior officers' actions except in rare cases, the President lacks the control necessary to ensure that the laws are faithfully executed. So, if SEC ALJs are "inferior officers" of an executive agency, as the Supreme Court in *Lucia* indicated was the case at least for the purposes of the Appointments Clause, they are sufficiently important to executing the laws that the Constitution requires that the President be able to exercise authority over their functions. Specifically, SEC ALJs exercise considerable power over administrative case records by controlling the presentation and admission of evidence; they may punish contemptuous conduct; and often their decisions are final and binding. *Lucia*, 138 S. Ct. at 2053–54. But 5 U.S.C. § 7521(a) provides that SEC ALJs may be removed by the Commission "only for good cause established and determined by the Merit Systems Protection Board (MSPB) on the record after opportunity for hearing before the Board." (Parenthetical not in original.) And the SEC Commissioners may only be removed by the President for good cause.

The dissenting opinion's response is all built on dicta from *Free Enterprise Fund*. There, in noting what issues the Court was leaving open, the Court identified characteristics that were true of ALJs that were not true of PCAOB members: "[U]nlike members of the [PCAOB], many" ALJs "perform adjudicative rather than enforcement or policymaking functions." *Free Enterprise Fund*, 561 U.S. at 507 n.10. Far from "stat[ing]" that this "may justify multiple layers of removal protection," *post* at 22, the Court merely identified that its decision does not resolve the issue presented here. In any event, the Court itself said in *Myers* that "quasi[-]judicial" executive officers must nonetheless be removable by the President "on the ground that the discretion regularly entrusted to that officer by statute has not been on the whole intelligently or wisely exercised." 272 U.S. at 135.[19] So even if ALJs' functions are more adjudicative than PCAOB members, the fact remains that two layers of insulation impedes the President's power to remove ALJs based on their exercise of the discretion granted to them.[20]

Finally, the SEC urges us to interpret the for-cause protections for ALJs to instead allow removal for essentially any reason. Even if we could do so (and the statutory language likely does not give us that flexibility), that

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[19] The dissenting opinion deems this proposition from *Myers* to be *obiter dicta* that the Court subsequently disregarded in *Humphrey's Executor v. United States*, 295 U.S. 602, 626–28 (1935). *Post* at 54 n.113. But that itself is to disregard the Supreme Court's more recent guidance, which fortifies the Court's "landmark decision" in *Myers* and narrowed *Humphrey's Executor*. *See Seila Law*, 140 S. Ct. at 2191–92, 2197–99 & n.2 (limiting the *Humphrey's Executor* exception to *Myers* to cases involving "for-cause removal protections [given] to a multimember body of experts, balanced along partisan lines, that perform[] legislative and judicial functions and [are] said not to exercise any executive power," while casting doubt on the existence of wholly non-executive, quasi-legislative or quasi-judicial agency powers altogether); *see also City of Arlington v. F.C.C.*, 569 U.S. 290, 305 n.4 (2013) (noting that "[agency] activities take 'legislative' and 'judicial' forms, but they are exercises of—indeed, under our constitutional structure they *must* be exercises of—the 'executive Power'" (citing U.S. Const. art. II, § 1, cl. 1)).

[20] In the next breath, the dissenting position draws from a law review article that "[t]he ALJs' role is similar to that of a federal judge." *Post* at 52. It then concludes that they must be insulated from removal by the president to maintain their independence. But that analogy runs out under a little scrutiny. The SEC's ALJs are not mere neutral arbiters of federal securities law; they are integral pieces within the SEC's powerful enforcement apparatus. The ALJs report to the Commission itself and act under authority delegated by it. SEC Organization Chart (2020), https://www.sec.gov/about/secorg.pdf; 15 U.S.C. § 78d-1(a); 17 C.F.R. § 200.30-10. As the amicus brief by the Cato Institute points out, these administrative proceedings differ significantly from cases resolved in federal district courts and reviewed by federal courts of appeals. Cato Amicus Br. at 19–31. First, the Commission has *ex parte* discussions with the prosecutors to determine whether to pursue securities-fraud claims. Then the Commission itself decides what claims should be brought by the prosecutors. Only then do ALJs resolve the claims, which are then again reviewed by the Commission. Suffice it to say, even if ALJs have some of the same "tools of federal trial judges," *Lucia*, 138 S. Ct. at 2053, they use those tools at the direction of and with the power delegated to them by the Commission.

would not solve the Article II problem. As noted above, the MSPB is part of the mix as well. Furthermore, MSPB members "may be removed by the President only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d). So, for an SEC ALJ to be removed, the MSPB must find good cause and the Commission must choose to act on that finding. And members of both the MSPB and the Commission have for-cause protection from removal by the President. Simply put, if the President wanted an SEC ALJ to be removed, at least two layers of for-cause protection stand in the President's way.

Thus, SEC ALJs are sufficiently insulated from removal that the President cannot take care that the laws are faithfully executed. The statutory removal restrictions are unconstitutional.

III.

In sum, we agree with Petitioners that the SEC proceedings below were unconstitutional. The SEC's judgment should be vacated for at least two reasons: (1) Petitioners were deprived of their Seventh Amendment right to a civil jury; and (2) Congress unconstitutionally delegated legislative power to the SEC by failing to give the SEC an intelligible principle by which to exercise the delegated power. We also hold that the statutory removal restrictions for SEC ALJs are unconstitutional, though we do not address whether vacating would be appropriate based on that defect alone.[21]

We GRANT the petition for review, VACATE the decision of the SEC, and REMAND for further proceedings consistent with this opinion.

[21] Petitioners also argue that the SEC violated their equal protection rights, and that its decision was infected with bias and violated their due process rights. Because we vacate the SEC's decision on other grounds, we decline to reach these issues.

W. Eugene Davis, *Circuit Judge*, dissenting:

The majority holds that (1) administrative adjudication of the SEC's enforcement action violated Petitioners' Seventh Amendment right to a jury trial; (2) Congress unconstitutionally delegated an Article I legislative power to the executive branch when it gave the SEC the discretion to choose between bringing its enforcement action in an Article III court or before the agency without providing an intelligible principle to guide the SEC's decision; and (3) the removal protections on SEC administrative law judges violate Article II's requirement that the President "take Care that the Laws be faithfully executed." I respectfully disagree with each of these conclusions.

I.

The majority holds that the Seventh Amendment grants Petitioners the right to a jury trial on the facts underlying the SEC's enforcement action, and administrative adjudication without a jury violated that right. In reaching this conclusion, the majority correctly recognizes that a case involving "public rights" may be adjudicated in an agency proceeding without a jury notwithstanding the Seventh Amendment.[1] But, the majority then erroneously concludes that the SEC's enforcement action does not involve "public rights." In my view, the majority misreads the Supreme Court's decisions addressing what are and are not "public rights."

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[1] *See, e.g.*, *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 42 n.4 (1989) ("If a claim that is legal in nature asserts a 'public right,' . . . then the Seventh Amendment does not entitle the parties to a jury trial if Congress assigns its adjudication to an administrative agency or specialized court of equity. The Seventh Amendment protects a litigant's right to a jury trial only if a cause of action is legal in nature and it involves a matter of 'private right.'" (citation omitted)).

A.

As declared by Professors Wright and Miller, "A definitive statement by the Supreme Court regarding congressional authority in this context is found in *Atlas Roofing v. Occupational Safety & Health Review Commission*."[2] That case concerned the Occupational Safety and Health Act ("OSHA" or "the Act"), which created a new statutory duty on employers to avoid maintaining unsafe or unhealthy working conditions. OSHA also empowered the Federal Government, proceeding before an administrative agency without a jury, to impose civil penalties on those who violated the Act.[3] Two employers who had been cited for violating the Act argued that a suit in a federal court by the Government seeking civil penalties for violation of a statute is classically a suit at common law for which the Seventh Amendment provides a right to a jury trial; therefore, Congress cannot deprive them of that right by simply assigning the function of adjudicating the Government's right to civil penalties to an administrative forum where no jury is available.[4] The Court, in a unanimous opinion, disagreed:

> At least in cases in which "public rights" are being litigated—*e.g.*, ***cases in which the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact***—the Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be incompatible. . . . This is the case even if the Seventh Amendment would have required a jury where the

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[2] 9 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 2302.2, at 59 (4th ed. 2020) (citing *Atlas Roofing Co. v. Occupational Safety & Health Rev. Comm'n*, 430 U.S. 442 (1977)) (italics added).

[3] *Atlas Roofing*, 430 U.S. at 445.

[4] *Id.* at 449–50.

adjudication of those rights is assigned instead to a federal court of law instead of an administrative agency.[5]

Atlas Roofing drew its definition of "public rights" from, inter alia, *Crowell v. Benson*, which described "public rights" in slightly broader terms: matters "***which arise between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments***."[6]

The Supreme Court has never retreated from its holding in *Atlas Roofing*.[7] In fact, the Court implicitly re-affirmed *Atlas Roofing*'s definition of "public rights" as recently as 2018, when it decided *Oil States Energy Services, LLC v. Greene's Energy Group, LLC*.[8] That case involved the Leahy-Smith America Invents Act, which granted the Patent and Trademark Office ("PTO") the power to reconsider a previously-issued patent via an administrative process called "inter partes review."[9] This was a departure from historical practice, which placed this function in Article III courts alone.[10] The petitioner argued that inter partes review violated both Article

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[5] *Id.* at 450, 455 (emphasis added; paragraph break omitted); *see also id.* at 458 ("Our prior cases support administrative factfinding in only those situations involving 'public rights,' *e.g.*, where the Government is involved in its sovereign capacity under an otherwise valid statute creating enforceable public rights.").

[6] *Id.* at 452 (quoting *Crowell v. Benson*, 285 U.S. 22, 50 (1932)) (emphasis added); *see also id.* at 456, 457, 460 (citing *Crowell*, 285 U.S. 22).

[7] Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. PA. J. CONST. L. 45, 95 (2016).

[8] 138 S. Ct. 1365 (2018).

[9] *Id.* at 1370–72.

[10] *Id.* at 1384 (Gorsuch, J., dissenting) ("[F]rom the time it established the American patent system in 1790 until about 1980, Congress left the job of invalidating patents at the federal level to courts alone.").

III and the Seventh Amendment.[11] The Court disagreed and explained that Congress has "significant latitude" to assign adjudication of "public rights" to non-Article III tribunals that do not use a jury.[12] Moreover, the Court, quoting *Crowell*, defined "public rights" as "matters 'which arise between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments.'"[13]

As mentioned, *Atlas Roofing*'s definition of "public rights" is a slightly narrower version of *Crowell*'s definition. Thus, when *Oil States* re-affirmed *Crowell*, it necessarily re-affirmed *Atlas Roofing*'s definition as well.[14]

Oil States is also significant because it held that historical practice is not determinative in matters governed by the public rights doctrine, as such matters "'from their nature' can be resolved in multiple ways."[15] Accordingly, the Court rejected the view that "because courts have traditionally adjudicated patent validity in this country, courts must forever continue to do so."[16]

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[11] *Id.* at 1372.

[12] *Id.* at 1373, 1379.

[13] *Id.* at 1373 (quoting *Crowell*, 285 U.S. at 50).

[14] *Oil States* did not purport to provide an exhaustive definition of "public rights," and the opinion alludes to the possibility that, under certain circumstances, matters not involving the Government may also fall within the realm of "public rights." *See id.* However, the Court did not need to address these other, "various formulations" of "public rights," because inter partes review fell squarely within *Crowell*'s definition. *See id.* This court reached a similar conclusion in *Austin v. Shalala*, discussed below.

[15] *Id.* at 1378 (quoting *Ex parte Bakelite Corp.*, 279 U.S. 438, 451 (1929)).

[16] *Id.*; *see also id.* ("That Congress chose the courts in the past does not foreclose its choice of the PTO today.").

Like *Oil States*, this court relied on *Crowell* to define "public rights" in *Austin v. Shalala*.[17] That case involved the Government's action to recover overpayment of social security benefits via an administrative proceeding before the Social Security Administration.[18] *Austin* rejected the plaintiff's argument that the proceeding violated her Seventh Amendment right, explaining that "if Congress may employ an administrative body as a factfinder in imposing money penalties for the violation of federal laws"—as was done in *Atlas Roofing* and in the securities statutes at issue here—"it plainly may employ such a body to recover overpayments of government largess."[19]

Consistent with the above cases, our sister circuits routinely hold that an enforcement action by the Government for violations of a federal statute or regulation is a "public right" that Congress may assign to an agency for adjudication without offending the Seventh Amendment.[20] For example, the Eleventh Circuit relied solely on *Atlas Roofing* when it rejected a Seventh Amendment challenge to administrative adjudication of an ***SEC*** enforcement action and declared "it is well-established that the Seventh

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[17] 994 F.2d 1170, 1177 (5th Cir. 1993).

[18] *Id.* at 1173.

[19] *Id.* at 1177-78 (citing *Oceanic Steam Navigation Co. v. Stranahan*, 412 U.S. 320, 339 (1909)).

[20] *See, e.g.*, *Imperato v. SEC*, 693 F. App'x 870, 876 (11th Cir. 2017) (unpublished) (administrative adjudication for violations of the Securities Exchange Act); *Crude Co. v. FERC*, 135 F.3d 1445, 1454–55 (Fed. Cir. 1998) (Mandatory Petroleum Allocation Regulations); *Cavallari v. Office of Comptroller of Currency*, 57 F.3d 137, 145 (2d Cir. 1995) (Financial Institutions Reform, Recovery and Enforcement Act); *Sasser v. Adm'r EPA*, 990 F.2d 127, 130 (4th Cir. 1993) (Clean Water Act).

Amendment does not require a jury trial in administrative proceedings designed to adjudicate statutory 'public rights.'"[21]

The SEC's enforcement action satisfies *Atlas Roofing*'s definition of a "public right," as well as the slightly broader definition set forth in *Crowell* and applied in *Oil States* and *Austin*. The broad congressional purpose of the securities laws is to "protect investors."[22] For example, the Securities Act of 1933 was "designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing."[23] The Dodd-Frank Act, which, inter alia, expanded the SEC's authority to pursue civil penalties in administrative proceedings,[24] was "intended to improve investor protection," particularly in light of the Bernard Madoff Ponzi scheme.[25] Other circuits have consistently recognized that "[w]hen the SEC sues to enforce the securities laws, it is vindicating public rights and furthering public interests, and therefore is acting in the United States's

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[21] *Imperato*, 693 F. App'x at 876 (citing *Atlas Roofing*, 430 U.S. at 455–56).

[22] *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 592 (5th Cir. 1974).

[23] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976). In a similar vein, the Investment Advisers Act of 1940 seeks to "protect[] investors through the prophylaxis of disclosure," in order to eliminate "the darkness and ignorance of commercial secrecy," which "are the conditions upon which predatory practices best thrive." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963).

[24] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Sec. 929P, 124 Stat. 1376, 1862–64 (2010) (codified at 15 U.S.C. §§ 77h-1(g), 78u-2(a), 80a-9(d), 80b-3(i)).

[25] Mark Jickling, Congressional Research Service, R41503 *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title IX, Investor Protection* at i (2010).

sovereign capacity."[26] Thus, the SEC's enforcement action is a "public right" because it is a case "in which the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact."[27] It is also a matter "which arise[s] between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments."[28]

Because the SEC's enforcement action is a "public right," the Seventh Amendment does not prohibit Congress from assigning its adjudication to an administrative forum that lacks a jury.[29] As discussed below, the fact that the securities statutes at issue resemble (but are not identical to) common-law fraud does not change this result.[30] It also makes

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[26] *SEC v. Diversified*, 378 F.3d 1219, 1224 (11th Cir. 2004*), abrogated on other grounds by Kokesh v. SEC*, 137 S. Ct. 1635 (2017); *see also SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993); *United States v. Badger*, 818 F.3d 563, 566 (10th Cir. 2016).

[27] *Atlas Roofing*, 430 U.S. at 450.

[28] *Crowell*, 285 U.S. at 22; *Oil States*, 138 S. Ct. at 1373; *Austin*, 994 F.2d at 1177.

The majority asserts that "[t]he dissenting opinion cannot define a 'public right' without using the term itself in the definition." First, I rely on definitions the Supreme Court has provided. Second, while *Atlas Roofing* does use "public rights" to define "public rights," *Crowell* does not. Furthermore, *Granfinanciera* observed that *Atlas Roofing* "left the term 'public rights' undefined" and so looked to *Crowell* to fill in any perceived gap. *Granfinanciera*, 492 U.S. at 51 n.8; *see also id.* at 53 (noting that, under *Atlas Roofing*, a "public right" is simply "a statutory cause of action [that] inheres in, or lies against, the Federal Government in its sovereign capacity").

[29] *Atlas Roofing*, 430 U.S. at 450; *Granfinanciera*, 492 U.S. at 52–54; *Oil States*, 138 S. Ct. at 1379.

[30] *See Granfinanciera*, 492 U.S. at 52 ("Congress may fashion causes of action that are closely ***analogous*** to common-law claims and place them beyond the ambit of the Seventh Amendment by assigning their resolution to a forum in which jury trials are unavailable" if the action involves "public rights.").

no difference that federal courts have decided claims under the securities statutes for decades.[31]

B.

The majority's conclusion that the SEC's enforcement action is not a "public right" is based primarily on an erroneous reading of *Granfinanciera, S.A. v. Nordberg.*[32] Specifically, the majority interprets that case as abrogating *Atlas Roofing*. *Granfinanciera* did nothing of the sort.

In *Granfinanciera*, a bankruptcy trustee sued in bankruptcy court (where a jury was unavailable) to avoid allegedly fraudulent transfers the defendants had received from the debtor.[33] The defendants argued that they were entitled to a jury trial under the Seventh Amendment.[34] A key issue was whether the trustee's claim involved "public" or "private" rights. The Court held that the action was a private right.[35]

Unlike *Atlas Roofing*, *Granfinanciera* did not involve a suit by or against the Federal Government. This distinction is important. In discussing what constitutes a "public right," *Granfinanciera*, citing *Atlas Roofing*, recognized that "Congress may effectively supplant a common-law cause of action carrying with it a right to a jury trial with a statutory cause of action shorn of a jury trial right if that statutory cause of action ***inheres in, or lies***

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[31] *See Oil States*, 138 S. Ct. at 1378 ("[W]e disagree with the dissent's assumption that, because courts have traditionally adjudicated patent validity in this country, courts must forever continue to do so. Historical practice is not decisive . . . [in] matters governed by the public-rights doctrine . . . . That Congress chose the courts in the past does not foreclose its choice of the PTO today.")

[32] 492 U.S. 33.

[33] *Id.* at 36.

[34] *Id.* at 40.

[35] *Id.* at 55, 64.

against*, *the Federal Government in its sovereign capacity*.**"[36] *Granfinanciera* then clarified that "the class of 'public rights' whose adjudication Congress may assign to administrative agencies . . . ***is more expansive than *Atlas Roofing*'s discussion suggests";[37] i.e., the "Government need not be a party for a case to revolve around 'public rights'" provided certain other criteria are met.[38] Nevertheless, and contrary to what is implied by the majority, *Granfinanciera*'s recognition that the public-rights doctrine can extend to cases where the Government is not a party in no way undermines or alters *Atlas Roofing*'s holding that a case where the Government sues in its sovereign capacity to enforce a statutory right is a case involving "public rights."[39]

Because the bankruptcy trustee's suit involved only private parties and not the Government, *Granfinanciera*'s analysis is solely concerned with whether the action was one of the "seemingly 'private' right[s]" that are

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[36] *Granfinanciera*, 492 U.S. at 53 (citing *Atlas Roofing*, 430 U.S. at 458) (emphasis added).

[37] *Id.* at 53 (emphasis added).

[38] *Id.* at 54 (citing *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 586, 596–99 (1985)).

[39] *Granfinanciera* itself makes this clear when it states:

> The crucial question, ***in cases <u>not</u> involving the Federal Government***, is whether "Congress, acting for a valid legislative purpose pursuant to its constitutional powers under Article I, [has] create[d] a seemingly 'private' right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary." If a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, ***and if that right neither belongs to nor exists against the Federal Government***, then it must be adjudicated by an Article III court.

Id. at 54-55 (quoting *Thomas*, 473 U.S. at 593–94) (footnote omitted; emphasis added; bracketed alterations in original).

within the reach of the public-rights doctrine. Thus, any considerations or requirements discussed in *Granfinanciera* that go beyond *Atlas Roofing* or *Crowell* apply only to cases not involving the Government.

This understanding of *Granfinanciera* is supported by our subsequent decision in *Austin*, which stated:

> Although the definition is somewhat nebulous, at a minimum, suits involving public rights are those "which arise between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments." *Crowell v. Benson*, 285 U.S. 22, 50, 52 S. Ct. 285, 292, 76 L.Ed. 598 (1932). ***Beyond that***, certain ***other cases*** are said to involve public rights where Congress has created a "seemingly 'private' right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary." *Granfinanciera*, 492 U.S. at 54 . . . .[40]

Similarly, while *Oil States* acknowledged that *Crowell* did not provide the sole definition of what constitutes a "public right," it did not discuss any of the other "formulations" because *Crowell*'s definition was met.[41]

The majority overlooks the fact that *Granfinanciera*'s expansion of the public-rights doctrine applies only when the Government is not a party to the case. As a result, the majority applies "considerations" that have no relevance here. For example, the majority, quoting *Granfinanciera*, states that "jury trials would not 'go far to dismantle the statutory scheme' or 'impede swift resolution' of statutory claims." Again, *Granfinanciera* discussed these considerations in the context of a suit between private

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[40] *Austin*, 994 F.2d at 1177 (emphasis added).

[41] *Oil States*, 138 S. Ct. at 1373.

persons, not a case involving the Government acting in its sovereign capacity under an otherwise valid statute creating enforceable public rights.[42] Indeed, neither *Austin* nor *Oil States*, both of which were decided after *Granfinanciera* and which found public rights to exist, mentions these considerations.[43]

The majority also states that the securities statutes at issue created causes of action that "reflect" and "echo" common-law fraud. But this does not matter, because, as *Granfinanciera* itself recognized, the public-rights doctrine allows Congress to "fashion causes of action that are closely ***analogous*** to common-law claims and place them beyond the ambit of the Seventh Amendment by assigning their resolution to a forum in which jury trials are unavailable."[44]

The majority asserts that *Atlas Roofing* is distinguishable from the SEC's enforcement action because "OSHA empowered the government to pursue civil penalties regardless of whether any employe[e]s were 'actually injured or killed as a result of the [unsafe working] condition.'"[45] But the securities statutes share this feature: The SEC may impose civil penalties on

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[42] *Granfinanciera*, 492 U.S. at 61, 63.

[43] The same goes for the out-of-circuit decisions cited in footnote 20 above. *Atlas Roofing*, in a footnote, does make a passing reference to "go far to dismantle the statutory scheme." 430 U.S. at 454 n.11. But the Court was merely describing its reasoning in another bankruptcy case. Nothing in *Atlas Roofing* suggests that this consideration is relevant to whether Congress may assign the Government's enforcement action to an administrative proceeding lacking a jury.

[44] *Granfinanciera*, 492 U.S. at 52 (citations omitted); *see also id.* at 53 ("Congress may effectively supplant a common-law cause of action carrying with it a right to a jury trial with a statutory cause of action shorn of a jury trial right if that statutory cause of action inheres in, or lies against, the Federal Government in its sovereign capacity." (citing *Atlas Roofing*, 430 U.S. at 458)); *accord Crude Co.*, 135 F.3d at 1455 ("The public right at issue is not converted into a common law tort simply because the theory of liability underlying the enforcement action is analogous to a common law tort theory of vicarious liability.").

[45] Majority Op. at 17–18 (quoting *Atlas Roofing*, 430 U.S. at 445).

a person who makes a material misrepresentation even if no harm resulted from the misrepresentation.[46] The statutory cause of action created by the securities statutes is as "new" to the common law as the one created by OSHA.[47]

Relatedly, the majority harps on the fact that federal courts have dealt with actions under the securities statutes for decades. But *Oil States* makes clear that "[h]istorical practice is not decisive here."[48] "That Congress chose the courts in the past does not foreclose its choice of [an administrative adjudication] today."[49]

The majority also states that "securities-fraud enforcement actions are not the sort that are uniquely suited for agency adjudication." Again, this is not relevant. As *Oil States* explained, "the public-rights doctrine applies to matters 'arising between the government and others, which from their nature

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[46] *See* 15 U.S.C. §§ 78u-2(c), 77h-1(g)(1), 80a-9(d)(3), 80b-3(i)(3).

[47] *Atlas Roofing* recognized that, before (and after) OSHA, a person injured by an unsafe workplace condition may have an action at common law for negligence. *See Atlas Roofing*, 430 U.S. at 445. Through OSHA, specific safety standards were promulgated, and the Government could bring an enforcement action for a violation even if no one was harmed by the violation. *Id.* Similarly, before enactment of the securities statutes, an investor who was defrauded in the course of a securities transaction had a common-law action for fraud. Like OSHA, the securities statutes expressly prohibited certain conduct and empowered the SEC to bring an enforcement action for a violation, even if no one was actually harmed by the violation.

[48] 138 S. Ct. at 1378.

[49] *Id. Oil States* likewise refutes the majority's assertion that "[t]he inquiry is thus inherently historical." I add that the majority's support for this proposition consists of a concurring opinion in *Granfinanciera* and the plurality opinion in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982) (plurality), which addressed whether a bankruptcy court may decide a breach of contract action between two private parties.

do not require judicial determination ***and yet are susceptible of it***.'"[50] Indeed, "matters governed by the public-rights doctrine 'from their nature' can be resolved in multiple ways."[51]

Finally, it should be emphasized that *Tull v. United States*[52] does not control the outcome here. That case concerned the Government's suit ***in district court*** seeking civil penalties and an injunction for violations of the Clean Water Act.[53] *Tull* did not involve an administrative proceeding. Thus, while *Tull* concluded that the Government's claim was analogous to a "Suit at common law" for Seventh Amendment purposes,[54] the Court did not engage in the "quite distinct inquiry" into whether the claim was also a "public right" that Congress may assign to a non-Article III forum where juries are unavailable.[55] *Tull* itself acknowledges in a footnote prior decisions "holding that the Seventh Amendment is not applicable to administrative proceedings," making clear that it was not deciding whether the defendant would be entitled to a jury in an administrative adjudication.[56]

C.

In summary, the SEC's enforcement action against Petitioners for violations of the securities laws is a "public right" under Supreme Court precedent as well as our own. Accordingly, Congress could and did validly

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[50] *Id.* at 1373 (citing *Crowell*, 285 U.S. at 50) (emphasis added).

[51] *Id.* at 1378 (quoting *Ex parte Bakelite Corp.*, 279 U.S. at 451).

[52] 481 U.S. 412 (1987).

[53] *Id.* at 414–15.

[54] *Id.* at 425.

[55] *Granfinanciera*, 492 U.S. at 42 n.4; *accord Sasser*, 990 F.2d at 130.

[56] *Tull*, 481 U.S. at 418 n.4 (citing *Atlas Roofing*, 430 U.S. at 454; *Pernell v. Southall Realty*, 416 U.S. 363, 383 (1974)).

assign adjudication of that action to an administrative forum where the Seventh Amendment does not require a jury.

II.

I also disagree with the majority's alternative holding that Congress exceeded its power by giving the SEC the authority to choose to bring its enforcement action in either an agency proceeding without a jury or to a court with a jury. The majority reasons that giving the SEC this power without providing guidelines on the use of that power violates Article I by delegating its legislative authority to the agency. The majority's position runs counter to Supreme Court precedent. As set forth below, by authorizing the SEC to bring enforcement actions either in federal court or in agency proceedings, Congress fulfilled its legislative duty.

In support of its determination that Congress unconstitutionally delegated its authority to the SEC, the majority relies on *Crowell v. Benson*, wherein the Supreme Court explained that "the mode of determining" cases involving public rights "is completely within congressional control."[57] *Crowell* did not state that Congress cannot authorize that a case involving public rights may be determined in either of two ways. By passing Dodd-Frank § 929P(a), Congress established that SEC enforcement actions can be brought in Article III courts or in administrative proceedings. In doing so, Congress fulfilled its duty of controlling the mode of determining public rights cases asserted by the SEC.

The majority maintains that because the SEC has "the power to decide which defendants should receive certain legal processes (those accompanying Article III proceedings) and which should not," then such a

[57] 285 U.S. at 50 (quoting *Ex parte Bakelite Corp.*, 279 U.S. at 451).

decision falls under Congress's legislative power. The Supreme Court's decision in *United States v. Batchelder*[58] demonstrates that the majority's position on this issue is incorrect.

In *Batchelder*, the issue presented was whether it was constitutional for Congress to allow the Government, when prosecuting a defendant, to choose between two criminal statutes that "provide[d] different penalties for essentially the same conduct."[59] The defendant had been convicted under the statute with the higher sentencing range, and the Court of Appeals determined that the delegation of authority to prosecutors to decide between the two statutes, and thus choose a higher sentencing range for identical conduct, was a violation of due process and the nondelegation doctrine.[60] Specifically, the Court of Appeals determined that "such prosecutorial discretion could produce 'unequal justice'" and that it might be "impermissibl[e] [to] delegate to the Executive Branch the Legislature's responsibility to fix criminal penalties."[61]

The Supreme Court disagreed. The Court explained that "[t]he provisions at issue plainly demarcate the range of penalties that prosecutors and judges may seek and impose."[62] The Court further stated: "In light of that specificity, the power that Congress has delegated to those officials is no broader than the authority they routinely exercise in enforcing the criminal laws."[63] The Court concluded: "Having informed the courts, prosecutors,

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[58] 442 U.S. 114 (1979).

[59] *Id.* at 116.

[60] *Id.* at 123, 125–26.

[61] *Id.* at 125–26.

[62] *Id.* at 126.

[63] *Id.*

and defendants of the permissible punishment alternatives available under each Title, Congress has fulfilled its duty."[64]

The Supreme Court has analogized agency enforcement decisions to prosecutorial discretion exercised in criminal cases.[65] If the Government's prosecutorial authority to decide between two criminal statutes that provide for different sentencing ranges for essentially the same conduct does not violate the nondelegation doctrine, then surely the SEC's authority to decide between two forums that provide different legal processes does not violate the nondelegation doctrine. Thus, the SEC's forum-selection authority is part and parcel of its prosecutorial authority.[66]

Although no other circuit court appears to have addressed the particular nondelegation issue presented in this case, a district court did so in *Hill v. SEC*.[67] Like the majority does here, the plaintiff in *Hill* relied on *I.N.S. v. Chadha*[68] to assert that the SEC's choice of forum is a legislative action because it "alter[s] the rights, duties, and legal relations of individuals."[69] *Chadha* addressed the question whether a provision in the Immigration and

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[64] *Id.* (citation omitted).

[65] *See Heckler v. Chaney*, 470 U.S. 821, 832 (1985) ("[W]e recognize that an agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive Branch not to indict—a decision which has long been regarded as the special province of the Executive Branch . . . .").

[66] *Cf. SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947) ("[T]he choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency.") (citation omitted).

[67] 114 F. Supp. 3d 1297 (N.D. Ga. 2015) (holding that SEC's forum-selection authority does not violate the nondelegation doctrine), *vacated and remanded on other grounds*, 825 F.3d 1236 (11th Cir. 2016).

[68] 462 U.S. 919 (1983).

[69] *Hill*, 114 F. Supp. 3d at 1312 (quoting *Chadha*, 462 U.S. at 952).

Nationality Act (INA) allowing one House of Congress to veto the Attorney General's decision to allow a particular deportable alien to remain in the United States violated the Presentment Clauses and bicameral requirement of Article I.[70] Specifically, it addressed whether Congress, after validly delegating authority to the Executive, can then alter or revoke that valid delegation of authority through the action of just one House.

I agree with the district court in *Hill* that if *Chadha*'s definition of legislative action is interpreted broadly and out of context, then any SEC decision which affected a person's legal rights—including charging decisions—would be legislative actions, which is contrary to the Supreme Court's decision in *Batchelder*.[71] *Chadha*, one of the primary authorities the majority relies on, does not touch on any issue involved in this case.

I agree with the persuasive and well-reasoned decision of the district court in *Hill* that "Congress has properly delegated power to the executive branch to make the forum choice for the underlying SEC enforcement action."[72] In sum, it is clear to me that Congress's decision to give prosecutorial authority to the SEC to choose between an Article III court and an administrative proceeding for its enforcement actions does not violate the nondelegation doctrine.

III.

Finally, the majority concludes that the statutory removal restrictions applicable to SEC administrative law judges are unconstitutional because they violate Article II's requirement that the President "take Care that the

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[70] 462 U.S. at 923, 946.

[71] *Hill*, 114 F. Supp. 3d at 1313.

[72] *Id.*

Laws be faithfully executed." Specifically, the majority determines that SEC ALJs enjoy at least two layers of for-cause protection, and that such insulation from the President's removal power is unconstitutional in light of the Supreme Court's decisions in *Free Enterprise Fund v. Public Company Accounting Oversight Board*[73] and *Lucia v. SEC*.[74] I disagree. Rather than support the majority's conclusion, these cases explain why the SEC ALJs' tenure protections are constitutional: ALJs perform an adjudicative function.

Free Enterprise concerned the Public Company Accounting Oversight Board ("PCAOB"), which Congress created in 2002 to regulate the accounting industry.[75] The PCAOB's powers included promulgating standards, inspecting accounting firms, initiating formal investigations and disciplinary proceedings, and issuing sanctions.[76] In other words, PCAOB members were inferior officers who exercised "significant executive power."[77] The President could not remove the members of the PCAOB; rather, they could be removed by the Securities and Exchange Commission under certain, limited circumstances.[78] Furthermore, SEC Commissioners cannot themselves be removed by the President except for inefficiency, neglect of duty, or malfeasance in office.[79] While prior cases upheld restrictions on the President's removal power that imposed one level of protected tenure, *Free Enterprise* held that these dual for-cause limitations on

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[73] 561 U.S. 477 (2010).

[74] 138 S. Ct. 2044 (2018).

[75] *Id.* at 484-85.

[76] *Id.* at 485.

[77] *Id.* at 514.

[78] *Id.* at 486, 503.

[79] *Id.* at 487.

the removal of PCAOB members unconstitutionally impaired the President's ability to ensure that the laws are faithfully executed, because "[n]either the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over the [PCAOB]."[80]

Free Enterprise, however, "did not broadly declare all two-level for-cause protections for inferior officers unconstitutional."[81] Furthermore, the Court expressly declined to address "that subset of independent agency employees who serve as administrative law judges."[82] The Court made two observations about ALJs that potentially distinguished them from the PCAOB: (1) whether ALJs are "Officers of the United States" was, at that time, a disputed question, and (2) "unlike members of the [PCAOB], many administrative law judges of course perform ***adjudicative rather than enforcement or policymaking functions or possess purely recommendatory powers***."[83]

The Supreme Court subsequently addressed the first observation in *Lucia v. SEC*.[84] There, the Court held that SEC ALJs are "inferior officers" within the meaning of the Appointments Clause in Article II.[85] However, the Court again expressly declined to decide whether multiple layers of statutory removal restrictions on SEC ALJs violate Article II.[86]

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[80] *Id.* at 496.

[81] *Decker Coal Co. v. Pehringer*, 8 F.4th 1123, 1122 (9th Cir. 2021).

[82] *Free Enter. Fund*, 516 U.S. at 507 n.10.

[83] *Id.* (citations omitted; emphasis added).

[84] 138 S. Ct. 2044 (2018).

[85] *Id.* at 2055.

[86] *Id.* at 2051 & n.1.

Thus, neither *Free Enterprise* nor *Lucia* decided the issue raised here: whether multiple layers of removal restrictions for SEC ALJs violate Article II. As the Ninth Circuit recently concluded, the question is open.[87]

It is important to recognize that the Constitution does not expressly prohibit removal protections for "Officers of the United States."[88] The concept that such protections may be unconstitutional is drawn from the fact that "Article II vests '[t]he executive Power . . . in a President of the United States of America,' who must 'take Care that the Laws be faithfully executed.'"[89] The test is functional, not categorical:

> The analysis contained in our removal cases is designed ***not*** to define rigid categories of those officials who may or may not be removed at will by the President, but to ensure that Congress does not interfere with the President's exercise of the "executive power" and his constitutionally appointed duty to "take care that the laws be faithfully executed" under Article II.[90]

Consistent with this standard, *Free Enterprise* thoroughly explained why two levels of removal protection for the PCAOB interfered with the executive power.[91] The first step in the Court's analysis focused on the fact that the PCAOB exercised "significant executive power"[92] as it

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[87] *See Decker Coal Co.*, 8 F.4th at 1122.

[88] ERWIN CHEMERINSKY, CONSTITUTIONAL LAW § 4.2 (5th ed. 2015) ("No constitutional provision addresses the [President's] removal power.").

[89] *Free Enter. Fund*, 561 U.S. at 483 (quoting U.S. CONST. , art. II §§ 1 & 3).

[90] *Morrison v. Olson*, 487 U.S. 654, 689–90 (1988) (footnote omitted; emphasis added).

[91] *Free Enter. Fund*, 561 U.S. at 495–96.

[92] *Id.* at 514.

"determine[d] the policy and enforce[d] the laws of the United States."[93] Then the Court explained how the PCAOB's removal protections subverted the President's ability to oversee this power.[94] The point here is that the function performed by the officer is critical to the analysis—the Court did not simply conclude that because members of the PCAOB were "Officers of the United States" (which was undisputed)[95] that dual for-cause protections were unconstitutional.

Unlike the PCAOB members who determine policy and enforce laws, SEC ALJs perform solely adjudicative functions. As the *Lucia* Court stated, "an SEC ALJ exercises authority 'comparable to' that of a federal district judge conducting a bench trial."[96] Their powers include supervising discovery, issuing subpoenas, deciding motions, ruling on the admissibility of evidence, hearing and examining witnesses, generally regulating the course of the proceeding, and imposing sanctions for contemptuous conduct or procedural violations.[97] After a hearing, the ALJ issues an initial decision that is subject to review by the Commission.[98] Commentators have similarly observed that "SEC ALJs do not engage in enforcement or rulemaking"[99]

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[93] *Id.* at 484; *see also id.* at 508 (describing the PCAOB as "the regulator of first resort and the primary law enforcement authority for a vital sector of our economy").

[94] *Id.* at 498.

[95] *Id.* at 506.

[96] *Lucia*, 138 S. Ct. at 2049 (quoting *Butz v. Economou*, 438 U.S. 478, 513 (1978)).

[97] *Id.*

[98] *Id.*

[99] Mark, *supra*, at 107.

and proceedings before them are "analogous to that which would occur before a federal judge."[100]

Free Enterprise stated, albeit in dicta, that the fact that an ALJ performs adjudicative rather than enforcement or policymaking functions may justify multiples layers of removal protection.[101] I believe this to be the case. The ALJs' role is similar to that of a federal judge;[102] it is not central to the functioning of the Executive Branch for purposes of the Article II removal precedents.[103] As the Southern District of New York concluded, invalidating the "good cause" removal restrictions enjoyed by SEC ALJs would only "undermine the ALJs' clear adjudicatory role and their ability to 'exercise[ ] . . . independent judgment on the evidence before [them], free from pressures by the parties or other officials within the agency.'"[104]

In fact, the Ninth Circuit recently employed similar reasoning in *Decker Coal Co. v. Pehringer*, which held that two layers of removal protection for ALJs in the Department of Labor do not violate Article II.[105] Like SEC ALJs, the ALJs in *Decker Coal* performed "a purely adjudicatory

[100] David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1166 (2016).

[101] 561 U.S. at 507 n.10.

[102] *Lucia*, 138 S. Ct. at 2049.

[103] *Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 537 F.3d 667, 669 (D.C. Cir. 2008) (Kavanaugh, J., dissenting) (citing *Morrison*, 487 U.S. at 691–92).

[104] *Duka v. SEC*, 103 F. Supp. 3d 382, 395–96 (S.D.N.Y. 2015), *abrogated on other grounds by Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (quoting *Butz*, 438 U.S. at 513–14). *See also* Mark, *supra*, at 102–08 (arguing that multiple layers of removal protection for SEC ALJs do not violate Article II); Zaring, *supra*, at 1191–95 (same).

[105] *Decker Coal Co.*, 8 F.4th at 1133.

function."[106] The majority's decision is in tension, if not direct conflict, with *Decker Coal*.

Free Enterprise also noted that the exercise of "purely recommendatory powers" may justify multiple removal protections.[107] When an SEC ALJ issues a decision in an enforcement proceeding, that decision is essentially a recommendation as the Commission can review it de novo.[108] Even when the Commission declines review, the ALJ's decision is "deemed the action of the Commission."[109] Furthermore, the Commission is not required to use an ALJ and may elect to preside over the enforcement action itself.[110] This further supports the conclusion that the SEC ALJs' removal protections do not interfere with the President's executive power.

The majority reasons that because *Lucia* determined that SEC ALJs are inferior officers under the Appointments Clause, "they are sufficiently important to executing the laws that the Constitution requires that the President be able to exercise authority over their functions," and, consequently, multiple for-cause protections inhibit the President's ability to take care that the laws be faithfully executed. But nowhere does the majority explain ***how*** the ALJs' tenure protections interfere with the President's ability to execute the laws. The majority does not mention *Free Enterprise*'s observation that the performance of "adjudicative rather than enforcement or policymaking functions" or "possess[ing] purely recommendatory powers" distinguishes ALJs from the PCAOB and may justify multiples

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[106] *Id.*

[107] *Free Enter. Fund*, 561 U.S. at 507 n.10.

[108] *See Lucia*, 138 S. Ct. at 2049 (citing 17 C.F.R. § 201.360(d)); 5 U.S.C. § 557(b).

[109] *Lucia*, 138 S. Ct. at 2049 (quoting 15 U.S.C. § 78d-1(c)).

[110] *Id.* (citing 17 C.F.R. § 201.110).

layers of removal protection for ALJs.[111] The majority does not mention that *Lucia* found SEC ALJs to be similar to a federal judge.[112] The majority does not mention *Decker Coal*. Instead, the majority applies what is essentially a rigid, categorical standard, not the functional analysis required by the Supreme Court's precedents.[113]

Accordingly, I disagree with the majority that multiple layers of removal protection for SEC ALJs violate Article II. Because SEC ALJs solely perform an adjudicative function, and because their powers are recommendatory, these removal restrictions do not interfere with the President's ability to "take Care that the Laws be faithfully executed."

IV.

I find no constitutional violations or any other errors with the administrative proceedings below. Accordingly, I would deny the petition for review.

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[111] 561 U.S. at 507 n.10.

[112] 138 S. Ct. at 2049.

[113] *Morrison*, 487 U.S. at 689–90. The majority also cites *Myers v. United States*, 272 U.S. 52, 135 (1926), for the proposition that quasi-judicial executive officers must be removable by the President. But that part of *Myers* is dicta, which is why the Court disregarded it in *Humphrey's Executor v. United States*, 295 U.S. 602, 626–28 (1935).

United States Court of Appeals for the Fifth Circuit

No. 20-61007

George R. Jarkesy, Jr.; Patriot28, L.L.C.,

Petitioners,

versus

Securities and Exchange Commission,

Respondent.

Petition for Review of an Order of the
Securities & Exchange Comm
Agency No. 3-15255

ON PETITION FOR REHEARING EN BANC

Before Davis, Elrod, and Oldham, *Circuit Judges*.

Per Curiam:

Treating the petition for rehearing en banc as a petition for panel rehearing (5th Cir. R. 35 I.O.P.), the petition for panel rehearing is DENIED. The petition for rehearing en banc is DENIED because, at the request of one of its members, the court was polled, and a majority did not vote in favor of rehearing (Fed. R. App. P. 35 and 5th Cir. R. 35).

In the en banc poll, six judges voted in favor of rehearing (Richman, Stewart, Dennis, Haynes, Graves, and Higginson), and ten judges voted against rehearing (Jones, Smith, Elrod, Southwick, Willett, Ho, Duncan, Engelhardt, Oldham, and Wilson).

HAYNES, *Circuit Judge*, joined by STEWART, DENNIS, GRAVES, and HIGGINSON, *Circuit Judges*,[1] dissenting from denial of rehearing en banc:

I respectfully dissent from the denial of the petition for rehearing en banc and would grant it. The excellent dissenting opinion explains the problems with the panel majority opinion's holdings, so, rather than repeat that, I will only summarize here.

Jarkesy and Patriot28 sought review in this court of an SEC order finding securities fraud. They advanced several constitutional challenges to the SEC enforcement proceeding. The panel majority opinion largely agrees with those challenges and holds that: (1) Petitioners were deprived of their Seventh Amendment right to a jury trial; (2) Congress unconstitutionally delegated legislative power to the SEC by failing to provide it with an intelligible principle by which to exercise delegated power; and (3) statutory removal restrictions on SEC ALJs violate Article II. *See Jarkesy v. Sec. & Exch. Comm'n*, 34 F.4th 446, 449 (5th Cir. 2022).

The Seventh Amendment "preserve[s]" the right to a jury trial in civil cases. U.S. CONST. amend. VII. But Congress may assign factfinding functions and initial adjudications to administrative forums without a jury if "the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact." *Atlas Roofing Co. v. Occupational Safety & Health Rev. Comm'n*, 430 U.S. 442, 450 (1977). A public right, at its core, is a matter "which arise[s] between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments." *Crowell v. Benson*, 285 U.S. 22, 50 (1932). The panel majority opinion

[1] As a Senior Judge, Judge Davis was not eligible to vote on whether to take this case en banc, but he agrees that the case should have been taken en banc and also agrees with this dissenting opinion.

recognizes the Seventh Amendment's public rights exception but concludes that it does not apply here because the SEC action at issue was enforcing a wholly private right as opposed to a public one. As the dissenting opinion explains at length, that conclusion is incorrect and in conflict with Supreme Court and this court's precedent. *See, e.g.*, *Jarkesy*, 34 F.4th at 470–73 (Davis, J., dissenting); *Oil States Energy Servs., LLC v. Greene's Energy Grp., LLC*, 138 S. Ct. 1365, 1373 (2018); *Austin v. Shalala*, 994 F.2d 1170, 1177 (5th Cir. 1993). The majority opinion relies upon dicta in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 60 (1989), but overlooks that *Granfinanciera*'s dicta expanding the public-rights doctrine to some unidentified, future case applies only when the Government is not a party. *Jarkesy*, 34 F.4th at 453; *but see id.* at 470–71 (Davis, J., dissenting). Under *Atlas Roofing* and a fair reading of *Granfinanciera*, there is no question that the SEC's enforcement action against Petitioners in this matter for violations of the securities laws involves "public rights." *Granfinanciera* offers no support for the panel majority opinion's position that this enforcement action by the SEC does not involve a public right.

I now turn to the majority opinion's nondelegation doctrine holding. *Jarkesy*, 34 F.4th at 459. The Dodd-Frank Act allows the SEC to select whether it enforces securities laws in-house or in federal court. *See* § 929P(a), 15 U.S.C. § 78u-2(a). Concluding that Congress failed to provide the SEC with an intelligible principle to guide that choice, the majority opinion holds that this was an impermissible delegation of legislative power. *Jarkesy*, 34 F.4th at 461–62. The majority opinion's holding rests on an incorrect conclusion that this was a delegation of legislative power. The majority opinion asserts that "*Government* actions are 'legislative' if they have 'the purpose and effect of altering the legal rights, duties and relations of persons . . . outside the legislative branch.'" *Id.* at 461 (emphasis added) (quoting *INS v. Chadha*, 462 U.S. 919, 952 (1983)). But the majority opinion borrows that definition of "legislative power" from *Chadha*—a case that does not discuss the nondelegation doctrine—and incorrectly applies it here. *Id.*

There are ample real-world examples of executive action that "alter[s] the legal rights, duties and relations of persons . . . outside the legislative branch" that are not considered exercises of legislative power. *Chadha*, 462 U.S. at 952. The dissenting opinion addresses that in detail. *See Jarkesy*, 34 F.4th at 474–75 (Davis, J., dissenting); *see also United States v. Batchelder*, 442 U.S. 114 (1979). In its petition, the Government also gave as an example the fact that it may choose to charge a defendant with a misdemeanor as opposed to a felony—a decision that would deprive the defendant of a right to a jury trial, *Baldwin v. New York*, 399 U.S. 66, 69–70 (1970), and remove the requirement of a grand jury, *United States v. Linares*, 921 F.2d 841, 844 (9th Cir. 1990). Additionally, of course, agencies have the discretion *not* to enforce. *See Heckler v. Chaney*, 470 U.S. 821, 837–38 (1985) (holding that an agency decision to initiate an enforcement action was within the agency's unreviewable discretion). Being required to defend yourself in an enforcement action certainly alters your legal rights and duties, but the Court has never defined such agency discretion as an exercise of legislative power.

I finally turn to the Article II holding. The majority opinion erroneously concludes that the removal restrictions on SEC ALJs are unconstitutional, citing that "SEC ALJs perform substantial executive functions." *Jarkesy*, 34 F.4th at 463. In summary, the majority opinion reaches this conclusion by incorrectly reading *Lucia v. SEC*, 138 S. Ct. 2044 (2018), and *Free Enterprise Fund v. Public Co. Accounting Oversight Board*, 561 U.S. 477 (2010). *See Jarkesy*, 34 F.4th at 463–64.

In *Lucia*, the Court concluded that SEC ALJs are inferior officers for purposes of the Appointments Clause. *See* 138 S. Ct. at 2055. According to the majority opinion, that decidedly means that SEC ALJs perform executive functions. *See Jarkesy*, 34 F.4th at 463–64. Stated differently, if you are an officer under the Appointments Clause, you automatically perform executive functions, and the President must be able to exercise authority over those functions. As such, two-layer, for-cause removal protections are categorically invalid.

Under Article II, however, inferior officers can be appointed by the President, "Courts of Law," or "Heads of Departments." U.S. CONST. art. II, § 2, cl. 2. The Constitution does not require—nor did *Lucia* hold—that the President *alone* must appoint SEC ALJs. *See* 138 S. Ct. at 2050–51. So how can the majority opinion conclude that, under *Lucia*, an ALJ's insulation from the *President's* ability to remove violates the constitutional duty to faithfully execute the laws?

The discussion of *Free Enterprise* is similarly worrisome as it addresses inherently executive functions but, by contrast, an SEC ALJ's duties are distinctly *adjudicatory*. These duties include, *inter alia*: (1) fixing the time and place of hearings, (2) postponing or adjourning hearings, (3) granting extensions to file papers, (4) permitting filings of briefs, (5) issuing subpoenas, (6) granting motions to discontinue administrative proceedings, (7) ruling on the admissibility of evidence, and (8) hearing and examining witnesses. *See* 17 C.F.R. §§ 201.111, 200.30-10. SEC ALJs do not decide to bring enforcement actions, they merely preside over administrative hearings as *neutral* arbitrators. The majority opinion's conclusion to the contrary lacks any authority. If, as the Court in *Seila Law LLC v. Consumer Financial Protection Bureau*, 140 S. Ct. 2183 (2020), determined, the purpose of removal is to hold officials accountable to the executive, what implications would that have on administrative proceedings more broadly? Certainly, ALJs would not continue to be independent. If the majority opinion is concerned with bias on behalf of the SEC, the solution is not to make ALJs—

whose authority is "comparable to that of a federal district judge"—subject to executive authority. *Lucia*, 138 S. Ct. at 2049 (internal quotation marks and citation omitted). Indeed, the reasons for insulating ALJs from executive authority are exactly the same as those reasons articulated in *Morrison v. Olson*, 487 U.S. 654 (1988); the potential "'coercive influence' of the removal power would 'threate[n] the independence'" of the ALJs. 487 U.S. at 688 (alteration in original) (quoting *Humphrey's Ex'r v. United States*, 295 U.S. 602, 630 (1935)).

The panel majority opinion, in addition to being incorrectly decided, is more than worthy of en banc consideration. Indeed, having deviated from over eighty years of settled precedent, the opinion doubtlessly merits a full review. Beyond its massive impacts on the directly involved statutes, the opinion's potential application to agency adjudication more broadly raises questions of exceptional importance. The Government's petition aptly sums up this point: "Each holding [in this case] strikes down an Act of Congress and so presents a question of exceptional importance. The majority's decision nullifies provisions Congress determined necessary to enforce the securities laws and calls into question adjudication within the Executive Branch more broadly." That is exactly the sort of peril that, in the face of an incorrect opinion, should cause us to grant en banc rehearing. Given the decision of the majority of this court not to do so, I respectfully dissent.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 10834 / September 4, 2020

SECURITIES EXCHANGE ACT OF 1934
Release No. 89775 / September 4, 2020

INVESTMENT ADVISERS ACT OF 1940
Release No. 5572 / September 4, 2020

INVESTMENT COMPANY ACT OF 1940
Release No. 34003 / September 4, 2020

Admin. Proc. File No. 3-15255

In the Matter of

JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT 28 LLC; and GEORGE R. JARKESY, JR.

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud violations

Investment adviser and its owner committed securities fraud by making material misstatements and omissions to investors in two hedge funds. *Held*, it is in the public interest to bar owner from the securities industry and from participating in the offering of a penny stock; to impose cease-and-desist orders on owner and adviser; to order adviser to pay disgorgement of $684,935.38 plus prejudgment interest; and to order owner and adviser to pay civil penalties of $300,000 jointly and severally.

APPEARANCES:

Karen Cook and *S. Michael McColloch* for John Thomas Capital Management Group LLC and Gary R. Jarkesy, Jr.

Todd D. Brody and *Alix Biel* for the Division of Enforcement.

Appeal filed: November 10, 2014
Last brief received: March 21, 2019

This proceeding concerns fraudulent conduct by George R. Jarkesy, Jr. and John Thomas Capital Management Group LLC ("JTCM"), the unregistered investment adviser that he owned, in the offer and sale of interests in two hedge funds: John Thomas Bridge and Opportunity Fund LP I ("Fund I") and John Thomas Bridge and Opportunity Fund LP II ("Fund II"). Jarkesy founded JTCM in 2007, and together they launched Fund I in 2007 and Fund II in 2009. JTCM served as the Funds' general partner; Jarkesy managed and controlled JTCM and the Funds. Together, the Funds had about 120 investors. Fund I accepted new investors from 2007 to 2010 (for a total of about $20 million assets under management), and Fund II accepted new investors from 2009 to 2010 (for a total of about $4 million assets under management).

Respondents appeal from an administrative law judge's initial decision finding that they violated, and aided and abetted and caused violations of, the antifraud provisions of the federal securities laws by (i) misrepresenting the identity of the Funds' auditor and prime broker, and the Funds' investment parameters and safeguards; and (ii) overvaluing the Funds' holdings to increase management and performance fees.[1] The ALJ barred Jarkesy from the securities industry and from participating in the offering of a penny stock; ordered Respondents to cease and desist from antifraud violations; and ordered Respondents to pay, jointly and severally, disgorgement of $1,278,597, plus prejudgment interest, and third-tier civil penalties of $450,000. On appeal, Respondents challenge the ALJ's findings of fact and conclusions of law, and raise numerous constitutional and procedural objections; the Division of Enforcement cross-appeals and requests an accounting and greater monetary sanctions.[2]

Based on our independent review of the record, we find that Respondents violated Section 17(a)(2) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(b) thereunder, and Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder. We impose bars on Jarkesy; cease-and-desist orders on Respondents; civil penalties of $300,000 on Respondents jointly and severally; and disgorgement of $684,935.38 plus prejudgment interest on JTCM.

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1 *John Thomas Cap. Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Initial Decision Release No. 693, 2014 WL 5304908 (Oct. 17, 2014). Two other respondents settled this proceeding: John Thomas Financial, Inc. ("JTF"), a broker-dealer and the Funds' primary placement agent, and Anastasios "Tommy" Belesis, JTF's founder and CEO. *John Thomas Cap. Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Exchange Act Release No. 70989, 2013 WL 6327500 (Dec. 5, 2013).

2 We previously granted in part and deferred ruling in part on Respondents' request to adduce additional evidence pertaining to ALJ Foelak's appointment as an SEC ALJ. *See John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 75590, 2015 WL 4608057 (Aug. 3, 2015). We now deny the remainder of Respondents' request because, as we stated in an order issued on February 21, 2019, Respondents expressly forfeited, waived, and withdrew from their petition for review "any right to challenge the historical proceedings before [ALJ Foelak] on the grounds that the ALJ had not been constitutionally appointed." *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 85172, 2019 WL 857535, at *1 (Feb. 21, 2019).

I. Violations

Exchange Act Section 10(b) and Rule 10b-5(b) thereunder prohibit, through means of interstate commerce and in connection with the purchase or sale of securities, making an untrue statement of material fact or omitting to state a material fact necessary to make statements not misleading.[3] A fact is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[4] Scienter is required to violate these provisions.[5] Scienter is the intent to deceive, manipulate, or defraud.[6] It includes recklessness—highly unreasonable conduct that represents an "extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it."[7]

Securities Act Section 17(a)(2) prohibits, through means of interstate commerce and in the offer or sale of securities, obtaining money or property by means of an untrue statement of material fact or omission of material fact.[8] And Advisers Act Section 206(4) and Rule 206(4)-8 thereunder make it unlawful for an investment adviser to a pooled investment vehicle to make a material misstatement or material omission to any investor or prospective investor in the pooled investment vehicle.[9] Negligence is sufficient to establish a violation of Securities Act Section 17(a)(2) and Advisers Act Section 206(4) and Rule 206(4)-8 thereunder.[10]

We find that Respondents violated Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, Securities Act Section 17(a)(2), and Advisers Act Section 206(4) and Rule 206(4)-8 thereunder by making material misstatements and omissions with scienter to Fund investors in

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3 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b).

4 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976) ("The question of materiality . . . is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor.").

5 *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976).

6 *See, e.g., SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992).

7 *Id.* (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)); *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005).

8 15 U.S.C. § 77q(a)(2).

9 15 U.S.C. § 80b-6(4); 17 C.F.R. § 275.206(4)-8. Unlike Securities Act Section 17(a) and Exchange Act Section 10(b), Advisers Act Section 206 does not require that the fraudulent conduct occur "in the offer or sale" or "in connection with the purchase or sale" of securities.

10 *See Aaron v. SEC*, 446 U.S. 680, 697 (1980); *Steadman*, 967 F.2d at 643 n.5, 647.

marketing materials, financial statements, and monthly account statements. Both Jarkesy and JTCM are liable because Jarkesy's actions are imputed to JTCM.[11]

In finding Respondents liable, we find that they acted through means of interstate commerce because they used wires and the mails to communicate with investors and transfer funds.[12] We also find that Respondents' misconduct was "in the offer or sale" and "in connection with the purchase or sale" of securities because Respondents' misrepresentations and omissions coincided with their offer and sale of interests in the Funds.[13] And Respondents "obtain[ed] money . . . by means of" their misstatements and omissions because they obtained investments in the Funds and fees from the Funds via their fraud.

We find further that Respondents were investment advisers under Advisers Act Section 206. The Advisers Act 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, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[14] JTCM met this definition because this was its business. Whether an individual meets the definition of an investment adviser is a facts and circumstances inquiry. In this circumstance, the fact that Jarkesy was JTCM's sole owner and that he controlled all of its operations and activities

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11 *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (holding that a firm "can act only through its agents, and is accountable for the actions of its responsible officers"); *Warwick Capital Mgmt., Inc.*, Advisers Act Release No. 2694, 2008 WL 149127, at *9 n.33 (Jan. 16, 2008) ("A company's scienter is imputed from that of the individuals controlling it.").

12 *United States v. Vilar*, 729 F.3d 62, 93 (2d Cir. 2013) (finding that defendant's use of "the mails and wire transfers to carry out his scheme" was sufficient to establish nexus to interstate commerce required to sustain defendant's conviction for securities fraud).

13 *See SEC v. Wolfson*, 539 F.3d 1249, 1262 (10th Cir. 2008) (stating that the Supreme Court has "stated that 'it is enough that the fraud alleged "coincide" with a securities transaction'" to satisfy the "in connection with" requirement) (citing *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006) and *SEC v. Zandford*, 535 U.S. 813, 819 (2002)); *Fundamental Portfolio Advisors, Inc.*, Exchange Act Release No. 48177, 2003 WL 21658248, at *8 (July 15, 2003) (finding that material misstatements and omissions by an investment adviser in a fund's prospectuses and sales materials "were made in connection with the offer, purchase, or sale of securities, *i.e.* shares of the Fund" under Securities Act Section 17(a), and Exchange Act Rule 10(b) and Rule 10b-5), *petition denied*, 167 F. App'x 836 (2d Cir. 2006).

14 Advisers Act Section 202(a)(11), 15 U.S.C. § 80b-2(a)(11); *see also Koch v. SEC*, 793 F.3d 147, 157 (D.C. Cir. 2015) (stating that the "definition of investment adviser does not include whether one is registered or not with the SEC").

is sufficient to establish that he met the definition of an investment adviser.[15] Respondents were also investment advisers to a "pooled investment vehicle"—the Funds—under Advisers Act Rule 206(4)-8(a) because they made investment decisions on behalf of their hedge funds.[16]

15 *Montford & Co., Inc., d/b/a/ Montford Assocs.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *2 n.8 (May 2, 2014), *petition denied*, 793 F.3d 76 (D.C. Cir. 2015); *see also Warwick Capital Mgmt.*, 2008 WL 149127, at *1 & n.4, *9 n.37 (finding that individual who owned investment advisory firm with his wife, was its founder, president, and sole control person, and acted at all times on its behalf met the definition of an investment adviser); *John J. Kenny*, Exchange Act Release No. 47847, 2003 WL 21078085, at *17 & n.54 (May 14, 2003) (finding that individual who owned investment advisory firm with his wife, served as its chairman and CEO, and admitted that he controlled it met the definition of an investment adviser), *aff'd*, 87 F. App'x 608 (8th Cir. 2004).

16 *See Timothy S. Dembski*, Advisers Act Release No. 4671, 2017 WL 1103685, at *10 (Mar. 24, 2017) (stating that the general partner of a hedge fund, a pooled investment vehicle, was an investment adviser to the fund), *petition denied*, 726 F. App'x 841 (2d Cir. 2018); *see also SEC v. The Nutmeg Grp., LLC*, 162 F. Supp. 3d 754, 781-82 (N.D. Ill. 2016) (finding that both advisory firm to hedge fund and firm's owner violated Rule 206(4)-8)).

A. Respondents violated the antifraud provisions by knowingly or recklessly making material misstatements and omissions in marketing the Funds.[17]

We find that Respondents misrepresented the identity of the Funds' auditor and prime broker. We also find that Respondents misrepresented Fund I's investment strategy and asset allocation. We reject Respondents' justifications for these misrepresentations.

1. Respondents misrepresented that KPMG was the auditor and Deutsche Bank the prime broker for the Funds.

From 2008 through 2010, Jarkesy drafted, and caused JTCM to distribute to investors, newsletters and a PowerPoint presentation that identified KPMG as the Funds' auditor and Deutsche Bank as the Funds' prime broker.[18] The newsletters were dated August and September

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[17] Respondents object to the admission of various business records offered by the Division. Reviewing the issue *de novo*, *see, e.g.*, *Michael Lee Mendenhall*, Exchange Act Release No. 74532, 2015 WL 1247374, at *1 (Mar. 19, 2015); *optionsXpress, Inc.*, Exchange Act Release No. 78621, 2016 WL 4413227, at *48-49 (Sep. 13, 2016), we overrule these objections. We have repeatedly stressed that "all relevant evidence" should be considered and given such weight as appropriate in light of its "probative value, reliability, and the fairness of its use." *City of Anaheim*, Exchange Act Release No. 42140, 1999 WL 1034489, at *2 (Nov. 16, 1999); *see also* Rule of Practice 320, 17 C.F.R. § 201.320. The Division's business records affidavits provide a foundation for, and sufficiently establish the authenticity and reliability of, the documents in question. Each affiant was either a custodian of records for or another qualified person familiar with the recordkeeping practices and systems of his or her respective institution. Each affidavit also recites that the documents, which were produced pursuant to subpoena, were made at or near the time of the occurrence of the matters set forth therein and both made as a regular practice and kept in the course of a regularly conducted business activity. Given our preference for "liberality in the admission of evidence" in administrative proceedings, we have no difficulty finding that the business record affidavits are sufficient to support admission of the documents at issue under Rule 320. *See Del Mar Fin. Servs., Inc.*, Exchange Act Release No. 48691, 2003 WL 22425516, at *8 (Oct. 24, 2003). Indeed, even under the Federal Rules of Evidence—which do not apply to our administrative proceedings, *City of Anaheim*, 1999 WL 1034489, at *2—the business records affidavits comply with Rules 803 and 902. Respondents assert that the business record affidavits were defective, but their failure to support this contention with argument means they have waived any such claim. *See, e.g.*, *Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *19 & n.115 (Feb. 20, 2015). And contrary to Respondents' claim, unavailability of the affiant is not a prerequisite to reliance on a business record affidavit, even in federal district court practice. *See, e.g.*, *United States v. Anekwu*, 695 F.3d 967, 976 (9th Cir. 2012).

[18] The ALJ correctly admitted these and other marketing materials. We reject Respondents' contention that the ALJ unfairly allowed Arthur Coffey, a manager at a JTF branch location, to testify and authenticate these documents and to confirm that Respondents provided them to JTF and/or to investors. Although Coffey did not appear on the Division's original witness list, we find no merit to Respondents' claim that they did not have an adequate opportunity to prepare for his cross-examination. Respondents had access to the Division's investigative file in the form of

(footnote continued . . .)

2008, April and May 2009, and March and August 2010. Respondents used the PowerPoint presentation in meetings with brokers and prospective investors, emailed it to brokers to solicit investors, and provided brokers, investors, and prospective investors with access to a virtual library that contained the presentation. Respondents admit, however, that KPMG never audited the Funds; instead, a small Houston-based firm, Mir Fox & Rodriguez, audited them. And neither the Funds nor JTCM ever had a prime brokerage account with Deutsche Bank.

Deutsche Bank learned that Respondents had identified it as the prime broker in Fund II's private placement memorandum ("PPM") dated February 5, 2009, and demanded that its name be removed from the document. Although Respondents complied, they continued to identify Deutsche Bank as the Funds' prime broker in newsletters and the PowerPoint presentation.

Respondents' misrepresentations that KPMG was the Funds' auditor and Deutsche Bank was the Funds' prime broker were material. Contrary to Respondents' claim that prime brokers are not relevant to a fund's operations or performance, we have stated that auditors and prime brokers "perform important roles as 'gatekeepers' for private funds,"[19] and disclosure of their identity by advisers helps investors "conduct[] due diligence," "evaluat[e] potential managers," and "protect against fraud."[20] Thus, a reasonable investor would have considered their identity important.[21] Respondents acted at least recklessly because Jarkesy controlled JTCM and the Funds and therefore knew or must have known that KPMG and Deutsche Bank never provided services to the Funds when he made the misstatements.

Respondents contend that they had "express authority to change professionals and the business plan," that they negotiated with KPMG and Deutsche Bank to be the auditor and prime broker for another fund that they never launched, and that they intended to feed Fund II's assets into that fund. But whether Respondents had the authority to change professionals or attempted to engage KPMG and Deutsche Bank for another fund has no bearing on whether Respondents misrepresented that KPMG was the auditor and Deutsche Bank the prime broker for the Funds.

(. . . footnote continued)

a text-searchable database, which allowed them to locate pertinent documents concerning Coffey. *See infra* section III.C. They also received a transcript of testimony that Coffey provided in a FINRA proceeding against Belesis. Moreover, they declined the opportunity to recall Coffey and cross-examine him a second time several days after his examination.

19 *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Advisers Act Release No. 3221, 2011 WL 2482892, at *24 (June 22, 2011) (adopting release).

20 *Id.* at *46; *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Advisers Act Release No. 3110, 2010 WL 4686053, at *39 (Nov. 19, 2010) (proposing release).

21 *Cf. Schwartzman v. Morningstar, Inc.*, No. 12-1647, 2014 WL 3843875, at *19 (E.D. Pa. Aug. 5, 2014) ("A rigorous audit . . . reduce[s] the likelihood that a hedge fund is fraudulent or mismanaged. Information that the [fund] had an obscure auditor . . . may have changed investors' view of the [fund] as a sound investment.").

2. Respondents misrepresented Fund I's asset allocation and investment strategy.

From 2007 through 2010, Respondents provided a PPM for Fund I to investors and prospective investors. Respondents reviewed and controlled the contents of this document. The PPM stated that Fund I would make two types of investments: (1) in-force life insurance policies acquired through life settlement transactions (hereinafter, "life settlement policies");[22] and (2) short to medium term debt and equity investments (hereinafter, "corporate investments").

With respect to life settlement policies, the PPM stated that Fund I would invest 50% of its capital commitments in the policies. The policies would provide a "Return *of* Capital," while the corporate investments would provide a "Return *on* Capital" (emphasis in original). The PPM stated that JTCM would put the life settlement portfolio in a master trust to "contain sufficient cash . . . to pay the premiums . . . for the expected life expectancy," and to segregate returns "from the risks associated with the [corporate] investments."

Respondents repeated these representations in newsletters, a podcast, and a PowerPoint presentation. Six newsletters—dated August and September 2008, April and May 2009, and March and August 2010—stated that JTCM had "segregate[d] half of the Fund's investment in life settlement policies." And three newsletters—dated January 15, April 15, and June 30, 2008—stated that JTCM had put the policies into a master trust.

In the podcast, Jarkesy stated that "50% of [capital commitments] go[] into life settlements"; "30% of the life settlement portfolio buys a dollar's worth at face, and 70% . . . is set aside to pay premiums through the life expectancy." Similarly, the PowerPoint presentation stated that 50% of capital commitments would be put in a master trust to purchase life settlement policies and "to pay for premiums based on life expectancies."

Jarkesy drafted and caused JTCM to distribute the newsletters to investors, caused JTCM to distribute the podcast to investors, and prepared and used the PowerPoint presentation in marketing Fund I. Indeed, Respondents do not contest that Jarkesy showed the presentation to investor Steven Benkovsky before Benkovsky invested in Fund I in 2008. Benkovsky testified that the life settlement portfolio made him "comfortable in" investing in Fund I. Respondents also do not contest that Jarkesy told another investor, Robert Fullhardt, that the life settlement portfolio would provide a return of capital in Fund I to hedge against any corporate investment losses. Fullhardt testified that this was important in his decision to invest in Fund I.

Despite these representations, Respondents invested substantially less than 50% of Fund I's capital commitments in life settlement policies. Between September 28, 2007 and May 1, 2009, Respondents purchased 13 life settlement policies in Fund I, which (combined with the premium payments thereon) represented 10% of capital commitments as of December 31, 2008, 11% as of December 31, 2009, and 19% as of December 31, 2010. Respondents also put only 11

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22 Life settlement refers to the purchase of existing life insurance policies at a discount to their face values, maintaining them by paying the premiums, and collecting when the insured dies. The face value is the amount to be paid on the death of the insured.

policies in a master trust and never set aside cash needed to pay the premiums in a master trust. Most of the policies lapsed because Fund I did not have sufficient cash to pay the premiums.

With respect to corporate investments, the PPM stated that Fund I's total investment in the debt and equity of "any one company at any one time w[ould] not exceed 5% of the aggregate Capital Commitments." Jarkesy also drafted, and caused JTCM to distribute to investors, newsletters dated January 15, April 15, June 30, July 15, and October 15, 2008, stating that Fund I "is limited to 5% in any one corporate investment"; and drafted and sent a Due Diligence Questionnaire to Fund I's placement agent, JTF, in 2009, stating that Fund I is "limited to no more than five percent allocation of the Fund's investable assets in any single investment." Jarkesy repeated this representation to JTF's sales force, which obtained investors for the Funds, in several meetings about information needed to sell Fund I. Respondents do not contest that Jarkesy told Benkovsky and Fullhardt, before they invested in Fund I in 2008, that Fund I would not invest more than 5% of its assets in any single company. Both investors testified that, because of benefits from diversification, the 5% limitation was important in deciding to invest.

Nearly from its inception, however, Fund I made investments in individual companies that exceeded the 5% limitation. Fund I held the following investments as a percentage of its capital commitments in 2007: 7.2% in UFood Restaurant Group, 6.8% in EnterConnect, Inc., 5.9% in Reddi Brake Supply Corp., and 5.5% in G/O Business Solutions, Inc. From 2008 through 2010, Fund I became heavily invested in America West Resources, Inc.; increasing its exposure from 8.4% in 2008, to 10.2% in 2009, to 11.3% in 2010.[23]

Respondents' misstatements were material because they concerned Fund I's risk profile: the life settlement portfolio was designed to hedge risk from the corporate investments; the master trust was designed to reduce risk by ensuring that premiums were paid through life expectancy and life settlement returns were segregated from corporate investments; and the corporate investment limitation was designed to reduce risk through diversification. A reasonable investor would have considered changes to portfolio composition that increased the risk exposure of the fund important.[24] Also, Respondents' misstatements were material because they concerned Fund I's investment strategy. A reasonable investor would consider important whether the fund "would be able to achieve its stated investment objectives."[25] Indeed, investors

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23 These percentages are derived from Fund I's cost to purchase the securities in comparison to its year-end capital commitments. In the alternative, if they were derived from the securities' year-end market values, they would have resulted in greater percentages for UFood (11.1%), EnterConnect (13%), and Reddi Brake (11.6%), and the same percentage for G/O.

24 *Fundamental Portfolio Advisors, Inc.*, 2003 WL 21658248, at *11-12 (holding that changes to a fund's portfolio resulting in increased interest rate risk and volatility were material); *see also SEC v. Fife*, 311 F.3d 1, 10 (1st Cir. 2002) (finding that misrepresentations regarding risk were material "because a reasonable investor would want to know the risks involved").

25 *Fundamental Portfolio Advisors, Inc.*, 2003 WL 21658248, at *12; *see also David Henry Disraeli*, Advisers Act Release No. 2686, 2007 WL 4481515, at *5 (Dec. 21, 2007) ("The disposition of the proceeds of a securities offering is material information, and issuers must adhere strictly to the uses for the proceeds described in [a PPM].") (quoting *Brian Prendergast*,

(footnote continued . . .)

Benkovsky and Fullhardt both testified that the life settlement portfolio and corporate investment limitation were important to their decisions to invest in Fund I.

We find that Respondents acted with scienter because Jarkesy controlled Fund I's assets and thus knew or must have known that the representations were not true.[26]

3. Respondents' contentions concerning the marketing materials lack merit.

a. Fund I's PPM did not authorize Respondents' misrepresentations.

Respondents contend that Fund I's PPM permitted them to adjust the asset mix and strategy. Although the PPM stated that JTCM may change Fund I's investment and management policies "at [its] discretion," we have held that "in offering documents, specific statements control more general language such as that an allocation plan is 'flexible.'"[27] It is misleading to include "specific language describing asset allocation when [a fund manager] intend[s] to rely on more general language to authorize a departure from" that description.[28] Respondents misled investors by failing to notify them that they intended to pursue an investment strategy different from the specific strategy identified in the PPM.[29] And Respondents' representations concerning the life settlement policies and corporate investment limitation in marketing materials they provided to investors *after* they deviated from the stated strategy were materially false.

Respondents also contend that a section on risk in the PPM warned that "[b]ecause *as much as 10%* of [Fund I's] aggregate committed capital may be invested in a single Portfolio Company, a loss with respect to such a Portfolio Company could have a significant adverse impact on [Fund I's] capital" (emphasis added). But "not every mixture with the true will neutralize the deceptive."[30] "It is only 'when the inconsistency would exhaust the misleading conclusion's capacity to influence' the reasonable investor that the conclusion will be rendered

(. . . footnote continued)
Exchange Act Release No. 44632, 2001 WL 872693, at *7 (Aug. 1, 2001)), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009).

26 *Cf. Prendergast*, 2001 WL 872693, at *8 (finding that respondent acted with scienter because he prepared a hedge fund's PPM and knew its provisions for the use of offering proceeds but did not tell investors of his "decision to change the disposition of the proceeds").

27 *Id*.

28 *Id*.

29 *Id.* (finding that respondent misled investors by changing the investment strategy from that stated in the fund's PPM without disclosing the change to investors).

30 *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991).

immaterial."[31] As a result, "a misleading statement displayed prominently and in numerous places may not be cured by inconspicuous and scattered warnings."[32]

Here, the statement about a 10% corporate investment limitation was not repeated in the other marketing materials in the record. Yet Respondents misrepresented that Fund I had a 5% corporate investment limitation not only in the PPM, but also in five newsletters, a questionnaire, and in statements by Jarkesy in separate meetings with investors Benkovsky and Fullhardt and JTF's sales force. These marketing materials were supposed "to inform [investors], not to challenge their critical wits in the hunt for contradictions."[33] To the extent the statement in the PPM that Respondents highlight served as a corrective disclosure, therefore, we find that it was not conveyed to investors "'with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by'" the misstatements.[34] In any case, the representation that there was a 10% corporate investment limitation was itself false because Fund I exceeded it in both 2009 and 2010.

Respondents contend further that the PPM for Fund I advised investors not to rely on any statements other than those in the PPM. But the PPM stated only that "[a]ny representations (whether oral or written) other than those expressly set forth in [the PPM] and any information (whether oral or written) other than that expressly contained in documents furnished by [Fund I] must not be relied upon." Here, Respondents' misrepresentations were either expressly set forth in the PPM or were contained in materials that Jarkesy and JTCM furnished on behalf of Fund I. In any event, Respondents cannot disclaim liability for their material misstatements or omissions.[35] Nor can Respondents evade liability because the PowerPoint presentations included disclaimers that their delivery "shall not constitute an offer to sell or a solicitation to purchase securities," and that any such offer or solicitation "can only be made by delivery of" a PPM. Respondents cannot contract away their duties and obligations under the securities laws.[36]

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31 *United States v. Morris*, 80 F.3d 1151, 1168 (7th Cir. 1996) (quoting *Sandberg*, 501 U.S. at 1097-98).

32 *In re Lehman Bros. Sec. and Erisa Litig.*, 799 F. Supp. 2d 258, 314 (S.D.N.Y. 2011).

33 *SEC v. Church Extension of the Church of God, Inc.*, No. 1:02CV1118-DFH-VSS, 2005 WL 3370568, at *8 (S.D. Ind. Dec. 12, 2005).

34 *SEC v. Mudd*, 885 F. Supp. 2d 654, 667 (S.D.N.Y. 2012) (citations omitted).

35 *See Ward*, 2003 WL 1447865, at *10 n.47 (holding that broker's disclaimer in promotional materials that information contained therein about securities "should not be relied upon" as accurate and complete "in no way overrode" broker's omission of material facts).

36 *See Avello v. SEC*, 454 F.3d 619, 626 (7th Cir. 2006).

Similarly, Respondents contend that the ALJ improperly ignored cautionary terms in the PPM, including "the discussion of risk factors." But Respondents do not identify, and we have not found, any terms that made their misstatements not misleading.[37]

Finally, Respondents contend that the ALJ erred in finding that they used the PPMs without alterations in selling interests in the Funds. We agree with the ALJ, however, that "Respondents, who are in the best position to know of any successor PPM amendments, did not offer evidence of any changes" to the PPMs.[38]

b. Respondents cannot blame others for their misrepresentations.

Respondents attempt to blame Benkovsky and Fullhardt for failing to review the PPM. Benkovsky's and Fullhardt's testimony was that they had read some but not all of the PPM. Nonetheless, Respondents assert that Benkovsky and Fullhardt represented prior to investing in Fund I that they had read the PPM and later testified that they had not read the PPM. They also assert that Benkovsky testified that he would not have invested in Fund I had he been aware of certain disclosures in the PPM. As discussed above, however, the PPM did not contain disclosures that cured Respondents' misstatements. Respondents' misstatements to Benkovsky and Fullhardt were material regardless of whether any disclosures in the PPM would have caused them to act differently because the misstatements were important enough that they would have assumed actual significance in the deliberations of a reasonable investor.[39] Whether Benkovsky or Fullhardt read and relied on the PPM's disclosures is legally irrelevant.[40]

Respondents also contend that, because JTF was the broker for Benkovsky and Fullhardt, JTF was responsible for explaining the PPM. But because the PPM itself contained material misstatements, explaining it to Benkovsky and Fullhardt would not have prevented Respondents' fraud. Respondents also made misstatements to those investors in other communications.

Respondents argue further that Jarkesy never solicited Benkovsky's investment in Fund I. The record contradicts this assertion. The record also belies Respondents' claim that Benkovsky testified that their representations did not matter to his investment decision and that what mattered was that his broker said that "everything is fine" with the investment. Benkovsky testified only that he "relied on [his] broker to say . . . everything is fine" as to the content of the

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37 *Cf. Dembski*, 2017 WL 1103685, at *12 ("For cautionary statements in a PPM to be meaningful, they must discredit the alleged misrepresentations to such an extent that the real risk of deception drops to nil." (internal quotations and citations omitted)).

38 Fund I's PPM was amended on August 21, 2007 to remove a $10 million minimum capital commitment requirement, but that amendment is immaterial to our finding here.

39 *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1533 (2d Cir. 1991) (stating that a fact need not "'have caused the reasonable investor to change his'" decision but rather "need only be important enough that it 'would have assumed actual significance in the deliberations of the reasonable shareholder") (quoting *TSC Indus.*, 426 U.S. at 449).

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

PPM, not as to whether to invest. He also testified that Fund I's life settlement portfolio strategy and corporate investment limitation were important to his investment decision.

c. Respondents' advice of counsel and fair notice defenses fail.

Respondents contend that the ALJ erred in rejecting their advice of counsel defense, which Respondents appear to base on Jarkesy's testimony that counsel prepared the PPMs and reviewed the newsletters. However, we have afforded no weight to Jarkesy's uncorroborated testimony as to disputed facts. The ALJ found that Jarkesy "generally testified in an evasive manner that did not provide any assurances of the reliability of his testimony," noting that "Jarkesy evaded a large portion of the Division's questions," while "his recollection markedly improved when questioned by his own counsel." We accord "explicit credibility" findings "considerable weight."[41] Having reviewed the hearing transcript, we, too, find that Jarkesy's testimony lacks credibility:[42] Jarkesy provided detailed answers to his attorneys' questions but repeatedly answered—hundreds of times—that he could not remember in response to the Division's questions. Given the myriad "examples in the record where [he] was selective and evasive in answering questions,"[43] we find that Jarkesy was not a credible witness.[44]

Moreover, "[a] claim of reliance on the advice of counsel requires a showing that the party claiming it 'made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith.'"[45] Respondents failed to make the required showing to establish an advice of counsel defense.

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41 *Kenneth R. Ward*, Exchange Act Release No. 47535, 2003 WL 1447865, at *10 (Mar. 19, 2003), *aff'd*, 75 F. App'x 320 (5th Cir. 2003)); *accord Kay v. FCC*, 396 F.3d 1184, 1189 (D.C. Cir. 2005) (stating "that an agency is not required to accept the credibility determinations of an administrative law judge" but may give as much weight to them as warranted).

42 Where "objective inconsistency or fundamental implausibility is at issue"—instead of a demeanor-based observation—an ALJ "has no special advantage . . . in determining credibility." *Dray v. RR. Ret. Bd.*, 10 F.3d 1306, 1314 (7th Cir. 1993); *NLRB v. Interboro Contractors, Inc.*, 388 F.2d 495, 501 (2d Cir. 1967) (distinguishing between "credibility findings" that "rest mainly on an analysis of the testimony" and those "explicitly based on demeanor").

43 *Yu Ying Zheng v. Gonzales*, 235 F. App'x 667, 668 (9th Cir. 2007).

44 *See, e.g.*, *Cannon v. Trammell*, 796 F.3d 1256, 1271 (10th Cir. 2015) (affirming credibility determination based on the witness's "evasive[ness] on cross-examination and . . . overly selective memory when it came to helpful and harmful facts"); *U.S. Marine Corp. v. NLRB*, 944 F.2d 1305, 1317 (7th Cir. 1991) (affirming agency's adoption of "ALJ's decision that [the witness's] testimony lacked credibility" based on the witness's "selective memory"); *see also United States v. Figueroa*, No. CR-10-0864-TUC-JMR-DTF, 2010 WL 5563545, at *3 (D. Ariz. Dec. 15, 2010) (finding that witness did not testify credibly when, "[o]n direct examination, [she] described the alleged promises with some precision," whereas "[o]n cross-examination, however, [she] was unable to recall most other aspects").

45 *Disraeli*, 2007 WL 4481515, at *7 n.39 (quoting *Markowski v. SEC*, 34 F.3d 99, 104-05 (2d Cir. 1994)).

Indeed, the record contains no evidence that Respondents made disclosures to counsel about the identities of the Funds' auditor and prime broker or the composition of Fund I's assets, and Respondents have not introduced evidence about the legal advice they sought or received.

Respondents also contend that they were denied "fair notice" because the Order Instituting Proceedings ("OIP") contained no allegations concerning "target ownership percentages in the [PPM] related to insurance policies." This contention is meritless because the OIP alleged that Respondents' "marketing materials for the Funds contained material misrepresentations about the Funds' . . . allocation of assets."[46] In any event, the record shows that Respondents "understood the issue and [were] afforded full opportunity to justify [their] conduct during the course of the litigation."[47] The parties fully litigated the issue before the ALJ, and Respondents did not assert that they lacked fair notice until this appeal. Nor have Respondents asserted or shown prejudice—they have not identified evidence or defenses they would have proffered had they better understood the charges against them.[48]

B. Respondents violated the antifraud provisions by knowingly or recklessly making material misstatements and omissions about asset valuations.

Respondents represented in the Funds' financial statements that JTCM followed generally accepted accounting principles ("GAAP") in valuing the Funds' assets, including GAAP's definition of "fair value." The Funds' Limited Partnership Agreements—entered into between the Funds' general partner (*i.e.*, JTCM) and limited partners (*i.e.*, investors)—stated that JTCM would value assets such as those discussed below "at fair value" or at "such value as [JTCM] may reasonably determine." We find numerous instances in which Respondents failed to value assets at their fair or reasonable value and misrepresented those asset valuations in the Funds' financial statements and the account statements they provided to investors.

1. Respondents misrepresented the value of the Funds' assets in financial statements and monthly account statements.

Under the PPMs, the Funds paid JTCM fees based on JTCM's "good faith" valuations of the Funds' holdings. These fees consisted of: (i) a management fee of 2% of the Funds' total net asset value ("NAV"); and (ii) a performance fee, from Fund II only, of 20% of any appreciation

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46 *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Exchange Act Release No. 69208, 2013 WL 1180836, at *8 (March 22, 2013).

47 *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (internal quotation marks omitted); *see also Clawson v. SEC*, No. 03-73199, 2005 WL 2174637, at *1 (9th Cir. Sept. 8, 2005) (finding notice sufficient where the facts ultimately found were "consistent with" and "subsumed in" the theory alleged in the OIP); *James L. Owsley*, Exchange Act Release No. 32491, 1993 WL 226056, at *4 (June 18, 1993) (stating that a defect in an administrative pleading "can be remedied if the record demonstrates that the respondent understood the issue and was afforded a sufficient opportunity to justify his conduct").

48 *See Aloha Airlines, Inc.*, 598 F.2d at 262.

above 7% in Fund II's total NAV. Although Fund I's PPM also included a performance fee provision, the record does not show that Fund I paid such a fee.

Jarkesy determined the valuations for JTCM, which in turn reported them to investors in the Funds' year-end financial statements. Respondents also sent investors monthly account statements that reported individual account values based on the value of the Funds' holdings. Through December 31, 2010, the Funds paid JTCM management fees of $1,278,597, and Fund II paid JTCM performance fees of $123,338.38.

From 2008 to 2011, Respondents grossly overvalued certain of the Funds' holdings. In doing so, they contravened assertions in the Funds' financial statements that, for all valuations, JTCM applied GAAP's definition of "fair value"—"the price that would be received to sell an asset . . . in an orderly transaction between market participants at the measurement date."[49] As a result, the Funds issued misleading statements to investors and paid Respondents excessive fees.

a. America West

Respondents overvalued the Funds' investment in America West by failing to write down defaulted notes. By the end of 2009, America West had defaulted on $1,330,000 in notes issued to Fund I. But Respondents did not write down the value of the notes at year-end 2009 or throughout 2010. The Funds made additional loans to America West in 2010. By year-end, America West had defaulted on $1,710,000 in notes issued to the Funds. But Respondents did not write down the value of the notes at year-end 2010.

Respondents contend that they did not write down the notes because they expected JTF to provide financing to America West to enable it to pay off the notes. But it was unreasonable for Respondents to assume, in determining "fair value" under GAAP, that the Funds would be able to sell the defaulted notes for their par value based on the possibility of future financing.[50]

b. Radiant

Respondents' valuation of the Funds' investment in the stock and warrants of Radiant Oil & Gas, Inc., was also inflated.[51] Because Radiant's stock traded infrequently—including from September 2009 to December 2010 when no one traded it on the open market—Respondents decided as early as 2008 to base "fair value" not on the quoted price but rather on their own assumptions as to the price at which the Funds would be able to sell the stock. For example, Radiant's stock had a quoted price of $0.12 per share from September 10, 2009 to December 16,

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49 Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820-10-20 (and its predecessor Financial Accounting Standards No. 157 ¶ 5).

50 *See, e.g.*, *The Heritage Org. LLC*, 413 B.R. 438, 504 (Bankr. N.D. Tex. 2009) (rejecting as "not credible" testimony that the fair value of defaulted notes was its "face value"), *aff'd*, 544 F. App'x 512 (5th Cir. 2013).

51 In April 2010, G/O Business Solutions changed its name to Radiant Oil & Gas, Inc.

2010, but Respondents valued it at \$0.06 per share from March 2009 to March 2010, \$0.30 per share from April to July 2010, and \$1.00 per share from August 2010 to December 2010.[52]

Nevertheless, at the end of 2010, Respondents changed their valuation method to take advantage of a more than 3,000% increase in the quoted price of Radiant's stock from \$0.12 to \$4.00 per share on December 17, 2010 (where the price finished the year). Respondents did not disclose the change in fair valuation technique to the Funds' investors despite the fact that such disclosure is required by GAAP, and they have not provided a justification for the change.

Respondents' change in valuation method was inconsistent with their decision more than a year earlier to continue valuing Radiant's stock at \$0.06 per share from March 2009 to March 2010 even though the quoted price was greater throughout that period. But the change allowed Respondents to take advantage of their own actions. Respondents caused the 3,000% increase in the quoted price in December 2010 by hiring a firm to promote Radiant's stock in postings on the firm's websites and emails to the firm's approximately 5,000 subscribers.

Respondents contend that the quoted price did not increase because of the promotional campaign but rather due to Radiant's acquisition of Jurasin Oil & Gas, Inc. in August 2010, issuance of 1,215,000 shares for \$1,215,000 in a private offering on November 17, 2010, and receipt of debt financing in the last quarter of 2010. But the first two events happened before the December 2010 promotional campaign and did not result in any price movement; indeed, there was no open-market trading of Radiant stock between September 10, 2009 and December 17, 2010. And the last event is based solely on Jarkesy's uncorroborated testimony.

Respondents also contend that there is no evidence that it was improper to pay third parties to render their professional opinions. But Respondents' liability is not based on the fact that they paid the promotional firm or on the firm's work. It is based on Respondents' overvaluations in the financial statements and monthly account statements that were not reasonable and were only purportedly supported by an arbitrary and unreasonable change in their valuation method. Indeed, the price increase resulting from the promotional campaign was inconsistent with Radiant's significant financial problems at the time. Radiant's Form 10-K for year-end 2010, which Jarkesy signed as a director of the company, reported that conditions at Radiant "raise[] substantial doubt as to [its] ability to continue as a going concern."

Moreover, for the monthly account statements dated January 31, 2011, Respondents arbitrarily changed their valuation method back to using their own assumptions. This let them value Radiant's warrants at prices in excess of the stock's quoted price.[53] At the time, the Funds owned 125,000 warrants to purchase Radiant stock at an exercise price of \$1.00 per share. Although the quoted price for Radiant stock was \$2.25 per share on January 31, Respondents valued the warrants at \$6.92 per warrant. When the Funds' administrator questioned the valuation for the warrants, stating that Respondents had last priced them at \$0.12 per warrant in

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52 These increases coincided with reverse stock splits.

53 A warrant "is a contractual right to purchase a security at a specified exercise price within the term of the contract." Harold S. Bloomenthal & Samuel Wolff, *Securities and Federal Corp. Law* § 2:91 (2d ed. 2016).

August 2010, JTCM's controller responded in an email: "I know the stock price was crazy in Jan[uary] for [Radiant]. Checked with George [Jarkesy] and he said to run with it at $6.92."

c. Galaxy

Respondents also overvalued the Funds' investment in Galaxy Media & Marketing Corp. Galaxy was formed in April 2010 through the merger of Amber Ready, Inc. and CK41 Direct, Inc. The Funds had been invested in Amber Ready's non-publicly traded stock since 2009, and continued to own millions of shares of Galaxy after the merger. Galaxy's stock also was not publicly traded and had no quoted price, so Respondents based its "fair value" on their assumptions as to the price at which the Funds could sell it. But Respondents continually increased their valuation of Galaxy's stock despite knowing it was essentially worthless.

Belesis (a significant investor in Amber Ready and its investment banker) emailed Jarkesy that Galaxy needed all money raised from the merger or it would "go out of business."[54] After the merger, Respondents received a series of requests from Galaxy for "urgently needed" financing because Galaxy was "without any money to operate." Respondents concede that—as Gary Savage, Galaxy's CEO, testified—"[a]ll along" Savage told "Jarkesy that [Galaxy's] shares weren't worth anything because the company had no real assets and no funding."

Galaxy's financial statements corroborated this conclusion. On October 1, 2010, Galaxy sent Jarkesy its financial statements showing that from mid-2005 to mid-2010, Amber Ready and CK-41 together had over $18 million in net losses and $45,198 in total revenues, and that Galaxy had over $36 million in liabilities and $5.6 million of assets. On February 11, 2011, Galaxy filed an amended Form S-1 Registration Statement which stated that its net losses—$75,808,771 in 2009 and $9,835,053 in 2008—"raise substantial doubt about [its] ability to continue as a going concern," that it did "not have any contracts or commitments for additional funding" needed to "continue [its] operations," and that it had a negative $0.80 net tangible book value per share.

Nevertheless, Respondents greatly inflated their valuation of Galaxy's stock. Respondents, who had been valuing Amber Ready's and then Galaxy's stock at $0.30 per share, increased their valuation by 1,000% to $3.30 per share in July 2010. They maintained that valuation for two months, then decreased it to $1.00 per share in September 2010 and to $0.80

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[54] We grant Respondents' January 13, 2015 motion and overrule the Division's objection to admit Belesis' March 13, 2014 affidavit. The affidavit, which Respondents procured, recites excerpts from Belesis' investigative testimony and avers that "if asked the following questions posed during that investigative testimony, [Belesis] would give the same answers." Although the ALJ declined to admit the affidavit, she did admit into evidence the proffered excerpts from Belesis' investigative testimony as well as the Division's counter-designations. We give minimal weight to an affidavit that does no more than quote and reaffirm earlier sworn testimony, especially given Respondents' representation that Belesis would assert his Fifth Amendment Privilege against self-incrimination and decline to testify if called at the hearing. *See, e.g.*, *United States v. $133,420.00 in U.S. Currency*, 672 F.3d 629, 642 (9th Cir. 2012); *United States v. Parcels of Land*, 903 F.2d 36, 43 (1st Cir. 1990). Nonetheless, we admit the affidavit and have considered Belesis' investigative testimony in making our factual findings.

per share in October 2010—amounts that were 233% and 167% greater than the prior $0.30 per share valuation. These valuations were arbitrarily inflated because they had no reasonable basis and ran counter to Galaxy's significant financial problems.

Respondents contend that their revaluations coincided with a reverse stock split and Galaxy's issuance of penalty shares for missing registration statement deadlines. But the reverse stock split occurred in April 2010. Respondents do not explain why the reverse stock split would justify increasing the stock price by 1,000% three months later in July 2010. Nor do they explain why, if the reason they increased the stock price three months later in July 2010 was to account for a reverse stock split, they reduced the stock price two months after that in September 2010. Galaxy's issuance of penalty shares cannot account for the reevaluation to $1.00 per share in September 2010 because Galaxy's first issuance of penalty shares occurred in October 2010, and Galaxy's second issuance of penalty shares occurred in January 2011.

Respondents also contend that the stock price was affected by (i) financing for Galaxy from the Funds and JTF "appear[ing] to be in place" until JTF failed to "live up to its promise to provide" the financing; and (ii) Galaxy issuing 25 million shares and then rescinding that issuance. But Respondents do not explain how these events justified the overvaluation. And the latter contention is based solely on Jarkesy's uncorroborated testimony, which we do not credit.

In addition to overvaluing Galaxy's stock, Respondents overvalued the Funds' $278,235 investment in Galaxy notes by failing to write down their value during the first half of 2011 after Galaxy defaulted on them in December 2010 and January 2011.[55] Respondents contend that they waited to write down the defaulted notes until July 2011 because they expected JTF to provide financing to Galaxy to enable it to pay off the notes. But it was unreasonable for Respondents to assume, in determining "fair value" under GAAP, that the Funds would be able to sell the defaulted notes for their par value based on the possibility of future financing.[56]

d. Restricted stock

Respondents overstated Fund I's investment in the restricted stock of various issuers by valuing the stock price at or greater than the quoted price for the issuers' free trading stock. For example, Respondents valued Fund I's investment in 296,000 restricted shares of Red Roller Holdings Inc. at a price greater than the quoted price for the issuer's free trading stock in March, June, and July 2008. Respondents also valued Fund I's investment in restricted stock at the same price as the issuer's free trading stock with respect to (i) the Red Roller shares from December 2007 to February 2008 and in August 2008; (ii) 500,000 shares of Sahara Media Holdings Inc. in October 2008; (iii) 150,000 shares of Nevada Gold Holdings in January 2009; (iv) 1,000,000 shares of Foster Drilling Corp. in February 2009; and (v) 17,879,999 shares of America West in September 2009. These valuations violated GAAP's requirement that the fair value of a restricted security "be based on the quoted price for an otherwise identical unrestricted security

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55 Respondents decreased their valuation of Galaxy's stock to $0.10 per share in December 2010, $0.02 per share in May 2011, and $0.00 per share in July 2011. Respondents eventually wrote down the value of the four notes to $279.03 in July 2011.

56 *See supra* note 50.

of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction."[57] "The adjustment would reflect the amount market participants would demand because of the risk relating to the inability to access a public market for the security for the specified period."[58] Yet Respondents made no such adjustment here.

Respondents contend that, as to Red Roller, the Division introduced no evidence specific to the company concerning the valuation of its stock. But Respondents stated in the Funds' financial statements that JTCM applied GAAP's definition of fair value, and GAAP required that the restricted nature of any securities be taken into consideration in valuing them. The Division introduced evidence that Respondents nonetheless valued Red Roller's restricted stock greater than Red Roller's free trading stock, and Respondents failed to provide any justification for their valuations of Red Roller's restricted stock to counter the Division's contention that its restricted stock should not have been valued greater than its free trading stock.[59]

e. Life settlement policies

Respondents overvalued Fund I's life settlement policies. Fund I bought five life settlement policies in April 2009. In that same reporting period, Respondents increased Fund I's valuation of the policies by $1,112,567 above their cost (*i.e.*, from $1,195,000 to $2,307,567). This violated GAAP's requirement that when third-party investors in life settlement policies use the fair value method, they "recognize the initial investment at the transaction price" and not "remeasure the investment at fair value" until subsequent reporting periods.[60]

2. Respondents' misrepresentations were material and made with scienter.

Respondents' misstatements about the value of the Funds' holdings were material. The valuation of an investment is of paramount importance to any reasonable investor.[61] Moreover, the overvaluations here were substantial both individually and in the aggregate.

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57 FAS 157 ¶ A.29 (2008).

58 *Id.*

59 *Cf. Worcester Cty. Tr. Co. v. Comm'r of Internal Revenue*, 134 F.2d 578, 582 (1st Cir. 1943) ("A commodity freely salable is obviously worth more on the market than a precisely similar commodity which cannot be freely sold.").

60 FASB Staff Position No. FTB 85-4-1 (March 27, 2006).

61 *See SEC v. Seghers*, 298 F. App'x 319, 330 (5th Cir. 2008) (affirming finding that misrepresentations overvaluing fund holdings were material because the "value of an investor's account and the month-to-month performance of the [f]unds are indisputably relevant to the investor's investment decision"); *see also SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at *20 (S.D. Fla. Sept. 24, 2008) (finding misrepresentations and omissions regarding a fund's portfolio valuation, which the fund's manager had "artificially inflat[ed]," to be "clearly material"), *aff'd*, 478 F. App'x 550 (11th Cir. 2012).

Respondents acted with scienter because Jarkesy controlled the Funds' valuations. As an experienced securities professional with a professed ability to value securities, Jarkesy knew or must have known that defaulted notes are not worth their par value, that valuation methods cannot be switched arbitrarily, and that the fair value of infrequently and non-publicly traded stock does not increase by many multiples in periods when no positive events occurred. Jarkesy also knew or must have known that the fair value of restricted stock is not equal to or greater than that of the issuer's free trading stock absent a reason for such valuation, and that life settlement policies cannot have their fair values double immediately after purchase.

Our finding that Respondents acted with scienter is supported by their motive to increase their fees by artificially inflating the value of the Funds' holdings. We have long held that a "pecuniary motive for engaging in the . . . scheme" is "circumstantial evidence of . . . scienter."[62]

3. Respondents' contentions concerning their asset valuations lack merit.

Respondents contend that the Division failed to establish that Respondents' valuations violated GAAP because it did not call a witness with knowledge of valuing the assets at issue. But we need not defer to an expert in determining whether Respondents violated GAAP.[63] Here, the GAAP standards did not require clarification, and it is clear the respondents had no reasonable basis for their valuations given the information available to them.

Respondents also blame the overvaluations on third parties, including the Funds' administrator, auditor, and counsel. According to Respondents, the Funds' administrator "influenced" valuations and "insisted on changes to valuations . . . by JTCM." The record shows, however, that Respondents were responsible for the valuation of the Funds' holdings, and that third parties relied on Respondents for those valuations.[64] For example, Respondents overrode objections by the Funds' administrator to valuing Radiant warrants at $6.92 per warrant and to valuing restricted America West stock at the same price as the issuer's free-trading stock.

Respondents contend that there is no evidence that the Funds' financial statements "were not prepared in good faith in a manner consistent with the Partnership's [*i.e.*, the Funds'] written guidelines in the Limited Partnership Agreement[s]." But Respondents represented that JTCM

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62 *Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *9 (Dec. 11, 2009), *petition denied*, 627 F.3d 1230 (D.C. Cir. 2010); *Fields*, 2015 WL 728005, at *16 ("Fields had a motive for overstating AFA's assets, which provides additional circumstantial evidence of his scienter." (internal quotation and alteration omitted)); *see also SEC v. Koenig*, 557 F.3d 736, 740 (7th Cir. 2009) (finding it unnecessary to prove a motive to establish securities fraud).

63 *See Gregory M. Dearlove, CPA*, Exchange Act Release No. 57244, 2008 WL 281105, at *20 (Jan. 31, 2008) ("The Commission may consider expert testimony, but it is not bound by such testimony even where it is available, and the absence of expert testimony does not preclude the Commission from making necessary findings with respect to principles of accounting."), *petition denied*, 573 F.3d 801 (D.C. Cir. 2009).

64 We note that the Funds' administrator used third-party valuations (*e.g.*, Bloomberg L.P.) where available for certain of the Funds' assets, but not for the assets at issue here.

followed GAAP in preparing the Funds' financial statements. Yet Respondents did not follow GAAP in valuing the assets at issue here. Nor were Respondents' valuations consistent with the Funds' Limited Partnership Agreements. For example, the Limited Partnership Agreements stated that assets such as those discussed above would be valued "at fair value" or at "such value as [JTCM] may reasonably determine," but we have found numerous instances where Respondents failed to value assets at their fair or reasonable value.

II. Sanctions

A. Industry and penny stock bars

Investment Company Act Section 9(b) authorizes us to bar a person from association with an investment company if we find that the person willfully violated the federal securities laws and such a bar is in the public interest.[65] Advisers Act Section 203(f) authorizes us to bar a person who willfully violated the federal securities laws from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization if we find that, at the time of the misconduct, the person was associated with an investment adviser and that such a bar is in the public interest.[66] Exchange Act Section 15(b)(6) also authorizes us to impose such a bar, as well as a bar from participating in the offering of penny stock, on a person who willfully violated the federal securities laws if the person participated in a penny stock offering at the time of the misconduct and such bars are in the public interest.[67]

As discussed above, Jarkesy violated antifraud provisions of the federal securities laws. Jarkesy does not dispute that he acted willfully, and we find that he did because he acted with scienter. We also find, and Jarkesy does not dispute, that at the time of his misconduct he was associated with JTCM, an unregistered investment adviser, as its owner and manager.[68] And Jarkesy participated in a penny stock offering at the time of his misconduct. As a director of, and investor and manager of Funds invested in, Radiant—a penny stock issuer[69]—Jarkesy orchestrated a campaign to promote the stock of that issuer.[70]

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[65] 15 U.S.C. § 80a-9(b).

[66] 15 U.S.C. § 80b-3(f).

[67] 15 U.S.C. § 78*o*(b)(6).

[68] *See* 15 U.S.C. § 80b-2(a)(17) (defining "person associated with an investment adviser").

[69] *See* Exchange Act Section 3(a)(51)(A), 15 U.S.C. § 78c(a)(51)(A); Exchange Act Rule 3a51-1, 17 C.F.R. § 240.3a51-1 (defining a "penny stock" to include "any equity security other than a security . . . that has a price of five dollars or more").

[70] *See* Exchange Act Section 15(b)(6)(C), 15 U.S.C. § 78*o*(b)(6)(C) (defining "person participating in an offering of penny stock" to include "any person acting as any promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock."); *cf. Harold F. Harris*, Exchange Act Release No. 53122A, 2006 WL 307856, at *4 (Jan. 13, 2006) (finding that officers of penny stock issuer who

(footnote continued . . .)

In determining whether bars are in the public interest we consider, among other things, 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 conduct, and the likelihood that the respondent's occupation will present opportunities for future violations.[71]

Jarkesy's misconduct was egregious, recurrent, and at least reckless. For over three years, Jarkesy repeatedly misled investors and prospective investors, thereby increasing the fees he collected from his clients.[72] "[W]e have consistently viewed misconduct involving a breach of fiduciary duty or dishonest conduct on the part of a fiduciary . . . as egregious."[73]

Jarkesy has not recognized the wrongful nature of his misconduct; instead he has attempted to blame the Funds' administrator, auditor, and counsel. Nor has Jarkesy supplied assurances against future violations. And considering his occupation as a fund manager and investment adviser, he will be presented with opportunities to violate the securities laws in the future. Jarkesy contends that he has no intention to serve as a fund manager or investment adviser, but absent a bar there would be nothing to prevent him from reentering the industry.

(. . . footnote continued)
drafted or reviewed documents the issuer "used to attempt to induce investors to purchase" its stock were persons "participating in an offering of penny stock").

71 *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, *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)), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

72 Respondents sought to subpoena tax returns and investment account statements from the investors who testified at the hearing. The ALJ correctly limited the scope of these subpoenas because this information was not relevant to any issue in the proceeding. The OIP does *not* allege that the Funds were sold to non-accredited investors or that they were unsuitable investments under FINRA guidelines. Investor sophistication is not a factor when evaluating materiality, *e.g.*, *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1535 (2d Cir. 1991); *see also Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184, 1191 (2013), and although it may bear on the reasonableness of reliance in other contexts, reliance is not an element of an enforcement action brought by the Commission, *e.g.*, *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012). Nor have we considered the investors' sophistication (or lack thereof) in assessing the egregiousness of respondents' conduct for purposes of sanctions. Finally, respondents were not prejudiced by the limitation of the subpoenas. The ALJ gave Respondents significant latitude in cross-examining the witnesses about their sophistication and risk tolerance, and they successfully elicited that one of the Funds' investors was an accountant, received an MBA in finance, and had previously invested in mutual funds and individual stocks.

73 *James C. Dawson*, Advisers Act Release No. 3057, 2010 WL 2886183, at *4 (July 23, 2010).

We conclude that Jarkesy poses a significant danger to investors, and that bars will prevent him from putting investors at further risk. Accordingly, we find it in the public interest to bar Jarkesy from the securities industry and from participating in a penny stock offering.[74]

Respondents contend that Jarkesy should not be barred because he was not a registered securities professional and JTCM was not registered. But Respondents acknowledge that this factor "is not a barrier to" a bar, and courts and the Commission have held that the Commission has authority under Advisers Act Section 203(f) to bar persons associated with unregistered investment advisers.[75] Moreover, Exchange Act Section 15(b)(6) and Investment Company Act Section 9(b) do not require that Jarkesy be a registered securities professional or JTCM a registered investment adviser in order for us to bar him to protect the public.[76]

B. Cease-and-desist order

Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) authorize us to issue cease-and-desist orders on any person who has violated the federal securities laws.[77] In determining whether to issue such an order, we look to whether there is some risk of future violation.[78] The risk "need not be very great" and is ordinarily established by a single past violation absent evidence to the contrary.[79] We also consider whether other factors demonstrate a risk of future violations, including the public interest factors discussed above as well as 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.[80]

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[74] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), expanded the categories of associational bars that Advisers Act Section 203(f) and Exchange Act Section 15(b)(6) authorize and allowed the Commission to impose a bar on participation throughout the securities industry. Respondents' misconduct after Dodd-Frank's effective date included overvaluing defaulted notes, Radiant stock and warrants, and Galaxy stock in financial statements and monthly account statements, and making misrepresentations in a newsletter. We are relying solely on Respondents' post-Dodd-Frank conduct in imposing the industry-wide bar.

[75] *See, e.g., Teicher v. SEC*, 177 F.3d 1016, 1017-18 (D.C. Cir. 1999).

[76] *See John Kilpatrick*, Exchange Act Release No. 23251, 1986 WL 626187, at *5 (May 19, 1986).

[77] 15 U.S.C. §§ 77h-3(a), 78u-3(a), 80a-9(f), 80b-3(k).

[78] *Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at *8 n.34 (Aug. 5, 2011).

[79] *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *24 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

[80] *Id.* at *26.

Here, Respondents' violations, the egregiousness of their misconduct, and the other public interest factors discussed above establish a risk of future violations. Accordingly, we find it in the public interest to order Respondents to cease and desist from committing or causing any violations or future violations of the antifraud provisions.

C. Civil money penalties

Securities Act Section 8A, Exchange Act Section 21B, Advisers Act Section 203(i), and Investment Company Act Section 9(d) authorize us to impose civil money penalties for willful violations of the securities laws when such penalties are in the public interest.[81] In determining the public interest, we consider: (1) whether the act or omission involved fraud; (2) whether the act or omission resulted in harm to others; (3) the extent to which any person was unjustly enriched; (4) whether the individual has committed previous violations; (5) the need to deter such person and others from committing violations; and (6) such other matters as justice may require.[82] A three-tier system establishes the maximum penalty that may be imposed for each violation found. A third-tier penalty may be warranted for "each act or omission" involving fraud that, directly or indirectly, resulted in (or created a significant risk of) substantial losses to other persons or resulted in substantial gains to the wrongdoer.[83]

We find that civil money penalties are in the public interest. Respondents repeatedly engaged in fraudulent misconduct that significantly harmed investors in the Funds and unjustly enriched themselves. Their conduct was highly egregious and at least reckless, and warrants the imposition of civil money penalties as a deterrent to Respondents and others. Respondents' lack of a disciplinary history does not outweigh such considerations.[84]

Third-tier penalties are warranted because Respondents' fraud resulted in substantial losses to investors and substantial gains to themselves. Respondents' misconduct caused investors to invest or remain invested in the Funds, and Respondents stated that the Funds had lost around $15 million by the time of the hearing. Respondents also received excessive fees from the Funds based on their overvaluation of the Funds' holdings.

We impose two maximum third-tier penalties—one for Respondents' misrepresentations and omissions in the marketing materials and in their other communications with investors, and one for Respondents' overvaluation of Fund assets.[85] The maximum third-tier penalty for natural

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81 15 U.S.C. §§ 77h-1(g)(1), 78u-2, 80a-9(d), 80b-3(i).

82 15 U.S.C. §§ 78u-2, 80a-9(d), 80b-3(i).

83 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3), 80a-9(d)(2), 80b-3(i)(2)(C).

84 *Cf. Dembski*, 2017 WL 1103685, at *16 (finding that "the egregiousness of [respondent's] misconduct and the need for appropriate deterrence outweigh any consideration of the lack of a prior disciplinary history in imposing third-tier civil penalties").

85 *See Fields*, 2015 WL 728005, at *24 n.162 (noting that, although the statute authorizes penalties for certain acts or omissions, it "leaves the precise unit of violation undefined"); *cf. Steven E. Muth*, Exchange Act Release No. 52551, 2005 WL 2428336, at *19 (Oct. 3, 2005) ("[W]e believe that a civil money penalty based on the number of customers that Muth defrauded

(footnote continued . . .)

persons for the period of Respondents' violations is $150,000.[86] Accordingly, we impose a total civil money penalty of $300,000 on Respondents jointly and severally.[87]

Respondents contend that we cannot impose civil money penalties for conduct that predated the Dodd-Frank Act's effective date—July 21, 2010—because we would be impermissibly applying its enhanced penalty provisions retroactively. But Respondents' misconduct after July 21, 2010, warrants the civil money penalties imposed.[88] In any case, the Dodd-Frank Act is not what authorizes us to impose civil money penalties in this proceeding. Although Section 929P(a) of Dodd-Frank amended the federal securities laws by authorizing us to impose civil money penalties in administrative proceedings that were instituted to determine whether a person should be ordered to cease-and-desist from violating the securities laws,[89] prior to Dodd-Frank we had authority to impose civil money penalties in administrative proceedings that were instituted to determine whether a person should be suspended or barred from associating in certain capacities in the securities industry.[90] As discussed above, this is such a proceeding.

D. Disgorgement

Securities Act Section 8A(e), Exchange Act Sections 21B(e) and 21C(e), Advisers Act Section 203, and Investment Company Act Section 9(e) authorize us to order disgorgement in this proceeding.[91] Disgorgement deprives wrongdoers of the net profits obtained from their violations.[92] Calculating disgorgement requires only a reasonable approximation of net profits

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(. . . footnote continued)
. . . is appropriate."). *See generally Brendan E. Murray*, Advisers Act Release No. 2809, 2008 WL 4964110, at *12 (Nov. 21, 2008) (stating that within the statutory framework governing civil money penalties "we have discretion in setting the amount of penalty").

86 *See* 17 C.F.R. § 201.1001.

87 The ALJ imposed a third maximum third-tier penalty of $150,000 (for a total of $450,000) on Respondents for material misrepresentations and omissions relating to their "relationship with JTF/Belesis." As discussed *infra* note 107, we make no findings on that issue and the sanctions we have imposed are not premised on it. Because Jarkesy is JTCM's sole owner, and it is through Jarkesy's conduct that JTCM's violations occurred, joint and several liability is appropriate for the amount of the civil penalty that we do impose. *Donald L. Koch*, Exchange Act Release No. 31047, 2014 WL 1998524, at *25 n.246 (May 16, 2014), *petition granted in part on other grounds and denied in part*, 793 F.3d 147 (D.C. Cir. 2015).

88 *See supra* note 74.

89 *See* Pub. L. No. 111-203, 124 Stat. 1376, 1862-65 (July 21, 2010).

90 *See* 15 U.S.C. §§ 78u-2, 80a-9(b), (d), 80b-3(f), (i).

91 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e), 80a-9(e), 80b-3(j), (k).

92 *Montford and Co., Inc. v. SEC*, 793 F.3d 76, 83 (D.C. Cir. 2015); *see also Liu v. SEC*, 140 S. Ct. 1936, 1940, 1946 (2020) (holding that disgorgement of net profits may qualify as equitable relief for purposes of Exchange Act Section 21(d)(5)).

causally connected to the violation.[93] Once the Division shows that its disgorgement figure is a reasonable approximation of the amount of the net profits, the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation.[94] Where disgorgement cannot be exact, the burden of uncertainty in calculating net profits falls "on the wrongdoer whose illegal conduct created that uncertainty."[95]

The Division has shown that the $1,401,935.38 in management and performance fees JTCM received through December 31, 2010, is a reasonable approximation of Respondents' net profits causally connected to their violations.[96] Respondents have not offered an alternative disgorgement amount or proposed what portion of their fees should be disgorged. Rather, Respondents contend that disgorgement of all fees is appropriate only as to "ventures that are completely fraudulent" and that JTMC's fees do not necessarily equal its net profits because it had expenses on behalf of the Funds. But ordering that Respondents disgorge all of their fees is appropriate. Respondents' fraud concerned the decision to invest in and remain invested in the Funds. Investors invested funds with Respondents as a result of the fraud, and the fees Respondents received represent their profits from the fraud.[97] And because Respondents

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93 *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989).

94 *Id.* at 1232.

95 *Id.*; *see also SEC v. Razmilovic*, 738 F.3d 14, 31 (2d Cir. 2013) ("[B]ecause of the difficulty of determining with certainty the extent to which a defendant's gains resulted from his frauds . . . the court need not determine the amount of such gains with exactitude."); Restatement (Third) of Restitution § 51(5)(c)-(d) & cmt. I (stating that "the claimant has the burden of proving revenues and the defendant has the burden of proving deductions," that if the claimant submits a reasonable approximation of the gain the "defendant is then free . . . to introduce *evidence* tending to show that the true extent of unjust enrichment is something less," and that any "uncertainty in calculating net profit is assigned to the defendant" since "the uncertainty arises from the defendant's wrong") (emphasis added).

96 We agree with the Division that when the ALJ ordered disgorgement of management fees ($1,278,597), she overlooked performance fees ($123,338.38), and that those amounts together are a reasonable approximation of JTCM's net profits.

97 *See Dembski*, 2017 WL 1103685, at *15 (ordering 50% owner of general partner for hedge fund to disgorge his share of fees paid by the fund to the general partner, which he received as a result of inducing his clients to purchase $4 million in limited partnership interests in the fund by misrepresenting the fund's investment strategy and projected returns and the professional background of a fund manager); *Joseph John VanCook*, Exchange Act Release No. 61039A, 2009 WL 4026291, at *17 (Nov. 20, 2009) (ordering disgorgement of all management fees earned from seven accounts held by a client even though the client had engaged in late trading in only two accounts because the client maintained all seven accounts as a result of respondent's offer to allow late trading), *petition denied*, 653 F.3d 130 (2d Cir. 2011).

introduced no evidence of any expenses paid out of those fees on behalf of the Funds,[98] there are no legitimate expenses in the record to deduct from the amount of the fees.[99]

Respondents seek an offset for the Funds' two distributions to investors (proceeds from a life settlement policy in 2011 and shares in Radiant stock in 2013). But we are not ordering that Respondents disgorge the money they deceived investors to invest in the Funds. Thus, the two distributions are irrelevant to our disgorgement calculation; they were a return on investment, not a refund of Respondents' ill-gotten fees. We also have not factored in the Funds' substantial losses in calculating disgorgement, which far outweigh the distributions. Jarkesy's contention that he lost his own money by investing in or loaning money to the Funds is likewise irrelevant.[100] We are ordering disgorgement from JTCM, not from Jarkesy.

Respondents contend that the Division "failed to present sufficient evidence showing the amount of fees paid from the Funds to the Advisor." But the Division established the payments by introducing the Funds' financial statements and Fund II's bank account transaction spreadsheet, which show that the Funds paid $1,401,935.38 to JTCM. For the reasons discussed above, we find $1,401.935.38 to be a reasonable approximation of JTCM's net profits from its wrongdoing.[101]

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98 The Supreme Court decided *Liu*, supra note 92, on June 22, 2020. In *Liu*, the court stated that "courts must deduct legitimate expenses before ordering disgorgement under" Exchange Act Section 21(d)(5). Respondents had numerous opportunities to introduce evidence of their expenses previously, and following *Liu* also could have made a motion to adduce additional evidence of their expenses under Rule of Practice 452. *See* 17 C.F.R. § 201.452 (stating that a "party may file a motion for leave to adduce additional evidence at any time prior to issuance of a decision by the Commission"). Respondents have not filed such a motion.

99 *See optionsXpress, Inc.*, Exchange Act Release No. 78621, 2016 WL 4413227, at *36 & nn.131-32 (Aug. 18, 2016) (recognizing that even when a respondent may be "'entitled to a deduction for all *marginal* costs incurred in producing the revenues that are subject to disgorgement,'" the respondent must provide evidence to substantiate such an offset, since the "risk of uncertainty" properly falls on the wrongdoer) (quoting Restatement (Third) of Restitution § 51 cmt. H); *see also Liu*, 140 S. Ct. at 1940, 1946, 1950 (holding that, in a district court action, disgorgement that does not exceed "net profits from wrongdoing" qualifies as "equitable relief" available under Exchange Act Section 21 and that as a result "courts must deduct legitimate expenses before ordering disgorgement").

100 *See Seghers*, 298 F. App'x at 336-37 (holding that district court erred in denying disgorgement on the ground that defendant lost his own money in the hedge funds because "[a]ny profits that [defendant] obtained by wrongdoing are ill-gotten gains whether he retained them or lost them in the [funds] or another investment").

101 *See* Restatement (Third) of Restitution § 51(4) (stating that disgorgement is a remedy that seeks to "eliminate profit from wrongdoing" and that the "unjust enrichment of a conscious wrongdoer . . . is the net profit attributable to the underlying wrong").

Nonetheless, because *Kokesh v. SEC* held that disgorgement is a penalty for purposes of the five-year statute of limitations in 28 U.S.C. § 2462 applicable to actions seeking a "fine, penalty, or forfeiture,"[102] we limit disgorgement to the $1,064,935.38 in fees from 2009 and 2010. Also, we offset that amount by $380,000 that Respondents paid investors to settle a class action.[103] Accordingly, we order JTCM to disgorge $684,935.38, plus prejudgment interest.

Respondents argue that, under *Kokesh*, disgorgement "is subject to the maximum cap[] imposed by statute" for civil money penalties of $150,000 per third-tier violation and that the disgorgement ordered here exceeds that cap and is duplicative of the $450,000 civil money penalty the ALJ imposed. But "the sole question presented" in *Kokesh* was whether a particular pecuniary sanction—disgorgement—constituted a fine, penalty, or forfeiture "within the meaning of § 2462."[104] *Kokesh* applied Section 2462's five-year statute of limitation to disgorgement actions. It did not hold that disgorgement was the same as the civil money penalties the Commission is authorized to impose under the securities laws.[105] Congress's statutory enactments make clear that the Commission is authorized to order disgorgement *in addition* to civil money penalties, and the statutory limits apply only to civil money penalties.[106]

Finally, Respondents contend that disgorgement and the other sanctions we are imposing are unwarranted because they are harsher than those we imposed in similar cases and on two parties who settled this proceeding: Belesis and JTF.[107] But Respondents have not identified

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102 *See Kokesh v. SEC*, 137 S. Ct. 1635, 1645 (2017) (quoting 28 U.S.C. § 2462).

103 *See e.g., Larry C. Grossman*, Exchange Act Release No. 79009, 2016 WL 5571616, at *22 (Sept. 30, 2016) ("Because the claims at issue in the arbitration overlap with Grossman's violations, we conclude as an equitable matter that the amount of disgorgement . . . should be reduced by . . . the amount he paid to settle the arbitration."), *vacated on other grounds*, No. 16-16907 (11th Cir. Aug. 11, 2017). Respondents made a total settlement payment to investors of $500,000. But because we included in disgorgement only 76% of the fees paid to JTCM, we offset disgorgement by 76% of Respondents' settlement payment. Also, we reject Respondents' request to offset disgorgement by $1,550,000 that JTF, Belesis, and MFR Group, Inc. (the Funds' former auditor) paid to investors to settle the class action. *See Ralph Calabro*, Exchange Act Release No. 75076, 2015 WL 3439152, at *44 & n.226 (May 29, 2015) (finding no basis to offset disgorgement by settlement to which respondent "made no monetary contribution").

104 *Kokesh*, 137 S. Ct. at 1639, 1642 n.3.

105 *See supra* note 91; *see also Liu*, 140 S. Ct. at 1946 (rejecting argument that the Supreme Court "effectively decided in *Kokesh* that disgorgement is necessarily a penalty").

106 *Compare* 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e), 80a-9(e), 80b-3(j) & (k) (authorizing the Commission to enter orders requiring disgorgement), *with* 15 U.S.C. §§ 77h-1(g), 78u-2(a) & (b), 80a-9(d), 80b-3(i) (authorizing the Commission to impose civil money penalties within the limitations imposed by the three-tier system discussed above).

107 The ALJ found that Respondents made material misrepresentations and omissions relating to their "relationship with JTF/Belesis," such as "Belesis's input into [Respondents'] decisions concerning [Fund] portfolio companies and [JTF's] receipt of fees from such companies." *John Thomas Cap. Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, 2014 WL 5304908, at

(footnote continued . . .)

any cases in support of their contention other than the settled action with Belesis and JTF.[108] And we have long held that the remedies imposed in settled actions are inappropriate comparisons.[109]

E. Accounting

The statutes that authorize us to order disgorgement also authorize us to order an accounting.[110] The Division requests an accounting for two reasons: (i) to "provide evidence of further disgorgement to be required of the Respondents;" and (ii) "to ensure the safety of the funds' assets," which it contends are at risk because "the current value of investors' assets is unknown," and because Respondents have not "distribute[d] the assets of the funds to investors notwithstanding that Respondents" dissolved Fund I in March 2013.

(. . . footnote continued)

*15-19, 27. In the exercise of our discretion, *see, e.g.*, *Swift v. United States*, 318 F.3d 250, 252-53 (D.C. Cir. 2003), we have determined to discontinue the proceeding as to that issue, and we accordingly make no findings and impose no sanctions with respect to it. JTF and Belesis consented to findings—without admitting or denying them—that they aided and abetted and caused Respondents' breaches of fiduciary duty to the Funds in violation of Advisers Act Section 206(2); and consented to the imposition of (i) a cease-and-desist order, (ii) a censure, (iii) industry, penny stock, and investment company bars for Belesis with the right to apply for reentry after one year; (iv) civil money penalties of $100,000 for Belesis and $500,000 for JTF; and (v) disgorgement of $311,948, plus prejudgment interest, for Belesis. *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 70989, 2013 WL 6327500, at *1, 7-8 (Dec. 5, 2013).

108 The ALJ correctly modified a subpoena to Belesis to exclude his tax returns and investment account statements. Respondents assert that "numerous financial transactions involving all respondents were at issue." But the violations we have found involved Respondents' misrepresentations to investors in marketing the Funds and their inflation of the Funds' holdings to increase the management fees paid to JTCM. Belesis' personal finances or the taxes he paid as an individual are irrelevant to those violations. Respondents also assert that the "relative culpability of the settling respondents versus themselves was an issue." We again disagree. As discussed, the settling respondents engaged in different conduct, and remedies imposed as to settling parties are not appropriate comparisons as a general matter. *See, e.g.*, *Monterosso*, 756 F.3d at 1339; *VanCook v. SEC*, 653 F.3d 130, 144 (2d Cir. 2011).

109 *Michael C. Pattison, CPA*, Exchange Act Release No. 67900, 2012 WL 4320146, at *11-12 (Sept. 20, 2012); *see also Leslie A. Arouh*, Exchange Act Release No. 50889, 2004 WL 2964652, at *11 (Dec. 20, 2004) (rejecting respondent's argument that sanction was unjust where "more culpable" respondent who settled with the Commission received lesser sanction because "the appropriate sanction depends on the facts and circumstances of each particular case" and "cannot be precisely determined by comparison with action taken in other proceedings").

110 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e), 80a-9(e), 80b-3(j), (k); *see also Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 WL 183600, at *11-12 & n.50 (Apr. 5, 1999).

The principal purpose of an accounting is to fix, or lend greater clarity to, the amounts to be disgorged.[111] Here, the OIP did not explicitly seek an accounting (even though it did specify disgorgement and civil penalties as potentially appropriate remedial action),[112] the Division did not before the ALJ identify any specific evidentiary gaps pertaining to disgorgement or the disposition of the funds' assets,[113] and the Division made only a conclusory request for an accounting in its briefs to the ALJ.[114] Under these circumstances—and because we are able to make a satisfactory assessment of the amount to be disgorged on the basis of the existing record—we will not delay these proceedings further by ordering an accounting.[115]

F. Fair Fund

Based on the facts of this case, we find that it is appropriate to order that the disgorgement, prejudgment interest, and civil penalty be used to create a Fair Fund for the benefit of investors harmed by Respondents' violations.[116]

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111 *See, e.g.*, *SEC v. Int'l Swiss Invs. Corp.*, 895 F.2d 1272, 1276 (9th Cir. 1990) (stating that the purpose of an accounting "is to identify assets subject to disgorgement").

112 *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, 2013 WL 1180836, at *13.

113 *Cf. First Commodity Traders, Inc. v. Heinold Commodities, Inc.*, 766 F.2d 1007, 1011 (7th Cir. 1985) (affirming denial of accounting because, among other things, plaintiff had full access to defendant's records during discovery and "could ascertain the correct amount of compensation to which [it] was entitled"); *Felton v. Teel Plastics, Inc.*, 724 F. Supp. 2d 941, 952 (W.D. Wis. 2010) (denying accounting because the plaintiff had not established "that ordinary discovery is inadequate to provide the answers he seeks").

114 *John Thomas Capital Mgmt. Group LLC, d/b/a Patriot28 LLC*, 2014 WL 5304908, at *30 n.39 ("The Division, however, nowhere provides any more detail about this request . . . .").

115 Our denial of the Division's request for an accounting in the context of the instant proceeding expresses no view as to whether an accounting might be appropriately pursued in another forum or by another party asserting different claims (e.g., the Funds' investors in a state-law action for breach of contract or unjust enrichment).

116 17 C.F.R. § 201.1100. The Funds had about 120 investors. The Division has not expressed a view on whether to create a Fair Fund here, but the statutory and regulatory scheme vests the Commission with the discretionary authority to create one in "any administrative proceeding in which a final order is entered against a respondent requiring disgorgement and payment of a civil money penalty." *Adoption of Amendments to the Rules of Practice*, Exchange Act Release No. 49412, 2004 WL 503739, at *5 (March 19, 2004); *see also* 15 U.S.C. § 7246(a) (providing for creation of Fair Fund "at the direction" of the Commission); *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 82-85 (2d Cir. 2006) (recognizing Commission's discretion regarding creation and terms of a Fair Fund).

III. Respondents' Constitutional and Procedural Claims

A. Alleged ALJ Bias

Respondents argue that "ALJs' status as mere employees infects the hearings they conduct" and raises a "substantial question of bias." They assert that there is a "substantial danger that the Division [of Enforcement] does not see ALJs as sufficiently removed and independent" because ALJs, like Enforcement staff, are employees of the Commission.

Supreme Court precedent forecloses the argument that the "structure of agency employment of ALJs is a . . . reason to conclude ALJs" are biased.[117] As the Supreme Court has explained, "[t]he process of agency adjudication is currently structured [under the APA] so as to assure that the hearing examiner exercises his independent judgment on the evidence before him, free from pressures by the parties or other officials within the agency."[118] It is well-settled that the Commission does not "improperly act[] as both an enforcer and arbiter" simply because "SEC employees gathered and presented the evidence," and the hearing is held before an ALJ.[119] The Supreme Court has held that the "combination of investigative and adjudicative functions" within an agency "does not, without more, constitute a due process violation."[120] There must be "special facts and circumstances present in the case" that indicate "that the risk of unfairness is intolerably high."[121] Respondents cite no such facts and circumstances here.

Respondents rely on a *Wall Street Journal* article in which a former ALJ of the Commission, who left the Commission years before the hearing in this matter, alleged that she experienced pressure from the Chief ALJ to rule in favor of the Division during her tenure at the Commission.[122] But ALJs are presumed to be unbiased.[123] To overcome this presumption, the

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117 *Harlin v. DEA*, 148 F.3d 1199, 1204 (10th Cir. 1998) (citing *Withrow v. Larkin*, 421 U.S. 35 (1975), *Butz v. Economou*, 438 U.S. 478 (1978), and *Ramspeck v. Fed. Trial Exam'rs Conference*, 345 U.S. 128 (1953)); *see also Knapp v. USDA*, 796 F.3d 445, 468 (5th Cir. 2015) ("Judicial Officer's employment relationship with the Department does not suffice to demonstrate bias").

118 *Butz*, 438 U.S. at 513.

119 *Sheldon v. SEC*, 45 F.3d 1515, 1518-19 (11th Cir. 1995); *see also Arlington v. FCC*, 569 U.S. 290, 305 n.4 (2013) (observing that combination of functions within agencies has been commonplace "since the beginning of the Republic"); *Baran v. Port of Beaumont Navigation Dist. of Jefferson Cnty. Tex.*, 57 F.3d 436, 446 (5th Cir. 1995) (holding that an agency's "dual role[] of investigating and adjudicating disputes and complaints" does not establish unconstitutional bias).

120 *Withrow*, 421 U.S. at 58.

121 *Id*.

122 *See* Jean Eaglesham, *SEC Wins with In-House Judges*, The Wall Street Journal (May 6, 2015). The Commission requested that its Office of the Inspector General investigate the allegations made in the *Wall Street Journal* article. The OIG's investigation was completed in January 2016 and "did not develop any evidence to support the allegations of improper

(footnote continued . . .)

party claiming bias must establish a "conflict of interest or some other specific reason for disqualification,"[124] such as where the ALJ's behavior, "in the context of the whole case, was 'so extreme as to display clear inability to render fair judgment.'"[125]

Far from presenting the requisite "convincing evidence that 'a risk of actual bias or prejudgment"' is present, Respondents offer only unsupported "speculation or inference" in attempting to link the former ALJ's allegations to this proceeding or the ALJ who presided overit.[126] That is not enough to demonstrate bias or unfairness here.[127] Nor is it enough to warrant further factual development as to that claim.[128] We accordingly deny Respondents' request for discovery relating to this issue and reject the claim.

B. Alleged Prejudgment and *Ex Parte* Communications

Respondents contend that the Commission engaged in prejudgment by accepting a settlement with Belesis and JTF. Although the Commission's order accepting that settlement stated that the "findings herein . . . are not binding on any other person or entity in this or any

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(. . . footnote continued)
influence" or "to support the allegation that ALJ personnel were pressured to shift the burden of proof to respondents." *See* Office of Inspector General, U.S. Securities and Exchange Commission, Report of Investigation, Case #15-ALJ-0482-I, *available at* https://www.sec.gov/oig/reportspubs/Final-Report-of-Investigation.pdf (last visited September 3, 2020).

123 *See, e.g.*, *Schweiker v. McClure*, 456 U.S. 188, 195 (1982); *Withrow*, 421 U.S. at 47.

124 *Schweiker*, 456 U.S. at 195.

125 *Rollins v. Massanari*, 261 F.3d 853, 858 (9th Cir. 2001) (quoting *Liteky v. United States*, 510 U.S. 540, 551 (1994)); *accord Keith v. Barnhart*, 473 F.3d 782, 788 (7th Cir. 2007).

126 *Collier v. Comm'r of Soc. Sec.*, 108 F. App'x 358, 364 (6th Cir. 2004) (rejecting argument that ALJ in a social security disability case was biased); *see also Wells v. SSA*, 777 F. App'x 429, 433 (11th Cir. 2019) (requiring "evidence in the record establishing any partiality on the part of or a specific reason to disqualify the administrative law judge"); *Valentine v. SSA*, 574 F.3d 685, 690 (9th Cir. 2009) (holding that "pointed questions," "general preconceptions," and "expressions of impatience, dissatisfaction, annoyance, and even anger" do not "come close to the required show" to overcome presumption that ALJs are unbiased).

127 A showing of actual bias is required to compel disqualification of an ALJ because the "appearance of impropriety standard is not applicable to administrative law judges." *Bunnell v. Barnhart*, 336 F.3d 1112, 1114 (9th Cir. 2003) (collecting cases); *Greenberg v. Bd. of Governors of Fed. Reserve Sys.*, 968 F.2d 164, 166-67 (2d Cir. 1992) (requiring case-specific showing that the "risk of unfairness is intolerably high").

128 We previously deferred ruling on Respondents' request for discovery regarding their "claim that their 'right to a fair forum and an impartial and unbiased judge has been violated,'" and now deny that request. *John Thomas Capital Mgmt. Grp. LLC*, 2015 WL 4608057, at *1.

other proceeding,"[129] Respondents argue that the Commission is now unable to fairly adjudicate the case against them. Respondents also contend that the Commission engaged in impermissible *ex parte* communications with the Division in connection with that settlement.

Respondents raised similar claims in a petition for interlocutory review, which we denied.[130] That denial has no force or effect given our subsequent order "vacat[ing] any prior opinion" we issued in this matter.[131] In any case, a denial of interlocutory review does not preclude a party from renewing its arguments if and when it petitions the Commission for review of an initial decision.[132] Therefore, we have considered Respondents' submissions without deferring or giving weight to our order denying interlocutory review. Nonetheless, we find persuasive the reasoning we articulated in our prior order[133] and adopt it anew.[134]

We briefly summarize that reasoning here. No prejudgment of a non-settling respondent's case occurs even when an agency may have acquired some familiarity with the underlying events at another stage of the proceedings involving respondents who settle. Specifically, the "consideration of [certain respondents'] offer of settlement" during the pendency of proceedings against "other respondents [is] proper and [does] not violate the

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[129] *John Thomas Capital Mgmt. Grp. LLC,* Exchange Act Release No. 70989, 2013 WL 6327500, at *1 n.1 (Dec. 5, 2013).

[130] *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 71415, 2014 WL 294551 (Jan. 28, 2014).

[131] *Pending Admin. Proceedings*, Exchange Act Release No. 83907, 2018 WL 4003609, at *1 (Aug. 22, 2018).

[132] *Gary L. McDuff*, Exchange Act Release No. 78066, 2016 WL 3254513, at *6 (June 14, 2016).

[133] A prior decision reversed or vacated on other grounds is often treated as persuasive authority by the court of appeals. *See Garcia-Dorantes v. Warren*, 801 F.3d 584, 603 (6th Cir. 2015) (holding that the district court "correctly considered" and followed as persuasive authority a Sixth Circuit decision "[d]espite its reversal on other grounds"); *In re Digital Island Sec. Litig.*, 357 F.3d 322, 334 n.17 (3d Cir. 2004) ("We regard [the court's prior case] as persuasive, despite the fact that it was reversed on other grounds . . ."); *Roe v. Anderson*, 134 F.3d 1400, 1402 (9th Cir. 1998) ("[O]ur prior affirmance . . . remains viable as persuasive authority, notwithstanding the Supreme Court's vacatur . . . on other grounds."); *Christianson v. Colt Indus. Operating Corp.*, 870 F.2d 1292, 1298 (7th Cir. 1989) ("decision vacated by Supreme Court remains persuasive precedent where Court did not reject the decision's underlying reasoning"); *see also United States v. Funds in the Amount of One Hundred Thousand*, No. 03 C 03644, 2016 WL 3459527, at *1 (N.D. Ill. June 24, 2016) (declining to reverse or reconsider district court's own pre-trial and other evidentiary rulings made prior to reversal and remand of case on other grounds).

[134] *John Thomas Capital Mgmt. Grp. LLC*, 2014 WL 294551, at *2 & nn.11-15 (collecting cases).

Administrative Procedure Act . . . or our rules regarding *ex parte* communications."[135] As the Supreme Court has recognized, the APA "'does not . . . forbid the combination with judging of instituting proceedings [or] negotiating settlements.'"[136]

Respondents claim that our decisions rejecting claims of disqualification or impermissible *ex parte* communications on analogous facts have "never been reviewed by a federal court, and undoubtedly would not be upheld."[137] This is incorrect. For example, in *Edward Sinclair*, the non-settling respondent, who was an employee of a broker-dealer, argued that any Commissioner who participated in the decision to accept the broker-dealer's offer of settlement for failing to supervise should be disqualified.[138] We rejected this argument, and the Second Circuit agreed by "find[ing] no merit in the argument that [the] Commissioner . . . had prejudged [the employee's] case by participating in the Commission's decision to accept [the broker-dealer's] settlement offer setting forth certain stipulated facts."[139]

More recently, in *The Stuart-James Co., Inc.*, we again concluded that acceptance of a settlement did not require dismissal of the administrative proceeding as to the non-settling respondents. We reasoned that, "[t]aken at face value, the respondents' arguments suggest that it

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135 *C. James Padgett*, Exchange Act Release No. 38423, 1997 WL 126716, at *16 (Mar. 20, 1997), *petition denied*, 159 F.3d 637 (D.C. Cir. 1998).

136 *Withrow*, 421 U.S. at 57 n.24 (quoting 2 K. Davis, *Administrative Law Treatise* § 13.11, p. 249 (1958)); *see also Richardson v. Perales*, 402 U.S. 389, 410 (1971) (upholding agency structure in which ALJs both investigate and decide claims in the first instance).

137 The principal case relied upon by respondents, *Antoniu v. SEC*, is inapposite. 877 F.2d 721 (8th Cir. 1989). There, a court found prejudgment where a Commissioner made a speech singling out the respondent as an "indifferent violator" and announcing that the bar imposed on him had been "made permanent," even though the Commission had yet to issue a final opinion. *See id.* at 723. The circumstances here are entirely different: the agreed-upon factual findings in the Commission's order accepting the settlement as to Belesis and JTF are expressly limited by the proviso that they are not "binding on any other person or entity in this or any other proceeding binding on any other person or entity in this or any other proceeding." Moreover, the violations for which we have imposed sanctions as to Respondents—their misrepresentation of the identity of the Funds' auditor and prime broker and the Funds' investment parameters and safeguards and their overvaluing of the Funds' holdings to increase fees—have only an attenuated connection to the stipulated facts agreed to by Belesis and JTF. *John Thomas Capital Mgmt. Grp. LLC*, 2013 WL 6327500, at *1, 7-8. As noted above, Respondents' violations and sanctions do not turn on whether they made material misrepresentations related to their relationship with JTF and Belesis. *See supra* notes 87 and 107.

138 Exchange Act Release No. 9115, 1971 WL 120487, at *4 (Mar. 24, 1971).

139 *Sinclair v. SEC*, 444 F.2d 399, 401-02 (2d Cir. 1971) (finding no grounds for disqualification where, as here, the settled decision "stated that it was not binding on the other respondents" and the Commission's "findings with respect to [the non-settling respondent] were based upon presentation of evidence before a Hearing Examiner, findings independently made by him on the basis of the proof, and independent review by the Commission").

is virtually impossible for the Commission . . . to . . . entertain individual settlements in proceedings involving multiple respondents," and rejected this result as "contrary to the Administrative Procedure Act" and "common sense."[140] We adhered to *The Stuart-James Co., Inc.* in a subsequent proceeding,[141] and in affirming the D.C. Circuit found the issues so well-settled that they "occasion[ed] no need for a published opinion."[142]

In short, ample precedent supports our rejection of Respondents' contention that an adjudicative body is precluded from further consideration of a multi-party case once it has passed upon one party's settlement. That conclusion, if accepted, necessarily would entail that a judge could not accept guilty pleas from fewer than all co-conspirators in a multiple-defendant case, which is not the law: "The mere fact that a judge has . . . accepted the guilty plea of a coconspirator . . . does not establish prejudice or bias."[143]

Additionally, Respondents assert that the Commission's acceptance of the offer of settlement "effectively removed" their ability to obtain corroborating testimony from Belesis by "preclud[ing] [him] from testifying" as to the "truth." But the offer of settlement expressly states that Belesis' "testimonial obligations" are unaffected by his settlement. Only a "[s]ubstantial [government] interference with a defense witness' free and unhampered choice to testify violates due process rights of the defendant," and a routine plea or settlement agreement does not violate due process.[144] At any rate, given that Belesis' name did not appear on Respondents' pre-

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140 Exchange Act Release No. 28810, 1991 WL 291802, at *1 (Jan. 23, 1991). A blanket rule that prohibited considering settlements that did not completely resolve a multi-respondent proceeding would be in tension with the APA, which requires agencies to give "all interested parties" the opportunity for the "submission and consideration of . . . offers of settlement, when time, the nature of the proceeding, and the public interest permit." 5 U.S.C. § 554(c)(1).

141 *Padgett*, 1997 WL 126716, at *15-16.

142 *Sullivan v. SEC*, 159 F.3d 637 (table), 1998 WL 388511, at *1 (D.C. Cir. 1998) (per curiam); *see also infra* note 143 (collecting cases holding that acceptance of a guilty plea of a defendant does not preclude judge from presiding over trial of alleged co-conspirators).

143 *United States v. Gigax*, 605 F.2d 507, 511 (10th Cir. 1979); *see also FTC v. Cement Inst.*, 333 U.S. 683, 702-03 (1948) ("[J]udges frequently try the same case more than once and decide identical issues each time, although these issues involve questions both of law and fact. Certainly, the Federal Trade Commission cannot possibly be under stronger constitutional compulsions in this respect than a court."); *United States v. Bernstein*, 533 F.2d 775, 785 (2d Cir. 1976) (stating that information acquired "by way of guilty pleas of codefendants or alleged coconspirators[] or . . . pretrial proceedings" does not require disqualification); *BCCI Holdings v. Khalil*, 182 F.R.D. 335, 340 (D.D.C. 1998) (explaining that "no appearance of prejudice" arises even when a district court "presided over criminal and civil litigation" arising out of same facts and "accepted guilty pleas on the basis of largely uncontested factual proffers").

144 *United States v. Terzado-Madruga*, 897 F.2d 1099, 1108 (11th Cir. 1990) (holding that due process was not violated where the "plea agreement did not prohibit the witness from testifying for the defendant, nor condition its operation upon the witness' refusal to testify) (quotation marks omitted; alteration in original); *accord United States v. Yarbrough*, 852 F.2d

(footnote continued . . .)

hearing witness list and they subsequently represented that Belesis would assert his Fifth Amendment privilege against self-incrimination if called as a witness at the hearing, we do not see how Respondents could have been prejudiced by this provision in the offer of settlement.

Finally, we find that Respondents' request to disqualify the entire Commission fails as a matter of law. The "Commission is the only governmental agency with the statutory authority" to institute and adjudicate administrative proceedings under the securities laws, which means that "disqualification cannot be permitted to prevent the Commission, the only tribunal with the power to act in this matter, from performing its duties."[145]

In sum, our findings as to Respondents are "based solely on the record" adduced before the law judge and have "in no way [been] influenced by our findings as to [Belesis and JTF] based on [their] offer of settlement."[146] We find no basis either for dismissing these proceedings or for disqualification on the basis that Respondents' cases have been prejudged.[147]

C. The Division of Enforcement's Disclosure Obligations

Respondents claim that the Division of Enforcement did not comply with its disclosure obligations. Under Rule of Practice 230, the Division must make its investigative file available to Respondents and may not withhold, "contrary to the doctrine of *Brady v. Maryland*, 373 U.S. 83, 87 (1963), documents that contain material exculpatory evidence."[148] The Division produced the investigative file in the form the Division maintained it—a text-searchable Concordance

(. . . footnote continued)
1522, 1537-38 (9th Cir. 1988) (setting forth "general rule" that a co-defendant "who has pled guilty may testify against non-pleading defendants without raising due process concerns").

145 *Jean-Paul Bolduc*, Exchange Act Release No. 43884, 2001 WL 59123, at *2 (Jan. 25, 2001) (applying the "rule of necessity"); *Augion-Unipolar Corp.*, Securities Act Release No. 5113, 1970 WL 103717, at *2 (Nov. 18, 1970). Each Commissioner has determined that his or her disqualification is not appropriate. *See* 17 C.F.R. § 200.60 (providing that each member shall individually rule on the question of his or her disqualification).

146 *Sinclair*, 1971 WL 120487, at *4.

147 We deny Respondents' request for discovery regarding the Division's communications with the Commission relating to the Settling Respondents' offer of settlement. These communications are irrelevant because they do not relate to the Commission's resolution of Respondents' claims and do not run afoul of either the APA or our rules governing *ex parte* communications. *Padgett*, 1997 WL 126716, at *16. Given their lack of relevance, the law judge correctly denied Respondents' subpoena requests directed at them.

148 17 C.F.R. § 201.230. Under *Brady*, the prosecution in a criminal case must disclose materially exculpatory or impeaching evidence to the defendant. *Brady* has no direct application to our administrative proceedings. *optionsXpress, Inc.*, Exchange Act Release No. 70698, 2013 WL 5635987, at *3 & n.15 (Oct. 16, 2013).

database.[149] It also provided Respondents with transcripts of investigative testimony taken before the institution of proceedings, exhibits used for those interviews, a declaration summarizing the potentially exculpatory material provided by those witnesses whose interviews were not transcribed, and a withheld document list and accompanying declaration stating that the listed documents did not contain material exculpatory evidence.

As with their claim of prejudgment, Respondents initially raised their discovery objections in a prior petition for interlocutory review, which we denied.[150] We again have considered Respondents' submissions without deferring or giving weight to our now-vacated order denying interlocutory review. Nonetheless, we continue to find persuasive the analysis we previously set forth, and adopt it as our present resolution of Respondents' *Brady* claim.[151]

Contrary to Respondents' submission, the Division was not obliged to direct them "to specific items of potentially exculpatory evidence within . . . a larger body of disclosed material" or provide a "roadmap" for respondents to most efficiently employ those documents.[152] Even in the criminal context, it is settled that an "open file" production satisfies the government's disclosure obligations and does not violate the defendant's due process rights.[153] Although the "Supreme Court in *Brady* held that the Government may not properly conceal exculpatory evidence from a defendant, it does not place any burden upon the Government to conduct a defendant's investigation or assist in the presentation of the defense's case."[154] Respondents cite several district court cases for the proposition that "large, haphazard document productions" may, under some circumstances, "violate the Federal Rules of Civil Procedure." But the Federal Rules of Civil Procedure do not apply in our administrative proceedings, and the investigative file was produced in the manner maintained by the Division.[155] Respondents offer no evidence to substantiate the assertion that the production was "haphazard."

Respondents claim that their due process rights also were violated because they had the opportunity to review only a "miniscule percentage" of these documents and lacked sufficient

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149 A significant proportion of the file consisted of documents provided to the Division by respondents in response to investigative subpoenas and document requests.

150 *John Thomas Capital Mgmt. Grp.*, Exchange Act Release No. 30820, 2013 WL 6384275, at *6 (Dec. 6, 2013).

151 *See supra* note 133 (collecting cases where a decision vacated on unrelated grounds retains value as persuasive authority).

152 *John Thomas Capital Mgmt. Grp.*, 2013 WL 6384275, at *6.

153 *See id.* at *6 & n.41 (citing *Rhoades v. Henry*, 638 F.3d 1027, 1039 n.12 (9th Cir. 2011); *United States v. Warshak*, 631 F.3d 266, 297 (6th Cir. 2010); *United States v. Mulderig*, 120 F.3d 534, 541 (5th Cir. 1997)); *United States v. Pelullo*, 399 F.3d 197, 212 (3d Cir. 2005) *United States v. Wooten*, 377 F.3d 1134, 1142 (10th Cir. 2004)).

154 *United States v. Marrero*, 904 F.2d 251, 261 (5th Cir. 1990).

155 *See, e.g.*, *John A. Carley*, Exchange Act Release No. 50954, 2005 WL 17992, at *2 n.6 (Jan. 3, 2005).

time to prepare for their defense. Although the Division's investigative file was voluminous, Respondents did not have to laboriously conduct a page-by-page review; the file was produced in an electronically searchable database format, which allowed them to locate documents matching specified parameters. And Respondents had sufficient time to prepare because the file was produced to them in May 2013 and they received several adjournments of the hearing, which did not commence until nine months later in February 2014.

Insofar as Respondents were denied an even lengthier continuance, we do not believe that to have been the product of an "unreasoning and arbitrary insistence upon expeditiousness in the face of a justifiable request for delay."[156] Respondents have been represented by counsel since the beginning of the investigation, several years before the Commission instituted proceedings in March 2013. Shortly afterwards, in May 2013, Respondents replaced their counsel with new lawyers who were unfamiliar with the record; subsequently, the ALJ twice postponed the hearing at Respondents' request.[157] Respondents' decision to substitute counsel did not, however, entitle them to dictate the timing of the hearing.[158] Finally, in August 2018, the Commission gave Respondents the opportunity for a new hearing before a different ALJ who would prepare an initial decision.[159] Respondents elected to forgo "another hearing on the same issues before another [ALJ]," and instead requested that the Commission consider the matter based on the original initial decision and the existing record.[160] Under the circumstances, we find that Respondents had a sufficient understanding of the matters in dispute, the relevant evidence, and a meaningful opportunity to prepare and present a defense, which is all that due process requires.

We also reject Respondents' specific *Brady* allegations, which relate to witness interview notes prepared by Division staff in connection with the investigation of Respondents and in anticipation of these proceedings. Because such notes reflect attorneys' mental impressions, opinions, and analyses, they are entitled to heightened work-product privilege protection.[161] The

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156 *Morris v. Slappy*, 461 U.S. 1, 11-12 (1983) (internal quotation marks omitted); *Dearlove*, 2008 WL 281105, at *35.

157 Respondents also secured a month-long interim stay of proceedings during the pendency of their petition for interlocutory review as to their *Brady* claim. *See John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 70841, 2013 WL 5960689 (Nov. 8, 2013).

158 *See, e.g.*, *United States v. Whitehead*, 487 F.3d 1068, 1071 (8th Cir. 2007); *Berri v. Gonzales*, 468 F.3d 390, 394-95 (6th Cir. 2006); *United States v. Todisco*, 667 F.2d 255, 261 (2d Cir. 1981); *see also United States v. Uptain*, 531 F.2d 1281, 1286 (5th Cir. 1976) (holding that the party's "role in shortening the effective preparation time" is "highly relevant" in assessing "claims of inadequate preparation time").

159 *Pending Admin. Proceedings*, 2018 WL 4003609, at *1.

160 *John Thomas Capital Mgmt. Grp. LLC*, 2019 WL 857535, at *1.

161 *See, e.g.*, *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981); *United States v. Gupta*, 848 F. Supp. 2d 491, 496 (S.D.N.Y. 2012); *SEC v. Treadway*, 229 F.R.D. 454, 455-56 (S.D.N.Y. 2005); *cf.* Fed. R. Civ. P. 23(b)(3)(B).

Division satisfied its obligations under Rule of Practice 230 by providing Respondents with a declaration setting out the potentially exculpatory facts contained in those documents.[162]

Respondents express skepticism as to whether the Division's summaries "contain all of the *Brady* material that the Division was required to produce" and ask that the Commission conduct an *in camera* review of the withheld notes. We do not believe that such action is warranted. It is well-established that the party seeking *in camera* review first must make a "plausible showing" that the undisclosed documents in question contain information that is both favorable and material to its defense.[163] "[I]t takes more than the adverse party's conclusory suspicions to impel the adjudicator" to conduct an *in camera* review and "delve behind the government's representation that it has conducted a *Brady* review and found nothing."[164] Here, "[e]xcept for bare speculation, [Respondents] ha[ve] nothing to suggest the existence" of favorable and material evidence in the notes that was omitted from the Division's summaries.[165]

D. Separation of Powers

Respondents assert that the Dodd-Frank Act's "transfer of coextensive administrative enforcement to the Commission" without "specific guidelines or an intelligible principle" to govern the Commission's selection of forum violates the separation of powers. According to Respondents, this "power of the Commission to institute administrative enforcement actions" is "legislative" in nature because it affects the "legal rights, duties and relations" of respondents.

This argument lacks merit. The provisions of the Dodd-Frank Act at issue confer on the Commission authority to obtain civil penalties in administrative cease-and-desist proceedings brought to enforce the securities laws. Contrary to Respondents' argument, whenever the Commission brings an enforcement action—whether in federal district court or in an administrative proceeding—it is not acting in a *legislative* capacity; instead, it is acting in an *executive* capacity, enforcing laws that Congress has enacted or regulations promulgated by the

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162 *optionsXpress, Inc.*, 2013 WL 5635987, at *4 & n.19.

163 *See, e.g.*, *Pennsylvania v. Ritchie*, 480 U.S. 39, 58 n.15 (1987); *Davis v. Litscher*, 290 F.3d 943, 947-48 (7th Cir. 2002); *United States v. Runyan*, 290 F.3d 223, 245 (5th Cir. 2002); *Riley v. Taylor*, 277 F.3d 261, 301 (3d Cir. 2001); *United States v. Williams-Davis*, 90 F.3d 490, 514 (D.C. Cir. 1996); *Love v. Johnson*, 57 F.3d 1305, 1313-15 (4th Cir. 1995).

164 *Landry v. FDIC*, 204 F.3d 1125, 1137 (D.C. Cir. 2000); *see also optionsXpress, Inc.*, 2013 WL 5635987, at *6.

165 *See Williams-Davis*, 90 F.3d at 513; *see also John Thomas Capital Mgmt. Grp.*, 2013 WL 6384275, at *4-5 (concluding that certain inadvertently produced notes "do not, in fact, contain material exculpatory or impeachment evidence that has not elsewhere been disclosed to respondents"). Because Respondents have failed to make the requisite "plausible showing" that the notes contain *Brady* material, we deny their *Brady* claim without the need to conduct an *in camera* review and deny their request for discovery and to adduce additional evidence on this claim.

Commission pursuant to its Congressionally authorized rulemaking authority.[166] Congress's decision to create a statutory scheme that allows the Commission to choose the forum in which it brings enforcement actions does not constitute a delegation of legislative authority.[167] The selection of a forum is not a legislative act, but part of the discretionary decisionmaking authority that the Commission exercises in carrying out its mandate to enforce—*i.e.*, execute—the law,[168] akin to the Commission's decisions regarding whether or not to bring an enforcement action, which parties should be named respondents, and what statutory violations to assert.[169]

Relying on *Metropolitan Washington Airports Authority v. Citizens for Abatement of Aircraft Noise, Inc.*, Respondents assert that any "Government action[] that ha[s] the 'purpose and effect of altering the legal rights, duties, and relations of persons . . . outside the Legislative branch,'" constitutes legislative action.[170] And invoking *INS v. Chadha*, Respondents claim that legislative action includes "decision-making surrounding agency adjudications" insofar as they "'alter[] the legal rights, duties, and relations of persons . . . outside the legislative branch,' and involve 'determinations of policy.'"[171] Neither case supports Respondents' contentions.

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166 *See, e.g.*, *Flint v. City of Belvidere*, 791 F.3d 764, 796 (7th Cir. 2015) ("[P]rosecution of crimes is a quintessentially executive function.") (quotation marks omitted); *United States v. Lujan*, 504 F.3d 1003, 1007 (9th Cir. 2007) (stating that "investigat[ion]" and "prosecut[ion]" are "quintessential law enforcement functions vested in the executive branch"); *see also In re Aiken County*, 725 F.3d 255, 264 n.9 (D.C. Cir. 2013) (opinion of Kavanaugh, J.) (characterizing "civil enforcement decisions brought by the Federal Government"—there, by the Nuclear Regulatory Commission, an independent agency—as "presumptively an exclusive Executive power").

167 Respondents assert that Congress can authorize an agency to bring an administrative proceeding only when those procedures are exclusive, and the agency lacks discretion to bring an enforcement action in federal district court. Their sole authority for this proposition is an out-of-context quote from *Free Enterprise Fund v. PCAOB.* There, the Court addressed whether a federal district court had jurisdiction to hear a constitutional challenge to the validity of the PCAOB or whether that challenge had to first proceed through the administrative process. It was in that context that the Court stated that procedures for *judicial review* of agency action are generally considered exclusive when they are intended to allow "agency expertise to be brought to bear on particular problems." *See* 561 U.S. 477, 489 (2010) (quotation marks omitted).

168 *See, e.g.*, 15 U.S.C. §§ 80b-3, 80b-9; 17 C.F.R. § 201.5(b) ("[T]he Commission may in its discretion take one or more of the following actions: Institution of administrative proceedings . . . , initiation of injunctive proceedings in the courts, . . .").

169 *Cf. Heckler v. Chaney*, 470 U.S. 821, 832 (1985) ("[A]n agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive Branch not to indict—a decision which has long been regarded as the special province of the Executive Branch . . . .") (quotation marks and citation omitted).

170 501 U.S. 252, 276 (1991).

171 462 U.S. 919, 952, 954 (1983).

The underlying issue in these two cases was whether Congress could fashion a statutory scheme in which legislative power was exercised other than through the legislative process contemplated by Article I of the Constitution—that is, passage of a bill by both houses of Congress and presentment to the President. In *Metropolitan Washington Airports Authority*, Congress created a board composed of members of Congress with authority to veto decisions made by a regional airport authority; in *Chadha*, either house of Congress reserved the right to nullify the Attorney General's decision to allow a removable individual to remain in the United States. Nothing like this is at issue here. Congress has empowered the Commission to enforce the securities law in an administrative forum, without reserving to itself (or any subset of its members) the power to overturn our enforcement decisions. In short, Congress does not unlawfully delegate legislative authority in violation of separation of powers when it provides agencies the authority to pursue administrative remedies to enforce the laws that it has passed.[172]

E. Removal

Citing the Supreme Court's decision in *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[173] Respondents assert that "ALJs' . . . appointments . . . violate the Appointments Clause of Article II of the Constitution" on the ground that they are inferior officers "separated from the President by at least two layers of 'for cause' tenure protection."

In *Free Enterprise Fund*, the Court held that the structure of the Public Company Accounting Oversight Board was unconstitutional because it "commit[ed] substantial executive authority to officers protected by two layers of for-cause removal."[174] Members of the PCAOB enjoyed "rigorous" protections from removal: A member could be removed only upon a finding by the Commission that the member "willfully violated" the Sarbanes-Oxley Act, the securities laws, or the PCAOB's rules; "willfully abused" his authority; or "without reasonable justification or excuse," failed to enforce compliance with the statutes, rules, or PCAOB standards.[175] And the Court assumed that members of the Commission, in turn, were removable by the President only for "inefficiency, neglect of duty, or malfeasance in office."[176] The Court held that the "novel" and "unusual" barriers to removal created by this two-tiered scheme left the President

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[172] To whatever extent the Commission's choice of forum can be seen as involving some policy judgment, the Court has held that Congress has considerable leeway in delimiting the boundaries of that judgment, even in the context of quasi-legislative, rulemaking authority. *Whitman v. Am. Trucking Ass'n, Inc.*, 531 U.S. 457, 464 (2001) ("We have almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.") (quotation marks and citations omitted). The Court has never held that inherently discretionary executive decisionmaking, such as whom, where, and how to prosecute, must be constrained by specific and objective criteria.

[173] 561 U.S. 477 (2010).

[174] *Id.* at 505.

[175] *Id.* at 486, 496 (quotation marks omitted).

[176] *Id.* at 487.

with insufficient ability to supervise the PCAOB's members, who collectively exercised "expansive powers to govern an entire industry."[177]

Free Enterprise Fund does not compel the conclusion that the statutory restrictions on removal of ALJs violate separation-of-powers principles. Section 7521 of the APA provides that an ALJ may be removed by an agency—here, the Commission—for "good cause established and determined by" the Merit Systems Protection Board, whose members themselves are removable by the President "only for inefficiency, neglect of duty, or malfeasance in office."[178] The Supreme Court has long recognized that Congress may impose such limited restrictions on the President's removal power, including, for example, for-cause removal restrictions on the power to remove principal officers of certain independent agencies and for-cause restrictions on a principal officer's ability to remove inferior officers.[179] *Free Enterprise Fund* itself declined to extend its holding to ALJs, noting that unlike members of the PCOAB, many ALJs—including those employed by the Commission—"perform adjudicative rather than enforcement or policymaking functions, or possess purely recommendatory powers."[180]

Free Enterprise Fund does not, in short, hold that multiple layers of removal protections are *per se* unconstitutional. While ALJs' status as inferior officers who enjoy such removal protections implicates separation-of-powers principles, Section 7521 can be construed to alleviate any constitutional concerns. In particular, construing Section 7521 to permit agency heads to remove ALJs for performance-related reasons, subject to limited review by the MSPB, provides constitutionally sufficient supervision, consistent with Article II. The term "good cause" is undefined in the APA, but we believe it is best read to authorize removal of an ALJ for misconduct, poor job performance, or failure to follow lawful directives.[181] This construction provides agencies with constitutionally sufficient latitude to remove an ALJ for appropriate job-related reasons, thereby ensuring the agency heads'—and by extension, the President's—control over inferior officers. Although this construction would still involve multiple layers of protection for ALJs at independent agencies, it comports with the constitutional requirements recognized in *Free Enterprise Fund*. Accordingly, the Commission does not find persuasive

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177 *Id.* at 485, 496.

178 5 U.S.C. §§ 1202(d), 7521(a).

179 *Free Enter. Fund*, 561 U.S. at 493-94 (collecting cases); *see, e.g.*, *Wiener v. United States*, 357 U.S. 349, 353-54 (1958) (upholding removal restrictions of War Claims Commission members in part because they performed "quasijudicial" rather than purely executive functions).

180 561 U.S. at 507 n.10.

181 *See* Black's Law Dictionary 822 (4th ed. 1951) (defining "good cause" as a "substantial" or "legally sufficient ground or reason"). Our briefs in other proceedings have set forth at length this analysis, and we do not repeat it here. Br. for the Securities and Exchange Commission at 45-53, *Lucia v. SEC*, No. 17-130 (S. Ct.); Reply Br. for the Securities and Exchange Commission at 17, *Lucia v. SEC*, No. 17-130 (S. Ct.); SEC Br. 30-33, *Cochran v. SEC*, No. 19-10396 (5th Cir.); Defs.' Mem. in Supp. of Mot. to Dismiss at 14-18, *Raymond J. Lucia Cos. v. SEC*, Case No.: 3:18-cv-02692-DMS-JLB (S.D. Cal.).

Respondents' contention that the longstanding, limited "good cause" removal protection provided for ALJs in Section 7521 violates the separation of powers.

F. The Seventh Amendment

Respondents argue that the provisions of the Dodd-Frank Act that authorize the imposition of civil penalties against unregistered persons in administrative proceedings violate their Seventh Amendment right to a jury trial. We have repeatedly rejected claims that our administrative proceedings violate the Seventh Amendment.[182] The Supreme Court held in *Atlas Roofing Co. v. OSHA* that the "Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be incompatible."[183] The statutory scheme approved in *Atlas Roofing* allowed the government, "proceeding before an administrative agency, . . . to impose civil penalties on any employer maintaining any unsafe working condition."[184] As a result, we again reject the argument that our administrative proceedings violate the Seventh Amendment.

Respondents contend that *Atlas Roofing* does not control. Instead, they assert that the civil penalty authority created by the Dodd-Frank Act violates the Seventh Amendment because it is indistinguishable from the civil penalty authority at issue in *Tull v. United States*, in which the Supreme Court held that the Seventh Amendment guarantees a jury trial when a suit is brought in federal district court to enforce a civil penalty under the Clean Water Act.[185] But Respondents' reliance on *Tull* is misplaced. Citing *Atlas Roofing*, *Tull* reiterated that "the Seventh Amendment is not applicable to administrative proceedings."[186]

G. The Equal Protection Clause

Respondents assert that the Commission violated the Equal Protection Clause for two reasons. First, they claim that the Commission's choice of an administrative forum violates their "fundamental right to a jury trial guaranteed by the Seventh Amendment" and therefore is subject to strict scrutiny. But, as discussed above, there is no right to a trial by a jury in the context of an administrative proceeding, and thus strict scrutiny does not apply.

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182 *See, e.g.*, *Charles L. Hill, Jr.*, Exchange Act Release No. 79459, 2016 WL 7032731, at *3 (Dec. 2, 2016); *Vladlen "Larry" Vindman*, Securities Act Release No. 8679, 2006 WL 985308, at *11 & n.60 (Apr. 14, 2006).

183 430 U.S. 442, 450 (1977).

184 *Id.* at 445.

185 481 U.S. 412, 427 (1987).

186 *Id.* at 418 n.4; *see also Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 51 (1989) (reiterating that Congress may assign the adjudication of an enforcement action "to an administrative agency with which a jury would be incompatible" without violating the Seventh Amendment (citing *Atlas Roofing*, 430 U.S. at 455)).

Second, Respondents invoke a "class-of-one" theory, under which someone who does not assert the deprivation of another constitutional right and is not a member of a protected class nonetheless may assert an equal protection claim by showing that he or "she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment."[187] We reject this claim as well. "Nothing in Dodd-Frank or the securities laws explicitly constrains the [Commission's] discretion in choosing between a court action and an administrative proceeding."[188] In *Engquist v. Oregon Department of Agriculture*, the Court held that a class-of-one claim does not apply to "forms of state action . . . which by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments."[189] And both the Sixth and Seventh Circuits have held that *Engquist* precludes such challenges to prosecutors' decisions about whom, how, and where to prosecute.[190] Relying on these authorities, the Commission has previously held that its inherently discretionary decision to enforce the securities laws in one forum rather than another is not, as a matter of law, susceptible to attack on a class-of-one theory.[191] Respondents have supplied no persuasive reason for the Commission to revisit these decisions.

Respondents' equal protection claim fails for another reason. They have not shown "an extremely high degree of similarity" between themselves and others purportedly similarly situated.[192] They identify other cases in which claims were pursued under the same statutory provisions in federal district court. But the mere fact that another case involves the same provisions of the law does not demonstrate that the respondent is being treated differently from others similarly situated for purposes of equal protection.[193]

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187 *Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000).

188 *Jarkesy v. SEC*, 803 F.3d 9, 12 (D.C. Cir. 2015); *see also SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285, 297 (2d Cir. 2014) (noting that the Commission "is free to eschew the involvement of the [district] courts and employ its own arsenal of remedies instead").

189 553 U.S. 591, 603 (2008).

190 *United States v. Green*, 654 F.3d 637, 650 (6th Cir. 2011) (rejecting class-of-one claim premised on "decision to prosecute [defendant] . . . in the civilian justice system while prosecuting his coconspirators . . . in the military justice system"); *United States v. Moore*, 543 F.3d 891, 901 (7th Cir. 2008) (rejecting class-of-one challenge brought by defendant who was prosecuted in federal court while similarly situated defendants were prosecuted in state court).

191 *E.g.*, *Newport Coast Sec., Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292, at *13 (Apr. 3, 2020); *Hill*, 2016 WL 7032731, at *2.

192 *Clubside, Inc. v. Valentin*, 468 F.3d 144, 159 (2d Cir. 2006).

193 *See Chau v. SEC*, 72 F. Supp. 3d 417, 435 n.148 (S.D.N.Y. Dec. 11, 2014) ("This Court . . . has serious doubts about whether plaintiffs' "superficial comparisons' are sufficient to allege plausibly a 'class of one' claim, particularly as to the SEC's discretionary choice of the forum in which to bring charges."), *aff'd*, 665 F. App'x 67 (2d Cir. 2016). We find that an adequate record for resolving Respondents' class-of-one claim exists and so deny their requests for additional information regarding the basis for the Commission's forum-selection decisions. *See,*

(footnote continued . . .)

H. Due process

Finally, Respondents argue that the Commission violated their right to due process because the Commission's administrative proceedings do not allow Respondents to assert counterclaims for constitutional violations or to develop an evidentiary record of such alleged violations. But Respondents have availed themselves of the opportunity to assert constitutional violations and develop a record before the law judge,[194] through petitions for interlocutory review to the Commission,[195] and on appeal to the Commission of the law judge's initial decision.[196] Thus, as the D.C. Circuit has explained, Respondents' "challenges lie firmly within the Commission's ordinary course of business," which has "proven fully capable of considering [respondents'] attacks on the fairness of [this] proceeding."[197] And there is "no dispute that [they] will have the opportunity to raise all of their constitutional claims before a Court of Appeals."[198] Accordingly, we find no due process violation.

An appropriate order will issue.[199]

By the Commission (Chairman CLAYTON and Commissioners PEIRCE, ROISMAN, LEE, and CRENSHAW).

Vanessa A. Countryman
Secretary

(. . . footnote continued)
e.g., *Mann v. Brenner*, 375 F. App'x 232, 238-39 (3d Cir. 2010) (affirming district court's dismissal of class-of-one claim without discovery); *Ponterio v. Kaye*, 328 F. App'x 671, 672-73 (2d Cir. 2009) (same). For this reason, we find that the ALJ properly quashed Respondents' subpoenas directed at obtaining documents on this issue.

194 *John Thomas Capital Mgmt. Grp. LLC*, 2014 WL 5304908, at *2-7.

195 *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 73375, 2014 WL 5282156 (Oct. 16, 2014); *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 71415, 2014 WL 294551 (Jan. 28, 2014); *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 71021, 2013 WL 6384275 (Dec. 6, 2013).

196 *John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 74345, 2015 WL 728006, at *3 (Feb. 20, 2015); *see also* Rule of Practice 452, 17 C.F.R. § 201.452.

197 *Jarkesy*, 803 F.3d at 28.

198 *Jarkesy v. SEC*, 48 F. Supp. 3d 32, 38 (D.D.C. 2014), *aff'd*, 803 F.3d 9 (D.C. Cir. 2015).

199 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.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10834 / September 4, 2020

SECURITIES EXCHANGE ACT OF 1934
Release No. 89775 / September 4, 2020

INVESTMENT ADVISERS ACT OF 1940
Release No. 5572 / September 4, 2020

INVESTMENT COMPANY ACT OF 1940
Release No. 34003 / September 4, 2020

Admin. Proc. File No. 3-15255

In the Matter of

JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT 28 LLC; and GEORGE R. JARKESY, JR.

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that George R. Jarkesy, Jr. and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC, cease and desist from committing or causing any violations or future violations of Section 17(a)(2) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(b) thereunder, and Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder.

ORDERED that George R. Jarkesy, Jr. and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC, pay a civil money penalty of $300,000 jointly and severally.

ORDERED that John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC, disgorge $684,935.38, plus prejudgment interest of $297,419.81, such prejudgment interest calculated beginning from January 1, 2011, with such interest continuing to accrue on funds owed until they are paid, in accordance with Rule of Practice 600, 17 C.F.R. § 201.600.

ORDERED that the disgorgement, prejudgment interest, and civil money penalty amounts be used to create a Fair Fund for the benefit of investors harmed by Respondents' violations.

ORDERED that George R. Jarkesy, Jr. is barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

ORDERED that George R. Jarkesy, Jr. is barred from acting as a promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, pursuant to Exchange Act Section 15(b)(6)(A), (C).

ORDERED that George R. Jarkesy, Jr. is 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.

Payment of civil money penalties and disgorgement plus prejudgment interest 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.

Vanessa A. Countryman
Secretary

INITIAL DECISION RELEASE NO. 693
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15255

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

In the Matter of	:	
	:	
JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT28 LLC, GEORGE R. JARKESY, JR., JOHN THOMAS FINANCIAL, INC., and ANASTASIOS "TOMMY" BELESIS	:	INITIAL DECISION AS TO JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT28 LLC, and GEORGE R. JARKESY, JR[1] October 17, 2014

APPEARANCES: Todd Brody and Alix Biel for the Division of Enforcement, Securities and Exchange Commission

Karen Cook and S. Michael McColloch for Respondents John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC, and George R. Jarkesy, Jr.

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that George R. Jarkesy, Jr. (Jarkesy) and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC (JTCM) (collectively, JTCM/Jarkesy or Respondents) violated the antifraud provisions of the federal securities laws. The ID orders Respondents to cease and desist from further violations and, jointly and severally, to disgorge $1,278,597 plus prejudgment interest and to pay a third-tier civil penalty of $450,000.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Proceedings (OIP) on March 22, 2013, pursuant to Section 8A of the Securities Act of 1933, Sections 15(b)(4), 15(b)(6), and 21C of the Securities Exchange Act of 1934, Sections

[1] The proceeding has ended as to Respondents John Thomas Financial, Inc., and Anastasios "Tommy" Belesis, who settled the charges against them. *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Exchange Act Release No. 70989, 2013 SEC LEXIS 3862 (Dec. 5, 2013).

203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940. The undersigned held a twelve-day hearing in New York City and remotely on February 3-7 and 24-27, 2014, and March 7 and 13-14, 2014. Thirteen witnesses testified, including Jarkesy, and numerous exhibits were admitted into evidence.[2]

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 96-104 (1981). Pursuant to the Administrative Procedure Act (APA), 5 U.S.C. § 557(c), the parties' Proposed Findings of Fact and Conclusions of Law were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns JTCM/Jarkesy's dealings with two hedge funds then known as the John Thomas Bridge and Opportunity Fund LP I (Fund I) and John Thomas Bridge and Opportunity Fund LP II (Fund II) (collectively, the Funds).[3] The OIP alleges that JTCM/Jarkesy engaged in various material misrepresentations and omissions, including concerning John Thomas Financial, Inc. (JTF), the Funds' placement agent, and JTF's owner, Anastasios "Tommy" Belesis (Belesis) (collectively, JTF/Belesis).

The Division of Enforcement (Division) is seeking a cease-and-desist order, disgorgement, and third tier civil money penalties against Respondents; and industry and officer and director bars against Jarkesy. Respondents argue that the charges are unproven and no sanctions should be imposed.

C. Due Process and Equal Protection

As discussed below, the Respondents have not established valid claims of due process and equal protection violations to prevent the determination of this proceeding against them.

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[2] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division of Enforcement (Division) and by Respondents will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively. Some documents were offered by both the Division and Respondents, for example, the February 5, 2009, Confidential Private Placement Memorandum of John Thomas Bridge and Opportunity Fund, L.P. II (Div. Ex. 210; Resp. Ex. 1).

[3] The Funds have been known as the Patriot Bridge and Opportunity Fund LP I and LP II since September 2011. Answer of JTCM/Jarkesy (Answer) at 1.

1. The Commission Has Neither Prejudged Respondents Nor Engaged in Improper *Ex Parte* Communications with the Division

Respondents argue that the Commission prejudged the proceeding as to them by making findings of fact pursuant to the settlement with JTF and Belesis.[4] Respondents contend that: the Commission's involvement in the settlement creates fundamental unfairness because, if the initial decision as to Respondents is appealed to the Commission, the Commission will have already determined the facts and concluded that there were securities violations, in violation of the APA, 5 U.S.C. § 551 *et seq*.; and because the Division has engaged in improper *ex parte* communications with the Commission in connection with the settlement. Respondents previously raised this argument in their January 3, 2014, motion to disqualify Commissioners from being involved in this proceeding going forward. *See John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Admin. Proc. Rulings Release No. 1148, 2014 SEC LEXIS 27 (A.L.J. Jan. 6, 2014) (denying motion for disqualification).

The Commission has considered and rejected this very argument on several occasions. *See The Stuart-James Co.*, Exchange Act Release No. 28810, 1991 SEC LEXIS 168, at *2-18 (Jan. 23, 1991), *adhered to by C. James Padgett*, Exchange Act Release No. 38423, 1997 WL 126716, at *15-16 (Mar. 20, 1997), *pet. for review denied*, *Sullivan v. SEC*, 159 F.3d 637 (table), 1998 WL 388511 (D.C. Cir. 1998) (*per curiam*); *Steadman Sec. Corp.*, Exchange Act Release No. 13695, 1977 SEC LEXIS 1388, at *56 n.82 (June 29, 1977); *Edward Sinclair*, Exchange Act Release No. 9115, 1971 SEC LEXIS 898, at *13-14 (Mar. 24, 1971), *aff'd*, 444 F.2d 399 (2d Cir. 1971); *Atlantic Equities Co.*, Exchange Act Release No. 8118, 1967 SEC LEXIS 531, at *27-29 (July 11, 1967), *aff'd on other grounds sub nom. Hansen v. SEC*, 396 F.2d 694 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 847 (1968); *see also Hortonville Joint Sch. Dist. No. 1 v. Hortonville Educ. Ass'n*, 426 U.S. 482, 493 (1976) ("Mere familiarity with the facts of a case gained by an agency in the performance of its statutory role does not, however, disqualify a decisionmaker.") (citations omitted); *New York State Dep't of Law v. FCC*, 984 F.2d 1209, 1217-18 (D.C. Cir. 1993) (deferring to Federal Communications Commission rule excepting settlement discussions from bar on *ex parte* communications). In this proceeding, the Commission stated – when considering Respondents' petition for interlocutory appeal – that it "has rejected arguments similar to those raised by JTCM and Jarkesy in an unbroken line of decisions." *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Securities Act Release No. 9519, 2014 SEC LEXIS 308, at *6 (Jan. 28, 2014).

It is well established that the Commission's combining administrative and adjudicative functions is consistent with due process, including when the Commission considers settlement as to one or more respondents, but reviews an initial decision as to another respondent based on similar facts. A policy prohibiting settlements during the pendency of a multi-party proceeding would be contrary to the APA, which requires an agency to give all interested parties the opportunity for the submission and consideration of offers of settlement, when time, the nature of the proceeding, and the public interest permit. 5 U.S.C. § 554(c)(1). Further, while agency staff are obligated under the APA to be separated according to investigative, prosecution, and adjudicative functions, 5 U.S.C. §

[4] *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Exchange Act Release No. 70989, 2013 SEC LEXIS 3862 (Dec. 5, 2013).

554(d), the APA exempts Commission members from this separation of functions requirement. 5 U.S.C. § 554.

The precedent that Respondents cite is inapposite. In *Antoniu v. SEC*, the court nullified Commission administrative proceedings where a Commissioner made a public speech indicating prejudgment of the respondent. 877 F.2d 721 (8th Cir. 1989), *cert. denied*, 494 U.S. 1004 (1990). In the speech, the Commissioner singled out the respondent as an "indifferent violator" and announced that the bar imposed on respondent had been "made permanent," although the proceedings against the respondent had yet to become final and the Commission had yet to issue its opinion upholding the administrative law judge's initial decision. *Id.* at 723; *see Adrian Antoniu*, Exchange Act Release No. 25169, 1987 SEC LEXIS 3086 (Dec. 3, 1987) (published nearly two months after the Commissioner's speech at issue). The court explained that the Commissioner's "words describing [the respondent's] bar as permanent can only be interpreted as a prejudgment of the issue." *Antoniu*, 877 F.2d at 723.

In *Antoniu*, the Commissioner's conduct was held to – and did not comport with – the appearance of justice. *Id*. at 724. The circumstances here are entirely different, and the Commission's publication of findings of fact, agreed on in a settlement, as to JTF and Belesis does not conflict with the appearance of justice. The other cases that Respondents cite are similarly misplaced; each also involved a speech by a Commissioner criticizing a party in a pending proceeding, not a prior published settlement. *See Cinderella Career & Finishing Schs., Inc. v. Fed. Trade Comm'n*, 425 F.2d 583 (D.C. Cir. 1970); *Texaco, Inc. v. Fed. Trade Comm'n*, 336 F.2d 754 (D.C. Cir. 1964), *vacated on other grounds*, 381 U.S. 739 (1965).

Respondents also maintain, without citing any precedent, that Article III courts have held that combining administrative and adjudicative functions is not acceptable. This is not so, and Article III courts have sanctioned such practices. In *Sinclair v. SEC*, the court specifically found no merit in the argument that a Commissioner had prejudged a non-settling respondent's case by participating in the decision to accept another respondent's settlement offer that set forth the facts stipulated by the settling respondent and the Division. 444 F.2d 399, 401-02 (2d Cir. 1971). The court noted that both the settled and litigated "proceedings met the standards of due process, with each respondent . . . being represented by competent counsel." *Id.* The Supreme Court has stated:

> It is also very typical for the members of administrative agencies to receive the results of investigations, to approve the filing of charges or formal complaints instituting enforcement proceedings, and then to participate in the ensuing hearings. This mode of procedure does not violate the [APA], and it does not violate due process of law.

Withrow v. Larkin, 421 U.S. 35, 56 (1975).[5]

[5] Part of Respondents' due process complaint is that there is a separation of powers problem because the Commission can seek money penalties both in administrative proceedings and in federal court and has unbridled discretion, without any guidelines or criteria, as to the choice of forum. Respondents describe this as "dual jurisdiction." However, Respondents do not support their argument with more than generalizations based on the Constitution.

Finally, Respondents raise this argument prematurely. Courts do not normally consider assertions of administrative bias before the completion of administrative proceedings and the exhaustion of administrative remedies. *SEC v. R.A. Holman & Co.*, 323 F.2d 284, 286-88 (D.C. Cir. 1963). The court will interrupt the progress of an adjudicative hearing only in the exceptional case where it is presented with undisputed allegations of fundamental prejudice. *Amos Treat & Co. v. SEC*, 306 F.2d 260, 261-62, 265 (D.C. Cir. 1962). The appropriate time to raise the issue is when a party seeks judicial review of the Commission's action. *R.A. Holman & Co.*, 323 F.2d at 287-88; *United States v. Litton Indus.*, 462 F.2d 14, 18 (9th Cir. 1972).

2. The Division's Production of Material to Respondents Does Not Violate Due Process

Respondents additionally argue that due process has been violated by the Division's deliberate withholding of *Brady* material and "document dump" production on Respondents. These arguments are not convincing.

The Division is required by 17 C.F.R. § 201.230 (Rule 230) to make available its investigative file to a respondent and may not withhold, contrary to the doctrine of *Brady v. Maryland*, 373 U.S. 83, 87 (1963), documents that contain material exculpatory evidence. Rule 230(b)(2). The Commission previously determined in this proceeding, on Respondents' petition for the interlocutory review, that Respondents did not establish that the Division had failed to comply with Rule 230(b)(2), and stated that Respondents "take an overly broad view of what constitutes *Brady* material." *John Thomas Capital Mgmt. Grp. LLC, d/b/a Patriot28 LLC*, Securities Act Release No. 9492, 2013 SEC LEXIS 3860, at *18-19 (Dec. 6, 2013) (Denial of Petition). Respondents have since made requests for witness interview notes, which they maintain were withheld in violation of Rule 230(b)(2). Tr. 1409-13, 1677-79, 1682-83. These requests were also unfounded; the undersigned conducted *in camera* reviews of some of the notes, and they contained no material exculpatory evidence. Tr. 1415, 1730. Further, as a general matter, complying with *Brady* does not necessitate production of witness interview notes. Denial of Petition at *17; *optionsXpress, Inc.*, Securities Act Release No. 9466, 2013 SEC LEXIS 3235, at *13-14 & n.19 (Oct. 16, 2013).

Respondents make a separate but related argument that, even if the Division has not withheld materials in violation of Rule 230(b)(2), they are unaware of exculpatory evidence because of the large amount of data the Division produced to them. Specifically, Respondents complain that the Division produced "700 gigabytes" of data in a Concordance® database,[6] and that the large amount of data to review left them unprepared for hearing. The Commission, however, has made clear that the Division's production approach in this proceeding satisfies its disclosure obligations under Rule 230(b). Denial of Petition at *26 ("Nothing in either Rule 230(b)(2) or *Brady* requires the Division to go further and prepare a 'roadmap' of the documents for the respondent's benefit."). The Commission explained:

[6] Concordance® is a software package that enables users to conduct searches and identify documents that contain matches to specified search parameters. *See* Denial of Petition at *22 n.37 (citing federal court of appeals and district court opinions).

> It is settled that the government is not required to direct a defendant to specific items of potentially exculpatory evidence within a larger body of disclosed material. Indeed, the Supreme Court has made clear that the government may satisfy its *Brady* obligations through an "open file" policy, which the Court reasoned could well "increase the efficiency and the fairness of the criminal process.

Id. at *24 (quoting *Strickler v. Greene*, 527 U.S. 263, 283 n.23 (1999)); *see also Harding Advisory LLC*, Securities Act Release No. 9561, 2014 SEC LEXIS 938 (Mar. 14, 2014) (denying petition for interlocutory review where respondents complained of large amount of data produced).

Respondents allege that due process was violated because the Division did not provide them with a list of "hot documents" to help direct them to the documents containing exculpatory evidence. However, the Commission has addressed this argument: "[Respondents] assert that the Division must go further and specifically identify material exculpatory or impeaching evidence within the production or, at the very least, provide a 'roadmap' for those documents. That is not so." Denial of Petition at *23.

3. Respondents Have Not Been Deprived of Equal Protection

Respondents claim they have been deprived of equal protection because the Commission "arbitrarily chose to litigate the claims against [them] in an administrative proceeding instead of filing suit on the same claims in federal court." This argument is not unlike that made by Rajat Gupta (Gupta) who petitioned in federal district court for declaratory and injunctive relief against the Commission, which had previously commenced administrative proceedings against him. *See Gupta v. SEC*, 796 F. Supp. 2d 503, 506-07, 513-14 (S.D.N.Y.). However, unlike Gupta, Respondents do not have a cognizable equal protection claim because there are no other defendants, connected to the same allegations of wrongdoing, against whom litigation was brought in a judicial instead of administrative proceeding. *See Harding Advisory LLC*, 2014 SEC LEXIS 938, at *33 n.42 (Mar. 14, 2014) (describing *Gupta* as "declining to dismiss complaint alleging an equal protection violation where there existed 'a well-developed public record of Gupta being treated substantially disparately from *28 essentially identical* defendants'").

Respondents mean to raise a "class of one" equal protection claim, yet such a claim requires a showing of (1) intentional different treatment from others similarly situated and (2) a lack of rational basis for such different treatment. Resp. Br. at 16; *see Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000) (*per curiam*); *Witt v. Vill. of Mamaroneck*, No. 12-cv-8778-ER, 2014 WL 1327502, at *7 (S.D.N.Y. Mar. 31, 2014). Respondents merely identify alleged similarly situated litigants that were prosecuted in federal court, without providing a specific argument as to how each of these litigants is so similarly situated to Respondents. *See Missere v. Gross*, 826 F. Supp. 2d 542, 561 (S.D.N.Y. 2011) (necessary to show an extremely high degree of similarity between claimants and the persons to whom claimants compare themselves). "[S]uperficial comparisons to a few other proceedings fall short of establishing a colorable equal protection violation." *Harding Advisory LLC* at *32-33. Thus, Respondents have not made out a class of one equal protection claim.

Respondents also assert that their not having an opportunity of a hearing before a jury violates the Seventh Amendment right to jury trial and denies them equal protection. Respondents' assertion has no merit; it is well established that the lack of jury trials in Commission administrative proceedings does not violate the Seventh Amendment. *See Harding Advisory LLC* at *35 n.46 ("[T]he Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be incompatible." (citing *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 450 (1977)); *see also Curtis v. Loether*, 415 U.S. 189, 194-95 (1974) (noting that the Seventh Amendment is generally inapplicable in administrative proceedings where jury trials would be incompatible with the whole concept of administrative adjudication); *Taggart v. GMAC Mortgage, LLC*, No. 12-cv-415, 2012 WL 5929000, at *4 (E.D. Pa. Nov. 26, 2012) (observing rule from *Curtis v. Loether*); *Vladlen "Larry" Vindman*, Securities Act Release No. 8679, 2006 SEC LEXIS 862, at *44 n.60 (Apr. 14, 2006) (citing *Atlas Roofing Co.*, 430 U.S. at 450). Further, the undersigned is aware of no authority suggesting that an equal protection claim can be established based on an agency's choice to bring enforcement proceedings in an administrative forum – lacking juries, the Federal Rules of Civil Procedure, and the Federal Rules of Evidence – over a judicial forum. *See* Denial of Petition at *26.

4. Untimeliness

Respondents contend that the claims set forth in the OIP are barred by the doctrine of laches and by the applicable statute of limitations. The defense of laches is not available against a United States government agency acting in the public interest. *David Disner*, Exchange Act Release No. 38234, 1997 SEC LEXIS 258, at *18 (Feb. 4, 1997) (citing *United States v. Summerlin*, 310 U.S. 414, 416 (1940); *United States v. Alvarado*, 5 F.3d 1425, 1427 (11th Cir. 1993)). Cease-and-desist orders and disgorgement are not subject to the five year statute of limitations provided in 28 U.S.C. § 2462. *Riordan v. SEC*, 627 F.3d 1230, 1234-35 (D.C. Cir. 2010); *Johnson v. SEC*, 87 F.3d 484, 491 (D.C. Cir. 1996). As to those sanctions that are covered by the statute of limitations, acts outside the statute of limitations may be considered to establish a respondent's motive, intent, or knowledge in committing violations that are within the statute of limitations. *Sharon M. Graham*, Exchange Act Release No. 40727, 1998 SEC LEXIS 2598, at *41 n.47 (Nov. 30, 1998) (citing Fed. R. Evid. 404(b) and *Local Lodge No. 1424 v. NLRB*, 362 U.S. 411 (1960)), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000); *Terry T. Steen*, Exchange Act Release No. 40055, 1998 SEC LEXIS 1033, at *14-15 (June 1, 1998) (citing *H.P. Lambert Co. v. Sec'y of the Treasury*, 354 F.2d 819, 822 (1st Cir. 1965)). Further, such acts may be considered in determining the appropriate sanction if violations are proven. *Steen*, 1998 SEC LEXIS 1033, at *14-17.

Respondents also claim that the OIP's charges are barred because they were not timely filed following the April 4, 2012, Wells notice (Div. Ex. 642). The Division's Director is authorized by Section 4E of the Exchange Act, 15 U.S.C. § 78d-5, to extend the 180-day time limit that Section 4E establishes after providing notice to the Chairman of the Commission. *See Eric David Wanger and Wanger Inv. Mgmt., Inc.*, Securities Act Release No. 9304, 2012 WL 1037682, at *1 (Mar. 29, 2012). While the Division has not provided evidence that notice was given to the Chairman extending the time limitation, it need not have done so, as Section 4E is not a statute of limitations providing any substantive rights to Respondents, or imposing any consequences on the Division, if the deadline goes unmet. *See Montford and Co., Inc., d/b/a Montford Assocs.*, Investment Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, *30-50 (May 2, 2014) (citing *Brock v. Pierce Cnty.*, 476 U.S. 253, 259 (1986) and *United States v. James Daniel Good Real Prop.*, 510 U.S. 43, 63-65 (1993)); *see also SEC v. NIR Grp., LLC*, No. 11-cv-4723, 2013 U.S. Dist. LEXIS 47522 (E.D.N.Y. Mar. 24, 2013); *SEC v. Levin*, No. 12-cv-21917, 2013 U.S. Dist. LEXIS 20027, at *34-35 (S.D. Fla. Feb. 14, 2013).

II. FINDINGS OF FACT

A. Relevant Individuals and Entities

1. JTCM and Jarkesy

JTCM, based in Houston, Texas, is an unregistered investment adviser and general partner of two hedge funds, Fund I and Fund II. Answer of JTCM/Jarkesy (Answer) at 1-2. Jarkesy controls all operations and activities of JTCM as its manager. *Id*. Jarkesy created JTCM in 2007 to serve as the adviser to Fund I. *Id*. Neither JTCM, Jarkesy, nor the Funds were registered with the Commission and Jarkesy was not associated with a registrant.[7]

2. The Funds

Jarkesy and JTCM launched Fund I in 2007 and Fund II in 2009. Answer at 1. Fund II was originally intended to be a domestic feeder fund for an international fund; due to a lack of foreign interest, Fund II was launched as an independent entity, not a feeder fund. Tr. 973, 2672-73, 2759, 2850-54; Div. Ex. 210. The Funds invested in three asset classes: bridge loans to start-up companies;[8] equity investments, principally in microcap companies; and life settlement policies. *Id.* The Funds' assets under management peaked at approximately $30 million at the end of 2011. *Id.* Together, the Funds have approximately 120 investors. Answer at 3. JTCM, acting through Jarkesy, represented that it was solely responsible for managing the funds. Answer at 6.

3. JTF and Belesis

JTF was a broker-dealer based in New York City. Answer at 2. Belesis was JTF's founder and chief executive officer. *Id*. Belesis and Jarkesy became acquainted in 2003.[9] *Id.* Until late 2011, JTF was the primary placement agent for the Funds and was one of several broker-dealers that executed equity trade orders for the Funds. Answer at 2-3; Tr. 2396. JTF brokers' representations, including misrepresentations, induced some customers to invest in the Funds. Tr. 752-53, 776-77, 782-83, 788-

[7] Official notice, pursuant to 17 C.F.R. § 201.323, is taken of the Commission's public official records.

[8] A bridge loan is made to a company as short-term financing before it raises capital from the public. Resp. Ex. 138 at 5.

[9] At the hearing Jarkesy denied that it was 2003 when he became acquainted with Belesis, but did not provide an alternate date. Tr. 2515-21. The reason for this is not apparent from the record.

90, 793-96, 826-29, 852-54, 1351-53, 1430 1443, 1488, 1491, 1826-27, 1838, 1850-51; Div. Exs. 607, 608.

Fund I's July 2007 Placement Agent Agreement provided that the Fund pay JTF 10% of the capital contributions it received (whether sold through JTF or not) plus a 0.05% trail commission each year. Div. Ex. 501 at JTBOF 1702. A similar representation was made in Fund II's Private Placement Memorandum (PPM), and Fund I's PPM disclosed that JTF would earn commissions, without specifying the amount. Div. Ex. 206 at 46, Div. Ex. 210 at 63, 67-68. JTF and Belesis occasionally introduced Jarkesy and JTCM to candidates for bridge loans. Answer at 7. JTF also served as investment banker to several of the companies that received bridge loans from the Funds, including three of the Funds' largest holdings: America West Resources, Inc., f/k/a Reddi Brake Supply Corporation (America West), Galaxy Media & Marketing Corp. f/k/a Amber Ready, Inc. (Galaxy), and Radiant Oil & Gas, Inc., f/k/a G/O Business Solutions, Inc. (Radiant). Answer at 3; Tr. 2158-59 & *passim*.

JTF's logo – "JTF" inscribed on a shield – was displayed on PPMs, monthly and quarterly reports, marketing materials, and emails and communications related to the Funds, including investor account statements.[10] *See, e.g.*, Div. Exs. 206-11, 215, 217-20, 222, 224, 229a, 237-38, 243-44, 258. However, JTCM's website made this representation about the relationship between JTF and JTCM and the Funds:

> John Thomas Bridge and Opportunity Fund is not affiliated with John Thomas Financial. John Thomas Financial is a New York Based Broker Dealer that is acting as a selling agent for the fund. No other relationship between the parties should be construed including that of owning, managing, directing or making any decisions for the fund. The fund operates pursuant to its board of directors and the fund's manager Mr. George Jarkesy.

Div. Ex. 502. America West's and Radiant's 2010 Forms 10-K – signed by Jarkesy – represented that JTF and Fund I were not affiliates. Div. Ex. 310 at 37, 39, Div. Ex. 311 at 72, 76. In his testimony, Jarkesy indicated that his selection of the John Thomas name was serendipitous. Tr. 74.

According to Financial Industry Regulatory Authority, Inc. (FINRA), records, JTF withdrew its registration as a broker-dealer on June 14, 2013. *See* John Thomas Financial BrokerCheck Report at 2 *available at* http://brokercheck.finra.org (last visited Oct. 9, 2014).[11] Additionally, FINRA cancelled JTF's membership on August 16, 2013, for failure to pay outstanding fees, and

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[10] One iteration of Fund I's PowerPoint® marketing material even included the name "John Thomas Financial" with the logo. Div. Ex. 211. The JTF logo was discontinued after the name change to Patriot 28. Div. Exs. 234, 242, 247.

[11] Official notice, pursuant to 17 C.F.R. § 201.323, is taken of these records. *See Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 SEC LEXIS 1148, at *2 n. 1 (Apr. 18, 2013), *pet. for review denied*, No. 13-1252, 2014 U.S. App. LEXIS 15559, at *1-2 (D.C. Cir. Aug. 13, 2104).

expelled it from the securities industry on October 31, 2013, for failure to pay fines or costs associated with an August 16, 2011, Letter of Acceptance, Waiver and Consent. *Id* at 15. JTF had also been sanctioned by several state regulators for various types of misconduct. *Id* at 21-22, 24-26, 29-31.

Belesis is unusually forceful and unpleasant in business dealings. Tr. 641-42, 648-51, 692, 697-98, 1556-68, 1868, 2504; Div. Exs. 514, 521, 631. He also has a disciplinary record. *See* Anastasios P. Belesis BrokerCheck Report at 8-35 *available at* http://brokercheck.finra.org (last visited Oct. 9, 2014). Jarkesy has stopped doing business with Belesis. Tr. 2369-70, 2510-12. He became unhappy with JTF and Belesis starting in 2010 due to JTF/Belesis's hardball tactics and failure to raise money for portfolio companies at that time. Tr. 2175, 2510-12.

During the time at issue, Jarkesy was in frequent contact with Belesis concerning various business dealings related to the Funds. Tr. 1555-56, 1567-68, 1577-78, 1582-83 and Div. Exs. 512, 513, 514, 516, 517, 518, 518A, 520, 639 (Galaxy); Tr. 642 and Div. Ex. 511 (America West); Div. Exs. 631, 645, 646 (EnterConnect Inc.). Belesis reinforced his position in the relationship through threats to stop selling interests in Jarkesy's Funds. Div. Ex. 631 (Mar. 12, 2009, email from Belesis to Jarkesy: "our relationship based on your actions is slowly coming to an end"), Div. Ex. 643 (Aug. 21, 2010, email from JTF to JTCM: "Per Tommy . . . [t]here will no longer be any funds from John Thomas Financial clients into the bridge fund.").

B. Credibility

Jarkesy testified at the hearing. Tr. 25-274, 1183-1339, 1499-1534, 2377-2469, 2474-77, 2486-2530, 2577-2590, 2599-2640, 2658-2818, 2830-3012. He generally testified in an evasive manner that did not provide any assurances of the reliability of his testimony. Thus, no weight has been placed on his testimony as to facts that are disputed or not corroborated by credible evidence elsewhere in the record.

In the course of his testimony, Jarkesy responded, "I don't recall" or a variant of that phrase more than 800 times, including to such questions as: "what is restricted stock?"; "what is your understanding of what institutional investors are?"; "if the fund had more than 5 percent in one company, it wouldn't be diversified?"; "[d]o you think that the addition of the term restricted makes that a different company?"; and "[d]id you have discussions with John Thomas Financial about how they were going to find investors for the fund?" Tr. 87, 160, 122-23, 185, 1184. He also responded, "I don't recall" to "why did you choose John Thomas Financial to be the lead placement agent?" and "[between] 2008 and 2009, the funds also had liquidity issues. Isn't that correct?" Tr. 2788, 2799.[12]

[12] Jarkesy also repeatedly "did not recall" when asked to identify evidence, such as emails with his name in the to, from, or cc fields that JTCM had produced, as was evidenced by the Bates numbers on the documents, starting with "JTBOF," or the path information on the bottom of the documents. Tr. 75-76; Div. Ex. 501; *see, e.g.*, Tr. 1993-94, 2883-84, 2989-90; Div. Exs. 621, 652, 660. While Jarkesy might indeed not recall specific emails, his argument that numerous documents JTCM produced through its prior counsel (not Jarkesy and JTCM's hearing counsel) are unreliable or lack foundation appears to be a suggestion that prior counsel manufactured evidence that could be used

While Jarkesy evaded a large portion of the Division's questions, his recollection markedly improved when questioned by his own counsel. Jarkesy's participation in the hearing on March 7, 2014, illustrates this. For the majority of that hearing day (approximately 120 transcript pages), Jarkesy's counsel conducted direct examination of him, during which Jarkesy used the phrase "I don't recall" or something similar about twenty-five times, while otherwise providing substantive answers to his counsel's questions. *See* Tr. 2658-2779. When the Division cross-examined Jarkesy, however, he responded to questions, with "I don't recall" or something similar over forty times in a significantly shorter period (less than twenty transcript pages) of questioning. *See* Tr. 2780-2818. For example, among the Division's first questions on cross-examination was "the bridge loans, those were high risk?," to which he answered, "I don't recall all the bridge loans, how they were done." Tr. 2781. The Division's next question, "[t]he private placements, those were high risk?," was answered with "I don't recall the private placements." *Id*.

Jarkesy further undermined his credibility by disclaiming responsibility for representations about the Funds made in the PPMs, financial statements, marketing materials, and newsletters, as discussed below.

C. The Funds

The Funds' PPMs and marketing materials contained various representations about the Funds and JTCM/Jarkesy's plans for managing them. Some of the representations that may have been accurate when the documents were first used became inaccurate and were not corrected.[13] The PPMs were put together with the assistance of lawyers engaged by Jarkesy. Tr. 105-06, 2371-73, 2378-80. Jarkesy determined the content of marketing materials, such as PowerPoint® presentations, with review by his lawyers. Tr. 211, 572-74, 952-53, 1484, 2557, 2783-84; Div. Exs. 211, 261, 600. Jarkesy drafted quarterly reviews provided to Fund investors; legal counsel reviewed them. Tr. 35-39; Div. Exs. 214, 218.

1. Warnings

Each PPM warned that the investment was speculative, involving substantial risks and was suitable only for those who could afford the risk of loss of their investment. Div. Ex. 206 at 2, Div. Ex. 210 at 26. In addition to the general warning, each PPM contained several pages of warnings about

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against him. However, he presented no independent evidence corroborating such wrongdoing. *See* Tr. 97, 106, 1525-27, 1980, 1991-92.

[13] Respondents argue that the Division did not prove that Fund I's June 1, 2007, PPM (as amended on August 21, 2007, to remove a $10 million minimum capital commitment requirement) and Fund II's February 5, 2009, PPM were used without alteration in selling interests in the Funds throughout the time at issue. However, Respondents, who are in the best position to know of any successor PPM amendments, did not offer evidence of any changes. Accordingly, it is found that Fund I's June 1, 2007, PPM, as amended on August 21, 2007, and Fund II's February 5, 2009, PPM were used without further amendments in selling interests in the Funds during the time at issue.

specific risks. Div. Ex. 206 at 20-32, Div. Ex. 210 at 26-50. The risks included: "These [investment, management, financing and disposition] policies may be changed from time to time at the discretion of the General Partner without a vote of the Limited Partners of the Partnership, although the General Partner has no present intention to make any such changes." Div. Ex. 206 at 20, Div. Ex. 210 at 26.

The PPM for Fund I also warned, "Any representations (whether oral or written) other than those expressly set forth in this memorandum and any information (whether oral or written) other than that expressly contained in documents furnished by the Partnership must not be relied on." Div. Ex. 206 at 3. Fund II's PPM contained a similar warning: "ONLY [JTCM] HAS BEEN AUTHORIZED TO MAKE REPRESENTATIONS, OR GIVE ANY INFORMATION, IN CONNECTION TO THE PARTNERSHIP INTERESTS. ANY INFORMATION, OTHER THAN THE INFORMATION CONTAINED HEREIN OR INFORMATION PROVIDED IN WRITING BY [JTCM], MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE PARTNERSHIP OR THE PARTNERS." Div. Ex. 210 at 7.

The Funds were organized as Delaware limited partnerships. Div. Exs. 206, 210. The PPMs noted, "Under the Delaware law, [JTCM] owes a fiduciary responsibility to [the] Limited Partners," that is, the investors. Div. Ex. 206 at 45, Div. Ex. 210 at 62. Fund I had a lock-up period of five years, Fund II, of four years, and each was to have a duration of ten years, with extensions possible.[14] Div. Ex. 206 at 11, 20, Div. Ex. 210 at 14, 22. Investors might be able to redeem their investments, but upon potential payment of a penalty. Div. Ex. 206 at 20 ("you will not be able to withdraw your investment from [Fund I] without significant penalty, if at all. See 'Liquidity Risks.'"), 28; Div. Ex. 210 at 28 ("During [the lock-up] period, Limited Partners may not be able to make any withdrawals from their Capital Accounts. See '<u>Risk Factors – Risks Relating to Illiquidity</u>'"). Jarkesy withdrew from Fund I $100,000 less a $20,000 penalty during February 2009.[15] Tr. 1330-35; Div. Ex. 236 at 17, Div. Ex. 316 at 11, Div. Ex. 659. Jarkesy had invested $500,000 in September 2007 as the first investor in Fund I. Div. Ex. 203 at 5.

Investments in the Funds were being sold as late as 2010. Div. Ex. 315 at 11 (Fund I's financial statement showing capital contributions for the period ended December 31, 2008), Div. Ex. 316 at 11 (Fund I's financial statement showing capital contributions for the period ended December 31, 2009), Div. Ex. 317 at JTBOF 6298 (Fund I's financial statement showing capital contributions for the period ended December 31, 2010), Div. Ex. 318 at JTBOF 6311 (Fund II's financial statement showing capital contributions for the period ended December 31, 2010). Neither Fund reached its target size. The target size for Fund I was $25 million; over its life, approximately $20 million was invested. Div. Ex. 206 at 7, Div. Ex. 317 at JTBOF 06298. The target size for Fund II was $250

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[14] In March 2012, Jarkesy emailed Fund I investors, stating his intention to wrap up the Fund, and saying, "By initial design it was contemplated that the fund would wrap up its business by September 2012." Div. Ex. 234. Investor Robert Fullhardt believed that the Fund had a September 2012 maturity date. Tr. 1362. Investor Steve Benkovsky also believed that the fund had a five-year duration that would end in 2012. Tr. 710, 746.

[15] The account statements for Jarkesy's investment in Fund I (under the name "Jarkesy Merchant Capital Ltd.") contain the notation "CC: Tommy Belesis." Div. Ex. 236.

million; approximately $4 million was invested. Div. Ex. 210 at 11, Div. Ex. 261 at 9, Div. Ex. 318 at JTBOF 6311, Div. Ex. 608 at 9. Jarkesy advised investors on March 13, 2013, that Fund I was dissolved as of that date.[16] Div. Ex. 242.

2. Investments

The PPM for each Fund stated that the Fund would make two types of investments: (1) investments in in-force life insurance policies with face values totaling 117% of the aggregate capital commitments and (2) short to medium term debt and equity investments in business enterprises. Div. Ex. 206 at 7, Div. Ex. 210 at 12. The insurance component was intended to be conservative, described in marketing materials as "Return **of** Capital," and the business component was intended to be more speculative, described in marketing materials as "Return **on** Capital." *See, e.g.*, Div. Exs. 222, 224. Thus, each Fund was described as "Two Investments ... One Fund ***Hedged***." *Id.*; *see also* Div. Exs. 211-21, 248. That is, the life insurance portfolio was represented as a conservative hedge that insured return of investors' principal and the corporate portfolio, as providing for the possibility of a profitable return on the principal. *Id.*

The PPMs described JTCM's plans to invest in a "Life Settlement Portfolio" and a "Corporate Portfolio." Div. Ex. 206 at 33-39, Div. Ex. 210 at 55-62. Life settlement refers to the purchase of existing life insurance policies at a discount to their face values, maintaining them by paying the premiums, and collecting when the insured dies.[17] *Id.* The corporate portfolio was to contain various forms of debt and equity in companies.

The PPM for Fund I represented that JTCM "intends to use up to 50% of the Capital Contributions" to acquire insurance policies. Div. Ex. 206 at 34. It represented that "[t]he aggregate face value of such acquired policies is intended to amount to approximately 117% of the aggregate capital commitments." *Id.* In a podcast sent to investors on May 21, 2009 (Podcast), Jarkesy explained that 50% of capital invested would go into life settlements; of that 50%, 30% would be used to buy the policies, and the remaining 70% would be "set aside to pay premiums through the life expectancy." Div. Ex. 203 at 21-22, Div. Ex. 204. The policies were to be held by a "Master Trust." Div. Ex. 206 at 35-36. The Master Trust was to have two deposit accounts: a collection account for the proceeds of payments of death benefits or receipts from sales of the policies, and a premium financing account, which "will contain sufficient cash upon the purchase of the Life Settlement Policies to pay the

[16] Division Exhibit 242 indicates that Fund I is being dissolved on March 13, 2013 and JTCM "will use all commercially reasonable efforts to sell all of [Fund I's] assets." Div. Ex. 242. The sale of all the assets had not occurred as of the time of the hearing; both Funds hold shares of Radiant and Fund II, at least, currently has an account at Wells Fargo Bank; Fund I has one life insurance policy. Tr. 551, 1252-53, 1314-16; Div. Ex. 404.

[17] Fund I's PPM warned, "The life settlements industry has been tainted by fraud." Div. Ex. 206 at 21. Fund II's PPM warned, "The life settlements industry has been tainted by allegations of fraud and misconduct" and noted an increasing amount of litigation concerning this. Div. Ex. 210 at 34. Indeed, an insurance company sued to have two policies that Fund I bought declared void as having been procured without an insurable interest. Div. Ex. 495.

premiums of such polic[i]es for the expected life expectancy" of the insured; the cash was to be invested in "overnight government securities until needed." Div. Ex. 206 at 36. The death benefits were to be distributed to the investors after five years. Div. Ex. 206 at 36, Div. Ex. 211 at 7, Div. Ex. 217 at 1. The PPM for Fund I further represented that the remaining amount of capital commitments "anticipated to be approximately 40%" would be devoted to corporate investments. Div. Ex. 206 at 38. The PPM for Fund II did not provide such numerical details. However, marketing materials for Fund II represented that about half of Fund II's investment would be in insurance policies amounting to at least 117% of capital commitments with additional funds to secure payment of premiums, with the other half in corporate investments. Div. Exs. 224, 608.

3. Compensation and Valuation

The PPMs disclosed that JTCM would be compensated by the "two and twenty" measure (investment management fee of 2%, per annum, of the Fund's net asset value (NAV) and performance, or incentive, fee of 20% of appreciation (in excess of a minimum) of the NAV). Div. Ex. 206 at 73, 85, Div. Ex. 210 at 19-20. Thus, the higher the value of the Funds' holdings, the higher JTCM's compensation would be.

The PPM for Fund I provided, "The value of investments made by [Fund I] will be determined solely by or under the direction of [JTCM]." Div. Ex. 206 at 40. The February 5, 2009, PPM for Fund II provided that JTCM would value insurance policies as it reasonably determines. Div. Ex 210 at 46. Corporate investments would be "fair valued." Div. Ex. 210 at 38-40. The PPM warned, "The process of valuing assets for which no published market exists is based in inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for such assets and may differ from the prices at which such assets may be sold." Div. Ex. 210 at 65. The Funds' financial statements represented that the assets were fair valued pursuant to Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157 (FAS 157), effective January 1, 2008, later updated and codified as Accounting Standards Codification 820. *See* Div. Ex. 315 at 9, Div. Ex. 316 at 9, Div. Ex. 317 at JTBOF 6296, Div. Ex. 318 at JTBOF 6308. The investments in interest-bearing and equity securities were "recorded at fair value as determined in good faith by [JTCM]." Div. Ex. 315 at 8, Div. Ex. 316 at 8, Div. Ex. 317 at JTBOF 6295, Div. Ex. 318 at JTBOF 6307. The values of insurance policies were "estimated by [JTCM] using a life expectancy model." Div. Ex. 315 at 8, Div. Ex. 316 at 8, Div. Ex. 317 at JTBOF 6295.

When he formed the Funds, Jarkesy engaged lawyers, auditors, and a fund administrator, AlphaMetrix 360 f/k/a Spectrum Global Fund Administration (AlphaMetrix or Spectrum). Tr. 65-66, 282-86, 2378-79; Div. Ex. 230. The services AlphaMetrix provided for the Funds are listed in a Services Agreement. Tr. 285-86, 293-94, 420; Div. Ex. 230 at Schedule I. These include calculating the NAV and calculating and distributing investor statements, monthly.[18] Tr. 286-87, 290-91; Div. Ex. 230 at Schedule I. The valuation of each asset in the Funds' holdings at each month-end was shown on each Fund's holdings pages. Tr. 326-27; Div. Exs. 301, 303. Each individual investor's share was

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[18] AlphaMetrix also sent communications such as a "research report" on America West, a letter from Jarkesy, and a press release concerning America West, and a Fund "Quarterly Review to investors at the request of Jarkesy. Tr. 339-44; Div. Exs. 214, 218, 239, 240, 250.

calculated from the aggregate valuation shown on the holdings pages. Tr. 326-28, 402-03. The account statement sent to an investor showed the valuation of his interest in the Fund and any performance, not the individual holdings of the Fund. Tr. 327-29; Exs. 236, 237, 238.

Contrary to the representations in the Funds' PPMs and financial statements that JTCM set the valuations for the Funds' positions, Jarkesy disclaimed responsibility for this, indicating that AlphaMetrix valued the Funds' positions. Tr. 2663 ("The valuations were provided and checked by Alpha[M]etrix."); *see also* Tr. 1144 (The auditors "considered AlphaMetrix part of the management team."), 2157 (Jarkesy describing AlphaMetrix as a valuation consultant). In reality, AlphaMetrix did not value any of the Funds' positions itself; it had no capability to do so. Tr. 289-90, 299-300. AlphaMetrix attempted to obtain valuations for the Funds' positions from independent sources, such as Bloomberg; for assets, such as the Funds' bridge loans and short-term notes, life settlement policies, and warrants, for which it could not obtain values from an independent data provider, it asked JTCM for valuations. Tr. 287-300. AlphaMetrix tried to get as much documentation as possible in support of JTCM's marks. Tr. 311-12. Questions concerning valuation were directed to Jarkesy or to his assistants Linda Ortiz and Patty Villa, who relayed Jarkesy's decisions. Tr. 295, 300-06, 428; Div. Exs. 329, 330, 333. Jarkesy had the final word, even if unreasonable, in setting valuations; for example, he insisted on valuing restricted America West stock at the same price as free-trading stock even after AlphaMetrix questioned this. Tr. 347-50. Prices on the Funds' holdings pages, which ultimately were reflected in the account values shown in investors' monthly statements, were obtained as described above. Tr. 325-29, 402-03; Div. Exs. 301-04. JTCM would approve the holdings, then approve any profit and loss, then approve financial statements, and ultimately the investor statements. Tr. 328. AlphaMetrix eventually terminated the relationship with the Funds due to nonpayment. Tr. 345, 434-37.

Management fees paid to JTCM through December 31, 2010, totaled $1,278,597. Fund I paid $337,000 during the fifteen months ended December 31, 2008 (Div. Ex. 315 at 11), $363,700 during 2009 (Div. Ex. 316 at 12), and $509,000 during 2010 (Div. Ex. 317 at JTBOF 6299). Fund II paid $68,897 during the eighteen months ended December 31, 2010 (Div. Ex. 318 at JTBOF 6311). *See also* Tr. 2710 (Jarkesy agrees that JTCM received about $1.3 million in management fees). The financial statements did not reflect any payments of incentive fees separate from management fees.[19]

4. KPMG and Deutsche Bank

Investor updates and other marketing materials created by Jarkesy and JTCM between 2008 and 2010 identified KPMG LLP (KPMG), among others, as the auditor of Fund I, and other marketing materials identified KPMG as the auditor for both Funds through 2010. Answer at 6; Div. Exs. 220-224, 248. However, KPMG never audited either Fund. Answer at 6; Tr. 565. The Funds' auditor was Mir Fox & Rodriguez (MFR), a small Houston firm. Tr. 982-97. Eventually, MFR terminated the relationship due to nonpayment. Tr. 998. Jarkesy and JTCM's marketing materials for the Funds identified Deutsche Bank, among others, as the Funds' prime broker. Answer at 6. However, Deutsche Bank never became the Funds' prime broker. Tr. 565; Div. Ex. 229A.

[19] Incentive fees are referenced in the record. Tr. 1326, 2664-65, 2710, 2730. However, there is no evidence that establishes the amount, if any, of incentive fees actually paid to JTCM.

5. America West, Galaxy, and Radiant[20]

Portfolio companies America West, Galaxy, and Radiant figure prominently in the events at issue. Tr. *passim*; Div. Exs. *passim*; Resp. Exs. *passim*.

a. America West

America West is a now-bankrupt domestic coal producer in Utah. Tr. 620-25; Form 8-K filed January 24, 2013.[21] Alexander Walker, III (Walker), a Salt Lake City lawyer whose family operated America West's mine before the Funds' investments, is now America West's sole officer and director. Tr. 620-23. Jarkesy was a director of and active in managing America West from about December 2007 to 2012. Tr. 626-28. Brian Rodriguez (Rodriguez), an associate of Jarkesy, was also a director and CFO of the company.[22] Div. Ex. 311 at 19, 64-65.

Jarkesy introduced America West to JTF, which became the company's investment banker from 2008 through June 2011. Tr. 637-38. America West paid JTF what amounted to a 13% commission on all funds raised and was also required to use JTF for insurance and other services; America West was forced to comply with these terms because it was in dire need of financing and had exhausted other alternatives. Tr. 638-42, 681, 683. In fact, it was always undercapitalized. Tr. 675. Jarkesy was the only person from America West who could talk to Belesis but was unsuccessful in persuading him to lower the fees. Tr. 642-43, 686-87. America West was also required to issue stock in addition to paying various fees; in fact, on one occasion when Walker thought America West had a binding deal for a desperately needed cash infusion from JTF, Belesis telephoned him and demanded 10 million shares of America West stock before he would wire the money. Tr. 647-49; Div. Ex. 311 at 30-31. Jarkesy told Walker he was upset but could do nothing. Tr. 649. Eventually, America West came to believe that JTF was an affiliate of the Funds. Tr. 656-65, 688-93; Div. Ex. 346 at 72. Walker was shocked in early 2012 when a JTF representative told him it was unnecessary for Jarkesy to participate in a conference call related to the Funds' investments in America West because he could speak for Jarkesy and, in fact, JTF and Jarkesy were partners in this and other investments and "are tied at the hip." Tr. 654-58.

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[20] The Division identified, at Tr. 2486-87, the companies referred to in the OIP as Companies A, B, C, and D as follows: Galaxy is Company A; B is Radiant; C is Amber Ready, Inc.; and D is America West.

[21] Official notice, pursuant to 17 C.F.R. § 201.323, is taken of the Form 8-K and of America West's and Radiant's Forms 10-K, which are in the Commission's public official records contained in EDGAR.

[22] Marathon Advisors, LLC, jointly owned by Jarkesy and Rodriguez, was designated as the successor general partner for Fund II in the event of the withdrawal of Jarkesy as a General Partner Key Man. Div. Ex. 210 at 15, 52-53. Rodriguez was also an officer and director of Radiant. Div. Ex. 310 at 32-33.

America West paid more than $3.2 million cash in fees to JTF. Tr. 644; Div. Ex. 346 at 72 ($1,767,265 in sales commissions from Q4 2010 to May 16, 2012); 2009 Form 10-K at 42 ($115,425 in sales commissions, $180,000 in consulting fees paid in 2009); 2008 Form 10-K at 26-27 ($1,226,065 in sales commissions paid in 2008). America West also issued warrants to JTF. Div. Ex. 346 at 72; 2010 Form 10-K at 31; 2009 Form 10-K at 42. As of April 14, 2010, JTF owned 4% and the Funds, Jarkesy, and affiliates owned 19.2% of America West. Div. Ex. 311 at 69.

In addition to purchasing America West stock, Fund I made loans to America West, totaling $925,000 by the end of 2008. Div. Ex. 301 at JTBOF 19211, 19235, 19247. Fund I received additional stock in connection with the loans. America West paid JTF a commission of $120,250 in connection with the $925,000 loan. 2008 Form 10-K at 26. America West paid off the loans in January 2009. Div. Ex. 203 at 13-14, Div. Ex. 301 at JTBOF 19207, 19211. Fund I made more loans in 2009, which by the end of 2009 amounted to at least $1.3 million. Div. Ex. 301 at JTBOF 19167. By then, America West had fallen behind on its payments; it was in default and the loan was due on demand. Div. Ex. 311 at 53. Jarkesy believed that the notes would be paid; either JTF or another bank would raise capital or the notes would be restructured. Tr. 2426-29. Fund I continued to lend during 2010, and, as of year-end, had twelve notes totaling $1,725,500. Div. Ex. 301 at JTBOF 19131. Fund II also made loans during 2010; as of year-end it had seventeen notes totaling nearly $1.4 million, many of which were past due. Div. Ex. 303 at JTBOF 19287. Respondents did not write down the value of the notes. Div. Ex. 301 at JTBOF 19131, Div. Ex. 303 at JTBOF 19287. Nor did they advise their auditors that any of the notes were impaired. Tr. 1047-48, 1159. The vast majority of the loans were not repaid. Tr. 633. Rather, in July 2011, much of the debt was converted into equity and America West issued nearly 13 million shares of common stock to the holders of the notes. Tr. 633-34; Div. Ex. 346 at 30. America West paid JTF approximately $580,450 in so-called "sales commissions" with respect to this conversion. Div. Ex. 312 at 3; Resp. Ex. 138 at 272.

Jarkesy spoke highly of America West in the Podcast. Tr. 208-10; Div. Ex. 203 at 13-14, 16-17, Div. Ex. 204. His optimism was inconsistent with America West's true financial condition; the unaudited financial statements included with America West's Form 10-Q for the quarter ended March 31, 2009, contained a going concern statement. Div. Ex. 348 at 11. Jarkesy also had an optimistic "Research Report" concerning America West sent to Fund investors in September 2010, and a press release concerning an interview with Jarkesy about America West. Tr. 339-41; Div. Exs. 239, 250. In August 2011 Jarkesy sent a letter to investors with optimistic predictions about America West for the following year. Div. Ex. 240. This was again inconsistent with America West's true financial condition; its 2010 Form 10-K, signed on April 15, 2011, by Jarkesy, contained a going concern statement. Div. Ex. 311 at 12, 46.

b. Galaxy

Galaxy's business plan included an infomercial for its skin care product that was ultimately not funded. Tr. 1548, 1550-51, 1556-58; Div. Ex. 314 at 6, Div. Ex. 521. Galaxy was in poor financial shape. Tr. 1587, 1598-1600, 1700; Div. Ex. 314, Div. Ex. 514 at 1. The audited financial statements for the year ended December 31, 2009, for Galaxy's two predecessor companies each contained a going concern statement. Div. Ex. 314 at 61, 126. After an appeal from then CEO Frank DelVecchio on December 17, 2009, Belesis ordered Jarkesy to provide funds "ASAP." Div. Ex. 513. The next day, December 18, 2009, Fund I bought $30,000, and Fund II, $10,000, of Galaxy stock. Div. Ex. 314

at 15. As of September 30, 2010, Galaxy had cash of $1,330, current liabilities vastly in excess of current assets, and an accumulated deficit of $42,116,148. Div. Ex. 314 at 98.

Gary Savage (Savage), who had been CEO of a predecessor company, was Galaxy's CEO from April 2010 to July 2011, when he resigned. Tr. 1550, 1560, 1638, 1645; Div. Ex. 314 at 32. In searching for funding, Savage met Belesis, who was interested and told him to meet with Jarkesy in Houston. Tr. 1554-56, 1686, 1689-90, 1694. Savage met with or spoke on the phone with Belesis many times. Tr. 1687, 1712. *See also* Tr. 1557-99 *passim*. Galaxy did receive some loans but not the amount of financing that Belesis promised. Tr. 1564, 1703, 2454. When Jarkesy did provide financing, he sent funds directly to Galaxy's creditors rather than to Galaxy. Tr. 1569-72, 2447-51. Belesis and Jarkesy installed a CFO of their choice into the company and tightened control over check-writing.[23] Tr. 1572-86; Div. Exs. 516, 517. Together, Belesis and Jarkesy exerted control over the company.[24] Tr. 1555-56, 1567-69, 1572-86, 1711. As of February 7, 2011, Fund I owned 43.18% of Galaxy. Div. Ex. 314 at 35.

Galaxy issued penalty shares, also referred to as liquidated damages shares, pursuant to a "Registration Rights Agreement" and other agreements, to the Funds due to its defaults under those agreements. Tr. 415-19, 1738-56, 2132, 2458; Resp. Exs. 4, 6, 7, 8.

AlphaMetrix relied on Jarkesy's valuations since Galaxy was not publicly traded. Tr. 308-09; Div. Exs. 324, 329, 330. On one occasion, there was a transfer of Galaxy shares from Fund I, where they were valued at $0.002, to Fund II, where Jarkesy attempted to value the same shares at $1.00; when confronted, Jarkesy backed down, and the matter was resolved satisfactorily from an accounting standpoint. Tr. 311, 323-25, 414-15; Div. Ex. 325. From the end of 2009 through the beginning of 2011, the value that Respondents assigned to Galaxy and its predecessor company varied widely from $0.10 to $3.30. Div. Exs. 301, 305. The number of shares outstanding during that time varied, due to a reverse split, issuance of penalty/liquidated damages shares, etc.; however, the changes in the valuations did not accord with these events. Tr. 307-25, 2468, 2733-35; Div. Exs. 324, 325, 329, 330, 333. In July 2011, Respondents wrote down the value of the shares to zero. Tr. 2736; Div. Ex. 301 at JTBOF 19107, Div. Ex. 303 at JTBOF 19273.

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[23] Two persons, in addition to Savage, had been authorized to write checks and had embezzled funds from the company. Tr. 1766-85. One of the persons was a convicted felon. Tr. 1778, 1783.

[24] Savage sued, among others, Fund I, JTCM, and JTF (JT Defendants) for unpaid salary and benefits owed by Galaxy. Resp. Ex. 312. The court declined to pierce the corporate veil and dismissed the claims against the JT Defendants, noting that the allegations "pertain precisely to the type of conduct implicated in [controlling precedent]; that the JT Defendants ensured the money they lent to Galaxy was used as they saw fit is to be expected of a lender." *Savage v. Galaxy Media & Mktg. Corp.*, No. 1:11-cv-6791 (S.D.N.Y. July 5, 2012), ECF No. 26 at 18, *aff'd*, 526 Fed. App'x. 102 (2d Cir. 2013); Official notice.

c. Radiant

Radiant is an oil and gas exploration and production company. Div. Ex. 310 at 4. As of December 8, 2010, Fund I and Jarkesy owned 17% and JTF owned 23% of Radiant. Div. Ex. 310 at 35. Jarkesy was a director of Radiant during 2010 through 2013. Tr. 1318, 2476; Div. Ex. 310 at 35-36; Form 10-K for 2011 and 2012, filed Jan. 22, 2014, at 47, Official notice. Jarkesy introduced the company to JTF. Tr. 2218. As with America West, JTF was to receive payments for investment banking services totaling 13% of the proceeds of equity financings, as well as stock and warrants. Div. Ex. 310 at 36, 57. As with Galaxy, JTF promised, but did not provide, financing of Radiant. Tr. 2491, 2511.

Radiant's predecessor, G/O Business Solutions, Inc. (GOBS), was founded in 2007. Resp. Ex. 311. At the time, the company's stock was held mostly by Sand Hills General Partners and its owner, Sand Hill Partners, LLC; Jarkesy owned a one-third interest in Sand Hill General Partners. Div. Ex. 343. On December 27, 2007, Jarkesy sold the shares of GOBS that he controlled through Sand Hill to Fund I for $400,000. Div. Ex. 301 at JTBOF 19258, Resp. Ex. 311 at 34. For more than a year, Respondents valued the shares of GOBS at cost but in March 2009 increased the value from $0.02 to $0.06 per share, recognizing an unrealized gain of $746,000. Div. Ex. 301 at JTBOF 19198. Respondents maintained this valuation until April 2010. Div. Ex. 301 at JTBOF 19154. At that time, the company reorganized, effected a 5:1 reverse split, and changed its name to Radiant. Resp. Ex. 310 at 29.

Based on the 5:1 reverse split, Respondents revalued the stock from $0.06 to $0.30 per share. Div. Ex. 301 at JTBOF 19154. In August 2010, Radiant acquired an oil and gas production company; the agreement was first announced in a Form 8-K dated July 23, 2010. Resp. Ex. 310 at 5, 9, 29. There were no public transactions in the stock during July, August, or September 2010. Div. Ex. 111. Respondents sold 300,000 shares of Radiant from Fund I to Fund II in August, with a cost basis to Fund II of $0.23. Div. Ex. 303 at JTBOF 19295. Nonetheless, Respondents increased their valuation of Radiant in Fund I to $1.00 per share in August 2010, causing an increase in Fund I's unrealized profits for this holding. Div. Ex. 301 at JTBOF 19142.

A further, 2:1, reverse split occurred in September 2010. Div. Ex. 310 at 23. The $1.00 valuation was maintained. Div. Ex. 301 at JTBOF 19136. The stock traded for the first time in fifteen months during four days in December 2010, ending the year at $4 per share. Div. Ex. 111 at 4. The price spike was coincident with the promotional campaign discussed *infra*. Using the $4 price, Respondents' valuation of Fund I's Radiant position reflected an unrealized gain at year-end of nearly $7 million, more than a $5 million gain from the previous month. Div. Ex. 301 at JTBOF 19130, 19133. Fund I's financial statements for year-end 2010 represent the fair value of the equity position in Radiant as $6,936,996. Div. Ex. 317 at 4, 8. Fund II's financial statements for year-end 2010 represent the fair value of the equity position in Radiant as $1,746,320. Div. Ex. 318 at 4, 8. Fund II held Radiant warrants, and AlphaMetrix relied on Jarkesy's valuations of them since they were not publicly traded. Div. Ex. 333. He insisted on valuing them at $6.92 as of January 31, 2011, even though they had last been priced at $0.12 on August 31, 2010. Tr. 302-06; Div. Ex. 333. JTCM justified the dramatic revaluation of the warrants, on the basis that "the stock price was crazy in Jan[uary]." Div. Ex. 333. However, this justification was inconsistent with the fact the price had fallen to $2.25 by the end of January. Div. Ex. 111.

Some of the Funds' Radiant shares were distributed to Fund I and II investors in October 2013. Tr. 48-49, 744, 818-19, 1314-15, 1398; Div. Ex. 247. Jarkesy sent the investors their stock certificates with an October 23, 2013, letter in which he enclosed a Radiant press release announcing a purchase of oil and gas properties in a cash and Radiant stock transaction; Jarkesy stated that these Radiant shares were valued at $2 per share and opined that the stock could be worth substantially more. Div. Ex. 247. Yet, the closing price available from Yahoo! Finance was $1.04 from at least October 24, 2013, to January 2, 2014; there were no transactions during that period. Div. Ex. 111A.

6. Promotions

Jarkesy directed America West to hire promotional firms to promote its stock and chose the firms. Tr. 628-32. At his behest, America West engaged MEC Promotions (MEC) to conduct a promotional campaign. Tr. 629, 870-71, 883-86. MEC received $5,000 from the Funds[25] in October 2010, $50,000 in December 2010, and $30,000 in January 2011;[26] these payments were for work being done at that time.[27] Tr. 888-91; Div. Exs. 306, 306d, 307a, 308.[28] MEC sent out ten to fifteen emails to its subscriber list of about 5,000 and posted information on its website as well.[29] Tr. 886, 897. America West, at the behest of Jarkesy, also engaged Park Avenue Consulting and Uptick Capital LLC for "investor relations services," paying them in stock, the former in October 2010, and the latter in November and December 2010. Div. Ex. 311 at 31-32. The price of America West spiked: it closed at $0.075 on October 1, 2010, but at $1.95 on December 31, 2010. Tr. 667-68; Div. Ex. 110. On December 30, 2011, it was $0.21, and on December 31, 2012, $0.047. *Id.* Respondents valued America West stock at $1.95 on Fund I's holdings page as of December 31, 2010. Div. Ex. 301 at JTBOF 19130.

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[25] These payments were pursuant to a flow of funds of loan[s] the Funds made to America West. Tr. 891-92, 2493-96.

[26] MEC also received, in February 2011, 150,000 shares from America West of its stock for consulting. Tr. 892-93, 906-07; Div. Ex. 311 at 32.

[27] Additionally, on September 28, 2010, Respondents, through AlphaMetrix, sent investors a research report on America West that they had commissioned. Div. Ex. 239. Additional articles by a promoter extolling America West were published in August and September 2010 on the Examiner.com website. Div. Exs. 254, 255.

[28] Division Exhibits 306, 306a, 306b, 306c, 306d, and 307, account statements for Wells Fargo Bank account number ending in 1597, are for Fund II. Tr. 586. Division Exhibits 307a and 308, account statements for Wells Fargo Bank account number ending in 2171 are, thus, for Fund I.

[29] MEC obtained the content from public sites, not from America West. Tr. 884, 886.

MEC also conducted a more limited promotion of Radiant for which it was paid $5,000 by Fund II on December 28, 2010.[30] Tr. 897-98; Div. Ex. 306c. Radiant stock, which had not traded since September 10, 2009, when it closed at $0.12, closed at $4 on December 17, 2010, and at $4 on December 31, 2010. Div. Ex. 111. Respondents used $4 for their valuation of Fund I's Radiant position, which reflected an unrealized 2010 year-end gain of over $6.5 million, a more than $5 million gain from the previous month. Div. Ex. 301 at JTBOF 19130, 19133. Fund I's financial statements for 2010 represent the fair value of its Radiant position as $6,936,996, and Fund II's, as $1,746,320. Div. Ex. 317 at JTBOF 6291, Div. Ex. 318 at JTBOF 6303.

7. Investment Limitation

Fund I's PPM provided, under the heading "**Investment Limitations**," "The total investment of [Fund I] in any one company at any one time will not exceed 5% of the aggregate Capital Commitments." Div. Ex. 206 at 12. However, elsewhere, in a discussion of risk factors, the PPM stated, "Because as much as 10% of [Fund I's] aggregate committed capital may be invested in a single Portfolio Company, a loss with respect to such a Portfolio Company could have a significant adverse impact on [Fund I's] capital." Div. Ex. 206 at 25. The 5% figure was repeated in marketing materials and newsletters. "The fund is limited to 5% in any one corporate investment." Div. Ex. 214 at 3, Div. Ex. 215 at 3, Div. Ex. 216 at 5, Div. Ex. 217 at 2. "The fund is limited to 5% in any one corporate investment at the time of investment." Div. Ex. 218 at 5. The 10% reference cannot be reconciled with the explicit 5% limitation, which is repeated in the marketing materials and newsletters. Accordingly, it is found that the limitation was 5%. Fund II's PPM did not contain a percentage limitation. Div. Ex. 210.

Respondents' investments were not consistent with the 5% limitation. As of December 1, 2007, Fund I had capital contributions of $7,231,021.92, 5% of which is $361,551. Div. Ex. 231 at JBTOF 1692. Yet, as of that date Fund I had invested $495,705 in EnterConnect Inc., $400,000 in GOBS, $425,000 in Reddi Brake Supply Corp., and $518,800 in UFood Restaurant Group. Div. Ex. 301 at JTBOF 19257-59. As of December 31, 2008, Fund I had capital contributions of $16,620,511, 5% of which is $831,025. Div. Ex. 315. Yet, as of that date Fund I had invested $1,392,000 in America West (eight notes totaling $925,000 and more than $467,000 in America West stock). Div. Ex. 301 at JTBOF 19209, 19211. As of December 31, 2009, Fund I had capital contributions of $18,358,002, of which 5% is $917,900. Div. Ex. 316 at 11. As of that date Respondents had invested $1,860,000 in America West (a $1,330,000 note and stock and royalties purchased for more than $530,000.) Div. Ex. 301 at JBTOF 19166-67. As of December 31, 2010, Fund I had capital contributions of $20,112,852, of which 5% is $1,005,623. Div. Ex. 317. As of that date Fund I had invested $2,255,500 in America West (twelve notes totaling $1,725,500 plus the stock and royalties that cost more than $530,000). Div. Ex. 301 at JTBOF 19130-31.

As described in Fund I's financial statements, the values (as opposed to purchase price) that it assigned to its holdings also showed investments inconsistent with the 5% limitation. As described in

[30] Respondents added the $5,000 to Fund II's cost basis for the Radiant stock. Div. Ex. 303 at JTBOF 19285, 19287 (holdings pages for January 31, 2011, and December 31, 2010, showing a $5,000 increase in the cost basis for the same number of shares).

its financial statements, as of December 31, 2008, America West stock (valued at $5,465,040) comprised 33% of Fund I's capital, and Sahara Media Holdings, Inc., stock (valued at $3,049,383), 18%. Div. Ex. 315 at 5. As of December 31, 2009, America West stock (valued at $4,747,302) comprised 19% of capital, and Amber Alert/Amber Ready[31] stock (valued at $9,090,654), 37%. Div. Ex. 316 at 5. As of December 31, 2010, America West stock (valued at $7,013,322) comprised 26% of capital, and Radiant stock (valued at $6,936,996), 25%. Div. Ex. 317 at JTBOF 6291.

8. Distributions to Investors

There was one distribution to Fund I investors from a life settlement policy after the insured died. Tr. 743-44, 817, 822, 1392-94. Jarkesy told investor Robert Fullhardt that the amount distributed was small because the Fund had to retain most of the proceeds to pay premiums on the remaining policies. Tr. 1393-94. At the end of 2013 there was a distribution of shares of Radiant. Tr. 744, 818-19, 1398; Div. Ex. 247. There were no other distributions. Tr. 746, 822, 1403.

Fund I's PPM represented that the Master Trust holding the insurance policies would have a separate premium financing account, which "will contain sufficient cash upon the purchase of the Life Settlement Policies to pay the premiums of such polic[i]es for the expected life expectancy" of the insured. Div. Ex. 206 at 36. The Fund's actions were not in accord with this; it did not maintain sufficient cash to pay the premiums, and most of the policies lapsed because of this. Tr. 2503-04, 2958.

9. Life Insurance Policies

Fund II did not buy any life insurance policies; neither its financial statements nor holdings pages show any indication that Fund II owned policies. Div. Exs. 303, 318. This was inconsistent with the representations in Fund II's PPM and marketing materials. Div. Ex. 210 at 12, 55-60, Div. Ex. 224. The PPM represented that Fund II would acquire policies with a face value of at least 117% of aggregate contributions and the marketing materials represented that Fund II would devote half of its investments to policies; insurance policies were half of Fund II's two-part investment strategy. Div. Ex. 210 at 12.

Between September 28, 2007, and January 25, 2008, Fund I purchased eight life insurance policies, with face values (amount to be paid on the death of the insured) totaling $13 million. Div. Ex. 405. In April and May 2009, Fund I bought five additional policies, with face values totaling $13.5 million.[32] *Id.* Respondents decided to allow one policy (Paul Evert) with a face value of $5 million to lapse during 2009. Div. Exs. 414, 418, 424. As of December 31, 2008, Fund I had capital contributions of $16,620,511. Div. Ex. 315 at 11. Thus, the $13 million total face value of the policies was less than the 117% of that sum as promised in the PPM and marketing materials. The $21.5

[31] Galaxy was formerly known as Amber Ready, Inc., which was formerly known as Amber Alert Safety Centers, Inc. Div. Ex. 314 at 6.

[32] Jarkesy mistakenly said there were fourteen (rather than thirteen) policies in the Podcast that was sent to Fund I investors. Div. Ex. 203 at 20, Div. Ex. 204.

million total face value of policies held on December 31, 2009, was more than 117% of the capital contributions as of that date, $18,358,002. Div. Ex. 316 at 11. The $21.5 million face value was less than 117% of capital contributions, $20,112,852, as of December 31, 2010. Div. Ex. 317 at 11. Further, Respondents spent only $3,865,309 (including paying premiums) on life insurance policies through December 31, 2010. Div. Ex. 317 at 10. This fact, together with the fact that Respondents did not set aside funds sufficient to pay premiums shows that Respondents did not invest in insurance policies as promised in the PPM and marketing materials. Nor did they timely put all policies in the Master Trust. Div. Exs. 401, 402, 405.

Respondents retained Steve Boger, an actuary, to assist in valuing the insurance policies. Tr. 247-48, 459-60, 462, 2707; Div. Ex. 601. Boger valued the eight policies that Fund I owned at the time of his valuation in January 2009. Tr. 495-97; Div. Ex. 425. Boger testified that the underwriters from which Jarkesy had obtained life expectancy estimates (LEs) had changed their LE process such that they were providing longer LEs starting in the second half of 2008.[33] Tr. 499-500. Also, the Society of Actuaries released new valuation tables, essentially extending LEs, and Boger sent information concerning this to his clients, including Jarkesy, in March 2008. Tr. 530-33; Div. Ex. 499. Jarkesy refers to the LE increase in the Podcast and notes that JTCM wrote down Fund I's policies by almost $1.2 million as a result in the financial statements for the period ended December 31, 2008, issued March 27, 2009, and in the Fund's holdings pages as of March 31, 2009. Div. Ex. 203 at 25, Div. Ex. 301 at JTBOF 19199, 19203 (68, 72 of 167), Div. Ex. 315 at 3-5.

To reach a present value for each policy, Boger provided a range of discount rates (14%, 15%, and 16%). Tr. 502-06; Div. Ex. 425. The choice of discount rates is a matter of judgment; in Boger's words, the numbers are "a little soft." Tr. 504. Applying 14%, 15%, or 16% resulted in a negative value for the portfolio of policies. Tr. 506-07; Div. Ex. 425. At Jarkesy's request, Boger produced a second iteration, applying 12%, 14%, and 16% discount rates. Tr. 508-09; Div. Ex. 426. The portfolio had a positive value at 12%.[34] Tr. 509; Div. Ex. 426. Jarkesy chose to use the positive value at the 12% discount rate for the financial statements for the period ended December 31, 2008. Div. Ex. 315. The statements reported the value for the five policies that had positive values without netting them with the negative values of the remaining three policies. Div. Exs. 315, 426. This was apparently on the assumption that a policy could not be worth less than zero since it could be allowed to lapse,[35] as was subsequently done with the Evert policy, which had a negative value ($310,165), even at 12%, as of December 2008. Div. Ex. 426 at 2.

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[33] Indeed, Fund II's PPM acknowledged the revised mortality tables. Div. Ex. 210 at 30-31.

[34] At Jarkesy's request, Boger also provided a table valuing the policies on dates in the future using 12%, 14%, and 16% discount rates. Tr. 511-15; Div. Exs. 419, 421. As Boger noted, variables, such as the discount rate, that might be accurate at the starting point could change over a period in the future. Tr. 513-15; Div. Ex. 421 at 1.

[35] Respondents make this argument in their Response to the Division's Proposed Findings of Fact and Conclusions of Law at 53-54. However, the policies had not lapsed as of December 31, 2008, and Respondents do not point to any accounting principle that allows a reporting entity to disregard an asset that it actually holds.

Respondents subsequently used different actuaries to value the five policies purchased in 2009, again requesting a 12% discount rate. Div. Exs. 432, 433, 436, 440, 442. Yet at the same time, Jarkesy knew he was currently purchasing policies at a 15% or better (that is, more inexpensively than 12%) discount. Div. Ex. 203 at 23, Div. Ex. 204, Div. Ex. 619 at 1. Respondents continued using the 12% discount rate for Fund I's 2010 financial statements. Div. Ex. 623.

Pursuant to Financial Accounting Standards Board (FASB) Staff Position 85-4-1, investors who use fair value must initially value a life insurance policy at the purchase price and remeasure it at fair value at each subsequent reporting period. Div. Ex. 119 at 2. However, Respondents immediately fair valued the new policies. Thus, as compared with the total purchase price of $1,195,000, the five policies (purchased between April 7 and May 1) were valued at $2,307,567 as of May 31, 2009, a write-up of $1,112,567. Div. Ex. 498B at AM_SEC 285200 (lines 379-93), 285203 (lines 491-92), Div. Ex. 647. While Respondents point to their reliance on attorneys, AlphaMetrix, etc., it is not clear how they could believe that life insurance policies would almost double their value a few weeks after purchase. It is noted that this revaluation offset most of the $1.2 million write-down of the first eight policies as of March 31, 2009. Jarkesy's August 2010 letter to investors stated that "we are adding more policies to the portfolio," which was untrue since Fund I purchased no policies after 2009. Div. Ex. 240.

In 2010, the Ohio National Life Assurance Corporation filed suit to have the Shirlee Davis and Joesph Griffin policies voided. *Ohio Nat'l Life Assurance Corp. v. Davis*, No. 10-cv-2386 (N.D. Ill. Apr. 16, 2010); *Ohio Nat'l Life Assurance Corp. v. Davis*, No. 10-cv-4241 (C.D. Cal. June 9, 1010). Official notice. In August 2010, Respondents wrote the policies down from $194,633 and $137,562, respectively, to $100,000 each. Div. Ex. 404 at JTBOF 10643, 10471. MFR challenged the write-down amounts as not being specifically supported in the court documents or any third-party valuation and recommended writing them back up to the amortization schedule. Div. Ex. 487 at 5. Respondents did so for the 2010 financial statements. Div. Ex. 404 at JTBOF 6453.

Although representing the insurance component as a conservative hedge, Respondents took no steps to reduce risk. Investing in a large number of policies reduces risk, known as mortality risk, as Jarkesy knew and Fund I's PPM represented; if there are only a few policies, the insureds might all live much longer than actuarially expected, thus postponing the payout and extending the time during which premiums must be paid. Tr. 465-66; Div. Ex. 206 at 36-37, Div. Ex. 600. Yet Respondents only acquired thirteen policies.

III. CONCLUSIONS OF LAW

The OIP charges that JTCM and Jarkesy willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and willfully aided and abetted and caused violations by the Funds of those provisions. Additionally, the OIP charges that JTCM and Jarkesy willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. As discussed below, it is concluded that these charges were proved.

A. Antifraud Provisions

Respondents are charged with willful violations of the antifraud provisions of the Securities, Exchange, and Advisers Acts – Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder – which prohibit essentially the same type of conduct. *United States v. Naftalin*, 441 U.S. 768, 773 n.4, 778 (1979); *SEC v. Pimco Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004). They are also charged with willfully aiding and abetting and causing violations by the Funds of Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5.

Securities Act Section 17(a) makes it unlawful "in the offer or sale of" securities, by jurisdictional means, to:

> 1) employ any device, scheme, or artifice to defraud;
>
> 2) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or
>
> 3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Similar proscriptions are contained in Exchange Act Section 10(b) and Rule 10b-5 and in Advisers Act Sections 206(1), 206(2), and 206(4), as well as in Advisers Act Rule 206(4)-8, which applies specifically to "any investment adviser to a pooled investment vehicle." 15 U.S.C § 80b-6(4); 17 C.F.R. § 275.206(4)-8.

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). *Aaron v. SEC*, 446 U.S. 680, 690-91, 695-97 (1980); *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." *Aaron*, 446 U.S. at 686 n.5; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976); *SEC v. Steadman*, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. *See David Disner*, Exchange Act Release No. 38234, 1997 SEC LEXIS 258, at *15 & n.20 (Feb. 4, 1997); *SEC v. Steadman*, 967 F.2d at 641-42; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is "conduct which is 'highly unreasonable' and which represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Securities Act Sections 17(a)(2) and 17(a)(3), and Advisers Act Sections 206(2) and 206(4) and Rule 206(4)-8; a showing of negligence is adequate. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *SEC v. Steadman*, 967 F.2d at 643 & n.5; *SEC v. Yorkville Advisors, LLC*, No. 12-cv-7728, 2013 WL

3989054, at *3 (S.D.N.Y Aug. 2, 2013); *SEC v. Quan*, No. 11-cv-723, 2013 WL 5566252, at *16 (D. Minn. Oct. 8, 2013); *Fundamental Portfolio Advisors, Inc.*, Securities Act Release No. 8251, 2003 SEC LEXIS 1654, at *29 (July 15, 2003), *recons. denied*, Securities Act Release No. 8574, 2005 SEC LEXIS 1192 (May 23, 2005); *Byron G. Borgardt*, Exchange Act Release No. 8274, 2003 SEC LEXIS 2048, at *37-38 (Aug. 25, 2003). Negligence is the failure to exercise reasonable care. *IFG Network Sec., Inc.*, Exchange Act Release No. 54127, 2006 SEC LEXIS 1600, at *37 (July 11, 2006).

Material misrepresentations and omissions violate Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8. The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. *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); *SEC v. Steadman*, 967 F.2d at 643.

1. Respondents Are Fiduciaries

JTCM was the general partner of the Funds and received fees for managing the Funds. Thus it was an investment adviser within the meaning of the Advisers Act. *See* Section 202(a)(11) of the Advisers Act.[36] *See also Goldstein v. SEC*, 451 F.3d 873, 876 (D.C. Cir. 2006) (holding that the general partner of a hedge fund is an investment adviser within the meaning of the Advisers Act).

Jarkesy, as owner and principal of JTCM, was an associated person of an investment adviser. *See* Advisers Act Sections 202(a)(17), 203(f). Investment advisers and their associated persons are fiduciaries. *Fundamental Portfolio Advisors, Inc.*, 2003 SEC LEXIS 1654, at *54; *see Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92, 194, 201; *see also Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979). As fiduciaries, they are required "to act for the benefit of their clients, . . . to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients." *SEC v. DiBella*, No. 3:04-cv-1342, 2007 WL 2904211, at *12 (D. Conn. Oct. 3, 2007) (quoting *SEC v. Moran*, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996)), *aff'd*, 587 F.3d 553 (2d Cir. 2009); *see also Capital Gains Research Bureau, Inc.*, 375 U.S. at 194 ("Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." (footnotes omitted)). "[W]hat is required is '. . . not simply truth in the statements volunteered, but disclosure' [of material facts]." *Capital Gains Research Bureau, Inc.*, 375 U.S. at 201. "The law is well settled . . . that so-called 'half-truths' – literally true statements that create a materially misleading impression

[36] Section 202(a)(11) provides:

> "Investment adviser" means 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 . . . .

– will support claims for securities fraud." *SEC v. Gabelli*, 653 F.3d 49, 57 (2d Cir. 2011), *rev'd on other grounds*, 133 S. Ct. 1216 (2013).

JTCM is accountable for the actions of its responsible officers, including Jarkesy. *See C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977)). A company's scienter is imputed from that of the individuals controlling it. *See SEC v. Blinder, Robinson & Co., Inc.*, 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of JTCM, Jarkesy's conduct and scienter are also attributed to the firm. *See* Section 203(e) of the Advisers Act.

2. Aiding and Abetting; Causing

The OIP charges that Respondents "aided and abetted" and "caused" violations by the Funds of the antifraud provisions. For "aiding and abetting" liability under the federal securities laws, three elements must be established: (1) a primary or independent securities law violation committed by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. *See Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *Woods v. Barnett Bank of Ft. Lauderdale*, 765 F.2d 1004, 1009 (11th Cir. 1985); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980); *IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 94-97 (5th Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304, 1316-17 (6th Cir. 1974); *Russo Sec. Inc.*, Exchange Act Release No. 39181, 1997 SEC LEXIS 2075, at *16-17 & n.16 (Oct. 1, 1997); *Donald T. Sheldon*, Exchange Act Release No. 31475, 1992 SEC LEXIS 3052, at *18 (Nov. 18, 1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995); *William R. Carter*, Exchange Act Release No. 17597, 1981 SEC LEXIS 1940, at *78 (Feb. 28, 1981). A person cannot escape aiding and abetting liability by claiming ignorance of the securities laws. *See Sharon M. Graham*, Exchange Act Release No. 40727, 1998 SEC LEXIS 2598, at *29 n.33 (Nov. 30, 1998), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000). The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant. *See Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990); *Cornfeld*, 619 F.2d at 923, 925; *Rolf*, 570 F.2d at 47-48; *Woodward*, 522 F.2d at 97. That is, it must be established that a respondent either acted with knowledge or that he "encountered 'red flags,' or 'suspicious events creating reasons for doubt' that should have alerted him to the improper conduct of the primary violator," or there was a danger so obvious that he must have been aware of it. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004).

For "causing" liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, Exchange Act Release No. 48406, 2003 SEC LEXIS 2041, at *13-14 (Aug. 25, 2003), *pet. for review denied*, 95 F. App'x 361 (D.C. Cir. 2004). A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. *See Graham*, 1998 SEC LEXIS 2598, at *30 n.35. Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. *See KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *82 (Jan. 19, 2001), *recons. denied*, Exchange Act Release No. 44050, 2001 SEC LEXIS 422 (Mar. 5, 2001), *pet. for review denied*, 289 F.3d 109 (D.C. Cir. 2002), *reh'g en banc denied*, 2002 U.S. App. Lexis 14543 (D.C. Cir. 2002).

3. Willfulness

In addition to authorizing a cease-and-desist order, pursuant to Sections 8A(a) of the Securities Act, 21C(a) of the Exchange Act, 9(f) of the Investment Company Act, and 203(k) of the Advisers Act, and disgorgement, pursuant to Sections 8A(e) of the Securities Act, 21B(e) and 21C(e) of the Exchange Act, 9(e) of the Investment Company Act, and 203(j) of the Advisers Act, the OIP authorizes sanctions pursuant to Sections 15(b) of the Exchange Act, 9(b) and 9(d) of the Investment Company Act, and 203(e), 203(f), and 203(i) of the Advisers Act. Willful violations by Respondents must be found in order to impose sanctions on them pursuant to Sections 15(b) and 21B of the Exchange Act, 9(b) and 9(d) of the Investment Company Act, and 203(e), 203(f), and 203(i) of the Advisers Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. *See Wonsover v. SEC*, 205 F.3d 408, 413-15 (D.C. Cir. 2000); *Steadman v. SEC*, 603 F.2d at 1135; *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

B. <u>Antifraud Violations</u>

The record shows that Respondents violated the antifraud provisions by making material misstatements and omissions. These include the representations in Fund I's PPM and marketing materials that the Fund would not invest more than 5% of capital in one company and that the Fund would set aside sufficient cash to pay the premiums of the policies that it purchased for the expected life expectancy of the insured.[37] Respondents argue that the representations were not false when made and that the PPM gave JTCM discretion to change the investment strategy of the Fund. Yet, Respondents never informed investors and potential investors of such changes. The marketing materials and newsletters even continued to stress that the insurance portfolio was a conservative hedge against the corporate portfolio and continued to stress the 5% limitation. These misrepresentations and omissions were clearly material; the lack of diversification of corporate investments increased the risk of loss and the lack of funds to pay insurance premiums guaranteed the loss of those assets. While the representations concerning insurance and corporate investments may have been true when originally made, they became misrepresentations thereafter. *See SEC v. Merchant Capital, LLC*, 483 F.3d 747,

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[37] Respondents appear to suggest that they are not responsible for representations in the PPMs because they were prepared by outside counsel. To the extent they raise a reliance on counsel defense, it is inapposite, as Respondents do not claim that they consulted counsel before undertaking the actions that were inconsistent with the representations. *See David Henry Disraeli*, Securities Act Release No. 8880, 2007 SEC LEXIS 3015, at *29 n.39 (Dec. 21, 2007). In considering whether to credit an advice of counsel claim, the Commission considers four elements: "that the person made complete disclosure to counsel, sought advice on the legality of the intended conduct, received advice that the intended conduct was legal, and relied in good faith on counsel's advice." *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *38 (footnote citing precedent omitted), *pet. for review denied*, 347 F. App'x 692 (2d Cir. 2009), *cert denied*, 559 U.S. 1102 (2010).

769 (11th Cir. 2007) ("What may once have been a good faith projection became, with experience, a materially misleading omission of material fact.").

Falsely representing and omitting to disclose the true relationship between JTCM/Jarkesy and JTF/Belesis was also material. The fact of concealment of or minimizing the relationship in itself was material. In addition, Belesis's input into decisions concerning portfolio companies and receipt of fees from such companies affected the degree of profit or loss that the companies might attain, directly affecting the returns, or lack thereof, of investors. To the extent that Respondents argue that the fees JTF/Belesis received were the result of agreements between JTF/Belesis and the companies, not JTCM/Jarkesy, Jarkesy was a director of America West and of Radiant, as was his affiliate Rodriguez who was also an officer of the companies. Thus, Jarkesy was involved in those companies' decisions and cannot disclaim responsibility for the fees the companies paid to JTF/Belesis.

Further, Jarkesy's influence on valuing Fund assets (always in an upward direction) was also material. The fact that the PPM for Fund I provided that the value of investments would be determined solely by JTCM did not give Respondents unlimited discretion to set arbitrary and capricious values that were self-serving. Indeed, the Funds' financial statements represented that the assets had been fair valued. Finally, the continuing misrepresentation, never corrected, that KPMG, a "Big 4" firm was the Funds' auditor, when in reality it was a small Houston firm (however well-qualified), was also material.

The evidence shows at least a reckless degree of scienter. Jarkesy was JTCM's *alter ego* and sole decision-maker for the Funds. Thus, he had to have been aware that the Funds were heavily concentrated in a few companies, such as America West, Galaxy, and Radiant, yet he never amended Fund I's PPM and used marketing materials and newsletters that represented that the Fund was limited to 5% in any one corporate investment. Likewise, he knew the truth about the Fund's investments in life insurance policies at the time he made the Podcast in which he represented that about half of capital contributions were devoted to insurance policies and that 70% of that half was set aside to pay premiums. In reality, most of the policies eventually lapsed because of failure to pay premiums.

The fact that others, such as JTF and Belesis, may have contributed to the misrepresentations and the downfall of portfolio companies does not relieve Respondents from responsibility. *See James J. Pasztor*, Exchange Act Release No. 42008, 1999 SEC LEXIS 2193, at *16-19, 25-30 (Oct. 14, 1999) (supervisor held liable for registered representative's execution of violative directed trades; supervisor had tried to stop the trading but was overruled by broker-dealer's owner who was friendly with the customer); *Charles K. Seavey*, Advisers Act Release No. 2119, 2003 SEC LEXIS 716, at *13-14, 19-20 (Mar. 27, 2003) (associated person found liable where investment adviser required him to sign materially misleading letter), *aff'd*, 111 F. App'x. 911 (9th Cir. 2004). Respondents point to investor witnesses' having failed to read the PPM. However, investors need not have in fact relied on a false statement for an enforcement action for fraud to be made out. *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Geman v. SEC*, 334 F.3d 1183, 1191 (10th Cir. 2003).

In sum, it is concluded that Respondents willfully violated the antifraud provisions of the Securities, Exchange, and Advisers Acts by their conduct described above. Additionally, by the same misconduct, the Funds violated Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5, and Respondents willfully aided and abetted and caused the Funds' violations.

IV. SANCTIONS

The Division requests a cease-and-desist order, disgorgement, a third-tier civil money penalty, an industry bar, and officer and director bars. As discussed below, Respondents will be ordered to cease and desist from violations of the antifraud provisions, to disgorge, jointly and severally, ill-gotten gains of $1,278,597 plus prejudgment interest, and to pay a third-tier penalty of $450,000; and industry and officer and director bars will be ordered against Jarkesy.[38]

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

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

Steadman, 603 F.2d at 1140 (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. *Marshall E. Melton*, Exchange Act Release No. 48228, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. *Schield Mgmt. Co.*, 2006 SEC LEXIS 195, at *35-36 & n.46. As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. *See Christopher A. Lowry*, Investment Company Release No. 2052, 2002 SEC LEXIS 2346, at *20 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, Exchange Act Release No. 11773, 1975 SEC LEXIS 527, at *52 (Oct. 24, 1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. *See Berko v. SEC*, 316 F.2d 137, 141 (2d Cir. 1963); *Leo Glassman*, Exchange Act Release No. 11929, 1975 SEC LEXIS 111, at *7 (Dec. 16, 1975).

B. Sanctions

1. Cease and Desist

Securities Act Section 8A, Exchange Act Section 21C(a), and Advisers Act Section 203(k) authorize the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of those Acts or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *101. Such a showing is "significantly less than that required for an injunction." *Id.* at 114. In determining whether a cease-and-desist order is appropriate, the

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[38] The Division also requests a censure. In view of the more severe sanctions imposed, a censure is unnecessary.

Commission considers the *Steadman* factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. *See WHX Corp. v. SEC*, 362 F.3d 854, 859-61 (D.C. Cir. 2004); *KPMG*, 2001 SEC LEXIS 98, at *116.

Respondents' conduct was egregious and recurrent; the various material misrepresentations and omissions continued during a period of more than two years. Up to 120 investors in the two Funds were affected. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. Respondents' attempt to displace all blame onto lawyers, the Funds' administrator, JTF/Belesis, and others is an aggravating factor. Jarkesy's chosen occupation in the financial industry will present opportunities for future violations. The violations were neither recent nor remote in time, but were ongoing within the past five years. The evidence of record does not quantify precisely the degree of harm to investors and the marketplace in dollars, but Fund investors, who were given inaccurate information, received very little in return out of a total investment of about $24 million. Harm to the marketplace is evident from the dishonest nature of Respondents' misconduct. In light of these considerations, a cease-and-desist order is appropriate.

Respondents' lack of a disciplinary history does not remove the need for sanctions. *Mitchell M. Maynard*, Advisers Act Release No. 2875, 2009 SEC LEXIS 1621, at *42 & n.39 (May 15, 2009) ("[T]he absence of disciplinary history is not mitigative as securities professionals should not be rewarded for complying with securities laws.").

2. Disgorgement

Sections 8A(e) of the Securities Act, 21B(e) and 21C(e) of the Exchange Act, 9(e) of the Investment Company Act, and 203(j) of the Advisers Act authorize disgorgement of ill-gotten gains from Respondents. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); *see also Hateley v. SEC*, 8 F.3d 653, 655-56 (9th Cir. 1993). Disgorgement returns a violator to where it or he would have been absent the violative activity. *See First City Fin. Corp.*, 890 F.2d at 1231.

The amount of the disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation. *See Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 SEC LEXIS 669, at *38 n.35 (Apr. 5, 1999) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *pet. for review denied*, 230 F.3d 362 (D.C. Cir. 2000); *see also SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1192 n.6 (9th Cir. 1998) (holding disgorgement amount only needs to be a reasonable approximation of ill-gotten gains); *accord First City Fin. Corp.*, 890 F.2d at 1231-32.

Management fees and incentive fees are appropriately disgorged where they constitute ill-gotten gains earned during the course of violative activities. *See SEC v. Kapur*, No. 11-cv-8094, 2012 WL 5964389, at *3-4 (S.D.N.Y. Nov. 29, 2012); *In re Parkcentral Global Litig.*, 884 F. Supp. 2d 464, 484-45 (N.D. Tex. 2012); *SEC v. Radical Bunny, LLC*, No. 09-cv-1560, 2011 WL 1458698, at *8 (D. Ariz. Apr. 12, 2011), *aff'd*, 532 Fed. App'x 775 (9th Cir. 2013); *Joseph John VanCook*, Exchange Act Release No. 61039A, 2009 SEC LEXIS 3872, at *72-73 (Nov. 20, 2009). Accordingly, Respondents will be ordered to jointly and severally disgorge $1,278,597, the fees they received from the Funds, plus prejudgment interest. Respondents will be held jointly and severally liable because JTCM was Jarkesy's *alter ego* in the violative activities. *See SEC v. Monterosso*, 756 F.3d 1326, 1337-38 (11th Cir. 2014); *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *100 n.246 (May 16, 2014), *pet. for review docketed*, No. 14-1134 (D.C. Cir. July 11, 2014); *Daniel R. Lehl*, Exchange Act Release No. 45955, 2002 SEC LEXIS 1796, at *50-53 & n.65 (May 17, 2002).[39]

3. Civil Money Penalty

Sections 8A of the Securities Act, 21B of the Exchange Act, 203(i) of the Advisers Act, and 9(d) of the Investment Company Act authorize the Commission to impose civil money penalties for willful violations of those Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. *See* Sections 21B(c) of the Exchange Act, 203(i)(3) of the Advisers Act, and 9(d)(3) of the Investment Company Act; *New Allied Dev. Corp.*, Exchange Act Release No. 37990, 1996 SEC LEXIS 3262, at *30 n.33 (Nov. 26, 1996); *First Sec. Transfer Sys., Inc.*, Exchange Act Release No. 36183, 1995 SEC LEXIS 2261, at *9 (Sept. 1, 1995); *see also Jay Houston Meadows*, Exchange Act Release No. 37156, 1996 SEC LEXIS 1194, at *25-27 (May 1, 1996), *aff'd*, 119 F.3d 1219 (5th Cir. 1997); *Consol. Inv. Servs., Inc.*, Exchange Act Release No. 36687, 1996 SEC LEXIS 83, at *22-24 (Jan. 5, 1996).

As to Respondents, there are no mitigating factors, and several aggravating factors. They violated the antifraud provisions, so their violative actions "involved fraud [and] reckless disregard of a regulatory requirement" within the meaning of Sections 21B(b)(3)(A), (c)(1) of the Exchange Act, 203(i)(2)(C)(i), (3)(A) of the Advisers Act, and 9(d)(2)(C)(i), (3)(A) of the Investment Company Act. Harm to others is shown by the millions of dollars of losses incurred by the Funds' investors, who may have decided not to invest or to stay invested had they received accurate information. Deterrence also requires a substantial penalty because of the abuse of the fiduciary duty owed by investment advisers.

Penalties in addition to the other sanctions ordered are in the public interest in this case in consideration of fraud, harm to others, unjust enrichment, and the need for deterrence. *See* Sections 21B(c) of the Exchange Act, 203(i)(3) of the Advisers Act, and 9(d)(3) of the Investment Company Act; *see also* H.R. Rep. No. 101-616 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 1384-87. The Division requests that Respondents be ordered to pay third-tier penalties. A third-tier penalty, as the Division requests, is appropriate because Respondents' violative acts involved fraud and resulted in

[39] In addition to requesting disgorgement, the Division requests "an accounting of all JTCM operations and investments." Div. Post-Hearing Mem. at 25. The Division, however, nowhere provides any more detail about this request or any authority for imposition of an accounting. Accordingly, the undersigned declines to impose such a sanction.

substantial losses to other persons who may have decided not to invest or to stay invested in the Funds had they received accurate information. *See* Sections 8A(g)(2)(C) of the Securities Act, 21B(b)(3) of the Exchange Act, 203(i)(2)(C) of the Advisers Act, and 9(d)(2)(C) of the Investment Company Act. Under those provisions, for each violative act or omission after February 14, 2005, and before March 4, 2009, the maximum third-tier penalty is $130,000 for a natural person. 17 C.F.R. §§ 201.1003, .1004. For each violative act or omission on or after March 4, 2009, and before March 5, 2013, the maximum third-tier penalty is $150,000 for a natural person. 17 C.F.R. § 201.1004, .1005. The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. *See* Colin S. Diver, *The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies*, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue started before, and continued after, March 4, 2009. They will be considered as three courses of action – the violations arising from the material misrepresentations and omissions relating to (1) the life settlement component of the Funds' investments; (2) the corporate investment component of the Funds' investments; and (3) Respondents' relationship with JTF/Belesis – resulting in three units of violation. Since JTCM was essentially Jarkesy's *alter ego* in the violative activities, a third-tier penalty amount of $450,000 will be ordered against Respondents, jointly and severally. Combined with the other sanctions ordered, this penalty is in the public interest. Insofar as Respondents argue that the imposition of penalties would be an impermissible retroactive application of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the argument fails. Respondents' violative conduct continued after the July 22, 2010, effective date of the Dodd-Frank Act.

4. Industry Bar

The Division requests that Jarkesy be barred from the securities industry. Combined with other sanctions ordered, bars are in the public interest and appropriate deterrents.[40] The violations involved scienter. Jarkesy's business provides him with the opportunity to commit violations of the securities laws in the future. The record shows a lack of recognition of the wrongful nature of the violative conduct. His attempts to deflect blame onto others are aggravating factors. In short, it is necessary in the public interest and for the protection of investors that Jarkesy be barred from the industry.

5. Officer and Director Bar

Securities Act Section 8A(f) and Exchange Act Section 21C(f) authorize a bar against a respondent who has violated, respectively, Securities Act Section 17(a)(1) or Exchange Act Section 10(b), from acting as an officer or director of any issuer with a class of securities registered

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[40] The fact Respondents were not registered with the Commission does not insulate Jarkesy from a bar. The Commission has authority to bar persons from association with investment advisers, whether registered or unregistered. *See Teicher v. SEC*, 177 F.3d 1016, 1017-18 (D.C. Cir. 1999). Likewise, the fact that the Funds were not <u>registered</u> investment companies is not a barrier to imposing an investment company bar. *See Zion Capital Mgmt. LLC*, Securities Act Release No. 8345, 2003 SEC LEXIS 2939, at *18 n.27 (Dec. 11, 2003).

pursuant to Exchange Act Section 12 or that is required to file reports pursuant to Exchange Act Section 15(d), "if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer." In line with the reasoning in *Joseph P. Doxey*, Initial Decision Release No. 598, 2014 SEC LEXIS 1668, at *74-78 (A.L.J. May 15, 2014), the so-called *Patel* factors[41] will be applied in addition to the *Steadman* factors in evaluating the appropriateness of this sanction.

As discussed above, Jarkesy violated Securities Act Section 17(a)(1) and Exchange Act Section 10(b) while acting with scienter and awareness of the deceptive and manipulative nature of his conduct. The violations continued for several years. As managing member of JTCM and the founder and adviser of the Funds, Jarkesy was at the center of the fraud. His economic stake in the violation is shown by the nearly $1.3 million in fees that JTCM received from the Funds. Also, Jarkesy was a director of companies that were affected by the fraud. Without an officer and director bar, Jarkesy would be free to assume officer and director roles in the future.

Thus, it is appropriate and in the public interest to impose a permanent officer and director bar against Jarkesy. He will be barred from acting as an officer or director of any issuer with a class of securities registered pursuant to Exchange Act Section 12 or that is required to file reports pursuant to Exchange Act Section 15(d).

V. PROCEDURAL ORDER

IT IS ORDERED that Division Exhibit 231 (Fund I partnership book allocation for 2007-2010, JTBOF 1691-99) IS ADMITTED.[42]

VI. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on September 23, 2014, and Division Exhibit 231.

VII. ORDER ON MOTION TO DISMISS

During the hearing the undersigned reserved ruling on Respondents' motion to dismiss. Based on the findings and conclusions set forth above:

IT IS ORDERED that Respondents' motion to dismiss IS DENIED.

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[41] The *Patel* factors are: (1) the egregiousness of the underlying securities law violation; (2) recidivism; (3) the defendant's role or position in the fraud; (4) degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood of recurrence. *SEC v. Bankosky*, 716 F.3d 45, 48 (2d Cir. 2013); *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995).

[42] Division Exhibit 231 was offered, objected to by Respondents, and not admitted during the hearing. The Division has renewed its request that the exhibit be admitted, and both parties have cited to it in their post-hearing Proposed Findings of Fact and Conclusions of Law. *See* Division Finding of Fact No. 47 and Respondents' Counter-Statement.

VIII. ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED that, pursuant to Sections 8A of the Securities Act, 21C(a) of the Exchange Act, and 203(k) of the Advisers Act GEORGE R. JARKESY, JR., and JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT28 LLC, CEASE AND DESIST from committing or causing any violations or future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

IT IS FURTHER ORDERED that, pursuant to Sections 8A(e) of the Securities Act, 21B(e) and 21C(e) of the Exchange Act, 203(j) of the Advisers Act, and 9(e) of the Investment Company Act, GEORGE R. JARKESY, JR., and JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT28 LLC, jointly and severally, DISGORGE $1,278,597 plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600(b). Pursuant to 17 C.F.R. § 201.600(a), prejudgment interest is due from November 1, 2013, through the last day of the month preceding which payment is made.

IT IS FURTHER ORDERED that, pursuant to Sections 8A(g) of the Securities Act, 21B of the Exchange Act, 203(i) of the Advisers Act, and 9(d) of the Investment Company Act, GEORGE R. JARKESY, JR., and JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, d/b/a PATRIOT28 LLC, jointly and severally, PAY A CIVIL MONEY PENALTY of $450,000.

IT IS FURTHER ORDERED that, pursuant to Sections 15(b) of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act, GEORGE R. JARKESY, JR., IS BARRED from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stock[43] and is 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.

IT IS FURTHER ORDERED that, pursuant to Sections 8A(f) of the Securities Act and 21C(f) of the Exchange Act, GEORGE R. JARKESY, JR., IS BARRED from acting as an officer or director of any issuer that has a class of securities registered with the Commission pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

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[43] Thus, he will be barred from acting as a promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, pursuant to Exchange Act Section 15(b)(6)(A), (C).

Payment of penalties and disgorgement plus prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made 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. *See* 17 C.F.R. § 201.601(a), (c). The payment, and a cover letter identifying the Respondents and Administrative Proceeding No. 3-15255, 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 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111(h) of the Commission's Rules of Practice, 17 C.F.R. § 201.111(h). If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Carol Fox Foelak
Administrative Law Judge