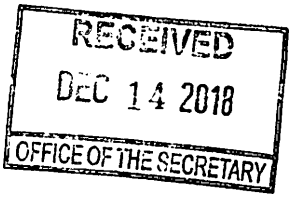
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255



In the Matter of	:
JOHN THOMAS CAPITAL MANAGEMENT GROUP, LLC, d/b/a PATRIOT28, LLC,	:
GEORGE R. JARKESY JR.,	:
JOHN THOMAS FINANCIAL, INC.,	:
ANASTASIOS "TOMMY' BELESIS,	:
Respondents.	:

THE DIVISION'S RESPONSE TO RESPONDENTS' OBJECTIONS

The Division of Enforcement ("Division") submits the following response to the Objections to Administrative Proceedings ("Objections") filed by Respondents George R. Jarkesy Jr. and John Thomas Capital Management Group, LLC d/b/a/ Patriot 28, LLC (collectively "Respondents"). The Division fully incorporates its previously filed submissions as referenced herein and this document provides only a summary of its response. As a preliminary matter, however, the Division notes that many of Respondents' objections were previously addressed and rejected by the Commission in its orders dated February 20, 2015 (Denying Motion to Stay Administrative Proceedings), October 16, 2014 (denying interlocutory review with respect to Respondents' motion for order directing alternative procedure for filing, service and publication of initial decision), January 28, 2014 (denying petition for interlocutory review) and December 6, 2013 (denying petition for interlocutory review). While the Commission may have vacated all prior orders in this matter, there is nothing in the Objections that lead to the

conclusion that the Commission's prior rulings were in error. Second, many of the "objections" asserted by Respondents do not relate at all to the current proceeding that is scheduled to commence on March 25, 2019, but rather relate to rulings previously made by ALJ Foelak, including the initial decision dated October 17, 2014. As the Commission's August 22, 2018 Order (In re: Pending Administrative Proceedings) explicitly states, going forward the ALJ "shall not give weight to or otherwise presume the correctness of any prior opinions, orders, or rulings in this matter". As Respondents will have ample opportunity to re-litigate the issues where they were previously unsuccessful, objecting to ALJ Foelak's rulings is inappropriate.

RESPONDENTS' OBJECTION 1 -- PREJUDGMENT

Respondents object to the proceeding, arguing that the Commission prejudged the case against them by making findings of fact concerning them in its settlement with co-Respondent Anastasios Belesis ("Belesis"). This argument was fully addressed in the Division's Opposition Brief filed on January 8, 2014 (attached hereto as Exhibit A and incorporated herein) at pp. 4-7 and in the Division's Opening and Response Brief filed on March 13, 2015 (attached hereto as Exhibit B and incorporated herein) at pp. 6-11. In summary, there was no pre-judgment as the Commission's December 5, 2013 Order specifically said that the findings therein were "not binding on any other person or entity in this or any other proceeding." In its January 28, 2014 Order, the Commission denied Respondents' Motion Petition for Interlocutory Appeal, stating, in part, that the "Commission has rejected arguments similar to those raised by JTCM and Jarkesy in an unbroken line of decisions. . . . In particular, the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs especially when—as took place here—the order accepting an offer of settlement 'expressly state[s] that it was not binding on

other [non-settling] respondents.' Any decision that the Commission makes as to JTCM and Jarkesy will be 'based solely on the record' adduced before the law judge and will 'in no way [be] influenced by our findings as to [JTF and Belesis] based on [their] offer of settlement.'" The Commission again rejected Respondents' argument in its October 16, 2014 Order. While the Commission may have vacated these orders, Respondents provide no reason in their Objections or in their Opening Appellate Brief to the Commission (Exhibit A attached to the Objections) to suggest why the Commission's reasoning was erroneous.

RESPONDENTS' OBJECTION 2 -- IMPROPER DELEGATION

Respondents object to the proceeding arguing that the authority given to the Commission to choose the forum for enforcement actions is an improper Congressional delegation of legislative authority to the Commission because Congress did not establish an "intelligible principle" to the Commission for how to choose the forum. This argument is fully addressed in the Division's Opening Brief (Exhibit B hereto) at pp. 18-24. In summary, this objection is faulty as the relevant provisions of Dodd-Frank do not constitute a delegation of legislative authority because when deciding whether to bring an action in federal district court or in an administrative proceeding the Commission is not acting in a legislative capacity. Nor does the fact that Congress enacted a statutory scheme allowing the Commission to choose the forum in which to bring an enforcement action constitute a delegation of legislative authority.

RESPONDENTS' OBJECTION 3 -- VIOLATION OF 14TH AMENDMENT

Respondents object to the proceeding arguing that the Division violated Respondents' Equal Protection rights by choosing to pursue the administrative proceeding in lieu of a district

court proceeding denying Respondents the right to a jury trial and also by treating Respondents differently than others similarly situated ("class of one" argument). This argument is fully addressed in the Division's Opening Brief (Exhibit B hereto) at pp. 24-27. In summary, these objections are faulty because the United States Supreme Court held in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*, 430 U.S. 442 (1977) that the use of administrative proceedings that lack juries does not violate the Seventh Amendment. Following *Atlas Roofing*, the Commission has rejected claims that administrative proceedings violate the Seventh Amendment. With respect to Respondents' "class of one" equal protection claim, Respondents must show that they have "been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment." *Village of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000) (*per curiam*). Respondents have made no such showing in this case. Nor have they made any showing that the intention of the Division was to deprive them of procedural safeguards afforded to other persons.

RESPONDENTS' OBJECTION 4 – PUNITIVE REMEDIES REQUIRE JURY TRIALS

Respondents object to the proceeding arguing that a jury trial is required where the Commission seeks penalties in an administrative proceeding. This argument is fully addressed in the Division's Opening Brief (Exhibit B hereto) at pp. 28-29. In summary, the Supreme Court held in *Atlas Roofing* that the Seventh Amendment right to a jury trial does not apply when the government brings an enforcement proceeding in an administrative forum, even when the government is seeking civil penalties. 430 U.S. at 455.

RESPONDENTS' OBJECTION 5 – APPOINTMENTS CLAUSE

Respondents object to the proceeding arguing that SEC administrative law judges have not been properly appointed. Consequently, the proceeding is void and should be dismissed. Respondents' objection is faulty as they do not address in any fashion the Commission's November 30, 2017 order "ratif[ying] the agency's prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil." Nor do Respondents address the Commission's August 22, 2018 Order lifting its stay on all pending administrative proceedings and reaffirming its November 30, 2017 order ratifying the constitutional appointment of certain ALJs. These orders of the Commission are binding in this matter and, as such, there is no basis for objection.

RESPONDENTS' OBJECTION 6 – EX PARTE COMMUNICATIONS

Respondents object to the proceedings arguing that ex parte communications between the Division and the Commission in connection with the settlement with Belesis violated the APA, the Commission's Rules of Practice, and the Order Instituting Proceedings in this case. This argument was fully addressed in the Division's Opposition Brief filed on January 8, 2014 (Exhibit A hereto) at pp. 4-6 and in the Division's Opening and Response Brief filed on March 13, 2015 (Exhibit B) at pp. 6-11. In its January 28, 2014 Order, the Commission stated that in an unbroken line of decisions, the Commission rejected the argument that consideration of certain respondents' offer of settlement while the proceedings are still pending against other respondents "[does] not violate the Administrative Procedure Act ... or our rules regarding *ex parte* communications." (parenthetical and ellipses in original). While the Commission may have

vacated the January 28, 2014 Order, Respondents provide no reason in their in their Objections or in the attachments thereto to suggest why the Commission's reasoning was erroneous.

RESPONDENTS OBJECTION 7: PURPORTED BRADY VIOLATIONS

Respondents claim that the Division violated Respondents' due process rights (1) by producing tens of thousands of documents to Respondents without an adequate way to sift through them, (2) by refusing to produce interview notes, and (3) by the fact that the withheld material was not entered into the record. The first two issues were addressed in the Division's October 21, 2013 Opposition to Respondents' Brady Motion (attached hereto as Exhibit C and incorporated herein) at pp.3-13 and in the Division's Opening and Response Brief filed on March 13, 2015 (Exhibit B) at pp. 11-17. In summary, the Division did not produce its documents to Respondents in a "document dump". Instead, the Division exceeded its production obligations by producing its documents to Respondents in a searchable database and in the same manner in which those documents were kept by the Division. While the Division did not produce its privileged interview notes to Respondents, the Division produced a summary of all exculpatory material to Respondents. In its December 6, 2013 Order, the Commission rejected Respondents' arguments, holding that "the Division's 'open file' production of its investigative file is consistent with the text of Rule 230(b)(2); JTCM and Jarkesy do not seriously contend otherwise." Likewise, the Commission held that the Division can satisfy its Brady obligations by "providing the respondent with the substance of the materially exculpatory statements; it need not turn over the documents themselves." While the Commission may have vacated its December 6, 2013 Order, Respondents provided no reason in their Opening Appellate Brief to the Commission (Exhibit A attached to their objections) or in their current objections to suggest

why the Commission's rulings were erroneous. Respondents' third objection was not addressed by the Commission. Respondents, however, do not provide any support for the counter-intuitive proposition that privileged material appropriately withheld from production should then be admitted into the public record so that it can be reviewed on appeal.

RESPONDENTS' OBJECTION 8: NO ABILITY TO BRING COUNTERCLAIMS

Respondents object to the proceedings arguing that the fact that they cannot assert counterclaims in this administrative proceeding against the Commission for Constitutional violations violates their due process rights. This argument was rejected by the Commission is its February 20, 2015 Order (Denying Motion to Stay Administrative Proceedings), where the Commission stated that "the eventual issuance of a final Commission decision in this proceeding—assuming hypothetically that it was adverse to respondents—would *vest* the court of appeal with jurisdiction to resolve respondents' claims. . . . As the D.C. district court stated in its order dismissing respondents' federal action for lack of jurisdiction, there 'is no dispute that [JTCM and Jarkesy] will have the opportunity to raise all of their constitutional claims before a Court of Appeals should . . . the Commission issue orders adverse to them.'" While the Commission may have vacated its February 20, 2015 Order, Respondents fail to demonstrate that the Commission's holding that they have an adequate venue to adjudicate their claims is incorrect.

RESPONDENTS OBJECTION 9: NO TIME TO PREPARE DEFENSE

Respondents object on the grounds that they did not have an adequate opportunity to prepare their defense in this matter. This objection is specious. To the extent that the Respondents are objecting to the current hearing presently scheduled to commence on March 25,

2019, Respondents will have had more than five years to review the documents (most of which were Respondents' own documents) on a searchable database. To the extent that Respondents are complaining about the prior hearing, that objection was rejected by the Commission in its December 6, 2013 Order where the Commission held because the materials were provided to Respondents in a searchable database, it was entirely feasible for Respondents to review 700 GB of electronic data. While the Commission may have vacated its December 6, 2013 Order, Respondents fail to demonstrate that the Commission's reasoning was erroneous.

RESPONDENTS OBJECTION 10: RETROACTIVE APPLICATION OF DODD-FRANK

Respondents object that the in the Initial Decision, ALJ Foelak impermissibly imposed a monetary penalty authorized by Dodd-Frank for conduct that occurred before Dodd-Frank was enacted. This is not a proper objection to the hearing presently scheduled to commence on March 25, 2019. To the extent that Respondents are arguing that it would be impermissible for this ALJ to issue such a ruling in the future, this argument is fully addressed in the Division's Opening Brief (Exhibit B hereto) at pp. 30-32. In summary, civil money penalties have been available in administrative proceedings, such as the instant matter, since 1990. There is thus, no issue of retroactive application of Dodd-Frank. Moreover, the conduct at issue in this case continued after the effective date of Dodd-Frank.

RESPONDENTS OBJECTION 11: AWARD OF REMEDIES WAS IMPERMISSIBLE

Respondents object that the award of remedies against Respondents in the Initial Decision was unsupported, disproportionate, and against public policy. This is not a proper

objection to the hearing presently scheduled to commence on March 25, 2019. To the extent that Respondents intend to argue in the future that it would be against public policy to be sanctioned with collateral bars, the penny stock bar, and the officer and director bar, this issue is addressed in the Division's Post-Hearing Memorandum of Law (attached hereto as Exhibit D and incorporated by reference herein) at pp. 30-31. To the extent that Respondents intend to argue in the future that any award against them must be proportional to that which Commission received in its settlement with the other respondents in this matter, this issue is addressed in the Division's Opening Brief (Exhibit B) at p. 39 n.14.

RESPONDENTS OBJECTION 12: INSTITUTIONAL BIAS

In this objection, Respondents complain that the Commission did not grant their request to take additional discovery on the issue of whether bias against respondents exists in the administrative proceeding process. This is not a valid objection to the hearing presently scheduled to commence on March 25, 2019 as Respondents will have the opportunity to request additional discovery from the Division in this matter. As per the scheduling order dated November 9, 2018, Respondents may submit request for document subpoenas until December 31, 2018 and fact discovery will continue through February 1, 2019.

RESPONDENTS OBJECTION 13: ERRONEOUS RULINGS

In this catchall objection, Respondents object to numerous procedural rulings, evidentiary findings, and legal conclusions made by ALJ Foelak in the Initial Decision and elsewhere. This is not a valid objection to the hearing presently scheduled to commence on March 25, 2019. To the extent that any of ALJ's Foelak's rulings in this case have any continued relevance, the

Division refers to its Opening Brief (Exhibit B) and to the chart attached thereto which demonstrate that the complained of rulings were correct and provides the factual basis for all of ALJ Foelak's evidentiary findings.

Respectfully Submitted,

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Respondents.	:
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The Division of Enforcement ("Division") submits this memorandum of law in opposition to Petitioners George R. Jarkesy Jr.'s ("Jarkesy") and John Thomas Capital Management LLC d/b/a Patriot28 LLC's (collectively "Respondents") Motion for Disqualification and Recusal of the Commission and Dismissal of Administrative Proceeding for Violations of the Administrative Procedures Act and Due Process Rights.

PRELIMINARY STATEMENT

The Division submits this brief response to the motion filed by Respondents that Hearing Officer Foelak has properly described as "frivolous." The Division does not believe that oral argument is required and requests expedited determination of this motion to avoid further unnecessary delay of the hearing currently scheduled to commence on February 3, 2014.[1]

[1] At a January 6, 2014 telephone conference, Hearing Officer Foelak stated that she would not stay the case while this motion was pending. The Division likewise requests that the Commission does not issue a stay order while it considers Respondents' motion.

Respondents argue that the Commission is biased against them by virtue of the fact that it published an Order Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order on December 5, 2013 against two settling respondents in this case (the "December 5 Order"). Because the December 5 Order contains factual and legal findings that Respondents contest, Respondents argue that the Commission is biased and cannot fairly adjudge the case against them, notwithstanding the fact that they concede that the December 5 Order specifically states that the findings "are not binding on any other person or entity in this or any other proceeding." Respondents also argue that the Commission entered into impermissible *ex parte* communications with the Division in connection with the settlement. Respondents argue that these ex parte communications violate their due process rights and also violate the Administrative Procedure Act. Based on these purported violations, Respondents state that "[b]inding judicial precedent holds – without exception that the Commission and each of the Commissioners, is disqualified from this matter." Consequently, Respondents request recusal of the Commission and each individual Commissioner and that the case against Respondents be dismissed.

Setting aside the fact that the issue raised by Respondents is premature as the case is presently before the Hearing Officer (who is not alleged to have had any involvement in the settlement and/or any *ex parte* communications with the Division) and not the Commission, Respondents' arguments have repeatedly been found to be meritless and lacking by the Commission. For example, in *In the Matter of Edward Sinclair*, 44 S.E.C. 523, 1971 SEC LEXIS 898 (1971), Respondent Sinclair, who was an order clerk for Filor, Bullard & Smith, argued that any SEC Commissioner who participated in the decision on consent to suspend Filor for failing to supervise Sinclair should disqualify himself in the case. The Commission rejected

this argument stating that there was "no merit in the motion." The order against Filor was based on a stipulated record and, like the December 5 Order, expressly stated that it was not binding on the other respondents. The Commission stated that its present decision regarding Sinclair was based solely on the record before it "and is no way influenced by our findings as to Filor based on the order of the settlement."

On appeal to the Second Circuit, *Sinclair v. SEC*, 444 F.2d 399 (2d Cir. 1971), the court agreed that Commissioner Smith was not biased and did not need to disqualify himself:

> We find no merit in the argument that Commissioner Smith had prejudged Sinclair's case by participating in the Commission's decision to accept a Filor settlement offer setting forth certain stipulated facts. The facts were stipulated by the parties solely for the particular settlement, just as is the practice in negotiation of consent decrees. The decision stated forth that it was not binding on the other respondents. Furthermore, each of the two proceedings met the standards of due process with each respondent ... being represented by competent counsel. The Commission's findings with respect to Sinclair 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 after oral argument and submission of briefs. In such a context Commissioner Smith was not called upon to disqualify himself from participation in Sinclair's case. (*Id.* at 401-02).

Because the Commission is allowed to consider a settlement by one respondent in an administrative action without having to disqualify itself with respect to any other respondent, it follows that any communications between the Division and the Commission in connection with that settlement are also not improper (and, in fact, are necessary), do not violate Due Process of other laws, and do not require the Commission to disqualify itself or to dismiss the action.

For the reasons set forth herein, the Division respectfully requests that the Commission deny Respondents' baseless motion and direct that the hearing go forward as scheduled.

ARGUMENT

It is premature for the Respondents to argue that the Commission is biased against them based on its settlement with other respondents. As Hearing Officer Foelak pointed out in another case while similarly rejecting the respondent's claim of the Commission's bias:

> the attempt to raise a due process defense is premature. Courts do not normally consider assertions of administrative bias before the completion of administrative proceedings and the exhaustion of administrative remedies. 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. The appropriate time to raise the issue is when a party seeks judicial review of the Commission's action.

In the Matter of Warren G. Trepp, File No. 3-8833, Initial Decisions Release No. 115, 1997 SEC LEXIS 1682 (Aug. 18, 1997) (citing *SEC v. R.A. Holman & Co.*, 323 F.2d 284 (D.C. Cir. 1963); *Amos Treat & Co. v. SEC*, 306 F.2d 260 (D.C. Cir. 1962); *United States v. Litton Indus.*, 462 F.2d 14 (9th Cir. 1972)). Because this matter is not presently in front of the Commission and, indeed, the hearing is not even scheduled to take place until February 3 (and will be before a hearing officer who is not alleged to have had any involvement in the settlement with the other respondents or to have had any ex parte communications with the Division), the claim of bias is premature.

Even if the Respondents' claim of bias were timely, however, the Commission has repeatedly found that it can approve a settlement with one respondent in an administrative action – even one that includes factual findings – without having to disqualify itself with respect to other respondents in the same action.[2] In *Sinclair*, discussed above, the Commission rejected as meritless the argument that a Commissioner who had approved a settlement with one respondent

[2] Respondents argue that the findings concerning their own actions in the December 5 Order were "gratuitous and totally unnecessary." This argument ignores the fact that the other respondents were charged not a primary violators, but as aiders and abettors. Because such a charge requires an underlying violation of the securities laws, the December 5 Order had to contain findings of underlying violations. It is clear from the order, however, that such findings are not binding on other parties including the Respondents.

had to disqualify himself for the remainder of the action. This decision was affirmed by the Second Circuit Court of Appeals.

More recently, in *In the Matter of the Stuart-James Co., Inc.*, 50 S.E.C. 468, 1991 SEC LEXIS 168 (Jan. 23, 1991), the Commission held that its settlement with one respondent did not require that the Commissioners who accepted that settlement to be disqualified or that the administrative proceeding to be dismissed. The Commission stated, "[t]aken a face value, the respondents' arguments suggest that it is virtually impossible for the Commission properly to entertain individual settlements in proceedings involving multiple respondents." *Id.* at *3. Rejecting this argument, the Commission found that consistent with due process, it could "authorize investigations of suspected securities violators, institute enforcement proceedings to determine whether the suspected violations occurred, and later make findings of fact and conclusions of law on the basis of the record that is complied. We may also consider offers of settlement during the court of those proceedings." *Id.* at *5. The Commission further held that it could have communications with the Division about the settlement stating that "[t]o exclude our staff from presenting relevant facts concerning a negotiated settlement would simply lead to wrong decisions about which settlement offers merited accepted. Such a result is not in the public interest and is not required by statute or rules." *Id.* at *12. Finally, while the Commission recognized that "non-settling respondents might wish to appear before us to dispute information presented by the staff, or to argue additional facts which they believe would influence our assessment of the public interest," the Commission held that there was no such requirement under the Administrative Procedure Act and "[c]ontrol over [the Division's] access to the Commission cannot be turned over to private parties." *Id.* at *14-19. Consequently, the Commission held that so long as the Division is not participating or advising in a decision by the

Commission as to the non-settling respondents, "there is no compelling reason the communications [between the Division and the Commission] as to a proposed settlement by one respondent in a multi-party proceeding may not take place ex parte." *Id.* at *20.

This reasoning has been applied by the Commission in several other matters and in each instance, the Commission found that there was no bias or prejudgment. *See In the Matter of C. James Padgett*, 52 S.E.C. 1257, 1997 SEC LEXIS 634 (March 20, 1997) (rejecting argument that by accepting settlement of one respondent it had prejudged other respondents' liability and had engaged in improper ex party communications with Division, and stating that while "[t]he APA and Commission rules prohibit ex parte communications relating to the decisional process ... circumscribed Division communications with the Commission in connection with a proffered settlement by one respondent in a multi-party proceeding are not part of the decisional process regarding other parties"); *In the Matter of Jean-Paul Bolduc*, 74 S.E.C. 492, 2001 WL 59123 (January 25, 2001) (not only was there no bias by virtue of settlement with another party, but also "[a]n administrative body such as the Commission may not be disqualified from performing its adjudicatory functions based on allegations of bias, prejudice, or prejudgment on the part of the Commission or its members.") (citing *FTC v. Cement Institute*, 333 U.S. 683 (1948)); *In the Matters of Atlantic Equities Co.*, 43 S.E.C. 354, 1967 SEC LEXIS 531 *28-29 (July 11, 1967) ("in our opinion, the claim of 'prejudgment' [based on an earlier settlement] is without substance"), *aff'd sub nom., Hanson v. SEC*, 396 F.2d 694 (D.C. Cir.); *In the Matter of Steadman Security Corp.*, 46 S.E.C. 896, 1977 SEC LEXIS 1388 *56 n.82 (June 29, 1977) (denying as "meritless" motion to dismiss on grounds of prejudgment, stating that APA permits Commission to consider settlement in its administrative capacity "and thereafter render a decision with respect to it in our quasi-judicial capacity").

The Commission should follow its own precedent and deny Respondents motion, which is based on the same arguments and the same facts as these earlier decisions.

CONCLUSION

For the reasons set forth herein, the Division respectfully requests that the Commission deny Respondents' Motion for Disqualification and Recusal of the Commission and Dismissal of Administrative Proceeding for Violations of the Administrative Procedures Act and Due Process Rights.

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OPENING AND RESPONSE BRIEF OF THE DIVISION OF ENFORCEMENT

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PRELIMINARY STATEMENT

This matter involves misstatements and omissions of material fact by George R. Jarkesy, Jr. ("Jarkesy") and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC ("JTCM") (collectively, the "Respondents") in the offer and sale of shares of two hedge funds then known as the John Thomas Bridge and Opportunity Fund LP I ("Fund I") and the John Thomas Bridge and Opportunity Fund LP II ("Fund II") (collectively, the "Funds"). Jarkesy was the manager of the Funds and JTCM was the Funds' adviser. The Order Instituting Proceedings ("OIP") charged Jarkesy and JTCM with violations of the antifraud provisions of the federal securities laws, and with aiding and abetting and causing the Funds' violations of those provisions. The OIP also charged John Thomas Financial, Inc. ("JTF"), a broker-dealer that acted as the Funds' placement agent, and Anastasios "Tommy" Belesis ("Belesis"), the president and chief executive officer of JTF. JTF and Belesis settled the charges against them.

After a hearing, Administrative Law Judge Carol Fox Foelak ("the ALJ") found that the Respondents violated the antifraud provisions of the federal securities laws by making material misrepresentations and omissions concerning the Funds. In particular, the ALJ found that Fund I's private placement memorandum ("PPM") and marketing materials falsely represented that the Fund would not invest more than 5% of its capital in any one company and that the Fund would set aside sufficient cash to pay the premiums on certain life insurance policies that were part of the Fund's portfolio. Initial Decision ("ID") at 28. The ALJ also found that the Respondents made material misrepresentations and omissions concerning their relationship with JTF and Belesis, the value of the Funds, and the identity of the Funds' auditor. *Id.* at 29.

The ID ordered Respondents 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. It also barred Jarkesy from the securities industry and from serving as an officer or director of a public or reporting company.

In their Petition for Review, Respondents raise a number of foundational challenges to these proceedings, including due process, equal protection, and other constitutional claims. Respondents also challenge certain of the ALJ's factual findings and legal conclusions. The Division of Enforcement ("Division") is challenging the ALJ's calculation of disgorgement, the amount of civil penalties ordered, and the failure to order an accounting. For the reasons set forth below, the Commission should affirm the factual and legal conclusions reached by the ALJ and reject the various due process, equal protection, and constitutional claims raised by the Respondents. However, the Commission should order full disgorgement, substantially higher penalties than were imposed by the ALJ, and an immediate accounting of the Funds' assets, sales and distributions.

FACTS

Respondents Made Numerous Material Misrepresentations to Investors

JTCM and Jarkesy managed two hedge funds. In 2007, Respondents launched Fund I and in 2009, they launched Fund II.[1] The investment objectives and strategies for the two funds were essentially identical: approximately half of each fund would be invested in corporate investments (with no more than 5% invested in a single company) and the other half would be invested in life settlement policies (totaling at least 117% of the investor capital), or be set aside to pay the premium on those policies. The life-settlement portion of each Fund was intended to hedge the more risky corporate investments. As Respondents represented, the corporate investments were intended to provide "return **on** capital" while the life settlements were intended

[1] For citations to the record, *see* Division's Proposed Findings of Fact and Conclusions of Law, filed Apr. 7, 2014.

to provide "return of capital." Respondents marketed the Funds as "two investments ... One Fund Hedged!" From 2007 through 2010, approximately 120 investors invested approximately $24 million in the Funds. In March 2012, Jarkesy wrote to investors that he was going to wrap up operations for Fund I that year. In 2013, Respondents formally dissolved the partnership. To this day, however, Respondents have not distributed the assets of the Funds to the investors, with the exception of the proceeds from one life settlement contract and some restricted stock. Respondents received approximately $1.3 million in management fees from the Funds. Additionally, Respondents received incentive fees of at least $123,000 from Fund II.

The evidence in the record and the facts adduced at the hearing clearly demonstrate that Respondents made numerous material misrepresentations to investors in connection with the offer and sale of shares in the Funds. Specifically, in the PPM and Limited Partnership Agreements, Respondents represented that: (1) half of all investor capital would be invested in small companies, including speculative start-ups, and the other half would be used to purchase life settlement policies (or would be set aside and segregated to pay premiums on the policies); (2) the life settlement policies would have a face value of at least 117% of the investor capital; (3) for the equity investments, the total investment in any one company at any one time would not exceed 5% of the aggregate capital commitments; (4) for the life settlement portfolio, Respondents would take steps to mitigate life expectancy risk, including purchasing a sufficient number of policies; (5) to further protect the life settlement portfolio, the policies would be transferred to the Master Trust; (6) the general partner, JTCM, would utilize good faith; (7) fair value would be used to value securities where no market quotation was readily available; (8) the Funds' financial statements would be prepared according to generally accepted accounting principles ("GAAP"); and (9) the

management of the partnership would be vested exclusively in the General Partner. Each of these misrepresentations was material and important to investors making investment decisions. Because Respondents had "ultimate authority" over the PPM and its contents, they are liable for any misrepresentations contained therein. Many of these misrepresentations were repeated numerous times in other documents that were attributable to Respondents, including marketing materials, power point presentations, periodic investor updates (including a podcast following the release of the 2008 audited financial statements), monthly account statements, and in the Funds' audited financial statements.

Respondents' marketing materials and investor updates contained additional misrepresentations, including that: (1) KPMG was the auditor for the Funds; (2) Deutsche Bank was the prime broker for the Funds; (3) insurance policies would be purchased from AA rated insurance companies; (4) Fund I had purchased fourteen life settlement policies from fourteen separate insurance companies; (5) the bridge loans would be "collateralized;" and (6) valuation of the Funds' assets would be conservative. Respondents' website made the further misrepresentation that JTF did not manage, direct, or make any decisions for the Funds. These misrepresentations, which also are attributable to Respondents, were material and important to investors making investment decisions.

In addition to the misrepresentations, Respondents fraudulently valued many of the positions in the portfolio including: (1) the life insurance policies, which Respondents valued using a 12% discount rate instead of the 15% discount rate implied by the purchase price and that the valuation consultants believed was the most appropriate; (2) the restricted stock, which Respondents valued at the same price as free-trading stock; (3) the notes of America West Resources ("America West") and Galaxy Media & Marketing Corp. ("Galaxy"), which

Respondents valued at par notwithstanding that the notes were in default; (4) the shares of Radiant Oil & Gas, Inc. ("Radiant") and America West, which Respondents valued based upon promotional activities they paid for with money from the Funds; (5) the Radiant warrants, which Respondents valued arbitrarily and without any relationship to the stock price; and (6) the shares of portfolio companies like Galaxy and America West, which Respondents overvalued given the poor financial condition of those companies. These valuations, which Respondents knew lacked any reasonable basis, were fraudulent.

STANDARD OF REVIEW

The Commission's Rule of Practice 411(a) provides that in reviewing initial decisions of administrative hearing officers, the Commission "may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). Pursuant to this rule, the Commission considers an appeal of an administrative law judge's initial decision on a *de novo* basis. *See* 5 U.S.C. § 557(b) (Administrative Procedures Act ("APA") provision granting agency reviewing initial decision "all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule"). *See also Mr. Sprout, Inc. v. United States*, 8 F.3d 118, 123 (2d Cir. 1993) (characterizing § 557(b) as allowing for *de novo* review of initial decision by Interstate Commerce Commission); *Gross v. SEC*, 418 F.2d 103, 105, 107-108 (2d Cir. 1969) (applying § 557(b) and *de novo* standard to Commission appellate decision); *Commercial Capital Corp. v. SEC*, 360 F.2d 856, 857-58 (7th Cir. 1966) (applying provisions of APA to activities of Commission).

ARGUMENT

I. Respondents' Due Process, Equal Protection, and Constitutional Claims Lack Merit

A. The Commission Has Not Prejudged Claims Against Respondents and There Have Been No Improper Ex-Parte Communications Between the Division and the Commission

Respondents contend that these proceedings deprive them of their due process rights and are void because the Commission allegedly has prejudged the case against them by issuing an Order Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order on December 5, 2013 against two settling respondents, Belesis and JTF (the "December 5 Order"). *See* Respondents' Opening Brief ("Resp. Br.") at 4-8. Because the December 5 Order contains factual and legal findings that Respondents contest, they argue that the Commission is biased and cannot fairly adjudge the case against them, notwithstanding the fact that the December 5 Order specifically states that the findings "are not binding on any other person or entity in this or any other proceeding." Respondents also contend that the Commission engaged in impermissible *ex parte* communications with the Division in connection with that settlement. Resp. Br. at 21-28. Respondents argue that these supposed *ex parte* communications violate their due process rights and the APA. Based on these purported violations, Respondents state that that the case against them is void and must be dismissed.[2]

The Commission repeatedly has found Respondents' arguments to be meritless, including in this very action where the Commission denied Respondents' Petition for Interlocutory Review on these same issues. (Jan. 28, 2014 Order Den. Pet. for Interlocutory Review). For example, in

[2] Respondents separately filed a motion asking the Commission to recuse itself from hearing this matter. Because the arguments in the Respondents' brief and motion for recusal are the same, the Division addresses them both in this single brief.

Edward Sinclair, 1971 SEC LEXIS 898 (1971), the respondent, who was an order clerk for Filor, Bullard & Smith, argued that any Commissioner who participated in the decision on consent to suspend Filor for failing to supervise should be disqualified from hearing the case. The Commission rejected this argument stating that there was "no merit in the motion." The order against Filor was based on a stipulated record and, like the December 5 Order, expressly stated that it was not binding on the other respondents. The Commission stated that its present decision regarding the respondent was based solely on the record before it "and is no way influenced by our findings as to Filor based on the order of the settlement."

On appeal, the Second Circuit agreed that Commissioner Smith was not biased and did not need to disqualify himself:

> We find no merit in the argument that Commissioner Smith had prejudged Sinclair's case by participating in the Commission's decision to accept a Filor settlement offer setting forth certain stipulated facts. The facts were stipulated by the parties solely for the particular settlement, just as is the practice in negotiation of consent decrees. The decision stated that it was not binding on the other respondents. Furthermore, each of the two proceedings met the standards of due process with each respondent ... being represented by competent counsel. The Commission's findings with respect to Sinclair 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 after oral argument and submission of briefs. In such a context Commissioner Smith was not called upon to disqualify himself from participation in Sinclair's case.

Sinclair v. SEC, 444 F.2d 399, 401-02 (2d Cir. 1971). More recently, in *Stuart-James Co., Inc.*, 1991 SEC LEXIS 168 (Jan. 23, 1991), the Commission held that its settlement with one respondent did not require that the Commissioners who accepted that settlement be disqualified or the administrative proceeding be dismissed. The Commission stated, "[t]aken at face value, the respondents' arguments suggest that it is virtually impossible for the Commission properly to entertain individual settlements in proceedings involving multiple respondents." *Stuart-James*, 1991 SEC LEXIS 168, at *3. Rejecting this argument, the Commission found that consistent

with due process, it could "authorize investigations of suspected securities law violations, institute enforcement proceedings to determine whether the suspected violations occurred, and later make findings of fact and conclusions of law on the basis of the record that is compiled. We may also consider offers of settlement during the course of those proceedings." *Id.* at *5. The Commission further held that it could have communications with the Division about the settlement stating that "[t]o exclude our staff from presenting relevant facts concerning a negotiated settlement would simply lead to wrong decisions about which settlement offers merited acceptance. Such a result is not in the public interest and is not required by statute or rules." *Id.* at *12.

Finally, while the Commission recognized that "non-settling respondents might wish to appear before us to dispute information presented by the staff, or to argue additional facts which they believe would influence our assessment of the public interest," it held that there was no such requirement under the APA and "[c]ontrol over [the Division's] access to the Commission cannot be turned over to private parties." *Id.* at *14-19. Consequently, the Commission held that so long as the Division is not participating or advising in a decision by the Commission as to the non-settling respondents, "there is no compelling reason the communications [between the Division and the Commission] as to a proposed settlement by one respondent in a multi-party proceeding may not take place *ex parte*." *Id.* at *20. *See also C. James Padgett*, 1997 SEC LEXIS 634, *59 (Mar. 20, 1997) (rejecting argument that by accepting settlement of one respondent it had prejudged other respondents' liability and had engaged in improper *ex parte* communications with Division, and stating while "[t]he APA and Commission rules prohibit *ex parte* communications relating to the decisional process ... circumscribed Division communications with the Commission in connection with a proffered settlement by one

respondent in a multi-party proceeding are not part of the decisional process regarding other parties"); *Jean-Paul Bolduc*, 2001 SEC LEXIS 2765, *5 (Jan. 25, 2001) (finding no bias by virtue of settlement with another party, but also "[a]n administrative body such as the Commission may not be disqualified from performing its adjudicatory functions based on allegations of bias, prejudice, or prejudgment on the part of the Commission or its members.") (*citing FTC v. Cement Institute*, 333 U.S. 683 (1948)); *Atlantic Equities Co.*, 1967 SEC LEXIS 531 *28-29 (July 11, 1967) ("in our opinion, the claim of 'prejudgment' [based on an earlier settlement] is without substance"), *aff'd sub nom., Hanson v. SEC*, 396 F.2d 694 (D.C. Cir.); *Steadman Security Corp.*, 1977 SEC LEXIS 1388, *56 n.82 (June 29, 1977) (denying as "meritless" motion to dismiss on grounds of prejudgment, stating that APA permits the Commission to consider settlement in its administrative capacity "and thereafter render a decision with respect to it in our quasi-judicial capacity").

Because the Commission is allowed to consider a settlement by one respondent in an administrative action without having to disqualify itself with respect to any other respondent, it follows that any communications between the Division and the Commission in connection with that settlement are also not improper (and, in fact, are necessary), do not violate due process of law, and do not require the Commission to disqualify itself or to dismiss the action. The Commission should follow its own precedent and deny Respondents' petition, which is based on the same arguments and the same facts as the decisions discussed above.[3] In denying Respondents' Petition for Interlocutory Review, the Commission admonished Respondents for their failure to address this unbroken line of Commission decisions, stating: "[a]lthough JTCM

[3] Respondents argue that the findings concerning their own actions in the December 5 Order were "gratuitous and totally unnecessary." This argument ignores the fact that the settling respondents were charged not as primary violators, but as aiders and abettors. Because such a charge requires an underlying violation of the securities laws, the December 5 Order had to contain findings of underlying violations. It is clear from the order, however, that such findings were not binding on the Respondents.

and Jarkesy are 'entitled to make a good faith argument for a change of law', they are 'obligated to acknowledge that they are doing just that and deal candidly with the obvious authority that is contrary to [their] position.'" Order of January 28, 2014 at 4. Respondents still do not deal candidly with the Commission's precedent on this very issue.

Recognizing the weakness of their argument, Respondents claim that the language in the Order with JTF and Belesis stating that the findings are not binding on any other person or entity does not apply to the Commission itself which, they assert, is bound by its prior findings. This is incorrect, as the Commission specifically stated in denying the Respondents' Petition for Interlocutory Review in this matter:

> In particular, the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs especially when—as took place here—the order accepting an offer of settlement "expressly state[s] that it was not binding on other [non-settling] respondents." Any decision that the Commission makes as to JTCM and Jarkesy will be "based solely on the record" adduced before the law judge and will "in no way [be] influenced by our findings as to [JTF and Belesis] based on [their] offer of settlement."

Order Den. Pet. for Interlocutory Review at 4 (footnotes omitted) (*citing Sinclair*, 1971 WL 120487, at *4 (Mar. 24, 1971)). It is clear that the Commission does not consider itself bound by the prior findings in the Order approving settlements with other Respondents and is free to deviate from those findings if they do not accord with the evidence in the record adduced before the ALJ.

Respondents' attempt to distinguish their situation from *Stuart-James* and its progeny is entirely unavailing. *See* Resp. Br. at 24-27. Respondents merely restate, without providing any evidence in support, that the Commission has prejudged the case against them by making findings of fact with respect to the settling respondents, and state that "the Commission, by virtue of its improper *ex parte* contact with the Division, issued findings of fact pertaining to the non-settling Respondents." Resp. Br. at 26. Respondents simply ignore the unambiguous

statement in the prior settlement that the factual findings are not binding on any other party. The Commission never issued any findings of fact pertaining to these Respondents.

Finally, while Respondents argue that the Commission violates the APA by considering settlements with respect to certain respondents if others are litigating the matter, the opposite is true. As the ALJ noted in the ID, a prohibition on considering settlements would likely run afoul of the APA:

> 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 review 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.

ID at 3 (internal citations omitted).

B. The Division Properly Produced All Required Documents and Complied with its Obligations Under *Brady* v. Maryland

Respondents assert that their due process rights were violated because the Division allegedly produced documents in a "document dump" and withheld supposedly exculpatory material contrary to the doctrine of *Brady v. Maryland*. Resp. Br. at 28-32. This claim is also meritless and was soundly rejected by the Commission which previously held in this case that Respondent "failed to grapple with [Supreme Court] authority [and] [t]heir contrary reliance on the unpublished district court decision in United States v. Salyer is misplaced." (Dec. 6, 2013 Order Den. Pet. for Interlocutory Review at 9-10).

The Division's discovery obligations are described in Rule 230 of the Commission's Rules of Practice. Pursuant to Rule 230(a)(1), the Division "shall make available for inspection and copying ... documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division's recommendation to institute

proceedings." Pursuant to Rule 230(a)(2), the Division may withhold documents that are obtained prior to the institution of proceedings that: (1) are privileged; (2) are internal memoranda, notes, or other attorney work product so long as those documents are not going to be offered into evidence; (3) identify confidential sources; and (4) the hearing officer grants leave to withhold for good cause shown. Rule of Practice 230(b)(1). The Division, however, may not withhold documents that contain material exculpatory evidence under *Brady v. Maryland*, 373 U.S. 83, 87 (1963). Rule of Practice 230(b)(2).

The Commission has described the Division's *Brady* obligations as follows:

> The Rules of Practice do not "authorize respondents to engage in 'fishing expeditions' through confidential Government materials in hopes of discovering something helpful to their defense. Unless defense counsel becomes aware that exculpatory evidence has been withheld and brings it to the judge's attention, the government's decision as to whether or not to disclose information is final. Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review. In order to justify such a review, a respondent must first establish a basis for claiming that the documents contain material exculpatory evidence. A 'plausible showing' must be made that the documents in question contain information that is both favorable and material to the respondent's defense."

Orlando Jett, 1996 SEC LEXIS 1683, *1-2 (June 17, 1996) (emphasis added); *see also OptionsXpress, Inc.*, 2013 SEC LEXIS 3235 (Oct. 16, 2013).

The Division complied with all disclosure requirements under the Commission's Rules of Practice. In fact, the Division exceeded its disclosure requirements, providing its entire investigation file (excluding privileged materials) to Respondents in a searchable Concordance database at no charge. Prior to producing the database, the Division produced to Respondents the investigative testimony taken prior to the commencement of this action (to the extent the Division had the transcripts) as well as all of the exhibits to that testimony, which taken together, comprised its "hot documents" file. The Division repeatedly offered to make the entire

investigative file (exclusive of privileged documents) available to Respondents for inspection and copying at the Commission's New York Regional Office at Respondents' convenience. Respondents never accepted the Division's offer.

The Division also provided to Respondents a "withheld document list" and a declaration that, read together, named the potential witnesses the Division interviewed where there was no transcript (both before and after the filing of this action), and summarized all of the potentially exculpatory material provided by these witnesses. The declaration further provides that the other withheld documents (internal Division emails, memoranda, and spreadsheets) do not contain material exculpatory statements under *Brady*.

Respondents further contend that because of the way the documents were produced to them, they did not have time to adequately review them. However, the Division produced its files to Respondents in the same way that the Division keeps the documents, that is, in an electronically searchable Concordance database format. The Commission previously has rejected Respondents' arguments, noting that "JTCM and Jarkesy's estimates for how long it would take to conduct a page-by-page review of the materials are irrelevant; they can use Concordance's search capabilities to home in on the documents that they need to prepare for the hearing." *John Thomas Capital Mgmt. Group LLC*, 2013 SEC LEXIS 3860, *22, n.37 (Order Den. Pet. for Interlocutory Review, Dec. 6, 2013). Most important perhaps, Respondents fail to acknowledge that the majority of the documents produced to them were the Respondents' *own* documents, that is, documents Respondents had produced to the Division during the investigation in response to subpoenas and document requests.

1. The Division Complied With Its *Brady* Obligations

The Division has not kept any potentially exculpatory materials from the Respondents. It produced its entire investigative file except for privileged materials (consisting of interview notes) and, even with respect to the privileged material, it summarized all potentially exculpatory material contained in those notes.

It has long been held that an "open file" policy satisfies the requirements of *Brady*. In *Strickler v. Greene*, 527 U.S. 263, 283 n.23 (1999), for example, the Supreme Court stated "we certainly do not criticize the prosecution's use of the open file policy. We recognize that this practice may increase the efficiency and the fairness of the criminal process." In *United States v. Warshak*, 631 F.3d 266, 297 (6th Cir. 2010), the Sixth Circuit Court of Appeals rejected the defendant's argument that the government failed to comply with its *Brady* obligations when it handed over "millions of pages of evidence and forc[ed] the defense to find any exculpatory information contained therein." The court held that there was no evidence that the government acted in bad faith, larding its production with entirely irrelevant documents or concealing exculpatory evidence in the information turned over. Consequently, the court rejected the argument that the government was obliged to sift through all of the evidence in an attempt to locate anything favorable to the defense, stating that such an argument "comes up empty." In *United States v. Rubin/Chambers, Dunhill Ins. Servs.*, 825 F. Supp.2d 451, 454-55 (S.D.N.Y. 2011), the court held that "it is apparent that prosecutors may satisfy their Brady obligations through 'open file' policies or disclosure of exculpatory or impeachment material within large production of documents of files." And "even when the material disclosed is voluminous," in the absence of prosecutorial misconduct [bad faith or deliberate attempts to knowingly hide *Brady* material] the prosecutor's use of "open file disclosures ...does not run afoul of Brady."

Similarly, in *United States v. Ohle*, 2011 U.S. Dist. LEXIS 12581, *7-11 (S.D.N.Y. Feb. 7, 2011), the court rejected defendants' argument that the prosecutors should be required to identify specific *Brady* documents within the files produced by the government -- even though the government in that case had produced nine separate searchable Concordance databases to the defendants, which contained several gigabytes of data "including millions of separate files extending to several million pages in length." The court held that "as a general rule, the Government is under no duty to direct a defendant to exculpatory evidence within a larger mass of disclosed evidence." *Ohle*, 2011 U.S. Dist. LEXIS 12581 at *11 (internal citations omitted). Moreover, the court noted that while there were many documents, the government had produced an electronically searchable database, to which both parties had equal access, and therefore the defendants "were just as likely to uncover the purportedly exculpatory evidence as was the Government." *Id.* at *10. *See also United States v. AU Optronics Corp.*, 2011 U.S. Dist LEXIS 148037 (N.D. Cal. Dec. 23, 2011) (denying motion seeking order requiring the government to review 37 million pages of documents produced to identify potentially exculpatory material under *Brady*).

2. The Division's Interview Notes are Privileged

It is beyond contention that witness interview notes are privileged work product. *See, e.g., United States v. Gupta*, 848 F.Supp.2d 491, 496 (S.D.N.Y., Mar. 26, 2012) (SEC's witness interview notes are protected work product requiring a showing of "substantial need" by defendant); *SEC. v. Nadel*, 2013 U.S. Dist. LEXIS 36251, *1-9 (E.D.N.Y. Mar. 15, 2013) (SEC interview notes constitute opinion/core work product and are subject to heightened protection); *SEC v. NIR Group, LLC*, 283 F.R.D. 127, 135 (E.D.N.Y. Aug. 17, 2012) (SEC notes and memoranda relating to witness and investor interviews are "highly protected work product of

which production may not be demanded"); *SEC. v. Strauss*, 2009 U.S. Dist. LEXIS 101227, *12-15 (S.D.N.Y. Oct. 28, 2009) (application to compel production of SEC interview notes and memoranda denied, since SEC interview notes and memoranda prepared in anticipation of litigation fit within protection of work-product doctrine). The witness interview notes at issue relate to interviews conducted by Division attorneys in connection with the investigation of Respondents, and were conducted in anticipation of this litigation. Although some of the interviews predated the formal initiation of this litigation, they "were conducted in order to provide the Commission with information so that it could make the determination whether to proceed with litigation," and thus, fall "squarely within the protections of the work-product doctrine." *SEC v. Cavanagh*, 1998 U.S. Dist. LEXIS 3713 at *5-6 (S.D.N.Y. Mar. 23, 1998). Because notes of attorneys' investigative interviews inherently reflect their mental impressions, opinions, theories and conclusions, such notes have long been entitled to the strictest level of work product protection. *See, e.g., Upjohn Co. v. United States*, 449 U.S. 383, 398-401 (1981) (disclosure of attorney interview notes is disfavored, and justified either rarely or "never"), *SEC. v. Stanard*, 2007 U.S. Dist. LEXIS 46432, *4 (S.D.N.Y. June 26, 2007) (analysis of case "in anticipation of litigation" is work product, and receives heightened protection under Rule 26(b)(3)); *SEC v. Treadway*, 229 F.R.D. 454, 455-56 (S.D.N.Y. July 26, 2005) (notes protected by work product privilege because they represent attorney work product that at least in part, reflects thought process of counsel); *SEC v. Downe*, 1994 U.S. Dist. LEXIS 708, *6-8 (S.D.N.Y. Jan. 27, 1994) (attorney work product based on oral statements of witnesses is likely to reveal attorney's mental processes).

While the Division did not turn over the witness notes to Respondents (except for one inadvertent disclosure), the Division provided a declaration describing all of the potentially

exculpatory statements contained within such notes, which has been held to be sufficient under Rule 230. *See Bandimere* 2013 SEC LEXIS 746, *8 (Mar. 12, 2013) (Order of ALJ Elliot denying respondent's request for production of interview notes when Division provided essential facts and substance of material exculpatory evidence in affidavit); *Dearlove*, 2006 SEC LEXIS 1476, *5 (Order of ALJ Kelley, Jan. 19, 2006) (declaration satisfies *Brady* obligations). Respondents speculate that the interview notes may contain other information that was not provided to them.[4] Mere speculation is insufficient to require the production of such notes even for an *in camera* review. *Jett*, 1996 SEC LEXIS 1683 at *2 ("Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review"); *OptionsXxpress*, 2013 SEC LEXIS 3235 at *15 (respondents must make plausible showing that documents contain information both favorable and material to their defense). In fact, the Commission reviewed the interview notes for investor Steven Benkovsky that had inadvertently been produced and concluded that those notes did not contain any additional undisclosed exculpatory material. Since these notes did not contain any undisclosed *Brady* material, the Commission held that Respondents argument that the other notes contained undisclosed material was mere speculation. Dec. 6, 2013 Order at 8. Likewise, during the course of the hearing, at Respondents' request the ALJ reviewed *in camera* the notes taken of investor Robert Fulhardt and concluded that "there is nothing there." Tr. 1414-15.

As described above, the Division has produced its entire investigative file to Respondents with the exception of privileged material. With respect to the privileged material, the Division provided a declaration to Respondents describing the potentially exculpatory materials contained

[4] *See, e.g.*, Resp. Br. at 31 ("Respondents ... were forced to the hearing without the *Brady* material that was almost certainly in the Division's possession.")

in the interview notes and stating that the other privileged material does not contain material exculpatory statements.

C. The Commission's Exercise of Discretion in Forum Selection Does Not Violate the Separation of Powers Doctrine

Respondents next contend that the "transfer of coextensive administrative enforcement authority to the Commission" pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 11-203, H.R. 4173) ("Dodd-Frank") "constitutes a delegation of legislative authority" that "tramples the doctrine of separation of powers." Resp. Br. at 8. Respondents refer to the "delegated power of the Commission to institute administrative enforcement actions" and claim that "the delegation to exercise this new administrative enforcement authority was legislative" in violation of the separation of powers doctrine. Resp. Br. at 9. This contention is nonsensical, and the cases cited by Respondents provide no support for it.

First, the relevant provisions of Dodd-Frank do not constitute a delegation of legislative authority. The relevant provisions of Dodd-Frank at issue did not transfer administrative authority to the Commission, nor did it create a new administrative authority; rather, with the enactment of Dodd-Frank, Congress provided the statutory authority for the Commission to obtain civil penalties in cease-and-desist proceedings brought to enforce the federal securities laws. When the Commission brings an action to enforce the federal securities laws, whether in federal district court or in administrative proceeding pursuant to Dodd-Frank, it is not acting in a *legislative* capacity. Rather, it is acting in an *executive* capacity, to enforce the laws that

Congress has enacted in accordance with the statutory mechanisms that Congress has explicitly provided.[5]

Second, the fact that Congress enacted a statutory scheme that allows the Commission to choose the forum in which to bring an enforcement action does not constitute a delegation of legislative authority. The choice of forum is not a legislative act, but part of the discretionary decision making authority the Commission has in carrying out its statutory mandate to execute the law. It is no different than the decision making authority that the Commission exercises every time it decides whether or not to bring an enforcement action at all,[6] regardless of the forum, or when it decides which of many potential statutory violations it chooses to bring.[7] Such decision making is not legislative in character, but part of the executive function.

Respondents contend that "Government actions that 'have "the purpose and effect of altering the legal rights, duties, and relations of persons ... outside the Legislative branch,"' constitute legislative action." Resp. Br. at 8-10 (*quoting Metro. Wash. Airports Auth. V. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 276 (1991)). Respondents further contend that "[t]he decision-making surrounding agency adjudications 'alter [] the legal rights, duties, and relations of persons ... outside the legislative branch,' and involve 'determinations of policy.'" Resp. Br. at 9 (*quoting INS v. Chadha*, 462 U.S. 919, 952, 954 (1983)). Both of these contentions are wide of the mark, and the cases cited provide no support for Respondents'

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[5] *Cf., Morrison v. Olson*, 487 U.S. 654, 706 (1988) (Scalia J. dissenting) ("Governmental investigation and prosecution of crimes is a quintessentially executive function.")

[6] *See, e,g.,* 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, inasmuch as it is the Executive who is charged by the Constitution to 'take care that the Laws be faithfully executed.'") (internal citation omitted)

[7] This is true even in the criminal context. The Supreme Court "has long recognized that when an act violates more than one criminal statute, the government may prosecute under either so long as it does not discriminate against any class of defendants." *U.S. v. Batchelder*, 442 U.S. 114, 123-24 (1979).

position. If every government action that has the effect of altering the legal rights, duties, and relations of persons constitutes *legislative* action, then every *executive* action would be turned into an instance of *legislative* activity. Likewise, treating the decision-making surrounding agency adjudication as a broad *policy* determination, would turn every instance of law enforcement – every prosecution, enforcement action, or statutory implementation, all classic examples of *executive* action – into quasi-legislative acts. It is Respondents' conflation, and frankly confusion, over what constitutes an executive action and what constitutes legislative action that does violence to the principle of separation of powers. As the Supreme Court held almost one hundred years ago, "[l]egislative power, as distinguished from executive power is the authority to make laws, but not to enforce them or appoint the agents charged with the duty of such enforcement. The latter are executive functions." *Springer v. Gov't of the Philippine Islands*, 227 U.S. 189, 202 (1928).

The cases cited by Respondents provide no support for their arguments. The underlying question in those cases was whether a part of *Congress* was engaging in actions that were legislative in nature – that is, whether some part of Congress was exercising legislative power – such that they could only lawfully be undertaken pursuant to the constitutional requirements for legislative enactment, namely passage by a majority of both houses and presentment to the President for signature or veto.

INS v. Chadha concerned the constitutionality of a statute that provided that either house of Congress could, by resolution, invalidate a decision by the Attorney General – an executive branch officer acting pursuant to authority delegated by Congress – to allow a deportable individual to remain in the United States. The court held that this legislative veto violated the separation of powers because Congressional action overturning an executive order on

deportation was necessarily legislative in character, and could lawfully be accomplished only through normal legislative processes, namely passage of a new bill by both houses of Congress and presentment to the President. *See INS v. Chadha*, 462 U.S. 919, 952-55 (1983). Nothing like that is at issue here, where Congress has empowered an executive agency to enforce the law. The separation of powers would only be implicated if Congress had somehow reserved to itself the power to overturn the Commission's actions.

Metropolitan Washington Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc., similarly is inapposite. That case involved the transfer of two airports owned by the federal government to a new regional airport authority created pursuant to laws enacted by the District of Columbia and the State of Virginia. Congress authorized the transfer conditioned on the District and the State creating a review board (the Board) composed of nine members of Congress who would have veto power over the Board's decisions. The court held that this arrangement violated the separation of powers on one of two grounds: if the Board was deemed to be exercising legislative power, then its actions would violate the requirement that legislation requires action by both houses of Congress and presentment to the President, and not a small subset of Congress; if the Board was deemed to be exercising executive power, then it would constitute an unconstitutional delegation by Congress of executive authority to its own agents. *See Metropolitan Washington Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 274-77 (1991). Once again, nothing of the sort is at issue here. With the passage of Dodd-Frank, Congress provided the Commission – the Executive – new powers to enforce the laws; Congress did not thereby delegate to a subset of itself the power to legislate, nor did it delegate the executive power to its own agents.

To argue that Congress unlawfully delegated legislative authority in violation of the separation of powers doctrine when it authorized new administrative remedies to enforce the laws Congress passed, turns logic on its head. It is Congress that could not institute enforcement proceedings without violating the separation of powers doctrine because it would be acting in both a legislative and executive capacity.[8]

Finally, to whatever extent the choice of forum can be seen as involving some policy determination, the Supreme Court has held that Congress has considerable leeway in setting the boundaries of executive judgment: "In short, 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.'" *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 464-75 (2001) (internal citation omitted). While it is true that any delegation of quasi-legislative authority must be limited by an "intelligible principle," the court has found that principle to be met in a host of circumstances where the degree of agency discretion is far greater than what is at issue here. Indeed, the court has upheld a broad degree of discretion even in cases that involve an agency's rule making authority.[9] *See, e.g., Entergy Corp. v. Riverkeeper, Inc.*, 566 U.S. 208, 218-23 (upholding Congressional delegation of discretionary authority to EPA to decide whether it should consider costs in making certain rules); *Whitman*, 531 U.S. at 472-76 (approving delegation to EPA to set national standards for air quality). The case at hand here – which involves nothing more than the forum the Commission chooses when executing the laws enacted

[8] *See, e.g., Buckley v. Valeo*, 424 U.S. 1, 138-39 (1976) (finding that FCC enforcement power cannot be regarded as an aid of the legislative functions of Congress, and concluding that remedy for breaches of law resides in the executive).

[9] *See, e.g., Department of Transportation v. Assn. of American Railroads*, 575 U.S. ___ (2015), 2015 U.S. LEXIS 1763, *66 (Mar. 9, 2015) ("For whatever reason, the intelligible principle test now requires nothing more than a minimal degree of specificity in the instruction Congress gives to the Executive when it authorizes the executive to make rules having the force and effect of law.") (Thomas J., concurring).

by Congress – presents none of the concerns that exist when an agency is engaged in rule making.

Respondents further claim that when Congress authorizes administrative procedures to resolve certain perceived problems, those procedures must be exclusive, and that the "boundaries required by [that] exclusivity" were breached by giving the Commission the power to decide in what forum to bring an enforcement action.[10]

However, the relevant section of the case Respondents cite in support of this proposition (*Free Enterprise Fund v. PCAOB*) has nothing to do with the question at issue here. The question the court was facing in the cited section of *Free Enterprise Fund* was whether a federal district court had jurisdiction to hear a constitutional challenge to the validity of the Public Company Accounting Oversight Board, or whether such a challenge had to first proceed through the administrative process at the conclusion of which it could be reviewed by an appellate court as provided by statute. The court noted that when Congress provides a mechanism for agency review by an aggrieved party, that mechanism is generally considered exclusive, but not in cases where it would effectively close off all avenues of judicial review. *See Free Enterprise Fund*, 561 U.S. at 489. That holding, concerning the jurisdiction of a federal district court to hear a facial challenge to the very existence of an administrative body, has nothing to do with the question whether Congress can provide an agency with the authority to bring an enforcement action either as an administrative proceeding or a federal district court action. Respondents

[10] *See* Resp. Br. at 10: "The Court has repeatedly stressed that 'when Congress creates procedures "designed to permit agency expertise to be brought to bear on particular problems," those procedures "are to be exclusive."' *Free Ent. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 489 (2010); *Whitney Nat'l Bank of Jefferson Parish v. Bank of New Orleans & Trust Co.*, 379 U.S. 411, 419-20 (1965). The boundaries required by the exclusivity of legislatively-created administrative procedures were uniquely lifted by Dodd-Frank, however, leaving it to the Commission to decide for itself which procedures are 'to be brought to bear' in the enforcement of securities statutes."

provide no support for the proposition that when Congress authorizes administrative resolution of certain agency actions such procedures must be exclusive.

D. Selection of the Administrative Proceeding as a Forum does not Violate Respondents' Equal Protection Rights

Respondents next contend that the decision to proceed in an administrative forum deprived them of their right to equal protection for two reasons: first, because it deprived them of their Seventh Amendment right to a jury trial in a discriminatory way that cannot survive strict scrutiny analysis; second, that it contravenes their equal protection rights pursuant to the "class of one" doctrine. Resp. Br. at 12. Both claims lack merit.

1. Use of the Administrative Forum Did Not Unfairly Deprive Respondents of their Seventh Amendment Jury Trial Rights

Respondents claim that the choice of an administrative forum violates their fundamental right to a jury trial and therefore denies them equal protection under the law. This claim flies in the face of controlling Supreme Court precedent. While Respondents go on at length about the importance of the jury trial in American history and how the right is so fundamental that any deviation must be subjected to strict scrutiny analysis, they completely fail to address how the Supreme Court's holding in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission,* 430 U.S. 442 (1977), affects their fundamental rights analysis. *See* Resp. Br. at 13-17. In *Atlas Roofing*, the Supreme Court held that the use of administrative proceedings that lack juries *does not* violate the Seventh Amendment: "[T]he Seventh Amendment does not prohibit Congress from assigning the fact finding function and initial adjudication to an administrative forum with which the jury would be incompatible." 430 U.S. at 450. Following *Atlas Roofing*, the Commission consistently has rejected claims that administrative proceedings violate the Seventh Amendment right to a jury trial. *See, e.g., Harding Advisory LLC*, 2014 SEC LEXIS 938, *35 n.46 (*citing Atlas Roofing*); *Vladlen "Larry" Vindman*, 2006 SEC LEXIS 862,

*44 n.60 (Apr. 14, 2006) (rejecting argument that ALJ's imposition of the civil penalty violated respondent's Seventh Amendment right to a jury trial); *Michael Tennenbaum*, 1982 SEC LEXIS 2434, *21-22 (Commission Op., Jan. 19, 1982) (finding respondent's argument that the ALJ could not assert "clearly penal sanctions" without affording the procedural safeguards of a jury trial "wholly lacking in merit"); *Hausmann-Alain Banet*, 2014 SEC LEXIS 361, *14 n.9 (Initial Decision, Jan. 30, 2014) (no jury trial right in administrative proceedings).

Atlas Roofing and its progeny clearly establish that trial by jury is not a fundamental right in the context of administrative proceedings. Yet Respondents fail to even mention *Atlas Roofing* in this section of their Brief, let alone try to distinguish it, even though it is controlling Supreme Court precedent. *See* Resp. Br. at 13-17. Respondents also fail to discuss or even mention in this section the long line of Commission cases that follow *Atlas Roofing*. Because the use of administrative proceedings that lack juries does not violate the Seventh Amendment at all, the decision to proceed administratively is not one that is subject to strict scrutiny analysis for purposes of deciding an equal protection challenge that is grounded on the alleged deprivation of Seventh Amendment rights. Respondents have not cited any authority to the contrary.

2. Respondents Cannot Sustain a "Class of One" Claim

Respondents further claim that the "[s]taff's arbitrary decision to send them into the administrative process" deprived them of equal protection, and that because "the SEC has sued other identical targets in federal court" they have a "class of one" equal protection claim. Resp. Br. at 17. This contention is also without merit.

To sustain a "class of one" equal protection claim, Respondents must show that they have "been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment." *Village of Willowbrook v. Olech*, 528 U.S. 562, 564

(2000) (*per curiam*). Respondents have made no such showing in this case. First, although Respondents have identified other allegedly similarly situated defendants whom the Commission sued in federal court, they have failed to show how each of these defendants is so similarly situated to Respondents as to raise an equal protection challenge. Parties asserting "class-of-one" equal protection claims must show an "*extremely high degree of similarity* between themselves and the persons to whom they compare themselves." *Lieberman v. City of Rochester*, 2014 U.S. App. LEXIS 4347, *39 (2d Cir. Mar. 7, 2014) (emphasis added) (citing *Ruston v. Town Bd. for Town of Skaneateles*, 610 F.3d 55, 59 (2d Cir.)). *See also Missere v. Gross*, 826 F. Supp. 2d 542, 561 (S.D.N.Y. 2011) ("class of one" challenge requires showing an extremely high degree of similarity between claimants and the persons to whom claimants compare themselves).

Here, Respondents have simply pointed to other cases where individuals were charged under the same statutory provisions in federal district court. They have not shown that any of these other individuals were similarly situated to themselves, let alone how they were similarly situated for purposes of establishing the high degree of similarity necessary to sustain an equal protection challenge. As the Commission recently said in rejecting a similar equal protection challenge, "superficial comparisons to a few other proceedings fall short of establishing a colorable equal protection violation." *Harding*, 2014 SEC LEXIS 938 at *32-33.

Second, to sustain a "class of one" equal protection challenge, the Respondents must show that they were *intentionally* treated differently from others who are similarly situated. Respondents have made no such showing. The Commission recently held that respondents' constitutional claim was facially defective because respondents "identify no evidence to support their allegations that, by bringing this case as an administrative hearing, the Division

intentionally deprived them of procedural safeguards afforded to similarly situated persons ...." (emphasis added). *Harding*, 2014 SEC LEXIS 938 at *35 n.46 (Order Den. Pet. for Interlocutory Review, Mar. 14, 2014). Respondents here similarly fail to identify any evidence that the intention of the Division when bringing this case against them as an administrative proceeding was to deprive them of procedural safeguards afforded to other persons.

Respondents claim that their situation is similar to that of Rajat Gupta, who brought an action in federal court against the Commission seeking declaratory and injunctive relief because he had been sued in an administrative proceeding rather than a federal court action. Resp. Br. at 18-19. The district judge found that Gupta sufficiently established a "class of one" claim. *Gupta*, however, is entirely different from the Respondents' case. In *Gupta* there were twenty-eight other defendants connected to the same insider trading ring who previously had been sued in federal district court and only Gupta was charged in an in administrative proceeding. Here there are no other defendants connected to the same allegations of misconduct as the Respondents who have had their cases brought in federal court rather than in administrative proceedings. *See Harding*, 2014 SEC LEXIS 938 at *33 n.42 (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'"). To the contrary, JTF and Belesis were part of this same administrative proceeding.

Because Respondents have failed to show that they have been intentionally treated differently than other similarly situated persons, their "class of one" argument cannot be sustained.

E. The Dodd-Frank Provisions Authorizing Civil Penalties in Administrative Proceedings Do Not Violate the Seventh Amendment

In addition to the above argument that bringing an administrative proceeding violates Respondents' equal protection right by depriving them of their Seventh Amendment right to a jury trial, Respondents separately argue that the provisions of Dodd-Frank which authorize the imposition of civil penalties against unregistered persons in administrative proceedings directly violate the Seventh Amendment right to a jury trial. Resp. Br. at 19-21.

As discussed above, it is well settled that the Seventh Amendment right to a jury trial does not apply in administrative proceedings. *See Atlas Roofing,* 430 U.S. 442. While this time acknowledging the holding in *Atlas Roofing*, Respondents claim that the penalty authority enacted under Dodd-Frank violates the Seventh Amendment because it is indistinguishable from the penalty authority at issue in *Tull v. United States*, 481 U.S. 412 (1987), where the court found the Seventh Amendment right to a jury trial applied in a government action to impose penalties pursuant to the Clean Water Act. Specifically, Respondents claim that:

> In giving the SEC unprecedented power to assess the [sic] civil penalties that are punitive in nature and are imposed under a separate statutory provision focused exclusively on adjudicating liability for penalties (in contrast to a statutory provision, such as the one before the Supreme Court in *Atlas Roofing,* where penalties are intertwined with remedial measures), Dodd-Frank transformed the SEC administrative enforcement program ... into a penalty-collection program that is indistinguishable from the Water Act penalty program before the Supreme Court in *Tull.*

Resp. Br. at 21.

This is a misreading of both *Tull* and *Atlas Roofing.* Contrary to Respondents' claim, the statutory scheme authorizing relief in *Atlas Roofing* was not materially different from the one at issue in *Tull.* Rather, the distinguishing feature between *Atlas Roofing* and *Tull* was simply the forum in which the case was brought. *Tull* stands for the proposition that when the government

seeks to impose civil penalties *in a federal district court action*, the Seventh Amendment right to a jury trial applies. *Atlas Roofing* stands for the proposition that the Seventh Amendment right to a jury trial does not apply when the government brings an enforcement proceeding *in an administrative forum*, even when the government is seeking civil penalties. As the court in *Atlas Roofing* stated: "when Congress creates new statutory 'public rights,' it may assign their adjudication to an administrative agency with which a jury trial would be incompatible without violating the Seventh Amendment[]." The court continued, "[t]his is the case even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned to a federal court of law instead of an administrative agency." *Atlas Roofing* at 455.

Tull did not overrule *Atlas Roofing* or alter its essential holding. Claims similar to Respondents' have been raised and rejected in previous administrative proceedings. For example, in a case in which respondents relied on *Tull* in arguing that imposing penalties in an administrative proceeding would violate their Seventh Amendment rights, Judge Foelak held:

> *Tull* does not apply to the Division's claim for civil monetary penalties because the claim in *Tull* was brought before a tribunal that offered a jury trial and the majority of the government's claim consisted of the monetary penalty. Further, in *Atlas Roofing Co., v. Occupational Safety and Health Review Commission*, 430 U.S. 442 (1976), the court held that an administrative agency has the authority to adjudicate a monetary penalty when Congress creates a new "public right" and vests the initial fact finding authority in a government agency. This is true, even though the Seventh Amendment would require a jury trial if a court was designated to hear the claim instead of an administrative agency.

Vladen "Larry" Vindman, Order Den. Mot. to Dismiss Claim for Civil Monetary Penalties, AP File No. 3-11247 (Feb. 17, 2005) (unreported). *See also SEC v. Kopsky*, 537 F. Supp 2d 1023 (2008) (E.D. Missouri) (applying *Tull* in SEC federal district court action). The new remedies authorized under Dodd-Frank come squarely within the holding of *Atlas Roofing*.

F. The ALJ Properly Imposed Penalties

Respondents argue that the ALJ improperly imposed monetary penalties on Respondents for conduct that predated the effective date of the Dodd-Frank, which was enacted in July 2010, in violation of the principle that a statute will be presumed not to allow the imposition of penalties retroactively, unless the statute specifically so provides. Resp. Br. at 35-36. This argument fails for two reasons.

First, as the OIP makes clear, this action is both a "Cease and Desist Proceeding" (brought under Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act")), and an "Administrative Proceeding" (brought under Section 15(b) of the Exchange Act, Section 9(b) of the Investment Company Act of 1940 ("Company Act"), and Sections 203(e)-(f) of the Advisers Act). *John Thomas Capital Management Group LLC*, 2013 SEC LEXIS 922 (Mar. 22, 2013). The enhanced penalty provisions of Dodd-Frank apply only to cease and desist proceedings. Civil money penalties have been available in administrative proceedings since 1990, twenty years before the enactment of Dodd-Frank, when Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act (Pub. L. No. 101-429, 104 Stat. 931, 949-51) ("Remedies Act"). The Remedies Act amended the Exchange Act, the Company Act, and the Advisers Act to authorize the Commission to impose civil penalties in administrative proceedings (as well as in actions brought in federal court).[11]

[11] To the extent that Respondents are suggesting that the Division could not have brought an administrative proceeding against them prior to Dodd-Frank because they were not registered investment advisers (and therefore, could not have obtained penalties against them prior to Dodd-Frank), that would also be incorrect. *See Teicher v. SEC*, 177 F.3d 1016, 1017-19 (D.C. Cir. 1999) (affirming the Commission's authority to bring administrative proceedings against all investment advisers, whether registered or unregistered); *Vindman*, 2006 SEC LEXIS 862 (Commission Op., Apr. 14, 2006) (penalty

Thus, in *Vindman*, the Commission affirmed the ALJ's authority to issue a penalty against a non-registered stock promoter. 2006 SEC LEXIS 862 (Commission Op., Apr. 14, 2006). *See also SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 847 (3d Cir. 2006) (pre-Dodd Frank case noting that Commission can assess monetary penalties in administrative proceedings); *SEC v. Gabelli*, 2010 U.S. Dist. LEXIS 27613, *30 (S.D.N.Y. Mar. 17, 2010) (noting that Remedies Act allows Commission to seek civil penalties in administrative proceedings), *rev'd in part on different grounds*, 653 F.3d 49 (2d Cir. 2011), *rev'd on different grounds*, 133 S.Ct. 1216 (2013); *aff'd in part, rev'd in part on different grounds,* 2013 U.S. App. LEXIS 9128 (2d Cir. 2013); *SEC v. Bolla*, 550 F. Supp.2d 54, 60 (D.D.C. 2008) ("Remedies Act ... which governs monetary penalties in administrative proceedings before the SEC's administrative law judges – explicitly provides such penalties").

Second, even if it is correct that Dodd-Frank penalties cannot be applied retroactively in cease and desist proceedings, the violative conduct at issue here continued after the July 2010 effective date of Dodd-Frank, as the ALJ noted in the ID. The ALJ found the misconduct consisted of three courses of actions: "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." ID at 33. Each of these courses of action continued after July 2010, when the Respondents continued to manage the Funds' equity and life insurance investments, sent communications to investors, and maintained their working relationship with JTF and Belesis. There is, therefore, ample basis to support the imposition of a penalty pursuant to Dodd-Frank,

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against unregistered stock promoter); *Zubkis*, 2005 SEC LEXIS 3125 (Commission Op. Dec. 2, 2005) (barring an unregistered associated person of an unregistered broker-dealer from association with a broker or dealer).

and indeed, as discussed below, even greater penalties than the ALJ imposed are appropriate and in the public interest.

G. Respondents' Due Process Rights Were Not Violated Because of their Inability to Assert Counterclaims or to Develop an Evidentiary Record for Such Counterclaims

Respondents also claim that their rights to due process were violated because of their inability to assert counterclaims for constitutional violations and their inability to develop an evidentiary record of such violations in an administrative proceeding. Resp. Br. at 32-34.

The Commission already has disposed of this due process claim in its Order Denying Motion to Stay Administrative Proceeding, dated February 20, 2015, noting that while the ALJ did deny Respondents requests for additional subpoenas to address their various claims, the Commission has the authority to direct that the record be supplemented and to allow supplemental briefing, or to remand to the ALJ for further proceedings. Order at 5-6. The Commission also noted that even if the Commission ultimately rejects the Respondents' attempts to expand the record and rules against them, a reviewing court can always remand the case to the Commission for further proceedings, including the taking of further evidence. Order at 6. Because there are adequate procedures on review for supplementing the record should it be found wanting in any respect necessary for a proper adjudication of the Respondents' claims, the ALJ's decision to deny further discovery did not violate Respondents' due process rights.

H. Respondents' Due Process Rights Were Not Violated Because of the Allegedly "Truncated" Duration of the Proceedings

Respondents claim that their rights to due process were violated because they lacked sufficient time to prepare for their defense. Resp. Br. at 34-35. They claim that they only had an opportunity to review a "miniscule percentage of the evidence" while the Division had years to

review the same documents. Resp. Br. at 34-35. This contention distorts the truth. First, Respondents were provided with all non-privileged material in an electronically searchable Concordance format (well beyond the requirements of the Rules of Practice). This provided Respondents a quick and easy way to sort through documents and prepare their defense. Second, the majority of the documents at issue were provided to the Division by Respondents themselves -- these were the Respondents' own documents produced to the staff in response to investigative subpoenas and document requests. Respondents are uniquely situated to know their contents. Third, Respondents had ample time to prepare and even received several adjournments. Fourth, any prejudice to the Respondents was of their own making. The investigation of this matter went on for two years, during which time Respondents had to review the documents in question in order to comply with the Division's subpoenas and document requests and to prepare for testimony. Shortly after the OIP was filed, Respondents replaced their counsel with lawyers who were entirely unfamiliar with the record. To argue that they were ambushed at the last moment is disingenuous.

II. Challenges to the ALJ's Factual Findings and Legal Conclusions

Rule of Practice 450 provides that "[e]xceptions shall be supported by citation to the relevant portions of the record, including references to the specific pages relied upon, and by concise argument including citation of such statutes, decisions and other authorities as may be relevant." As a general matter, Respondents have not complied with Rule 450 with respect to all of the claimed exceptions. Pages 36-50 of Respondents' Brief, which comprises Respondents' entire discussion of the purported erroneous evidentiary rulings, findings of fact, and conclusions of law, does not contain a single citation to any Commission decision or other precedent. And even after the Commission ordered an additional submission to comply with Rule of Practice

450, Respondents still have failed to provide any precedent for their arguments that the ALJ made erroneous rulings. Moreover, most of Respondents' citations to the record do not relate to the ALJ's factual findings that are being contested. For these reasons, the Commission should reject Respondents' exceptions. As described below, however, the ALJ was correct with respect to her evidentiary rulings, findings of fact, and conclusions of law.

A. The ALJ's Evidentiary Rulings Were Correct

1. Business Records were Properly Admitted

The Commission has repeatedly held that law judges have broad discretion in deciding whether to admit or exclude evidence. *See, e.g., Anthony Fields, CPA*, 2015 SEC LEXIS 662 *30 n.32 (Commission Op. Feb. 20, 2015); *Toby G. Scammell*, 2014 SEC LEXIS 4193 *38-39 (Commission Op. Oct. 29, 2014); *Ronald S. Bloomfield*, 2014 SEC LEXIS 698 *38 (Commission Op. Feb. 27, 2014). Respondents argue in their moving brief and additional submission that the ID should be rejected on appeal because the ALJ's findings were based, in part, on documents that were accepted into evidence in reliance on facially defective business record affidavits. Nowhere, however, do Respondents describe why they believe the business record affidavits were defective or cite any authority to demonstrate that these affidavits were defective.

The ALJ admitted the sworn declarations of each of the following: the Wells Fargo custodian of records, Frank Larthey; the MFR P.C. custodian of records, Landie Lacayo; the AlphaMetrix 360 LLC chief of staff and chief compliance officer, Victoria Adams; the Christiana Trust vice president and group manager of corporate trusts, Lori Cooney; Life Settlement Solutions secretary and general counsel, Karen Canoff; and JTF chief compliance officer, Joseph Castellano. DX 113-117. Each of these declarations made clear that the signor was either the custodian of records or was familiar with the recordkeeping practices and systems

of their institution. And each of the declarations certified that the records produced pursuant to subpoena during the Division's investigation were (1) made at or near the time of the occurrence of the matters set forth therein; (2) kept in the course of regularly conducted business activity; and (3) made as a regular practice as part of regularly conducted business activity.

The ALJ's decision to admit the business record declarations and the documents produced pursuant to those declarations was permissible. The Commission has repeatedly stated "that the Federal Rules of Evidence, including the rules on hearsay, are not applicable to our administrative proceedings which favor liberality in the admission of evidence. Under the Commission's Rule of Practice 320, a law judge may receive all relevant evidence and shall exclude evidence that is irrelevant, immaterial, or unduly repetitious. Moreover, in deciding when to admit and whether to rely on hearsay evidence, its probative value, reliability, and the fairness of its use must be considered. In doubtful cases, we have expressed a preference for inclusiveness." *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538, *29 (Commission Op., Oct. 24, 2003); *see also Anthony Fields*, CPA, 2015 SEC LEXIS 662, *84-85 (Commission Op.. Feb. 20, 2015) ("hearsay is admissible in administrative proceedings"); *Calais Resources, Inc.*, 2012 SEC LEXIS 2023 *14 (Commission Op., June 29, 2012) (same). The signed, sworn declarations were reliable, and as such, support the authenticity of the documents as business records.

Even under the Federal Rules of Evidence, these declarations were valid and met the requirements of Rule 803. While Respondents do not state why the declarations were defective, at the hearing they suggested that some of the declarations were defective because they were not signed by the custodian of records but, instead, by another employee such as the general counsel or chief compliance officer. The federal rules, however, do not require that a business records

declaration be signed by the actual custodian of records. Rather, Rules of Evidence 803(6)(D) and 902(11) both allow testimony or declarations by either the custodian "or another qualified person." On the face of the declarations, the chief compliance officers, general counsels and other administrators were qualified persons. Indeed, in the case of a broker dealer such as John Thomas Financial, which is required under law to maintain documents, the chief compliance officer would keenly be aware of the firm's record keeping policies and procedures.[12]

2. The Subpoenas to Investors and Belesis were Properly Limited

On Friday evening, November 8, 2013 (6:47 pm), with the hearing scheduled to start on November 18, 2014, Respondents first requested that subpoenas *duces tecum* be issued to six investors that the Division had identified on its witness list, as well as to Belesis. The subpoenas called for the production of voluminous documents by Friday, November 16. On November 12, 2013, the Division objected to the subpoenas as being untimely and burdensome; if issued, the subpoenas would give the witnesses a mere day or two to gather all of the documents. The Division noted that the Respondents had known the identities of the Division's witnesses since

[12] Respondents also argue, without citation, that the Division did not demonstrate that the declarants who signed the business record declarations were unavailable. Consequently, they argue that the declarations are themselves hearsay and should have been excluded. Respondents' argument is nonsensical. The point of business record declarations is to avoid the often unnecessary cost and waste of time that would occur if the custodian of records was required to testify at trial. Indeed, courts have held that business record declarations are not "testimonial" as the purpose is not to "establish or prove some fact at trial" but simply to authenticate the records. *See United States v. Yeley-Davis*, 632 F.3d 673, 680 (10th Cir. 2011); *United States v. Anekwu*, 695 F.3d 967 (9th Cir. 2012). The Division provided written notice that it was going to use the declarations as the Division's exhibit list included such certifications. Respondents could have requested that the ALJ issue subpoenas for these individuals so they could challenge the declarations if they believed the declarations were deficient. Despite this advance notice, Respondents did not request any subpoenas or otherwise attempt to call the declarants as witnesses. FRE 902(11) only requires that the proponent of the business record declaration provide notice and make the declaration and the records available for inspection by the adversary. The Division complied with this requirement.

October 28.[13] On November 12, the ALJ issued an order modifying the subpoenas to the investors and to Belesis to exclude production of tax returns and account statements. The ALJ held that those items contained personal information that was irrelevant to the expected testimony or any issue in the proceeding, and requiring production would be unreasonable and oppressive.

Respondents argue that the ALJ's order modifying the subpoenas was in error because "[t]hese witnesses' status as 'accredited' and 'sophisticated' and risk-tolerant investors were an issue in this case." Resp. Br. at 37. This is incorrect. The OIP does not allege that the interests in the Funds were sold to non-accredited investors. Nor does the OIP allege that investment in the Funds was unsuitable for the investors. Rather, the OIP claims that Respondents made fraudulent representations to the investors concerning the manner in which the Funds would be managed, the assets valued, and the relationship with JTF and Belesis. To the extent that the investors' sophistication might relate to the issue of whether they reasonably relied on Respondents' false statements, reliance is not an element the Division must prove. *See, e.g., Anthony Fields, CPA*, 2015 SEC LEXIS 662, *16, n.9 (Commission Op., Feb. 20, 2015); *John P. Flannery*, 2014 SEC LEXIS 4981, *46 n.64 (Commission Op., Dec. 15, 2014). Moreover, even if it were error for the ALJ to modify the subpoenas to exclude some documents, it was a harmless error as Respondents admitted into evidence the subscription agreements for the three investors who testified, which contained acknowledgments that they were all accredited investors (RX 31, 38, 69, 7), and the investor witnesses testified and were cross-examined about their investment history. Tr. 706-07, 836-37, 1350-51, 1431-34.

[13] Respondents claim that the ALJ made this determination on her own motion without the Division taking action. This is false, and is belied by the ALJ's order, which specifically states "[u]nder consideration are subpoenas duces tecum requested by JTCM/Jarkesy and a brief November 12, 2013, email from the Division of Enforcement (Division) objecting to the subpoenas as 'untimely and burdensome."

Respondents also argue, without citation, that "in a case where penalties are sought, the level of the investor vulnerability versus sophistication is relevant to any analysis of the degree of egregiousness of conduct." Resp. Br. at 37-38. However, in determining whether a penalty is in the public interest, the Commission considers: "(1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 15(b)(4)(B) of this title; (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require." Section 21B(c) of the Exchange Act.

Similarly, the level of penalty at the third tier is determined based on whether the act or omission (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (b) directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission. Section 21B(b)(3) of the Exchange Act. The sophistication of the victim is not mentioned anywhere in the statute as a factor in determining the amount of the penalty. Importantly, the ALJ did not consider the investors' lack of

sophistication in determining the amount of the penalty in this case. Rather, the aggravating factors the ALJ considered were (1) fraud; (2) harm; and (3) the abuse of the fiduciary duty.

It also was proper for the ALJ to modify the subpoena to Belesis to exclude his personal tax returns and personal account statements, as these documents had no bearing on the issues at the hearing. Respondents argue that the relative culpability of the settling respondents versus themselves was an issue at the hearing, but they do not explain how Belesis' personal financial information related to the parties' relative culpability.[14] Resp. Br. at 38. Respondents also argue that "numerous financial transactions involving all respondents were at issue, and Respondents were left to try to defend the case without access to the records for those transactions." This is not so. The OIP concerns transactions entered into by the Funds controlled by Respondents and fees improperly paid to JTF. It does not concern financial transactions entered into by Belesis personally or what taxes he paid.

[14] In their post-hearing brief, Respondents argued that the penalty sought by the Division against them was disproportionate to the penalty ordered against Belesis and JTF. This argument was groundless as Respondents cannot be compared to the settling respondents. First, the alleged facts against each are different. Respondents engaged in valuation fraud in which there is no evidence of Belesis' or JTF's role. Moreover, the misrepresentations in the sales and marketing materials were prepared by Respondents, not Belesis or JTF. Second, the charges are different. Belesis and JTF were charged solely as aiders and abettors, while Respondents were charged as primary violators in addition to being aiders and abettors. Third, Belesis and JTF settled their claims, while Respondents chose to litigate; it is well-established that it is inappropriate to compare remedies pursuant to a settlement and remedies sought in a litigated matter. *SEC v. Monterosso,* 2014 U.S. App. LEXIS 3891, *30 (11th Cir., Mar. 3, 2014) (disproportionate argument "unavailing, because Lynch chose not to settle with the SEC as to penalties and he had a different role in the scheme than his co-defendants"); *VanCook v. SEC*, 653 F.3d 130, 144 (2d Cir. 2011) (affirming Commission's order on penalties stating that "other individuals chose to settle with the SEC, whereas VanCook chose to litigate"); *SEC v. Razmilovic*, 822 F. Supp.2d 234, 281 (E.D.N.Y. 2011) ("the compromised amount of the civil penalties imposed upon Razmilovic's co-defendants in this case have no bearing upon the appropriate amount of any penalty imposed upon him"), *aff'd in all relevant parts*, 738 F.3d 14 (2d Cir. 2013) ("we reject Razmilovic's proportionality challenge because we see no other similarly situated codefendant"), *cert. den.*, (March 24, 2014).

3. The Subpoenas to the SEC were Properly Quashed

On February 13, 2014, ten days after the hearing commenced, Respondents requested subpoenas directed to the Commission's Office of General Counsel and Custodian of Records. In these subpoenas, Respondents requested documents concerning the settlement between the Commission and Belesis and JTF, including communications between the Division and the Commission concerning the settlement; documents concerning the decision to initiate this proceeding as an administrative proceeding instead of a federal court proceeding; and the standards applied by the Commission for determining whether to initiate an administrative proceeding as opposed to a federal court proceeding. Respondents themselves have characterized this subpoena as requesting documents concerning their "constitutional claims." On that same date the Division objected to the issuance of the subpoenas on the grounds that they called for the production of documents that are subject to numerous privileges, including the attorney-client privilege, and that they called for the production of information with no relevance to this hearing. The Division further objected on grounds that the request was not timely and should have been made prior to the commencement of the hearing.

On February 14, 2014, the ALJ declined to issue the requested subpoenas finding as follows:

> First, they are untimely. While no deadline was set for the submission of subpoena requests, the subpoenas specify a large quantity of documents and were requested ten days after the commencement of the hearing, so they are untimely as a general matter. Additionally, were JTCM/Jarkesy to obtain and serve the subpoenas, this would be accomplished, at the earliest, during the week of February 18, 2014, and the Division and any person to whom the subpoenas are directed, or who is an owner, creator, or subject of the documents to be produced, are allowed fifteen days from the date of service to request that the subpoenas be quashed. See17 C.F.R. § 201.232(e)(1). By that time, the hearing and record will have been closed. Second, aside from their untimeliness, the subpoenas are unreasonable. Subpoena No. 1 specifies evidence largely consisting of privileged internal Commission deliberations concerning the JTF/Belesis Settlement and concerning the institution of this proceeding against JTCM Jarkesy. Documents

specified in Subpoena No. 2 relate to the topics enumerated in Subpoena No. 1. Accordingly, the subpoenas will not be issued.

2014 SEC LEXIS 564, *2 (Order of ALJ Foelak declining to issue subpoenas, Feb. 14, 2014).

The ALJ's reasoning was correct. There were additional and compelling reasons, however, why the subpoenas should have been quashed. On January 28, 2014, the Commission denied Respondents' Petition for interlocutory appeal, holding that an unbroken line of Commission decisions had established that "'consideration of [certain respondents'] offer of settlement while the proceedings were still pending against ... other respondents [is] proper and [does] not violate the Administrative Procedure Act ... or our rules regarding ex parte communications.' In particular, the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs . . . ." Given this unequivocal statement from the Commission, it was clear that the issues for which Respondents were seeking discovery would have no bearing in the hearing that had already started and, instead, was intended to support the case that Respondents had filed in federal district court.[15]

4. The ALJ Properly Allowed Arthur Coffey to Testify

During the first days of the hearing, Jarkesy repeatedly testified "I don't know" or "I don't recall" to the Division's questions concerning Respondents' promotional materials (including materials that Respondents had themselves produced during the investigation). In addition, Respondents' counsel repeatedly objected to the admission of the promotional materials on the grounds that (1) the Division had not established a proper foundation for the exhibits; (2) the Division could not establish the authenticity of the exhibits; and (3) the Division could not

[15] Respondents filed a separate motion with the Commission to Adduce Additional Evidence, which largely concerns the same discovery requests sought in the two subpoenas to the Commission, *i.e.*, discovery relating to Respondents' constitutional claims. The Division does not submit a separate opposition to Respondents' motion but for the reasons described herein, that motion should also be denied.

establish that the promotional materials were provided to investors. In response to Jarkesy's testimony and the objections of counsel, the Division sought to take the testimony of a JTF witness to authenticate the marketing materials, to confirm that Respondents provided them to JTF in order that they be given to investors and potential investors, and to confirm that the materials were in fact provided to investors. After a review of the investigative file, the Division determined to call Arthur Coffey ("Coffey"), the branch manager of JTF's Hauppague, Long Island office who happened to be on numerous emails where Respondents transmitted the marketing materials to JTF. On Thursday, February 20, 2014, the Division served Respondents with a supplemental witness list stating that it intended to call Coffey as a witness instead of the two other JTF witnesses who previously had been identified, and requesting that the ALJ issue Coffey a hearing subpoena. Respondents filed an emergency motion to quash arguing that the subpoena request was untimely and that they would not have sufficient time to prepare a cross-examination. The Division responded, noting that Respondents had a searchable Concordance database, which would allow them to quickly find all relevant documents.

That same day, the Division sought to address the concerns that Respondents raised about the lack of time to prepare a cross-examination. The Division informed counsel for Respondents that Coffey was available to testify on either Monday February 24 or Thursday February 27.[16] Respondents informed the Division that should the ALJ allow Coffey to testify, they would prefer the 20th.[17] The ALJ permitted Coffey's testimony, and he was examined and cross examined. Following his testimony, Respondents again complained about their lack of time to

[16] Coffee could not testify on Tuesday or Wednesday because of personal obligations.

[17] In that same communication, the Division informed Respondents that it had just received a transcript of testimony Coffey had provided in a FINRA case against Belesis and provided that transcript to Respondents.

prepare. The ALJ allowed Respondents to recall Coffey and cross-examine him a second time on Thursday, February 27, but Respondents declined to do so.

The ALJ's decision to allow Coffey to testify was proper. Unlike the untimely subpoenas that Respondents attempted to serve on the Commission (which had no bearing on the hearing), the Coffey testimony was pertinent. Moreover, Coffey's testimony was prompted by Jarkesy's evasive testimony and the objections of his counsel. While Respondents claim that they did not have sufficient time to prepare their cross-examination of Coffey, it is uncontroverted that they were on notice that some witness from JTF would be testifying. They had a searchable database (provided by the Division) that should have allowed them to quickly find all documents concerning Coffey. They had the transcript of the testimony that Coffey provided to FINRA concerning Belesis. And most important, they had a week to prepare their cross-examination. It was Respondents who chose the earlier date for Coffey's testimony, and Respondents elected not to recall Coffey as the ALJ had permitted.

5. The ALJ Properly Declined to Admit the Belesis Affidavit

Respondents did not name Belesis as a witness in this case. In early March 2014, they suggested to the Division that they would seek to introduce into evidence certain excerpts from Belesis's investigative testimony.[18] However, instead of seeking to admit the excerpts, at 11:08 p.m. on March 6, 2014, Respondents' counsel emailed the Division an affidavit signed by Belesis. The affidavit contained excerpts from Belesis's investigative testimony and stated that "if asked the following questions posed during that investigative testimony, I would give the

[18] Notably, on February 26, 2014, the Division sought to admit certain excerpts from Jarkesy's investigative testimony. Tr. 2327-2331. The Division invited the Respondents to make any counter designations. Tr. 2330-31. The ALJ did not rule on the issue at the time. On March 13, citing the Commission opinion in *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538 (Commission Op. Oct. 24, 2003), the ALJ allowed the excerpts into evidence. Tr. 3012-3018; DX 122. Respondents declined to counter designate parts of Jarkesy's investigative testimony.

same answers under oath today." The Division objected to the admission of this affidavit, stating that the witness was available to testify in person. On March 7, 2014, Respondents moved the affidavit into evidence, but the ALJ rejected it, stating that "[t]he affidavit is off the table." Tr. 2821. Respondents' counsel replied that she would call Belesis as a witness, *id.*, and the ALJ ordered that Respondents should inform the Division by 5:30 p.m. if they were going to call Belesis as a live witness. Tr. 2822-23. On March 7, at 5:30 pm, Respondents' counsel informed the Division that they intended to call Belesis to provide testimony.

On March 13, 2014, Respondents' counsel once again brought up the Belesis affidavit and stated that they had been informed that Belesis intended to assert his Fifth Amendment Privilege against self-incrimination and was, therefore, unavailable; thus, she said, his affidavit should be admitted. The Division argued that based on this representation, the affidavit would on its face be false. If Belesis was going to assert his Fifth Amendment privilege, he would not be giving the same answers today as his affidavit described. The ALJ again declined to admit the affidavit. Tr. 3043. On March 14, 2014, Respondents once again raised the issue with the ALJ. This time, instead of moving the affidavit into evidence, they sought admission of certain pages from Belesis' investigative testimony as had been done with Jarkesy's investigative testimony. The ALJ agreed to admit the excerpts into evidence and to allow the Division to make counter-designations, which the Division did. RX 138; Tr. 3074-75.

The ALJ's rulings were correct. Commission precedent allows excerpts from investigative testimony to be admitted into evidence. See *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538 (Commission Op., Oct. 24, 2003). There is no precedent, however, to create a new affidavit which does no more than quote earlier testimony, as Respondents attempted. Such an affidavit would have accorded greater weight to the testimony than warranted, particularly

since Belesis had entered into a settlement with the Commission subsequent to his investigative testimony in which he agreed to not take any action to deny any finding in the Order or to create the impression that the Order was without factual basis. Moreover, as the Division argued, Belesis, in fact, was not prepared to give those answers if he was called to testify live; his counsel had informed the Division and Respondents that Belesis would assert his Fifth Amendment privilege. Finally, even if the ALJ erred by not allowing the affidavit, the error was harmless since she admitted RX 138 and Respondents were allowed to designate the same excerpts from Belesis's testimony that they were trying to introduce into evidence through the affidavit.[19]

B. The ALJ's Factual Findings Were Correct

Respondents challenge 52 of the ALJ's factual findings. As described in the spreadsheet attached hereto as the Division's Appendix, the ALJ's factual findings were supported by both the testimony and the admitted documents. In this brief, the Division addresses several common themes in Respondents exceptions.[20]

1. George Jarkesy's Credibility

In her decision, the ALJ held that "no weight has been placed on [Jarkesy's] testimony as to facts that are disputed or not corroborated by credible evidence elsewhere in the record." ID at 10. The ALJ's credibility determination was based on her view that Jarkesy "generally testified in an evasive manner that did not provide any assurances on the reliability of his

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[19] Respondents' separate Motion to Adduce Additional Evidence also requests that the Belesis affidavit be considered by the Commission. Because the same issues were raised in Respondents' Opening Brief, the Division does not submit a separate brief opposing the motion, but rather requests that that motion be denied for the reasons set forth herein. Because the excerpts from Belesis's investigative testimony are already in the record through RX 138, the Commission need not consider the Belesis's affidavit.

[20] Perhaps Respondents' main argument is that the documents relied upon were not properly admitted into evidence because of a lack of foundation or lack of authenticity. As described above, these documents were properly admitted as business records pursuant to the business records declarations. And even to the extent that the documents were hearsay, hearsay evidence is not inadmissible in an administrative proceeding.

testimony." *Id.* The ALJ found that Jarkesy responded "I don't recall" or a variant of that phrase more than 800 times during his testimony" including as to basic questions. However, the ALJ noted that Jarkesy's "recollection markedly improved when questioned by his own counsel." *Id.* at 11. The ALJ stated that "Jarkesy further undermined his credibility by disclaiming responsibility for representations made in the PPMs, financial statements, marketing materials, and newsletters ...." *Id.* In their appeal, Respondents attack the ALJ's determination of Jarkesy's credibility in two respects: First, they argue that the credibility determination itself was incorrect. Second, in arguing that other factual findings of the ALJ were incorrect, they cite the testimony of Jarkesy as evidence to the contrary.

While the Commission's review is *de novo*, it is well-established that "considerable weight and deference" should be accorded to an ALJ's credibility determinations. *See, e.g., Montford and Co., Inc.*, 2014 SEC LEXIS 1529, *81 (Commission Op., May 2, 2014) (citing *Robert M. Fuller*, 2003 WL 22016309, *7 (Aug. 25, 2003) ("We give considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. . . . Such determinations can be overcome only where the record contains 'substantial evidence' for doing so.")); *Michael R. Pelosi*, 2014 SEC LEXIS 1114, *6-7 (Commission Op., March 27, 2014) (same); *William J. Murphy*, 2013 SEC LEXIS 1933, *54 (Commission Op., July 2, 2013) (same). Respondents do not provide substantial evidence for overturning the ALJ's credibility determination. Indeed, notwithstanding that the Commission's January 20, 2015 Order, taking Respondents to task for failing to do anything more than provide conclusory challenges to the ALJ's factual findings, Respondents still fail to cite any evidence to counter the ALJ's credibility determination. *See* Respondents' Additional Submission, Nos. 30-31. Respondents only citation to the record is the ALJ's comment that there was a contrast

between Jarkesy's testimony when he was answering the Division's questions and when he was answering his own counsel's questions. Tr. 2689-90. This is not "substantial" evidence. Indeed, the ALJ's statement only confirmed what was obvious to all who were present at the hearing.

For these reasons, the Commission should not overturn the ALJ's credibility determination concerning Jarkesy. Moreover, to the extent that Respondents argue that a factual finding was incorrect because the ALJ failed to consider contrary evidence – and that contrary evidence is Jarkesy's uncorroborated testimony – the Commission should also not overturn that factual finding.

2. The Authorization to Change the Strategy of the Funds

In their moving brief and their additional submission, Respondents argue that many of the ALJ's factual determinations were incorrect because the PPMs gave Respondents the ability to change the investment strategy for the funds, including changing professionals such as auditors. For example, Respondents argue that the ALJ's determination that Fund I did not meet its obligation over its life to maintain insurance policies with a face value of 117% of the money invested was erroneous because they had express authority to change business plans and asset mix. Resp. Additional Submission Nos. 48-49. Likewise, Respondents argue that the ALJ made erroneous conclusions regarding the role of KPMG and Deutsche Bank and the representations about them to investors because they had express authority to change professionals. The fallacy of this argument, however, is that while Respondents may have had some ability to change strategy, there is no evidence that they did so. At no point in his testimony did Jarkesy ever claim that he changed the investment strategy, and there are no documents in evidence that suggest he did. There is no evidence that the PPM for Fund I was ever amended to remove the 117% requirement for life insurance coverage or the 5% investment limitation.

To the contrary, the documents sent to investors uniformly describe the same investment strategy. Respondents continually represented throughout the life of the Funds that they were investing half of the money in insurance policies and that they had purchased policies with a face value of at least 117% of capital invested. *See, e.g.*, DX 260 (March 2009); DX 220 (May 2009); DX 262 (June 2009); DX 637 (July 2009); DX 221 (March 2010); DX 259 (June 2010); DX 248 (August 2010). During the podcast, Respondents emphatically reiterated the 117% coverage requirement: "Our charter requires that we have 117 percent of the value of our investor cash in face value life settlement policies. We do this not to make money. We do it, because at the end of the fund, we want our investors to have some assurance that they get their money back." DX 203 at 3. Likewise, Respondents repeated that they were limited to a 5% investment in a single company. DX 214-217; DX 258. The authorization to change strategy is thus a red-herring. Even assuming that Respondents had secretly changed investment strategies, telling the investors and prospective investors that your strategy is one thing while you are doing another is, quite blatantly, fraud.

Moreover, there is a fundamental difference between an investment strategy and an "investment limitation" such as the 5% limitation. If "investment limitations" could be changed at will, then they really would not be limitations at all. *See Rochester Funds Group Sec. Litig.*, 838 F. Supp.2d 1148, 1171-72 (D. Colo. 2012) (rejecting defendants' interpretation of the limitation, stating that such an interpretation would "convey[] no meaningful information and certainly no meaningful assurances to prospective investors. Yet the statements clearly suggest that something real is being warranted").

3. Reliance on Counsel

During the hearing and to some extent in their papers on appeal, Respondents claimed that the materials sent to investors (including the PPMs and the promotional materials) were reviewed by counsel. Because they claim to have relied on counsel's advice, they argue that they did not have the necessary scienter to violate the securities laws. Respondents, however, asserted the attorney client privilege during the investigation as grounds for withholding documents and, therefore, cannot now assert the attorney client privilege as a defense or as a mitigating factor.[21]

Even if their assertion of the privilege does not preclude them from arguing reliance on counsel, it is clear that Respondents have not met their burden. 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*, 2008 SEC LEXIS 3141, *38 (Commission Op., Nov. 14, 2008), *pet. for review den.*, 347 F. App'x 692 (2d Cir. 2009), *cert denied*, 559 U.S. 1102 (2010). In *Berger*, the Commission described the evidentiary burden that a respondent must meet in order to assert reliance on counsel:

> We believe that the respondent asserting such reliance must provide sufficient evidence to the body making the sanction determination that the respondent made full disclosure to counsel, appropriately sought to obtain relevant legal advice, obtained it, and then reasonably relied on the advice. Courts consider it important that "the advice of counsel [the client] received was based on a full and complete

[21] *SEC v. Wyly*, 2011 U.S. Dist. LEXIS 87660, *5-6 (S.D.N.Y. July 27, 2011) ("A client who claims that he acted on advice of counsel cannot use the privilege to prevent inquiry into the communications that the client and lawyer had about that advice. There is a compelling notion that the adversary "cannot be stonewalled by the simultaneous assertion of the [advice of counsel] defense and the privilege." Put another way, the attorney-client privilege can be used to shield information, but it cannot be used as a sword against the adversary.")

> disclosure." Further, it "isn't possible to make out" an advice-of-counsel claim "without producing the actual advice from an actual lawyer." The Seventh Circuit rejected a defendant's argument that "reliance on advice of counsel exculpates his conduct" because the defendant "offered nothing more than his say-so." The court noted that "[h]e did not produce any letter from a securities lawyer giving advice that reflected knowledge of all material facts; he did not produce any opinion letter, period. Nor did [he] offer the live testimony of any securities lawyer."

Id. at *40; s*ee also David Henry Disraeli*, 2007 SEC LEXIS 3015, *30 (Commission Op. Dec. 21, 2007) (rejecting reliance on counsel defense where "[t]he record contains no evidence that Disraeli made complete disclosures to counsel regarding his use of the offering proceeds, that he received advice that his conduct wshieas legal, and that he relied on any advice in good faith despite knowing that he did not intend to use the proceeds of the offering as described in either the October Memorandum or the December Memorandum."); *Rockies Fund, Inc.*, 2003 SEC LEXIS 2361, *72 (Commission Op., Oct. 2, 2003) ("As for the Fund's reliance on counsel, Respondents proffered no evidence that they asked for any advice or received a legal opinion about the propriety of particular actions"). Respondents in this case have not made the proper evidentiary showing. They have not described what legal advice they sought. They have not described what they told their attorneys or what their attorneys told them. And they have not demonstrated that they followed their attorneys' advice. Jarkesy's bare assertion that counsel drafted the documents or that he relied on the advice of counsel is not sufficient to meet their burden of proof.

III. The Division's Arguments on Appeal: Disgorgement, Penalties and an Accounting

While the Commission should uphold the ALJ's factual findings and legal conclusions, the Division respectfully requests that the Commission modify the ID with respect to the some of the sanctions and remedies. Specifically, the Division believes that the ALJ erred in calculating the appropriate amount of disgorgement and set a penalty that was far too low given the egregious

nature of the conduct at issue. Finally, the Division also believes the ALJ erred in concluding that she had no legal authority to order an accounting. The legal authority for such remedy is clear, and an accounting is warranted in this case.

A. Sanctions Against the Respondents Are Appropriate and in the Public Interest

As the ALJ discussed, in weighing appropriate 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." ID at 30 *(citing Steadman v. SEC*, 603 F.2d 1125, 1140 (5th Cir. 1979) (*quoting SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978))). "The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation." *Id.* (*citing Marshall E. Melton*, Exchange Act Rel. No. 48228, 2003 SEC LEXIS 1767, *4-5 (July 25, 2003)). "Additionally, the Commission considers the extent to which the sanction will have a deterrent effect." *Id.* (*citing Schield Mgmt. Co.*, 2006 SEC LEXIS 195, *35-36 & n.46 (Jan. 31, 2006)). "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." *Id.* (*citing Christopher A. Lowry*, Investment Company Act Rel. No. 2052, 2002 SEC LEXIS 2346, *20 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, Exchange Act Rel. No. 11773, 1975 SEC LEXIS 527, *52 (Oct. 24, 1975)).

Based on these factors, and the ALJ's factual findings supported by the record, Respondents should receive the most severe sanctions available. Since 2007, when Jarkesy created JTCM and Fund I, the Respondents continuously and willfully have perpetrated a fraud

on some 120 investors, squandering approximately $24 million of investor assets. *See* ID at 8-24, 28-29, 31 (and citations to the record therein). The record is replete with evidence of the Respondents' intent to defraud: they made material misrepresentations or omissions regarding, among other things, the Funds' investment strategy, equity investments, insurance hedge, portfolio valuations, service providers, and relationship with John Thomas Financial, Inc. and its chief executive officer, Anastasios "Tommy" Belesis. ID at 28-29. To this day, the Respondents continue to operate the Funds, thus continuing the fraud even as the Commission weighs this appeal. *See* ID at 22; DX 247 (distribution of near-worthless, restricted shares in October 2013).

In the face of a wealth of evidence against him and JTCM, Jarkesy steadfastly denies any wrongdoing and has given no assurance against future violations. Any such assurances would not be believable, in any event; his credibility was given no weight by the ALJ, who observed his evasiveness and mendacity first hand during the hearing. ID at 10-11 (noting that he claimed "I don't recall," or a variant thereof, more than 800 times). Finally, Jarkesy's continued activity in the securities industry presents robust opportunity for him to violate the securities laws again in the future: he is chairman of the National Eagles & Angels Association, a small business organization dedicated to "creating a climate where the American business owner can soar in the current market," according to its website, www.eagleandangel.com. *See* Tr. 1295: 16-17 (Jarkesy).

Thus, the fullest panoply of the most severe sanctions is appropriate and in the public interest to deter the Respondents' conduct, to deter similar conduct of like-minded violators, and to protect investors and the integrity of the securities industry generally. *See Schield Mgmt. Co.*, 2006 SEC LEXIS 195 at *35-36 & n.46; *Christopher A. Lowry*, 2002 SEC LEXIS 2346 at *20; *Arthur Lipper Corp.*, 1975 SEC LEXIS 527 at *52.

B. The Applicable Statutory Provisions Authorize the Commission To Penalize the Respondents for Each Act or Omission That Constitutes a Violation of the Federal Securities Laws

Under Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 9(d) of the Company Act and Section 203(i) of the Advisers Act, the Commission may impose civil penalties if it finds, on the record and after notice and opportunity for hearing, that a person has willfully violated any provision of the Securities Act, the Exchange Act or the Advisers Act. In considering whether a penalty is in the public interest, the Commission considers various factors including fraud, harm to others, unjust enrichment, and previous violations. Section 21B(c) of the Exchange Act; Section 9(d)(3) of the Company Act; Section 203(i)(3) of the Advisers Act. The statutes specify penalties up to the maximum amount "for each act or omission" in violation of the federal securities laws. Section 8A(g)(2) of the Securities Act; Section 21B(b) of the Exchange Act; Section 9(d)(2) of the Investment Company Act; Section 203(i)(2) of the Advisers Act.

Consistent with the plain language of these statutes, respondents in numerous Commission actions have been penalized for each violation of the federal securities laws. *See e.g., Steven E. Muth*, Initial Decision Rel. No. 262, 2004 SEC LEXIS 2320, at *118 (Oct. 8, 2004) (stating statutory maximum "is not an overall limitation, but a limitation per violation."). For example, in *Mark David Anderson* the Commission imposed ninety-six penalties against a respondent, one for each of ninety-six trades in which he charged customers an undisclosed markup or markdown. Securities Act Rel. No. 8265, Exchange Act Rel. No. 48352, 2003 SEC LEXIS 1935, at *39-40 (Aug. 15, 2003). *Accord, Kevin H. Goldstein*, Initial Decision Rel. No. 243, 2004 SEC LEXIS 87, at *52 (Jan. 16, 2004) (finding in fraudulent offering of securities that each fraudulent misrepresentation to each investor constituted a separate act or omission); *J.W.*

Barclay & Co., Initial Decision Rel. No. 239, 2003 SEC LEXIS 2529, at *114-115 (Oct. 23, 2003) (holding that each unauthorized trade and each unsuitable transaction constituted a separate act or omission); *Robert G. Weeks,* Initial Decision Rel. No. 199, 2002 SEC LEXIS 268, at *177 (Feb. 4, 2002) (finding a separate act or omission for each misrepresentation mailed to each shareholder, each sale of unregistered securities, and each failure to file required reports), *aff'd*, Securities Act Rel. No. 8313, Exchange Act Rel. No. 48684, 2003 SEC LEXIS 2572 (Oct. 23, 2003). Federal courts also have imposed multiple penalties based on a per-violation sanction. *See, e.g., United States v. Reader's Digest Ass'n.*, 662 F.2d 955, 966-67 (3d Cir. 1981) (holding that each individual mailing constituted a separate violation); *SEC v. Ramoil Mgmt., Ltd.*, 2007 U.S. Dist. LEXIS 79581, at *35 (S.D.N.Y. Oct. 25, 2007) (penalizing defendant for each false document he filed with the Commission under each statute that the false filings violated).

In this proceeding, the evidence indicates that the Respondents' violative activities began in or about 2007 and are ongoing, as they continue to manage the two Funds and purport to be winding down the older Fund's operations. *See* ID at 8, 20 (and record evidence cited therein); DX 247 (distribution of near-worthless, restricted shares in October 2013). The ID details the Respondents' material misrepresentations and omissions to 120 investors during the life of the Funds. ID at 8-24. In considering whether penalizing the Respondents was in the public interest, the ALJ found there were no "mitigating factors and several aggravating factors," including their "reckless disregard of a regulatory requirement," the "millions of dollars of losses" they visited on investors, and "the abuse of the fiduciary duty owned by investment advisers." ID at 32. She found that penalties were appropriate due to the Respondents' "fraud, harm to others, unjust enrichment and the need for deterrence." ID at 32.

Yet, after meticulously chronicling the Respondents' fraud, and acknowledging that substantial penalties were in the public interest, the ALJ paradoxically concluded the Respondents had committed only three violative acts arising from misstatements and omissions relating to (1) the life settlement component of the Funds' investments, (2) the corporate investment component, and (3) their relationship with JTF/Belesis. ID at 32-33. She viewed JTCM as Jarkesy's *alter ego* and ordered a joint and several third-tier penalty of $450,000. ID at 33. Such scant penalty is inconsistent with the ALJ's findings of fact and public interest analysis, as well as the statutory language and precedent for penalizing wrongdoers per violation.

Instead, the Respondents should be penalized separately for each of the 120 investors they willfully harmed – and continue harming – by their material misrepresentations and omissions. Maximum third-tier penalties are appropriate due to their fraud and deceit that directly or indirectly resulted in substantial losses to investors and substantial gains to themselves. *See* Section 8A(g)(2)(C) of the Securities Act; Section 21B(b)(3) of the Exchange Act; Section 9(d)(2)(C) of the Company Act; Section 203(i)(2)(C) of the Advisers Act. The Respondents' violations are ongoing for as long as the Funds exist, and thus the inflationary adjustment for post-2013 penalties is appropriate. *See* 17 C.F.R. § 201.1005.

The maximum, inflation-adjusted, third-tier penalty for a natural person such as Jarkesy, is $160,000 per violation. *See* 17 C.F.R. § 201.1005, Table V to Subpart E (reflecting inflation adjustments for conduct after Mar. 5, 2013). For a violator other than a natural person, such as JTCM, the maximum inflation-adjusted, third-tier penalty is $500,000. *See id.* Thus, calculating maximum, inflation-adjusted, third-tier penalties based on each of the 120 harmed investors, Jarkesy's penalty could be as high as $19.2 million and JTCM's penalty could be as high as $60 million.

Alternatively, the Commission appropriately may penalize the Respondents for each of the twenty-two misstatements or omissions detailed in the record. Those include the following:

■ From the Respondents' PPM and Limited Partnership Agreements: (1) the Funds would purchase insurance policies with face value of 117% of the investor capital; (2) half of all investor capital would be used to purchase the insurance policies or would be set aside and segregated to pay premiums; (3) Respondents would mitigate life expectancy risk; (4) the insurance policies would be transferred to the Master Trust; (5) the total investment of the partnership in any one company at any one time would not exceed 5% of the aggregate capital commitments; (6) the general partner, JTCM, would utilize good faith; (7) fair value would be used to value securities where no market quotation was readily available; (8) the Funds' financial statements would be prepared according to GAAP; and (9) management of the partnership would be vested exclusively in the General Partner. *See* DX 206, 210.

■ From the Respondents' marketing materials and investor updates: (10) KPMG was the auditor for the Funds; (11) Deutsche Bank was the prime broker for the Funds; (12) insurance policies would be purchased from AA rated insurance companies; (13) Fund I had purchased fourteen policies from fourteen separate insurance companies; (14) the bridge loans were be "collateralized"; and (15) valuations of the Funds' assets would be conservative. *See* DX 211, 214-222, 224, 248.

■ From the Respondents' website, (16) that JTF did not manage, direct, or make any decisions for the Funds. *See* DX 502.

■ From the Respondents' fraudulent valuation of many of the Funds' portfolio positions, including: (17) the life insurance policies, which Respondents valued using a 12% discount rate instead of the appropriate 15% discount rate; (18) the restricted stock, which Respondents valued

at the same price as free-trading stock; (19) the notes of America West and Galaxy, which Respondents valued at par notwithstanding that the notes were in default; (20) the shares of Radiant and America West, which Respondents valued based upon promotional activities they paid for with money from the Funds; (21) the Radiant warrants, which Respondents valued at an arbitrary price bearing no relationship to the market price; and (22) the shares of portfolio companies like Galaxy and America West, which Respondents overvalued, given the poor financial condition of those companies. *See* DX 220, 301, 303, 305, 306(b), 306(d), 307(a), 308-312, 333, 425, 447, 455, 600, 618-619, 647; Div's Proposed Findings of Fact Conclusions of Law at ¶¶ 68-71 (and citations to the record therein).

Using this alternative calculation based on the twenty-two misrepresentations and omissions in the record, the Commission could impose an appropriate, inflation-adjusted, third-tier, per violation penalty against Jarkesy of $3.52 million and against JTCM of $11 million. The ALJ found that the Respondents managed approximately $24 million of investor money. ID at 8. Thus, combined penalties of $14.52 million based on the twenty-two incidents of material misrepresentations and omissions still would amount to a fraction of the investor assets that the Respondents managed – and lost – through their fraud, deception, and violative conduct.

C. Disgorgement Should Include Incentive Fees of More than $123,000

The Respondents should be ordered to disgorge all ill-gotten gains in the evidentiary record, including $1,278,597 in management fees and $123,338.38 in incentive fees, for a total disgorgement of $1,401,935.38. *See* DX 309 (bank account spreadsheet), DX 315-318 (audited financial statements). In concluding there was no record evidence of incentive fees, the ALJ overlooked Division's Exhibit 309. ID at 15 n.19.

As the ALJ noted, the Commission may order disgorgement of ill-gotten gains pursuant to Section 8A(e) of the Securities Act, Section 21B(e) and 21C(e) of the Exchange Act, Section 9(e) of the Company Act and Section 203(j) of the Advisers Act. Disgorgement is an equitable remedy designed to strip violators of wrongfully obtained profits and return them to their financial position before the violations. ID at 31 (*citing SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); *Hateley v. SEC*, 8 F.3d 653, 655-56 (9th Cir. 1993)). Disgorgement need not be exact, but only a reasonable approximation of profits causally connected to the violations. *Id.* (*citing, inter alia, Laurie Jones Canady*, Exchange Act Rel. 41250, 1999 SEC LEXIS 669, *38 n.35 (Apr. 5, 1999)). Management and incentive fees appropriately are disgorged where they constitute ill-gotten gains generated from violative activities. *Id.* (internal citations omitted).

The ALJ ordered disgorgement of $1,278,597 in management fees, based on her summing up the management fees for both Funds. ID at 15 (*citing* DX 315-318). She indicated that while incentive fees were referenced in the record, "there is no evidence that establishes the amount, if any, of incentive fees actually paid." ID at 15 n.19. However, the ALJ overlooked at least $123,338.38 of incentive fees from 2010 that are part of the record. *See* DX 309 at 2 (bates JTBOF 06903, $63,338.38 incentive fee on 2/3/2010), 8 (bates JTBOF 06837, $20,000 incentive fee on 8/9/2010; $10,000 partial incentive fee on 8/18/2010), 10 (bates JTBOF 07058, $30,000 quarterly incentive fee on 11/12/2010).

Inasmuch as Respondents should disgorge the management fees they earned from their fraudulent activities, they also should disgorge ill-gotten incentive fees and prejudgment interest thereon. The disgorgement that the ALJ ordered should be enhanced to include the $123,338.38 in incentive fees, for total disgorgement of no less than $1,401,935.38, plus prejudgment interest,

which is a reasonable approximation of Respondents' wrongful earnings. *See First City Fin. Corp*, 890 F.2d at 1230-32; *Hateley*, 8F.3d at 655-56; *Canady*, 1999 SEC LEXIS 669 at *38 n.35.

D. An Accounting Should Be Ordered to Quantify and Safeguard Investor Assets

The Division sought an accounting of JTCM's operations and investments, but the ALJ declined to order one for want of detail and authority. ID at 32 n.39. This was in error. An accounting is explicitly authorized by statute and warranted where, as here, approximately $30 million of investor money is unaccounted for.

The ALJ found that the Respondents managed $24 million of investor assets which, at the Funds' height, was worth as much as $30 million, ID at 8, 31, but the current value of investors' assets is unknown. The Respondents have given conflicting statements of the current value of investments they manage. Jarkesy testified at the administrative hearing that he could neither identify nor quantify the Funds' assets. Tr. 63:15-16 (Jarkesy testimony, Feb. 3, 2014). Yet six days earlier, he had filed a complaint in United States District Court for the District of Columbia, where he was seeking emergency and declaratory relief to halt the administrative proceeding, claiming the Funds' then-current value was approximately $15 million. Compl. at ¶ 11, *Jarkesy v. SEC*, 1:14-cv-00114-BAH (D. D.C. Jan. 29, 2014).

Investors who testified at the administrative hearing in the spring of 2014 also were mystified by the value of their investment in the Respondents' Funds. Tr. 747:3-5 (Benkovsky, unaware of value of his investment); Tr. 822:24-823:3 (Beam, "[n]ot a clue" as to value of his investment). And while Jarkesy testified he was in the midst of obtaining an accounting, none has been rendered and/or shared with the Commission staff. *See* Tr. 63:17-24 (Jarkesy).

Respondents have been careless in accounting for investor money for years. Partnership agreements for the Funds they manage require annual auditing and GAAP-compliant financial statements, but none has been done since the end of 2010. *See* DX 206 at 44 (Fund I private placement memorandum, annual audit provision), DX 210 at 14 (Fund II private placement memorandum, annual audit provision), DX 317-318 (Funds' audited financial statements for year ended Dec. 31, 2010). Thus, for more than four years, Respondents have managed some unknown amount of investor assets without any assurance that the assets have not been wasted, dissipated or misused for improper purposes.

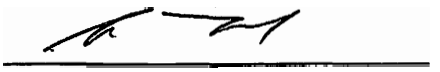
The authority to order an accounting is explicit in Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 9(e) of the Company Act, and Sections 203(j) and 203(k)(5) of the Advisers Act. Based on this, the Commission should order an accounting that, at minimum, (1) lists the current assets of the Funds and their fair value pursuant to GAAP; (2) lists the dates that all other portfolio positions were sold, distributed, or otherwise ceased to be in the Funds and the sale price (if those positions were, in fact, sold); and (3) lists all disbursements of cash by the Funds. Such accounting would provide reasonable assurance as to the whereabouts of millions of investor dollars, would help ensure the safety of any remaining investor assets, and could provide evidence of further disgorgement to be required of the Respondents. The statutorily authorized accounting should be ordered.

CONCLUSION

For the reasons set forth herein, the Commission should deny Respondents' various constitutional, due process, and equal protection challenges, affirm the ALJ's factual findings and conclusions of law, but modify the remedies and sanction imposed by the ALJ.

Dated: As of March 13, 2015
New York, New York

DIVISION OF ENFORCEMENT



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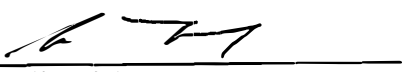
CERTIFICATE OF COMPLIANCE

I hereby certify that the text of the foregoing Division's Brief contains no more than 21,000 words as reported by the word processing system on which it was prepared, including footnotes and citations, and excluding the table of contents, table of authorities, the certificates of counsel, and attached Appendix (spreadsheet), in compliance with the Commission's Rule of Practice 450(d), 17 C.F.R. § 201.450(d) and the Commission's Extension Order issued March 3, 2015.

By: 
Alix Biel, Esq.

DIVISION'S APPENDIX

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
26	Eventually, America West came to believe that JTF was an affiliate of the Funds. 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."	The ALJ erroneously concluded that an undisclosed relationship exists between Respondents and the settled respondents, John Thomas Financial ("JTF") and Anastasios Belesis ("Belesis"). Initial Decision 16. This finding is not supported by credible evidence and ignores contradictory evidence that they acted independently.	Tr. 654-65, 688-93; Div. Ex. 346 at 72.	DFPOP ¶¶ 151-152. In addition, Jarkesy was helping to promote JTF's investment banking business, another undisclosed relationsip. DFPOP ¶¶ 139-42. Finally, Respondents did not disclose . the control that they had delegated to Belesis/JTF concerning Galaxy. DFPOP ¶¶ 153-55.	RX-327, Tr. 558, 657-658, 666, 688-694; Respondent's Proposed Findings of Fact ("RPFoF"), ¶¶ 151-52.	The focus of Respondents' exception appears to be that America West was never able to confirm that this relationship between Jarkesy and Belesis/JTF existed. America West, however, believed this relationship existed sufficiently to make the public disclosure. DX-346. Moreover, Alexander Walker of America West testified that he gave Jarkesy the opportunity to address what the JTF representative had told him but Jarkesy did not address it directly and said that they would just have to move on. Tr. 660-61.
27	In his testimony, Jarkesy indicated that his selection of the John Thomas name was serendipitous.	The ALJ erroneously concluded that the selection of the name for John Thomas Financial was serendipitous. Initial Decision 9. This finding mischaracterizes the evidence and ignores contradictory evidence.	Tr. 74		RX-327, p.4; Tr. 74.	This factual finding of the ALJ, even if erroneous, had no bearing on the decision and, as such, was harmless error.
28	Belesis and Jarkesy became acquainted in 2003. At the hearing Jarkesy denied that it was 2003 when he became acquainted with Belesis, but did not provide an alternate date. The reason for this is notapparent from the record.	The ALJ erroneously concluded that Belesis and Jarkesy became acquainted in 2003. ALJ further erroneously concluded in a footnote that Jarkesy denied that date but did not provide an alternate date. Initial Decision 8. This finding mischaracterizes the evidence and ignores and excluded contradictory evidence of the correct date offered by Respondents.	Tr. 2515-21		RX-327, p. 1; Tr. 74-75, 2514-2521.	Jarkey initially testified in response to questions from the Division that he did not recall when he met Belesis. Tr. 74. When questioned by his attorneys, he was asked to read into the record his investigative testimony where he had stated that he met Belesis in 2003 or 2004 in connection with the Opexa financing. Tr. 2516. This testimony is consistent with the ALJ's factual finding that Jarkesyand Belesis met in 2003. Even if the factual finding was erroneous, however, it had no bearing on the decision and, as such, was harmless error.
29	Belesis reinforced his position in the relationship through threats to stop selling interests in Jarkesy's Funds.	The ALJ erroneously concluded that Belesis reinforced his position in the relationship through threats to stop selling interests in Jarkesy's Funds. Initial Deeision 10. This finding mischaracterizes the evidence and ignores contradictory evidence.	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.").	DFPOP ¶136.	RX-327, p. 3-5; Tr. 558, 657-658, 666, 688-694, 2659-2660, 2702-2703, 2708-2709, 2760-2761; RPFoF, ¶¶ 151-52.	None of Respondents' citations concern Belesis' threats to stop selling Fund interests, which was directly established by the documents. In addition, the vast majority of the testimony cited is the not credible testimony of Jarkesy that there was no undisclosed relationship and that he did not delegate authority to Belesis and JTF.

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30	He [Jarkesy] 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 elswhere 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?"	The ALJ erroneously concluded that Jarkesy testified in an evasive manner that did not provide any assurances of the reliability of his testimony. Initial Decision 10. These findings mischaracterize Jarkesy' s testimony.	Tr. 87, 160, 122-23, 185, 1184.	Division's Post-Hearing Memorandum of Law at p. 1-2.	Tr. 2689-2690.	Respondents' citation to the record is to a comment made by the ALJ that she noticed that Jarkesy was able to answer a question asked by his own attorney but was unable to answer the same question when asked by the Division. Respondents fail to provide any citations to the record that undermine the ALJ's credibility determination regarding Jarkesy.
31	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. 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. 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 were they done. The Division's next question, "[t]he private placements, those were high risk?," was answered with "I don't recall the private placements. Jarkesy further undermined his credibility by disclaiming responsibility for representations about the Funds made in PPMs, financial statements, marketing materials, and newsletters as discussed below.	The ALJ erroneously concluded that while Jarkesy evaded a large portion of the Division's questions, his recollection markedly improved when questioned by his own counsel. Initial Decision 11. This finding mischaracterizes Jarkesy's testimony.	Tr. 2780-2818, Tr. 2658-2779.	Division's Post-Hearing Memorandum of Law at p. 1-2.	Tr. 2689-2690.	Respondents' citation to the record is to a comment made by the ALJ that she noticed that Jarkesy was able to answer a question asked by his own attorney but was unable to answer the same question when asked by the Division. Respondents fail to provide any citations to the record that undermine the ALJ's credibility determination regarding Jarkesy.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
32	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. Respondents argue that the Division did not prove that Fund I's June 1, 2007 PPM (as amended on August 21, 2007 ...) and Fund II's February 5, 2209. 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.	The ALJ erroneously concluded that some of the representations in the marketing materials may have accurate when the documents were first used became inaccurate and were not corrected. The ALJ further erroneously states that Respondents argue that the Division did not prove that the private placement memoranda were used without alteration 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. The ALJ further erroneously found that the private placement memoranda were used without further amendments in selling interests in the Funds during the time in issue. Initial Decision 11. These erroneous findings mischaracterize the evidence-including express authority to change professionals, business plan and asset mix-and Respondents' legal obligations and the applicable burden and standard of proof.		DFPOP at ¶¶ 11-30, 43-51.	RX-1, RX-2, RX-3, RX-316, RX-321, RX-322, RX-323, RX 324, RX-325, RX-326.	Respondents' primary argument appears to be that they were authorized to change the strategy of the Funds and to change professionals. The fallacy of this argument is that through 2010, Respondents continued to represent that the strategy in the PPM was in fact the strategy employed. Respondents continually represented throughout the life of the Funds that they were investing half of the money in insurance policies and that they had purchased policies with face value of at least 117% of capital invested. *See, e.g.*, DX 260 (March 2009); DX 220 (May 2009); DX 262 (June 2009); DX-637 (July 2009); DX 221 (March 2010); DX 259 (June 2010); DX 248 (August 2010). During the podcast, Respondents emphatically reiterated the 117% coverage requirement: "Our charter required that we have 117 percent of the value of our investor cash in face value life settlement policies. We do this not to make money. We do it, because at the end of the Fund, we want our investors to have some assurance that they get their money back." DX-203 at 3. Likewise, Respondents repeated that they were limited to a 5% investment in a single company. DX-214; DX-215; DX-216; DX-217; DX-258.
33	Investors might be able to redeem their investments, but upon potential payment of a penalty. Jarkesy withdrew from Fund I $100,000 less a $20,000 penalty during February 2009.	The ALJ erroneously concluded that investors might be able to redeem their investments, but upon potential payment of a penalty. Initial Decision.Initial Decision 12. This conclusion mischaracterizes the evidence, the written terms of the investment, relies on unreliable evidence and ignores contradictory evidence.	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 'Risk Factors -- Risks related to illiquidity'"), Tr. 1330-35; Div. Ex. 236 at 17 Div. Ex. 316 at 11, Div. Ex. 659	DFPOP ¶65.	RX-1, p. 16-54, RX-2, p. ii-iii, 12-35; RX-3.	Not only does the PPM provide that there might potentially be a penalty if an investor tried to take money out of the Fund, but Jarkesy, himself, paid a penalty when he withdrew $100,000 from Fund I. Even if this factual finding was erroneous, it is a harmless error as it had no impact on the legal conclusions that Respondents violated the securities laws.
34	Investor Robert Fullhardt believed that the Fund had a September 2012 maturity date. Investor Steve Benkovsky also believed that the fund had a five-year duration that would end in 2012.	The ALJ erroneously concluded that investor Robert Fulhardt believed that the Fund has a September 2012 maturity date, and investor Steve Benkovsky also believed that the fund had a five-year duration that would end in 2012. Initial Decision 12. These findings mischaracterize the evidence-including the written terms of the investment-rely on unreliable evidence and ignore contradietory evidence.	Tr. 710, 746, 1362.	DFPOP ¶¶160-161.	RX-1, DX-206 (PPM specifies Fund I as a 10-year fund with the option to extend the fund by two one-year extensions at Respondents' option); Tr. 2513-2514; RPFoF, ¶ 160.	Jarkesy repeatedly told investors that Fund I was designed to wind up by September 2012. DFPOP ¶¶ 160-161. These representations provided a sufficient basis for the investors to believe that the fund would terminate in September 2012. Indeed, in his investigative testimony, Jarkesy testified that the Fund would shut down and go into liquidation in September 2012. DX-122 at 71:1-72:6.

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35	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."	The ALJ erroneously concluded that in a podcast sent to investors on May 21, 2009, Jarkesy explained that uses of investment capital by percentages. Initial Decision 13. This conclusion mischaracterizes the evidence, relies on unreliable evidence, ignores contradictory evidence and misapplies the law.	Div. Ex. 203 at 21-22, Div. Ex. 204	DFPOP ¶ 19.	RX-1, DX-206, at cover iii, 15-27; RPFoF, ¶ 9.	The podcast transcript, stipulated as to accuracy to by counsel for Respondents, Tr. 210, is clear on its face. The transcript was sent to the investors. DX-204.
36	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. . . . The PPMs described JTCM's plans to invest in a "Life Settlement Portfolio" and a "Corporate Portfolio." 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 corporate portfolio was to contain various forms of debt and equity in companies.	The ALJ erroneously concluded that remaining portion of funds after life insurance policies were bought was to go to medium term debt and equity in business enterprises. Initial Decision 13. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignore material other evidence.	Div. Ex. 206 at 7, 33-39, Div. Ex. 210 at 12, 55-62.	DFPOP ¶¶11-12, 18	RX-1, DX-206, at 3-4, 7, 30, 33; RPFoF, ¶ 18	Respondents do not contest that the PPMs for the Funds explained how the money would be invested. Instead, they argue that the PPMs gave Respondents the authority to change business plans and investment strategies. The problem with this argument is that, as stated above, Respondents in marketing materials continued to represent that this would be how the Funds would be invested. And the Funds continued to be sold pursuant to the PPMs, which described the investment strategy.
37	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.	The ALJ erroneously concluded that 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. Initial Decision 14. These findings mischaracterize the evidence, the written terms of the investment, rely on unreliable evidence and ignore contradictory evidence.	Div. Exs. 224, 608.		RX-1, p. 16-54; RX-2, p. ii-iii, 12-35; RX-3; Tr. 231-235, 350, 954-955.	Respondents' citation to RX-2 and RX-3, which are documents for Fund I, is curious because the contested finding concerns Fund II and not Fund I. The ALJ's factual finding was correct. The PPM for Fund I specifically stated that the Fund would purchase life insurance policies with a face value of 117% of the invested amount. DX-206 at 29. In contrast, while the PPM for Fund II stated that the Fund would invest in life insurance policies, the PPM did not provide the 117% number. DX 210 at 47-48. The 117% number for Fund II only appears in marketing materials. Similarly, the PPM for Fund I stated that approximately 40% of money invested would go into corporate investments. DX-206 at 33. The PPM for Fund II, while describing the corporate portfolio, did not provide this percentage. DX 210 at 51-52. Respondents' citations to the transcript do not contradict the ALJ's findings in any way.
38	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. Questions concerning valuation were directed to Jarkesy or to his assistants Linda Ortiz and Patty Villa, who relayed Jarkesy's decisions.	The ALJ erroneously concluded that 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. The ALJ made additional erroneous conclusions regarding who participated in valuing assets and how assets were valued. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	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). Tr. 295, 300-06, 428; Div. Exs. 329, 330, 333.		Ex. DX-230; Tr. 286, 288-290, 409-415, 420-422, 2396, 2662-2664; RPFoF, ¶ 57.	The testimony cited by Respondents does not counter the ALJ's finding that Jarkesy disclaimed his role in the valuation process. Indeed, in their response to the Division's proposed findings of fact, Respondents continue to assert that the administrator "influenced the manner in which certain positions were valued where no outside validation existed."

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39	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. However, KPMG never audited either Fund. . . . . Jarkesy and JTCM's marketing materials for the Funds identified Deutsche Bank, among others, as the Funds' prime broker. However. Deutsche Bank never became the Funds' prime broker.	The ALJ made erroneous conclusions regarding the role of KPMG and Deutsche Bank and the representations about them to investors. Initial Decision 15. These findings mischaracterize the evidence-including express authority to change professionals and the business plan-rely on unreliable evidence and ignore material other evidence.	Answer at ¶ 6. Div. Exs. 220-224, 229A, 248, Tr. p. 565.	DFPOP ¶¶27-29.	Answer, ¶¶ 4, 59-61; RX-316; RX-327, p. 4; Tr. 2669-2672, 2677-2688, 2759-2760; RFPoF, ¶ 57.	Respondents admitted in their answer that KPMG was never enaged to audit Fund I and, in fact, did not audit Fund I. Consequently, any marketing material that said that KPMG was the auditor for Fund I was blatantly false. KPMG was also never engaged to audit Fund II and never audited Fund II, although KPMG may have been engaged to audit a Fund structure that was ultimately scrapped. As such, any marketing material that identified KPMG as the auditor for Fund II was also false. There is no evidence that Deutsche Bank was the prime broker for either of the Funds.
40	The Funds' PPMs and marketing materials contained various representations about the Funds and JTCM/Jarkesy's plan for managing them. Some of the representations that may have been accurate when the documents were first used became inaccurate and not corrected.	The ALJ erroneously concluded that some statements in the PPM may have been accurate when made, became inaccurate and remained uncorrected. Initial Decision 11. These findings mischaracterize the evidence-including express authority to change professionals and the business plan-and mischaracterize the law and duties applicable to Respondents.		See Response to Exception 32 above.	RX-1, RX-2, RX-3, RX-316, RX-324, RX-325.	Respondents in this case did not produce any amendments to the PPMs outside of DX-208, which did not concern any of the representations at issue in the hearing. Fund interests continued to be sold through at least 2010. Even if the statements in the PPMs were accurate when initially made, during later periods of time, those statements were false. Respondents were not complying with the 5% investment limitation or the 117% insurance coverage requirement. Yet Respondents continued to sell Fund interests pursuant to those PPMs, which they knew did not accurate describe what was happening. The marketing materials contained many of those same representations.
41	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,	The ALJ erroneously concluded that Financial Statements represented valued according to FAS 157. Initial Decision 14. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 315 at 9, Div. Ex. 316 at 9, Div. Ex. 317 at JTBOF 6296, Div. Ex. 318 at JTBOF6308	DFPOP at ¶¶ 52-56.	RPFoF, ¶ 55.	In Paragraph 55 of their proposed findings of fact, Respondents concede that the notes to the financial statements explicitly provided that they were going to be prepared according to FAS 157. This is exactly the ALJ's finding so it is unclear on what basis Respondents are challenging the ALJ's finding.
42	The valuation of each asset in the Funds' holdings at each month-end was shown on each Funds' holding pages. Each individual investor's share was calculated from the aggregate valuation shown on the holdings pages.	The ALJ erroneously concluded that valuation of each asset in the Funds' holdings was listed on each Funds' holdings pages, and that each investor's share was calculated from those holding pages. Initial Decision 14-15. These findings mischaracterize the evidence, rely on unreliable evidenee and ignore material other evidence.	Tr. 326-28, 402-03; Div. Exs. 301, 303.	DFPOP at ¶¶ 57-59.	Tr. 175-180, 1199.	In his testimony, Troy Golinghorst from the Fund administrator identified DX 301 as the holdings pages for Fund I for various points in time, and he explained how this information made its way into each individual investor's account statements. Tr. 326-28. The testimony cited by Respondents in support of their proposed exceptions is Jarkesy denying any knowledge of these documents (notwithstanding that they had been produced by Respondents in the investigation). This is another example of Jarkesy's unreliable and unbelievable testimony.

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43	In reality, AlphaMetrix did not value any of the Funds' positions itself; it had no capability to do so. 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. AlphaMetrix tried to get as much documentation as possible in support of JTCM's marks. AlphaMetrix tried to get as much documentation as possible in support of JTCM's marks.	The ALJ erroneously concluded that Alphametrix did not participate in valuing the funds. Initial Decision 14. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence	Tr. 287-300, 311-12.	DFPOP at ¶¶ 57, 92-93, 129.	DX-230; Tr. 286, 288-290, 409-415, 420-422, 2396, 2662-2664; RPFoF, ¶ 57.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
44	Questions concerning valuation were directed to Jarkesy or to his assistants, Linda Ortiz and Patty Villa, who relayed Jarkesy's decisions. 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.	The ALJ erroneously concluded that any question concerning valuation would go to Jarkesy (through subordinates at times) and Jarkesy had the final word setting valuations, even if unreasonable. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 295, 300-06, 347-50, 428.	DFPOP at ¶¶ 57-58, 129.	Tr. 288, 294-295, 297-299, 306, 308-309, 311-312, 316-318; RPFoF, ¶ 58.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
45	JTCM would approve the holdings, then approve any profit and loss, then approve financial statements, and ultimately the investor statements.	The ALJ erroneously concluded that JTCM approved all statements - holdings, profit and loss, financial statements, and investor statements. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 328.	DFPOP at ¶¶ 57-59.	RX-19; RX-20; RX-21; RX-22; RX-300; RX-301; Tr. 328; 409-415, 420-422; RPFoF, ¶ 59.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
46	After an appeal from then CEO Frank DelVecchio on December 17, 2009, Belesis ordered Jarkesy to provide funds "ASAP." The next day, December 18, 2009, Fund I bought $30,000, and Fund II, $10,000, of Galaxy stock.	The ALJ erroneously concluded that on December 12, 2009 Belesis ordered Jarkesy to deliver funds and on December 18 Fund I bought $30,000 in Galaxy stock and Fund II bought $10,000 in Galaxy stock. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 513, 314 at 15.	DFPOP at ¶¶ 153-155.	Tr. 2449-2450, 2697-2702, 2760, 2762; RPFoF, ¶ 154.	As the documents demonstrate, on December 17 at 3:25 pm, Belesis told Jarkesy: "George, get frank the bridge ASAP." DX-513. Galaxy's public filings demonstrate that the very next day, the Funds bought $40,000 worth of shares of Galaxy in a private placement. DX-314 at 15. The DFPOP describes other examples of Belesis ordering Jarkesy to do something and it got done. Jarkesy's testimony to the contrary, that he only did what was in the Funds' interests, was held by the ALJ to be unreliable and not credible.

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47	Fund II did not buy any life insurance policies; neither its financial statements nor holdings pages show any indication that Fund II owned policies. This was inconsistent with the representations in Fund II's PPM and marketing materials.	The ALJ erroneously concluded that inconsistent with the PPM, Fund II bought no life insurance policies. Initial Decision 22. These findings mischaracterize the evidence, rely on unreliable evidence and ignorematerial other evidence.	Div. Exs. 303, 318, 210 at 12, 55-60, 224.	DFPOP at ¶¶ 37-39.	RX-1, RX-2, RX-3, RX-318.	There is no evidence that Fund II ever bought a single insurance policy. It appears, however, that Fund II purchased interests in the insurance policies that Fund I had purchased. Respondents, however, did not comply with their obligation to purchase 117% insurance coverage for Fund II as described in the marketing materials. As such, while the ALJ's factual finding might technically have been wrong, Respondents still did not comply with their obligations end, as such, the error is harmless.
48	Between September 28, 2007 and January 25, 2008 Fund I purchased eight life insurance policies with face values ... totalling $13.5 million. 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 ALJ erroneously concluded that Fund I did not meet 117% obligation in 2008. Initial Decision 22. This finding mischaracterizes the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignore material other evidence.	Div. Exs. 405, 315 at 11.	DFPOP at ¶¶ 37-39.	RX-1; DX-206.	Respondents fail to explain how their citation to the PPMs for Fund I demonstrate that the ALJ's factual finding was false. To the extent that they are suggesting that they had the ability to change strategy and did not need to comply with this requirement, the Division refers the Commission to its response above demonstrating that Respondents continually represented that they would meet the 117% requirement.
49	In April and May 2009, Fund I bought five additional policies, with face values totalling $13.5 million. Respondents decided to allow one policy (Paul Evert) with a face value of $5 million to lapse during 2009. . . . 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.	The ALJ erroneously concluded that Fund I did not meet 117% obligation in 2010. Initial Decision 23. This finding mischaracterizes the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignores material other evidence.	Div. Exs 405, 317 at 11.	DFPOP at ¶¶ 37-39.	DX-206 at cover-iii, 15-27, 33; DX-405 (Funds owned policies with face value of $24.5 million, which meant that Respondents did not misrepresent that they had 117% face value); Tr. 2386-2388, 2398-2399; RPFoF, ¶ 43	By the end of 2009, the Funds owned policies with a combined face value of $21.5 million -- because Respondents allowed the Evert policy to lapse in mid-2009 and cannot be included in the total. It is unclear how Respondents arrive at the $24.5 million number. With total investor capital of approximately $19.158 million by year end, Respondents were required to purchase insurance policies with a combined face value of more than $22.4 million. They were short by approximately $1 million. Moreover, from that point until this date, Respondents did not comply with the 117% requirement. To the extent that Respondents are arguing that they could change strategy, see above.
50	Further, Respondents spent only $3,865,309 (including paying premiums) on life insurance policies through December 31, 2010. 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.	The ALJ erroneously concluded that Respondents did not spend the amount pledged on insurance policies/premiums; nor put the policies in the master trust in a timely fashion as promised in the PPM and marketing materials. Initial Decision 23. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-rely on unreliable evidence and ignore material other evidence.	Div. Exs. Div. Ex. 317 at 10, 401, 402, 405	DFPOP at ¶ 40.	Tr. 1504-1524	The testimony cited by Respondents in support of their exception is Jarkesy's testimony that he does not recall how much money he spent on the policies and premiums. This testimony does not undermine the ALJ's findings, which were based on the financial statements provided by the Funds to the investors.

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51	Respondents subsequently used different actuaries to value the five policies purchased in 2009, again requesting a 12% discount rate. Yet at the same time, Jarkesy knew he was currently purchasing policies at a 15% or better (that is, more inexpensively than 12%) discount. Respondents continued using the 12% discount rate for Fund I's 2010 financial statements.	The ALJ erroneously concluded that Respondent purchased policies at 15% rate, but valued at 12% rate. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 432, 433, 436, 440, 442, 203 at 23, 204, 619 at 1, 623.	DFPOP ¶¶ 66-72.	DX-425; DX-621; Tr. 504-505, 2405-2406, 2662-2264; RPFoF, ¶¶ 68-69, 71.	DX-425 concerns policies purchased in 2007 and is irrelevant to the ALJ's finding concerning the 5 policies purchased in 2009. DX-621, in fact, demonstrates that Respondents were looking to purchase policies at a 15% discount rate, which supports the ALJ's findings. The testimony of Steve Boger does not concern the valuation of the policies bought in 2009. Tr. 504-505. Boger was not involved in those purchases. The remainder of the testimony is Jarkesy's and it does not address the issue decided by the ALJ.
52	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. 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.	The ALJ erroneously concluded that Respondent immediately wrote up the value of policies in contravention of FASB Staff Position 85-4-1. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 119 at 2, 498B at AM_SEC 285200 (lines 379-93), 285203 (lines 491-92), Div. Ex. 647.	DFPOP at ¶60.	Record devoid of expert testimony on this issue; see 1 supra.	The requirements of FASB Staff Position 85-4-1 could not be more clear. "Under the fair value method, an investor shall recognize the initial method at the transaction price. In subsequent periods, the investor shall remeasure the investment at fair value in its entirety and each reporting period." (DX-119 at 2). No expert testimony was necessary. Moreover, it is clear that Jarkesy understood this requirement as the policies purchased in 2007 were initially valued at the transaction price and only "fair valued at the end of the reporting period."
53	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.	The ALJ erroneously concluded that Jarkesy represented to investors that Fund I continued to purchase insurance policies in an August 2010 letter to investors which was a misrepresentation because Fund I never acquired a policy after 2009 year end. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Ex. 240.	DFPOP ¶ 158.	Tr. 2501-03.	Jarkesy's testimony says nothing about purchasing insurance policies after 2009 but instead concerns whether Respondents were able to sell certain policies. As such, this testimony does not in any way support Respondents' claimed exception.
54	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. Yet Respondents only acquired thirteen policies.	The ALJ erroneously concluded that Respondents represented the insurance policies as a conservative hedge but took no steps to reduce risk. Did not invest in a large number of policies as required to reduce risk. Initial Decision 24. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-rely on unreliable evidence and ignore material other evidence.	Tr. 465-66; Div. Ex. 206 at 36-37, Div. Ex. 600.	DFPOP ¶¶ 13-15, 39	RX-1; DX-206 at cover-iii, 15-27, 33; RPFoF, ¶ 14.	Respondents are in error. The PPM's disclosure of mortality risk do not excuse Respondents from failing to take any steps to mitigate the risk, as they explicitly promised they would do. Nor would such disclosure allow Respondents to continue making false representations that the insurance policies were less risky investments and a hedge to the more risky elements of the portfolio, which was misleading because they had failed to take any steps to mitigate mortality risk.

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55	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.	The ALJ erroneously concluded that Respondents never told investors and potential investors that the strategy from the PPM changed. Initial Decision 28. These findings mischaracterize the evidence including express authority to change business planand asset mix-rely on unreliable evidence, ignore material other evidence, and mischaracterize the law and duties applicable to Respondents.		DFPOP ¶¶ 19-26, Division's Post-Hearing Reply Memorandum of Law at pp. 24-26.	RX-1, p. 16-54, RX- 2, p. ii-iii, 12-35; RX-3.	See above concerning Respondents' argument that they PPMs gave them the ability to change strategy.
56	Nor did they advise their auditors that any of the notes were impaired.	The ALJ erroneously concluded that Respondents did not advise auditors of impairment of the notes. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 1047-48, 1159.	DFPOP ¶ 107.	Tr. 2748- 2750; RPFoF, ¶ 102	Jarkesy's testimony says nothing about whether he advised the auditors that the notes were impaired.
57	Jarkesy spoke highly of America West in the Podcast. 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.	The ALJ erroneously concluded that Jarkesy spoke highly of Am. West in a podcast that did not reflect the true condition of America West. Initial Decision 17. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 208-10; Div. Ex. 203 at 13-14, 16-17, Div. Ex. 204. Div. Ex. 348 at 11		Tr. 2409-2413, 2426-2430, 2725-2731, 2748-2479.	The only evidence that Respondents provide in support of this exception is Jarkesy's self-serving testimony, which the ALJ held was not credible or reliable. Even if Jarkesy subjectively believed that America West was going to be a succesful company, his statements were misleading because he did not inform the investors of the objective facts: that the auditors had issued a going concern opinion and that America West was in default on the loans the Funds had made to it.
58	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.	The ALJ erroneously concluded that Jarkesy sent an optimistic "Research Report" to investors in September 2010 and issued a press release regarding America West that did not reflect true financial condition of the company. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 339-41; Div. Exs. 239, 250.	DFPOP ¶¶ 113-114.	Tr. 2409-2413, 2426-2430, 2725-2731, 2748-2479.	The only evidence that Respondents provide in support of this exception is Jarkesy's self-serving testimony, which the ALJ held was not credible or reliable. Even if Jarkesy subjectively believed that America West was going to be a succesful company, his statements were misleading because he did not inform the investors of the objective facts: that the auditors had issued a going concern opinion and that America West was in default on the loans the Funds had made to it.
59	AlphaMetrix relied on Jarkesy's valuations since Galaxy was not publicly traded.	The ALJ erroneously concluded that Alphametrix relied on Jarkesy for valuation of Galaxy because it was not publicly traded. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 308-09; Div. Exs. 324, 329, 330.	DFPOP ¶¶ 57-58, 93	Tr. 2706-2708; RPFoF, ¶¶ 83, 89, 93.	See notes to exception 43. In addition, Jarkesy's testimony cited here (which is neither credible nor reliable), does not concern Galaxy specifically.

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60	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.	The ALJ erroneously concluded that from 2009 - 2011 Jarkesy valued shares wildly. Initial Decision 18. This finding mischaracterizes the evidence including material corporate events affecting pricerelies on unreliable evidence and ignores material other evidence.	Div. Exs. 301, 305.	DFPOP ¶ 90.	Tr. 2468, 2706-2708, 2735-2739; RPFoF, ¶¶ 83, 89-90.	Much of the testimony cited by Respondents does not concern the valuation of Galaxy from 2009 through early 2011. The testimony at Tr. 2735-39 concerns a valuation report for Galaxy that Respondents obtained in June 2011 and, as such, could not have been relied upon by Respondents during the time period in question for the valuations. This report, which was unreliable, is discussed in detail in the DFPOP ¶¶ 95-97. Notably, the author of the report was listed on Respondents witness list, but Respondents declined to call him as a witness. To the extent that any of the cited testimony of Jarkesy concerns the valuation of Galaxy during this time period, that testimony was unreliable and not credible.
61	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.	The ALJ erroneously concluded that changes in price did not coordinate with events occurring inside Galaxy. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 307-25, 2468, 2733-35	DFPOP ¶¶ 90-91.	Tr. 2706-2708, 2735-2739; RPFoF, ¶¶ 83, 89-90.	The chart contained in the DFPOP at ¶ 90 and explained in ¶ 91 demonstrates that the changes in Respondents' valuation of Galaxy did not match up with the dates of the reverse splits and share issuances.
62	Together, Belesis and Jarkesy exerted control over the company [Galaxy].	The ALJ erroneously concluded that together Jarkesy and Belesis exerted control over Galaxy. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 1555-56, 1567-69, 1572-86, 1711.	DFPOP ¶¶ 153-55.	Tr. 558, 2449-2450, 2697-2702, 2760, 2762; RPFoF, ¶¶ 153-154.	Besides Jarkesy's own testimony, the only so-called evidence that Respondents cite in support of this exception is the testimony of Jarkesy's assistant, Patty Villa, that Jarkesy made all of the invetsment decisions. Tr. 558. At the same time, however, Villa testified she never spoke with Belesis about anything substantive, Tr. 598, and that she couldn't hear Jarkesy's phone conversations and had no idea what Jarkesy might have spoke about with various entities. Tr. 603-05. Consequently, Villa's testimony on who made the investment decisions for the Funds is of limited probative value.

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63	There were no public transactions in the stock [of Radiant] during July, August, or September 2010. 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. 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.	The ALJ erroneously concluded that Fund I sold 300,000 shares of Radiant to Fund II in Aug. 2010 with a cost of $0.23 per share. Respondents increased the valuation of those shares the same month to $1.00 per share causing Fund I's unrealized profits to rise. Initial Decision 19. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence	Div. Exs. 111; 303 at JTBOF 19295; 301 at JTBOF 19142.	DFPOP ¶¶ 122-123, 125.	Tr. 2586-2587, 2662-2264; RPFoF, ¶¶ 123-125.	Jarkesy's testimony at 2586-2587 does not concern the August transaction in Radiant stock between Fund I and Fund II. His testimony at 2662-2664 is simply his self-serving statement that Respondents did not record arbitrary vaulations, used their best efforts, and that the valuations were checked by the administrator. This testimony again does not specifically concern the August transaction and is also unreliable and not credible. In their RFPoP. Respondents suggest that the increase in price to $1.00 resulted from a 5:1 reverse split. That 5:1 split took place in April 2010, however , and was the basis for Respoindents increasing their valuation of Radiant stock from $0.06 to $0.30. (DFPOP ¶ 121). Indeed, a 5:1 reverse split would not result in a change in valuation from $0.30 to $1.00. In sum, Respondents have not provided any basis for increasing the value to $1.00 in August or for their valuing the shares at $0.23 and $1.00 at the same time.
64	The stock traded for the first time in fifteen months during four days in December 2010, ending the year at $4 per share. 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.	The ALJ erroneously concluded that in December 2010 Radiant stock traded for the first time in 15 months at $4.00 per share coinciding with a marketing campaign. Initial Decision 19. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 111 at 4. Div. Ex. 301 at JTBOF 19130, 19133.	DFPOP ¶¶ 126-128.	Tr. 2583-2586, 2662-2264, 2740-2742; RPFoF, ¶¶ 126-128.	Respondents do not contest any of the share price or volume information concerning Radiant. RFPoF ¶ 126. Instead, they dispute the cause of the spike in the share price, stating that it was the result of a round of financing that was done in the last quarter of 2010. Radiant's filing, which actually disclosed this financing, was on November 17, 2010. RX-308. The stock price did not move at all for another month, however, until December 17, 2010. DX-111. Consequently, it is much more likely that the spike in the stock price resulted from the December promotion as opposed to the November financing, which was old news by that point in time.
65	Fund II held Radiant warrants, and AlphaMetrix relied on Jarkesy's valuations of them since they were not publicly traded. He [Jarkesy] 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.	The ALJ erroneously concluded that Jarkesy valued certain warrants in Radiant at $6.92 though they were previously valued at $0.12 four months earlier. Initial Decision 19. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 333, Tr. at 302-06.	DFPOP ¶ 129.	RPFoF, ¶ 129.	Respondents do not contest that it was Jarkesy who valued the warrants at $6.92. Nor do Respondents contest that Alphametrix relied on Jarkesy's valuation or that the last time that the warrants had previously been valued at $0.12. (RPFoF ¶ 129). No explanation has ever been provided for the $6.92 value, which was even higher than the stock price on that same date ($4.00).

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
66	Jarkesy stated that these Radiant shares were valued at $2 per share and opined that the stock could be worth substantially more. 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.	The ALJ erroneously concluded that Jarkesy sent stock certificates of Radiant to certain fund investors on October 23, 2014 with a letter stating the Radiant shares were valued at least $2.00 per share. The closing price on Yahoo! Was $1.04 on Yahoo! Finance with no activity from October 24, 2013 through January 2, 2014. Initial Decision 20. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence; there were no transactions during that period.	Div. Ex. 247. Div. Ex. 111A.		RX-310.	In support of their exception, Respondents cite to a Form 8-K/A for Radiant dated October 14, 2010. Respondents do not explain how this four-year-old filing contradicts the ALJ's factual finding that Jarkesy stated that the shares were worth $2 and could be worth more when the closing price of the stock at that time was $1.04.
67	Jarkesy directed America West to hire promotional firms to promote its stock and chose the firms. The price of America West spiked: it closed at $0.075 on October 1, 2010, but at $1.95 on December 31, 2010. Respondents valued America West stock at $1.95 on Fund I's holdings page as of December 31, 2010.	The ALJ erroneously concluded that Jarkesy initiated a promotional campaign in the fourth quarter of 2010 for America West stock. This caused the stock price to go up to $1.95 per share in December 2010. Subsequently on the financial statements, Jarkesy valued the stock at $1.95 per share. Initial Decision 20. This finding mischaracteriaes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 628-32, 667-68; Div. Exs. 110, 301 at JTBOF 19130.	DFPOP ¶¶ 115-118.	Tr. 2740-2742, 2746-2747; RPFoF, ¶¶ 108, 111, 115-116,	The stock price of America West on the relevant dates is uncontested. It is also uncontested that Respondents valued the share price of America West at $1.95 at the end of 2010. It is further uncontested that America West hired several promotional firms to promote the stock. Instead, what appears to be contested is Jarkesy's role in the promotions. Alexander Walker of America West testified that "[i]t was Mr. Jarkesy's [idea to hire these PR and promotional firms]. We relied heavily on Mr. Jarkesy's experience in this area. He spearheaded our efforts in that regard." Tr. 629-30. While the Division believes that it was reasonable to conclude that the spike in the price of America West stock was caused by the promotion, the ALJ did not specifically hold that that was the case. The initial decision does not state that the promotion "caused the stock price to go up," as Respondents characterize her finding.
68	MEC also conducted a more limited promotion of Radiant for which it was paid $5,000 by Fund II on December 28, 2010. 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. 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.	The ALJ erroneously concluded that Jarkesy initiated a promotional campaign for Radiant as well resulting in the share price going up to $4.00 per share in December 2010, resulting in very large gains reported on the year-end financial statements of the Funds. Initial Decision 20. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 897-98; Div. Exs. 306c, 111, 301 at JTBOF 19130, 19133.	DFPOP ¶ 127.	Tr. 2583-2586, 2740-2742; RPFoF, ¶ 127.	Respondents do not contest any of the share price or volume information concerning Radiant. RFPoF ¶ 126. Instead, they dispute the cause of the spike in the share price, stating that it was the result of a round of financing that was done in the last quarter of 2010. Radiant's filing, which disclosed this financing, was on November 17, 2010. RX-308. The stock price did not move at all for another month, however, until December 17, 2010. DX-111. Consequently, it is much more likely that the spike in the stock price resulted from the December promotion as opposed to the November financing, which was old news by that point in time.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
69	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."	The ALJ erroneously concluded that Fund I capped the aggregate capital commitments in any 1 company at 5%. Initial Decision 21. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 206 at 12.	DFPOP ¶ 18.	Ex. DX-206, 20 (authorizing up tyo aggregate capital commitments of 10%), 43 (authorizing General Partner to change the strategy of the Funds); RFPoF ¶46.	Respondents claim that the ALJ ignored evidence concerning the investment limitation of 5%, including a statement in the PPM authorizing capital commitments of up to 10%. In fact, the ALJ specifically discussed this provision and found that it could not be reconciled with the 5% investment limitation in the PPM or with the repeated references to the 5% limitation in marketing materials. Accordingly, the ALJ found that the limitation was 5%.
70	The 5% figure was repeated in marketing materials and newsletters.	The ALJ erroneously concluded that marketing materials repeated the 5% limitation. Initial Decision 21. This finding mischaracterizes the evidence, relies strategy on unreliable evidence and ignores material other evidence.	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.	DFPOP ¶ 26, 32, 35.	Ex. DX-206, 43 (authorizing General Partner to change the strategy of the Funds); RFPoF ¶24.	See above concerning Respondents' argument that the PPMs gave them the ability to change strategy.
71	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. 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. As of December 31, 2008, Fund I had capital contributions of $16,620,511.5% of which is $831,025. 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). As of December 31, 2009, Fund I had capital contributions of $18,358,002, of which 5% is $917,900. 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.) As of December 31, 2010, Fund I had capital contributions of $20,112,852, of which 5% is $1,005,623. 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).	The ALJ erroneously concluded that Fund I did not meet the cap in 2007, 2008, 2009, or 2010. Initial Decision 21. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 231 at JBTOF 1692; Div. Ex. 301 at JTBOF 19257-59; Div. Ex. 315. Div.Ex. 301 at JTBOF 19209, 19211; Div. Ex. 316 at 11, Div. Ex. 301 at JBTOF 19166-67. Div. Ex. 317. Div. Ex. 301 at JTBOF 19130-31.	DFPOP 46-51.	Tr. 2758-2759; RX-3.	At Tr. 2758, Jarkesy attempts to explain how the Galaxy investment became larger than 5%. Jarkesy's testimony, however, does not explain how or why Respondents violated the limitation with respect to EnterConnect, Reddi Brake, or UFood in 2007, and America West in 2008, 2009, and 2010. Indeed, Jarkesy admitted in 2011 that it was the "very large position" in America West that was responsible for the "wild swings" in the value of the Funds that was causing investor concern. DX-240.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
72	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.	The ALJ erroneously concluded that Belesis' input into decisions concerning portfolio companies and receipt of fees from such companies directly affected investors and losses. Initial Decision 29. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.		DFPOP ¶¶ 145-149.	RX-327, p. 3-5; Tr. 558, 657-658, 666, 688-694, 2659-2660, 2702-2703, 2708-2709, 2760-2761; RPFoF, ¶¶ 151-52.	Respondents' citations do not address the ALJ's conclusion that the excessive fees the portfolio companies paid had an impact on the ability of those companies to continue operations, which in turn, had a direct impact on the investors in the Funds. Jarkesy's testimony that the fees were not excessive is not credible and unreliable.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
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,	:
	:
Respondents.	:
	:

CERTIFICATE OF SERVICE

I certify that on March 16, 2015, I have served the Opening and Response Brief of the Division newly formatted with the table of contents and table of authorities by overnight mail and/or e-mail on the following:

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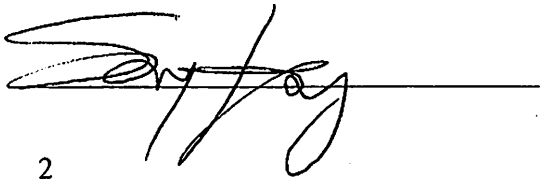

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	:
GEORGE R. JARKESY JR.,	:
	:
JOHN THOMAS FINANCIAL, INC.,	:
	:
ANASTASIOS "TOMMY' BELESIS,	:
	:
Respondents.	:
	:

THE DIVISION'S MEMORANDUM OF LAW IN OPPOSITION TO THE EXPEDITED MOTION OF GEORGE R. JARKESY AND JOHN THOMAS CAPITAL MANAGEMENT TO COMPEL (1) PRODUCTION OF BRADY AND JENCKS ACT MATERIAL, (2) DESIGNATION OF BRADY AND JENCKS ACT MATERIAL IN VOLUMINOUS RECORDS PREVIOUSLY PRODUCED, (3) CERTIFICATION OF BRADY AND JENCKS ACT COMPLIANCE, (4) DESIGNATION OF DOCUMENTS PRODUCED IN RESPONSE TO SUBPOENAS AND DOCUMENT REQUESTS, (5) MOTION TO CONTINUE AND EXTEND TIME, AND (6) MOTION TO CHANGE VENUE OF HEARING

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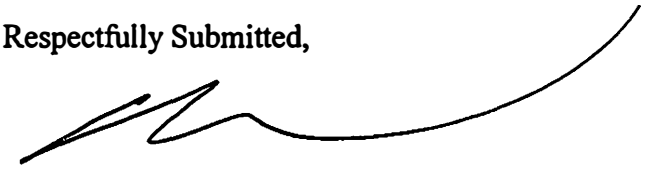
CONCLUSION

For the reasons set forth herein, the Division respectfully requests that Jarksey/JTCM's motion for expedited relief be denied in full, with the exception of their request for a reasonable adjournment of the hearing date.

Respectfully Submitted,



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The Division of Enforcement ("Division"), through its attorneys, responds to the expedited motion by Respondents John Thomas Capital Management LLC d/b/a/ Patriot28 LLC ("JTCM") and George R. Jarkesy Jr. ("Jarkesy") seeking to compel (1) production of Brady and Jencks Act Material; (2) a designation of Brady and Jencks Act material in voluminous records previously produced; (3) certification of Brady and Jencks Act compliance; (4) designation of documents produced in response to subpoenas and document requests and separately seeking (1) to continue the hearing; and (2) to change the venue of the hearing from New York to Texas.

PRELIMINARY STATEMENT

The Division has complied with all disclosure requirements under the Rules of Practice. In fact, the Division exceeded its disclosure requirements, providing its entire investigation file (excluding privileged materials) to Jarkesy/JTCM in a **searchable** Concordance database at no charge. Prior to producing the database, the Division produced to Jarkesy/JTCM the investigative testimony taken prior to the commencement of this action (to the extent the Division had the transcripts) as well as all of the exhibits to that testimony, which taken together, comprises its "hot documents" file. The Division also repeatedly offered to make the entire investigative file (exclusive of privileged documents) available to Jarkesy/JTCM for inspection and copying at the SEC's New York Regional Office at their convenience. Jarkesy/JTCM have never taken the Division up on its offer and, prior to the filing of the instant motion, never complained about the manner in which the Division produced documents to them.

The Division also provided to Jarkesy/JTCM a "withheld document list" and a declaration that, read together, name the potential witnesses the Division spoke to where there was no transcript (both before and after the filing of this action) and summarize all of the potentially exculpatory material provided by these witnesses. The declaration further provides

that the other withheld documents (internal Division emails, memoranda, and spreadsheets) do not contain material exculpatory statements under Brady.

The relief that Jarkesy/JTCM seek – that the Division review all of the documents already produced and identify any document that contains potential Brady material – is extraordinary and to the Division's knowledge has never been required by the Commission or any ALJ. Indeed, the relief Jarkesy/JTCM seek in their Brady motion is not even required in criminal cases filed in federal court. Jarkesy/JTCM simply want the Division to prepare their defense for them. Likewise, the Division is not required to produce the actual interview notes of potential witnesses and has complied with its Brady obligations with respect to those notes. Finally, the Division has already produced a declaration of its compliance with Brady obligations and the Division need not produce a second declaration. To the extent that Jarkesy/JTCM does not like the searchable Concordance databases that the Division provided (which is the same way the files are kept by the Division), they have another option. They can come to the New York Regional Office and review hard copies of the documents and, at their own expense, pay to have photocopies made (as has been repeatedly offered to them). This is what Rule 230 requires. No more. The provision of the searchable databases was a courtesy.

With respect to the second part of Jarkesy/JTCM's motion, which seeks an adjournment of the hearing date and a transfer of the venue to Texas, the Division recognizes that the investigative file is voluminous and does not object to a reasonable adjournment.[1] However, the Division objects to a transfer of venue. Jarkesy/JTCM's unsubstantiated claim that the majority of witnesses reside in Texas is not a sufficient reason to change the venue. Likewise, the

[1] The Division has separately requested a three-week adjournment in order to give the Commission the appropriate time to review the terms of a settlement offer made by the New York-based respondents in order to avoid the possibility of duplicative hearings should the Commission reject the settlement offer. That prior request is hereby renewed.

Division's receipt of an offer of settlement from the New York-based respondents, which it intends to recommend to the Commission, does not mean that Anastasios "Tommy" Belesis and/or other current and former employees of John Thomas Financial, Inc. ("Belesis/JTF") will not be witnesses at this hearing against Jarkesy/JTCM. Indeed, the fact that Jarkesy chose a New York-based placement agent for his funds should preclude him from arguing that New York is not a proper venue. Moreover, Jarkesy/JTCM does not (and cannot) claim that all investors reside in Texas or that it will be convenient for non-Texan investors to come to Texas for a hearing. Nor should the location of their professional witnesses and/or their counsel be considered. Jarkesy/JTCM could have chosen New York counsel – there is no shortage of New York lawyers who handle SEC administrative proceedings. Instead, they engaged two Dallas-based lawyers (at separate firms) and a third Washington, D.C.-based counsel. Jarkesy/JTCM's request boils down to the fact that it will be more convenient **for them** if this matter is adjudicated in Texas. That is insufficient reason to change the venue.

ARGUMENT

I. JARKESY/JTCM OVERSTATE THE RULE 230 PRODUCTION OBLIGATIONS

The Division's discovery obligations are described in Rule 230 of the Rules of Practice. Pursuant to Rule 230(a)(1), the Division "shall make available **for inspection and copying** ... documents **obtained by the Division prior to the institution of proceedings, in connection with the investigation** leading to the Division's recommendation to institute proceedings" (emphasis added). Pursuant to Rule 230(a)(2), the Division may withhold documents that are obtained prior to the institution of proceedings that: (1) are privileged; (2) are internal memoranda, notes, or other attorney work product so long as those documents are not going to be offered into evidence; (3) identify confidential sources; and (4) the hearing officer grants

leave to withhold for good cause shown. Rule of Practice 230(b)(1). The Division, however, may not withhold documents that contain material exculpatory evidence under *Brady v. Maryland*, 373 U.S. 83, 87 (1963). Rule of Practice 230 (b)(2). Rule of Practice 230(b)(2), which prevents the Division from withholding exculpatory documents, is the only application of the Brady doctrine in SEC enforcement actions. Indeed, as a general matter of law, Brady does not apply in civil proceedings. *See SEC v. Follick*, 00 Civ. 4385, at 9 (slip op. Mar. 3, 2003) ("[T]he prosecutorial duty to disclose exculpatory evidence, articulated in Brady [and] Giglio . . . applies to defendants in criminal actions, not to defendants in civil actions where the government is plaintiff."). Consequently, Brady only applies in SEC administrative actions to the extent that the SEC Rules of Practice require, and the Commission has never expansively interpreted Brady. *See, e.g., In the Matter of City of Anaheim*, File No. 3-9739, 1999 SEC LEXIS 1662 (Decision of ALK Kelly, July 30, 1999); Notes to Proposed Rule of Practice 20(a), 1993 SEC LEXIS 3062 (Nov. 5, 1993) ("The principles enunciated in *Brady v. Maryland*, 373 U.S. 83 (1963) are not directly applicable to Commission administrative proceedings").

The Commission described the Division's Brady obligations as follows:

> **The Rules of Practice do not "authorize respondents to engage in 'fishing expeditions'** through confidential Government materials in hopes of discovering something helpful to their defense. Unless defense counsel becomes aware that exculpatory evidence has been withheld and brings it to the judge's attention, the government's decision as to whether or not to disclose information is final. **Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review.** In order to justify such a review, a respondent must first establish a basis for claiming that the documents contain material exculpatory evidence. A 'plausible showing' must be made that the documents in question contain information that is both favorable and material to the respondent's defense."

In the Matter of Jett, File No. 3-8919, 1996 SEC LEXIS 1683 *1-2 (June 17, 1996) (emphasis added); *see also In the Matter of OptionsXpress, Inc.*, File No. 3-14848, 2013 SEC LEXIS 3235 (Oct. 16, 2013) (same).

With respect to interview notes, the Division is not required to produce unredacted interview notes even pursuant to Rule 230(b)(2). *See In the Matter of Aesoph, CPA*, File No. 3-15168, 2013 SEC LEXIS 2325 *2 (Aug. 9, 2013) (denying respondents' request for unredacted interview notes). Other SEC ALJs have held that the Division can fulfill its Brady obligations under Rule 230(a)(2) by providing short summaries of potentially exculpatory statements made by witnesses without producing interview notes at all. *In the Matter of Bandimere*, File No. 3-15124, 2013 SEC LEXIS 746 *4-5 (Decision of ALJ Elliot, Feb. 5, 2013) (denying request for interview notes, stating "[t]he Division will be ordered to submit a declaration describing its compliance with Brady, but that is all Bandimere is entitled to").

The Rules of Practice do not presumptively require the Division to submit a withheld document list to respondents. The hearing officer, however, may require the Division to submit for review a list of withheld documents or to submit any document withheld, and may determine whether or not such document should be made available to the respondents for inspection and copying. Rule of Practice 230(c). To date, the Hearing Officer has not required that the Division produce such a list although, as described below, the Division in an abundance of caution provided this list to respondents.

Rule 231 separately provides that any respondent in an enforcement proceeding may seek any statement of any person to be called as a witness that pertains to his or her testimony and that would be required to be produced pursuant to the Jencks Act, 18 U.S.C. 3500. For purposes of the rule, "statement" is a defined term and means either: (1) a written statement **made by said**

witness and signed or otherwise adopted or approved by him; (2) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a **substantially verbatim recital of an oral statement** made by said witness and recorded contemporaneously with the making of such oral statement; or (3) a statement, however taken or recorded, or a transcription thereof, if any, **made by said witness to a grand jury**. These are the only witness statements that require production under Rule 231. The requirement to produce Jencks materials does not mature until the filing of the Division's witness list. *Aesoph*, 2013 SEC LEXIS 2325 at *3. Notably, prior to filing this motion, Jarkesy/JTCM did not move for the production of Jencks material.

II. THE DIVISION'S PRODUCTION EXCEDED ITS OBLIGATIONS

JTCM was served on May 7, 2013 and Jarkesy was served on May 15, 2013. On May 10, the Division produced certain documents to the respondents that were immediately available (including transcripts of investigative testimony and exhibits) and informed Jarkesy/JTCM that they could inspect the remainder of the documents at the New York Regional Office. On May 20, the Division produced the bulk of the investigative file to Jarkesy/TTCM in the form of a hard drive containing **searchable** databases of all documents produced to the Division during the investigation. The documents were produced to Jarkesy/JTCM as they were produced by third-parties to the Division. Thus, if a subpoenaed party "bates stamped" the documents, the copies produced to Jarkesy/JTCM were bates stamped. If a subpoenaed party did not bates stamp the documents, the copies produced to Jarkesy/JTCM were not bates stamped.

The Division far exceeded its obligations under the Rules of Practice. The Rules of Practice only require that the Division make the documents available for inspection and copying in the New York Regional Office. Moreover, the Rules of Practice provide that respondents

have to pay for copies. Nothing in the rules required the Division to turn over all of the documents or to provide the documents in an electronic searchable format. The Division did so without receiving any payment from Jarkesy/JTCM for the costs of copying and producing the documents. Likewise, while the Rules of Practice do not require that the Division provide a list of withheld documents to Jarkesy/JTCM, the Division did so, listing categories of documents withheld (internal e-mail, internal memoranda and internal spreadsheets). The withheld document list also provided a list of persons with whom the Division spoke where there was no transcript during the pre-filing investigation. Further, the Division provided a declaration from the its lead trial counsel in this matter stating that he personally reviewed all of the documents on the withheld document list and that other that certain witness statements, none contained Brady material. His declaration provided a summary of potentially exculpatory statements made by individuals with whom the Division spoke during the investigation. Even further, his declaration provided a summary of potentially exculpatory statements made by individuals with whom the Division spoke **subsequent** to filing this administrative proceeding; the Rules of Practice require only such disclosure of materials generated prior to the filing of an administrative proceeding.

The Division has not yet made a specific Jencks disclosure to Jarkesy/JTCM. There are two reasons for this: (1) prior to this motion being filed, Jarkesy/JTCM had not moved for the Division to produce such materials, which is required under Rule 231(a); and (2) the Division has not yet submitted its list of witnesses for this proceeding and, as such, any Jencks production would be premature. The Division notes, however, that it produced all of the transcripts of the investigative testimony to Jarkesy/JTCM and that, outside of such testimony transcripts, it has no other Jencks "statements" to produce as defined under 18 U.S.C. 3500(e).[2]

[2] *See In the Matter of Thomas J. Fittin*, File No. 3-6571, 1991 SEC LEXIS 880 (Order of the Commission, May 8, 1991) (respondents not entitled to interview notes under Jencks because they are not the substantial verbatim

III. THE DIVISION HAS COMPLIED WITH ITS BRADY OBLIGATIONS

Jarkesy/JTCM has asked your Honor to require the following: (1) that the Division produce its witness interview notes, (2) that the Division review every document that it has already produced to the moving respondents to look for Brady material and then to provide those documents to them in some form of a binder, and (3) to produce a certification of compliance with Brady beyond what the Division has already produced. These requests should be denied as the Division already has fully complied with its Brady obligations.

A. The Division's Interview Notes are Privileged

It is beyond contention that witness interview notes are privileged work product. *See, e.g., U.S. v Gupta*, 848 F.Supp.2d 491 (S.D.N.Y., Mar. 26, 2012) (SEC's witness interview notes are protected work product requiring a showing of "substantial need" by defendant); *S.E.C. v. Nadel*, 2013 U.S. Dist. LEXIS 36251, (E.D.N.Y. Mar. 15, 2013) (SEC interview notes constitute opinion/core work product and are subject to heightened protection); *SEC v. NIR Group, LLC*, 283 F.R.D. 127 (E.D.N.Y. Aug. 17, 2012) (SEC notes and memoranda relating to witness and investor interviews are "highly protected work product of which production may not be demanded"); *S.E.C. v. Strauss*, 2009 U.S. Dist. LEXIS 101227, (S.D.N.Y. Oct. 28, 2009) (application to compel production of SEC interview notes and memoranda denied, since SEC interview notes and memoranda prepared in anticipation of litigation fit within the protection of

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statements of a witness); *In the Matter of George J. Kolar*, File No. 3-9570, 1999 SEC LEIXS 2300 (Order of ALJ Kelly, Oct. 28, 1999) ("although the Division interviewed Mr. Czerny several times before the hearing, it did so in a fashion that did not create Jencks Act statements, releasable to Mr. Kolar under Rule 231(a)"); *In the Matter of Orlando Joseph Jett*, File No. 3-8919, 1996 SEC LEXIS 1367 (Order of ALJ, May 14, 1996), *order to produce memoranda for in camera review vacated*, 1996 SEC LEXIS 1683 (Order of the Commission, June 17, 1996) ("Not all documents containing descriptions of statements by a witness will be Jencks Act material"); *In the Matter of Kevin Upton*, File No. 3-7604 (Order of ALJ Regensteiner, March 10, 1992) (interview notes do not meet the Jencks test because they are not a substantial verbatim recital of an oral statement); *In the Matter of Robert E. Iles, Sr.*, File No. 3-7261, 1990 SEC LEXIS 3931 (Order of Chief ALJ Blair, April 19, 1990) (interview notes not substantial verbatim statements of the witness); *In the Matter of Stuart-James Co., Inc.*, File No. 3-7164 (Order of ALJ Regensteiner, Sept. 29, 1989) (same).

work-product doctrine). The witness interview notes at issue relate to interviews conducted by Division attorneys in connection with the investigation of respondents, and were conducted in anticipation of this litigation. Although the interviews predated the formal initiation of this litigation, they "were conducted in order to provide the Commission with information so that it could make the determination whether to proceed with litigation," and thus, fall "squarely within the protections of the work-product doctrine. *S.E.C. v. Cavanagh*, 1998 U.S. Dist. LEXIS 3713, at *6 (S.D.N.Y. Mar. 23, 1998). Because notes of attorneys' investigative interviews inherently reflect their mental impressions, opinions, theories and conclusions, such notes have long been entitled to the strictest level of work product protection. *See, e.g., Upjohn Co. v. United States*, 449 U.S. 383, 398-401 (1981) (disclosure of attorney interview notes is disfavored, and justified either rarely or "never"), *S.E.C. v. Stanard*, 2007 U.S. Dist. LEXIS 46432 (S.D.N.Y. Jun. 26, 2007) (analysis of case 'in anticipation of litigation' is work product, and receives heightened protection under Rule 26(b)(3)); *S.E.C. v. Treadway*, 229 F.R.D. 454 (S.D.N.Y. Jul. 26, 2005) (notes protected by work product privilege because they represent attorney work product that at least in part, reflects thought process of counsel); *S.E.C. v. Downe*, 1994 U.S. Dist. LEXIS 708 (S.D.N.Y. Jan. 27, 1994) (attorney work product based on oral statements of witnesses is likely to reveal attorney's mental processes).

While the Division has not turned over the witness notes to Jarkesy/JTCM, the Division has provided a declaration describing all of the potentially exculpatory statements that are contained within such notes, which has been held to be sufficient under Rule 230. See *Bandimere* 2013 SEC LEXIS 746 at *8. (denying respondent's request for production of interview notes when Division provided essential facts and substance of material exculpatory evidence in affidavit); *In the Matter of Dearlove*, File No. 3-12064, 2006 SEC LEXIS 1476 *5

(Order of ALJ Kelley, Jan. 19, 2006) (declaration satisfies Brady obligations). Jarkesy/JTCM speculate in their memorandum of law that the interview notes may contain other information that was not provided to them. Mere speculation is not sufficient to require even the production of such notes to the ALJ for an *in camera* review. *Jett*, 1996 SEC LEXIS 1683 at *2 ("Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review"); OptionsXpress, 2013 SEC LEXIS 3235 at *15 (respondents must make plausible showing that documents contain information both favorable and material to their defense).

Moreover, if Jarkesy/JTCM believed that the witnesses with whom the Division spoke had something to offer their defense, they are free to inquire directly of the individuals without offending the Division's privileges. Jarkesy/JTCM have not even attempted to state in their memorandum of law that they are unable to speak with these witnesses themselves and must, instead, rely on the Division's privileged work product.

B. Rule 230 Does Not Impose the Duties Suggested by Respondents

JTCM/Jarkesy request that the Division review each document that has already been produced to them, identify all documents that contain potential exculpatory material, and put them into a binder so that they can easily go through those documents and prepare their defense. Rule 230 does not require that the Division take such steps. Rule 230 simply states that the Division cannot **withhold** from production documents that might be covered under Brady. By definition, the documents that were produced to respondents were not "withheld." The notes to the proposed rule of practice 20 (now memorialized as Rule 230) make clear the Brady obligation in the rule only applies to withheld documents ("if the interested division disclosed

under Proposed Rule 20(a) that it has withheld material directly relevant to the culpability of any respondent, the hearing officer ...")

In *Bandimere*, ALJ Elliot stated that "Brady is not a discovery rule, it is intended to insure that exculpatory material known to the Division is not kept from the respondent." 2013 SEC LEXIS 746 at * 7-8. Moreover, ALJ Elliot stressed that "Rule 230(b)(2) only prohibits the Division from acting 'contrary to the doctrine of Brady.' I am aware of no support for the proposition that the Commission intended to hold the Division to a higher standard than what Brady requires." *Id.* at *9. The Division has not kept any potentially exculpatory materials from the respondents. It has produced its entire investigative file to Jarkesy/JTCM except for privileged materials and, even with respect to privileged material, it has summarized all potentially exculpatory material contained in that privileged material. Respondents simply want the Division to do their work for them.

Respondents have not cited any Commission or ALJ decision that imposes on the Division the obligation they now seek. The Division is not aware of case in which such relief was granted. To the contrary, in *In the Matter of CMKM Diamonds, Inc.*, File No. 3-11858, 2005 SEC LEXIS 998 *7 (Decision of Chief ALJ Murray, May 2, 2005), the ALJ denied the request "that I require the Division to search through all the Commission's files for exculpatory evidence because it is excessive and impractical." Similarly, in *In the Matter of David M. Haber*, File No. 3-8155, 1994 SEC LEXIS 352 (ALJ decision, Feb. 2, 1994), the Judge held that "Division counsel is not obligated to search the entire investigatory record to meets its Brady obligation."

The only federal court case cited by Jarkesy/JTCM where such a request was granted is *United States v. Salyer*, CR. No. S-10-0061, U.S. Dist. LEXIS 77617 (E.D. Ca. Aug. 2, 2010).

Salyer is inapplicable here. *See Bandimere*, 2013 SEC LEXIS 399 at *5 ("All the cases cited by Bandimere were decided under the Federal Rules of Civil Procedure (FRCP), which do not govern this proceeding") (and cases collected). Moreover, *Salyer* is, at best, an outlier and should not be considered precedential in any way in this matter given the wealth of authority that runs counter to it. In *Strickler v. Greene*, 527 U.S. 263, 283 n.23 (1999), for example, the United States Supreme Court stated "we certainly do not criticize the prosecution's use of the open file policy. We recognize that this practice may increase the efficiency and the fairness of the criminal process." In *United States v. Warshak*, 631 F.2d 266, 297 (6th Cir. 2010), the Sixth Circuit Court of Appeals rejected the defendant's argument that the government failed to comply with its Brady obligations when it handed over "millions of pages of evidence and forc[ed] the defense to find any exculpatory information contained therein." The Court held that there was no evidence that the government acted in bad faith, larding its production with entirely irrelevant documents or concealing exculpatory evidence in the information turned over. Consequently, the court rejected the argument that the government was obliged to sift through all of the evidence in an attempt to locate anything favorable to the defense, stating that such an argument "comes up empty." In *United States v. Rubin/Chambers, Dunhill Ins. Servs.*, 825 F. Supp.2d 451, 454-55 (S.D.N.Y. 2011), the court specifically rejected *Salyer*, holding that "it is apparent that prosecutors may satisfy their Brady obligations through 'open file' policies or disclosure of exculpatory or impeachment material within large production of documents of files." And "even when the material disclosed is voluminous," in the absence of prosecutorial misconduct (bad faith or deliberate attempts to knowingly hide Brady material), the prosecutor's use of "open file disclosures ...does not run afoul of Brady." Similarly, in *United States v. Ohle*, S3 08 CR 1109, 2011 U.S. Dist. LEXIS 12581 *7-11 (S.D.N.Y. Feb. 7, 2011), the court rejected defendants'

argument that the prosecutors should be required to identify specific Brady documents within the files produced by the government -- even though the government in that case had produced nine separate searchable Concordance databases to the defendants, which contained several gigabytes of data "including millions of separate files extending to several million pages in length." The court held that "as a general rule, the Government is under no duty to direct a defendant to exculpatory evidence within a larger mass of disclosed evidence." (*Id.* at *11, citations omitted). Moreover, the court noted that while there were many documents, the government had produced an electronically searchable database, to which both parties had equal access, and therefore, the defendants "were just as likely to uncover the purportedly exculpatory evidence as was the government. *See also United States v. AU Optronics Corp.*, No. C 09-0110, 2011 U.S. Dist LEXIS 148037 (N.D. Cal. Dec. 23, 2011) (denying motion seeking order requiring the government to review 37 million pages of documents produced to identify potentially exculpatory material under Brady).[3]

C. The Division has Produced a Brady Declaration to Jarkesy/JCTM

As described above, the Division has produced its entire investigative file to Jarkesy/JTCM with the exception of privileged material. With respect to the privileged material, the Division provided a declaration to Jarkesy/JTCM describing the potentially exculpatory materials contained in the interview notes and stating that the other privileged material produced does not contain material exculpatory statements. Because the Division should not be required

[3] Jarkesy/JTCM's citation of *United States v. Skilling*, 554 F.3d 529 (5th Cir. 2009), *aff'd in part and vacated on other grounds*, 130 S.Ct. 2896 (2010) only underscores the Division's argument. First, the court in that case did not order the government to go through the files that had already been produced and identify potentially exculpatory material under Brady. Second, the court in that case held that the potential issues caused by the government's production of a large file was mitigated by the fact that file produced was searchable and that the government had also produced hot documents. Here the Division did the same, producing the documents in a searchable Concordance database and also separately producing the investigative testimony and the exhibits thereto, which comprise its hot documents file. Jarkesy/JTCM has not explained how the fact that the Division's production of several databases makes it more difficult to search or that it cannot combine those databases itself.

to review the entire investigative file already produced to identify additional potentially exculpatory documents, no further declaration is required.

Jarkesy/JTCM's claim that the Division did not produce the declaration to them on a timely basis is also inaccurate. The Division produced this declaration to Jarkesy/JTCM more than one month in advance of the scheduled hearing date. The timing of the Division's production is not a violation of Respondents' rights since this material was provided to them with more than sufficient time to prepare for the hearing. *In the Matter of Egan-Jones Rating Co.*, File No. 3-14856, 2012 SEC LEXIS 2204 *14 (ALJ decision, July 13, 2012).

IV. JARKESY/JTCM'S REQUEST TO CHANGE VENUE SHOULD BE DENIED

Separately from their unsupported request for additional Brady disclosures, Jarkesy/JTCM request that the venue of the proceeding be changed from New York to either Houston or Dallas Texas. In support of this motion, Jarkesy/JTCM state that they expect to call six Texas-based witnesses, and that the professionals that were hired by Jarkesy/JTCM may also expect to be indemnified for the travel costs associated with coming to New York for the hearing. Notably, Jarkesy/JTCM do not identify any of these witnesses, explain what their testimony might be, or state why it is inconvenient for them to travel to New York (except potentially for cost). Nor do Jarkesy/JTCM attach a copy of the indemnification agreement. Consequently, it is impossible for the Division and/or the Hearing Officer to evaluate these statements and they should be ignored. *See, e.g., Union Cent. Life Ins. Co. v. Anchor Fin. Servs., LLC*, No. 1:10-cv-95, 2010 U.S. Dist. LEXIS 139405 *7 (S.D. Ohio May 21, 2010) ("[w]hen a party moves for change of venue based on inconvenience to witnesses or the burden of transporting documents, the party should provide specific evidence of inconvenience"); *Farmers Select, LLC v. United Motor Freight*, 07-CV-342, 2008 U.S. Dist. LEXIS *12 (E.D. Tex. Dec.

19, 2008) ("the party seeking transfer 'must clearly specific the key witnesses to be called and make a general statement of what their testimony will cover.'").[4]

In addition, Jarkesy/JTCM fail to consider the fact that Belesis and the current and former employees of his firm are located in New York. The fact that Belesis/JTF have made an offer to settle this case that the Division intends to recommend to the Commission does not mean that Belesis and/or employees of his firm will not be called as witnesses. Jarkesy/JTCM also ignore that numerous investors (including investors on the list of individuals with whom the Division has spoken) are located in New York or close to New York. Jarkesy/JTCM do not address how a proceeding in Texas will be convenient for these individuals. The location of Jarkey/JCTM's lawyers is irrelevant. *See, e.g., National Gypsum Co. v. Tremco.*, Inc., No. 97 C 2818, 1997 U.S. Dist. LEXIS 11814 (N.D. Ill. Aug. 8, 1997) (the location of a party's attorneys is not, however, a proper consideration in the [change of venue] analysis"); *Solomon v. Continental American Life Ins. Co.*, 472 F.2d 1043, 1047 (3d Cir. 1973) ("[t]he convenience of counsel is not a factor to be considered").

In sum, Jarkesy/JTCM simply want this case adjudicated in Texas because it will be more convenient for them to litigate in Texas. This is not a sufficient reason to change the venue, particularly in light of the fact that Jarkesy/JTCM used a New York-based broker dealer as the placement agent for their funds. By virtue of this fact alone, Jarkesy/JTCM reasonably should have expected that they might have to litigate in New York. Consequently, the Division respectfully requests that the change of venue motion be denied.

[4] While federal court decisions resolving procedural matters under the federal rules do not have precedential value in administrative proceedings, we were unable to find ALJ decisions with a substantive discussion of the standards for moving venue. Consequently, we cite these case as guidance.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

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,	:
	:
Respondents.	:
	:

Division of Enforcement's Post-Hearing Memorandum of Law Pursuant to Rule of Practice 340

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TABLE OF AUTHORITIES

Pursuant to Rule of Practice 340, the Division of Enforcement ("Division") submits the following post-hearing memorandum of law, which outlines its case against John Thomas Capital Management Group LLC, d/b/a Patriot28, LLC ("JTCM") and George R. Jarkesy, Jr. ("Jarkesy") (collectively "Respondents") and the legal theories upon which the Division relies. The facts upon which this memorandum of law is based are described in the Division's proposed findings of fact and conclusions of law, filed herewith.[1]

I. The Credibility of the Witnesses Who Testified at the Hearing.

Twelve witnesses testified in this case, eleven of them credibly and believably. Only Jarkesy's testimony lacked credibility. During the Division's examination, Jarkesy repeatedly answered that he did not remember essentially anything that occurred while he managed the two John Thomas Bridge and Opportunity Funds (the "Funds"). Jarkesy even claimed he could not recall the assets that are currently in the two Funds or their values, notwithstanding his testimony that those Funds are still operating. And Jarkesy repeatedly suggested that documents he was shown were inauthentic, even though the documents were his own records that had been produced by his own counsel during the investigation. During examination by his own attorneys, however, Jarkesy's memory suddenly improved and he was able to answer questions substantively. Just as suddenly, when the Division followed up on these answers during cross-examination, Jarkesy's memory again failed him. Jarkesy's self-serving and seemingly coached testimony should not be given any credence by the Hearing Officer. *See, e.g., In the Matter of*

[1] As described in the proposed findings of fact and conclusions of law, the Division offered DX 231 and DX 503-506 into evidence but those documents were not admitted. DX-231 is a document that was produced by Respondents and carries the JTBOF bates stamp. DX-503-506 are documents that were produced pursuant to subpoena and are the subject of business record declarations by John Thomas Financial, Inc. ("JTF") It would be inconsistent with the other evidentiary rulings in this case to exclude such exhibits and the Division renews its request that they be admitted. The Division notes that DX 503-506 are discussed and explained in the pages from the investigative testimony of Anastasios "Tommy" Belesis ("Belesis") that were counter-designated by the Division as per the order of the Hearing Officer.

Next Financial Group, Inc., 2008 SEC LEXIS 1393 *54 (Initial Decision June 18, 2008) (fact that witnesses "developed poor memories when the inquiry turned to their personal involvement" leads Hearing Officer to discount their testimony"); *In the Matter of Gregory M. Dearlove, CPA*, 2006 SEC LEXIS 1684 *159 (Initial Decision July 27, 2006) (witnesses "inordinate number of 'I don't recall' answers" leads Hearing Officer to conclude that his testimony was not credible"); *In the Matter of Steven E. Muth*, 2004 SEC LEXIS 2320 *58 (Initial Decision Oct. 8, 2004) (hearing officer finds Respondent not credible where his "testimony was littered with references about being unable to remember certain events, yet he recalled specific facts and details when it served his interests to do so").

II. The Claims Asserted by the Division against Respondents

The Division asserts claims against Respondents based on Section 10(b) of the Exchange Act of 1934 ("Exchange Act") and Rules 10b-5(a)-(c) thereunder; Section 17(a)(1)-(3) of the Securities Act of 1933 ("Securities Act"); and Section 206 of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-8 thereunder.

Section 10(b) of the Exchange Act prohibits fraud in connection with the purchase or sale of securities. Specifically, Section 10(b) and Rule 10b-5(b) thereunder prohibit the making of material misstatements or omissions in connection with the sale or purchase of securities. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (U.S. 1988); *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. den.*, 394 U.S. 976 (U.S. 1969). Rules 10b-5(a) and (c) prohibit any "scheme ... to defraud" or "course of business which operates ... as a fraud or deceit upon any person."

To prove a § 10(b) violation or Rule 10b-5 violation, the SEC must show (1) material misrepresentations or materially misleading omissions, (2) in connection with the purchase or

sale of securities, (3) made with scienter. *See, e.g., SEC v. Curshen*, No. 09-1196, 2010 U.S. App. LEXIS 7555 (10th Cir. 2010); *SEC v. Merch. Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007). In actions brought by the Division, reliance, damages, and loss causation are not required elements. *See, e.g., SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. May 2, 2012).

Section 17(a) of the Securities Act prohibits any person in the offer or sale of securities from (1) employing any device, scheme or artifice to defraud, (2) obtaining money or property by means of material misstatements and omissions, and (3) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a purchaser. Section 17(a) of the Securities Act prohibits fraud in the offer or sale of securities, using the mails or instruments of interstate commerce. Section 17(a)(1) forbids the direct or indirect use of any device, scheme, or artifice to defraud; Section 17(a)(2) makes it unlawful to obtain money or property through misstatements or omissions about material facts; and Section 17(a)(3) proscribes any transaction or course of business that operates as a fraud or deceit upon a securities buyer. *SEC v. Softpoint, Inc.*, 958 F.Supp. 846, 861 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998). Claims under Section 17(a) of the Securities Act have essentially the same elements as 10(b), although subsections (a)(2) and (a)(3) require only a finding of negligence not scienter. *Aaron v. SEC*, 446 U.S. 680, 697 (U.S. 1980); .*SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285 (2d Cir. 2013). Subsection 17(a)(2) also requires that the person "obtained money or property" through the misstatements. The statute does not require that the person obtained "some kind of additional 'fraud bonus.'" *Sec v. Tourre*, 10 Civ. 3229, 2014 U.S. Dist. LEXIS 1570 *11-12 (S.D.N.Y. Jan. 7, 2014).[2]

[2] A Respondent may be liable under Section 17(a)(2) even if he did not personally obtain money or property. *See SEC v. Stoker*, 865 F. Supp.2d457, 463 (S.D.N.Y. 2012); *see also SEC v. Mudd*, 885 F. Supp.2d654, 669-70 (S.D.N.Y. 2012). In *Stoker*, the court rejected the argument that Section 17(a)(2) requires personal gain by the defendant, reasoning that the statute, "on its face, does not state that a defendant must obtain the funds personally or

Section 206 of the Advisers Act makes it unlawful for any investment adviser, among other things, "(1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client ...; [and] (4) to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative." Rule 206(4)-8 specifically prohibits advisers of pooled investment vehicles from making material misrepresentations and omissions or otherwise engaging in any fraud, deception or manipulation. Proof under Section 206 of the Advisers Act has been deemed less stringent than under Section 10(b) of the Exchange Act because there is no requirement under Section 206 that the fraudulent activity be in the offer or sale of a security or in connection with the purchase of a security. *SEC v. Lauer*, No. 03-80612, 2008 U.S. Dist. LEXIS 73026 *90-91 (S.D. Fla. Sept. 24, 2008) (*citing* Advisers Act Rel. No. 1092, 1987 SEC LEXIS 3487 (Oct. 8, 1987)). "Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund and its investors, and includes an obligation to provide 'full and fair disclosure of all material facts' to investors and independent trustees of the fund. *SEC v. Tambone*, 550 F.3d 106, 146 (1st Cir. 2008) (*quoting SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963)); *see also SEC v. Batterman*, 00 Civ. 4835, 2002 U.S. Dist. LEXIS 18556, *23 (S.D.N.Y. Sept. 30, 2002) ("An investment adviser has a fiduciary duty to exercise good faith, full and fair disclosure of all

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directly," and that it would defeat the statute's remedial purpose "to allow a corporate employee who facilitated a fraud that netted his company millions of dollars to escape liability for the fraud by reading into the statute a narrowing requirement not found in the statutory language itself." 865 F. Supp.2dat 463. *Stoker* further observed that to narrow the statute would be to ignore the Supreme Court's instruction that "Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purpose.'" *Id.* (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (U.S. 1972)). Thus, even if Jarkesy did not personally obtain money or property but JTCM received money or property, Jarkesy can still be held liable.

material facts, and an affirmative obligation 'to employ reasonable care to avoid misleading' his clients.") (*internal citation omitted*).

A. Respondents Made Numerous Misrepresentations to Investors

Respondents made numerous misrepresentations to investors. In the Private Placement Memoranda ("PPM") and Limited Partnership Agreements, Respondents represented that (1) the Funds would purchase insurance policies with face value of 117% of the investor capital; (2) half of all investor capital would be used to purchase the insurance policies or would be set aside and segregated to pay premiums; (3) Respondents would mitigate life expectancy risk; (4) the insurance policies would be transferred to the Master Trust; (5) the total investment of the partnership in any one company at any one time would not exceed 5% of the aggregate capital commitments; (6) the general partner, JTCM, would utilize good faith; (6) fair value would be used to value securities where no market quotation was readily available; (7) the Funds' financial statements would be prepared according to generally accepted accounting principles ("GAAP"); and (8) that the management of the partnership would be vested exclusively in the General Partner. Many of these misrepresentations were repeated in marketing materials, in periodic investor updates (including a podcast following the release of the 2008 audited financial statements), and in the Funds' audited financial statements.

Respondents' marketing materials and investor updates made additional misrepresentations, including that: (1) KPMG was the auditor for the Funds; (2) Deutsche Bank was the prime broker for the Funds; (3) insurance policies would be purchased from AA rated insurance companies; (4) Fund I had purchased fourteen policies from fourteen separate insurance companies; (5) the bridge loans were be "collateralized"; and (6) valuations of the

Funds' assets would be conservative. Respondents' website made the additional misrepresentation that JTF did not manage, direct, or make any decisions for the Funds.

In addition to the misrepresentations, Respondents fraudulently valued many of the positions in the portfolio including (1) the life insurance policies, which Respondents valued using a 12% discount rate instead of the 15% discount rate that valuation consultants had used; (2) the restricted stock, which Respondents valued at the same price as free-trading stock; (3) the notes of America West Resources ("America West") and Galaxy Media & Marketing Corp. ("Galaxy"), which Respondents valued at par notwithstanding that the notes were in default; (4) the shares of Radiant Oil & Gas, Inc. ("Radiant") and America West, which Respondents valued based upon promotional activities they paid for with money from the Funds; (5) the Radiant warrants, which Respondents valued at a non-existent stock price; and (7) the shares of portfolio companies like Galaxy, which Respondents overvalued, given the poor financial condition of those companies. These valuations, which Respondents knew lacked any reasonable basis, are fraudulent. *See, e.g. IKB Int'l S.A. v. Bank of America*, 12 Civ. 4036, 2014 U.S. Dist. LEXIS 45813 *2 (S.D.N.Y. March 31, 2014) (implicit representation that there is a reasonable basis for valuation); *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) ("[a]n opinion must have a reasonable basis"); *In re Connetics Corp. Sec. Litig.*, 542 F. Supp.2d996, 1010 (N.D. Cal. 2008) (opinions are actionable where there is no reasonable basis for the belief or the speaker is aware of undisclosed facts tending to seriously undermine the accuracy of the statement); *SEC v. Gane*, No. 03-61553, 2005 U.S. Dist. LEXIS 607 *30-31 (S.D. Fla. Jan. 4, 2005).

Respondents may argue that under the U.S. Supreme Court's holding in *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (U.S. 2011), they cannot be held liable for the misrepresentations in the PPM because those misrepresentations are attributable

only to the Funds and not to themselves. This argument fails for numerous reasons. First, because Respondents had "ultimate authority" over the PPM and its contents, they are liable for the misrepresentations contained therein. *See, e.g., Janus,* 131 S. Ct. at 2302 (attribution can be implicit from surrounding circumstances); *SEC v. Levin,* No. 12-21917-CIV, 2013 U.S. Dist. LEXIS 146702 *43 (S.D. Fla. Oct. 10, 2013) (managing member and owner of company had sufficient control over the statements); *In re Stillwater Capital Partners Inc. Litig.*, 858 F. Supp.2d277, 288 (S.D.N.Y. 2012) (reasonable fact finder could conclude that in company with few employees, statements made by its officers); *In re Merck & Co., Deriv. & ERISA Litig.*, MDL No. 1658, 2011 U.S. Dist. LEXIS 87578 *25 (D.N.J. Aug. 8, 2011) (senior executive liable as maker of company's financial statements). As demonstrated at the hearing, Respondents had the "ultimate authority" for the statements in the PPM.

Second, the misstatements in the PPM were repeated numerous times in documents that were directly attributable to Respondents, including the power point presentations, the investor updates, the marketing materials, the audited financial statements, the monthly account statements, and the website. Consequently, even if Respondents were not liable for the misstatements in the PPM, they would be liable for the misstatements in the other documents that they provided or caused to be provided to Fund investors.

Third, *Janus* applies only to cases brought under Rule 10b-5(b). It does not apply to scheme liability claims under Section 10(b) of the Exchange Act and it does not apply to any claims under Section 17 of the Securities Act. *See, e.g., SEC v. Garber,* 959 F.Supp.2d 374, 380 (S.D.N.Y. 2013) ("The textual basis for *Janus* does not extend to claims based on schemes to defraud under Rule 10b–5(a) and (c), which do not focus on the 'making' of an untrue statement"); *SEC v. Pentagon Capital Mgmt. PLC,* 844 F.Supp.2d 377, 421 (S.D.N.Y. 2012);

SEC v. Boock, 2011 U.S. Dist. LEXIS 129673, at *2-5 (S.D.N.Y. Nov. 9, 2011) (liability under Rule 10b-5(a) and (c) was not affected by *Janus*); *SEC v. Monerosso*, 2014 U.S. App. LEXIS 3891, *16 (11th Cir. Mar. 3, 2014) (Janus does not apply to Section 17 or scheme liability provisions); *SEC v. Geswein*, 2014 U.S. Dist. LEXIS 28057 (N.D. Ohio Mar. 5, 2014) ("the Court will not presume to extend Janus to violations of the Securities Act Section 17(a)").[3]

B. Respondents Misrepresentations Were Material

A statement is material if a substantial likelihood exists that a reasonable investor would consider the information important in making an investment decision. *Basic*, 485 U.S. at 231-32; *SEC v. Mayhew*, 121 F.3d 44, 51-52 (2d Cir. 1997). The information need not be of a type that necessarily would cause an investor to change his investment decision. Rather, a statement is material so long as the investor would have viewed it as significantly altering the total mix of information available. *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000); *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1533 (2d Cir.), *cert. den.*, 502 U.S. 983 (1991).

Misstatements that are quantitatively off by more than five percent are presumptively material. *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009). Misstatements may be material, however, even if they fall beneath a numerical threshold; qualitative factors may cause even small misstatements to be material. Staff Accounting Bulletin No. 99, provides a non-exhaustive list of qualitative factors that may make small misstatements material. *Ganino* 228 F.3d at 162; *SEC v. Penthouse Int'l, Inc.*, 390 F. Supp.2d344, 353 (S.D.N.Y. 2005).

Misrepresentations concerning the value of the investments are considered qualitatively material as a matter of law. *See Evergreen Investment Mgmnt. Co., LLC*, 2009 SEC LEXIS 1853

[3] To date, there have been no decisions addressing whether *Janus* applies to Rule 206(4)-8 under the Advisers Act,

*31-32 (June 8, 2009); *SEC v. Lauer*, No. 03-80612, 2008 U.S. Dist. LEXIS 73026 *77-78 (S.D. Fla. Sept. 24, 2008); *SEC v. Seghers*, No. 3:04-CV-1320, 2006 U.S. Dist. LEXIS 69293 *3-5 (N.D. Tex., Sept. 14, 2006), *aff'd in part and vacated in part on other grounds* 2008 U.S. App. LEXIS 23507 (5th Cir. 2008). This includes misrepresentations about the actual value of the securities as well as misrepresentations about the way in which the securities would be valued. Therefore, all of Respondents' fraudulent valuations were qualitatively material.

From a quantitative standpoint, however, the fraudulent valuations were also material. As demonstrated at the hearing, the Funds' auditors determined that for the year ended December 31, 2008, any misstatement (or combination of misstatements) of more than $150,000 was material. (DX-340). For the year ended December 31, 2009, any misstatement (or combination of misstatements) of more than $180,000 was material. (DX-341). And for the year ended December 31, 2010, any misstatement (or combination of misstatements) of more than $210,000 was material. (DX-342). The fraudulent valuations well-exceeded this amount. For example, had Jarkesy used Steve Boger's December 31, 2008 valuation of the eight insurance policies based on 15% NPV, the policies would have been valued at negative $176,452. Instead, Jarkesy valued the policies at $555,149, which represented the value of only five of the eight policies at 12% NPV. The difference in the two valuations is $731,601, well above the $150,000 materiality threshold. Similarly, Respondents failed to write-down hundreds of thousands of dollars of America West notes that were in default. Furthermore, Jarkesy valued the Galaxy stock position in 2010 at millions of dollars. Had he used an appropriate valuation for the shares, the value of the position would have been negligible.

In a similar vein, misrepresentations concerning the risks of the investment are material as a matter of law. See, e.g. *Krasner v. Rahfco Funds, L.P.*, 11 CV 4092, 2012 U.S. Dist. LEXIS

134353 *14 (S.D.N.Y. Aug. 9, 2012) (misrepresenting the risk entailed in the investments is a material misrepresentation).[4] The representations concerning the five percent limitation on investment in a single company, the 117% insurance coverage requirement, and the identity of the prime broker and auditor all relate to risk. Accordingly, the investors testified at the hearing that these representations were important to them. The insurance feature was a primary reason why they invested; they thought that the policies would ensure a return of their principal. As Robert Fulhardt testified, "it was like a backstop investment that would protect against downside losses." The five percent limitation was important factor in their investment because they believed that diversification would reduce the risk. As Mr. Fulhardt testified, "if the Fund limited its investment in any one company it could withstand a number of bad investments without devastating the Fund." Having Deutsche Bank and KPMG associated with the Fund was also important to investors. As Steven Benkovsky testified, knowing that Deutsche Bank was the prime broker gave him comfort in his investment in the Fund. The investor testimony establishes that Respondents' misrepresentations were material. *See, e.g., SEC v. Koester*, No. 1:12-cv-01364, 2014 U.S. Dist. LEXIS 45863 *11 (S.D. Ind. April 2, 2014);

[4] *See also Pennsylvania. Pub. Sch. Emplys. Ret. Sys.v. Bank of Am. Corp.*, 874 F. Supp.2d 341 (S.D.N.Y. 2012) (representations that defendant held particular loan assets were material because of a failure to disclose clouded ownership); *SEC v. Fife*, 311 F.3d 1 (1st Cir.), *cert. den.*, 538 U.S. 1031 (U.S. 2002) ("a reasonable investor would want to know the risks involved"); *SEC v. Novus Techs., LLC*, No. 2:07-CV-235, 2010 U.S .Dist. LEXIS 111851 *33 (D. Utah Oct. 20, 2010), *aff'd*, 783 F.3d 1151 (10th Cir. 2013) ("[m]isrepresentations regarding ... the risk associated with the investment are material"); *In re Sadia, S.A. Sec. Litig.*, 269 F.R.D. 298, 315 (S.D.N.Y. 2010) ("common sense ... suggest[s] that risk taking is material to investors").

1. The PPM Disclosures did not Make the Representations Immaterial

Respondents may argue that the warnings in the PPMs made some of the misrepresentations immaterial. As described below, this argument would be unsupported by the law or the specific facts of this case.

First, the "bespeaks caution" doctrine does not apply to facts. "Fraud is still fraud, and all of the cautionary language in the world will not replace a true material omission or misstatement of a fact which would matter to a reasonable investor." *In re Integrated Resources Real Estate Ltd. Part. Sec. Litig.*, 815 F. Supp. 620, 674 (S.D.N.Y. 1993). Consequently, no warning in the PPMs would eliminate liability for Respondents' representations that they had actually purchased 117% face value of life insurance policies (or more) or had set aside the money to pay the premiums on the policies when, in fact, they did neither. Second, general boilerplate warnings that the investment was risky or speculative, or that the investor could lose all of its investment, do not qualify under the "bespeaks caution" doctrine. *See, e.g. In the Matter of Leaddog Capital Markets LLC,* 2012 SEC LEXIS 2918 *44-45 (Initial Decision, Sept. 14, 2012) ("boilerplate language in the offering materials warning against the possibility of almost any eventuality ... does not excuse misrepresentations"); *In re S1 Corp. Secs. Litig.*, 173 F. Supp.2d 1334, 1351 (N.D. Ga. 2001) ("boilerplate warnings merely reminding an investor that the investment holds risk are not sufficient"); *Underland v. Alter*, No. 10-3621, 2011 U.S. Dist. LEXIS 102896 *25 (E.D. Pa. Sept. 9, 2011) ("a blanket warning that an investment is risky is likely to be insufficient to ward off a securities fraud claim"); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3d Cir. 1993), *cert. den.*, 510 U.S. 1178 (U.S. 1994) ("blanket (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate to prevent misinformation").

Respondents might argue that because the PPMs gave them some discretion over the valuation of portfolio positions, the valuations – even if inflated – cannot form the basis of a fraud claim. This argument was rejected in *In re: Rochester Funds Group Sec. Litig.*, 838 F. Supp.2d 1148, 1171-72 (D. Colo. 2012), where the court stated:

> [i]f a security's designation of liquidity is purely subjective and solely within the business judgment of Defendants to determine, then the statement [that the fund would monitor liquidity and maintain less than a certain amount of illiquid securities] conveyed no meaningful information and certainly no meaningful assurances to prospective investors. Yet the statements clearly suggest that something real is being warranted.

Moreover, such an argument by Respondents would ignore the specific provisions in the PPMs and the limited partnership agreements stating that GAAP and fair value would be utilized and that valuations would be reasonable and in good faith. Similarly, the Fund's audited financial statements specifically stated that the statements had been prepared using GAAP and fair value. Thus, Respondents' discretion was limited. A valuation without basis and/or contrary to the valuations purportedly provided by outside consultants is neither reasonable nor in good faith.

Respondents similarly might argue that because the PPMs stated that some of the positions would be hard to value, the valuations – even if inflated – cannot be deemed material. This exact argument was rejected in *SEC v. Mannion*, 789 F. Supp.2d 1321, 1333 (N.D. Ga. 2011). In that case, the defendants argued that statements about the value of an investment in a "side pocket" were not material because they had represented to investors that valuing these assets would be a challenge and the existence of the "side pocket" sent a "powerful signal" that the assets were illiquid, impaired, or hard to value. The court disagreed.

> Under Defendant's theory, creating the Side Pocket and calling it hard to value would give fund advisors free reign to assign any value they wish to the Side Pocket. This argument is illogical and contradicts the remedial purpose of the

> securities laws. The SEC does not allege that Defendants simply had difficulty valuing the Side Pocket, but that they deliberately inflated the Side Pocket's value. A reasonable investor would know that the valuation of the Side Pocket was less reliable than typical market-traded securities and that the value of World Health assets would be unstable, but **they were entitled to expect Defendants to attempt in good faith** to determine the best, most accurate value possible for the Side Pocket. Defendants' estimate of the Side Pocket is especially relevant where **investors rely on Defendants' investing expertise and specific familiarity** with World Health. *Id.* at 1333-34 (emphasis added).

Finally, even the more specific warnings in the PPMs about the risks of the corporate investments or the risks associated with the insurance policy portfolio (including life-expectancy risk) were insufficient because the PPMs were used during the entire existence of the Funds and did not disclose that some of the contingencies actually had taken place. Thus, even if some of the risk warnings in the Fund I PPM originally were sufficient in 2007, they became insufficient upon the occurrence of the contingencies. *SEC v. Merchant Capital*, 483 F.3d 747, 759 (11th Cir. 2007) ("what may once have been a good faith projection became, with experience, a materially misleading omission of material fact"). The PPM used to sell Fund I interests in 2009 did not disclose that Respondents had decided to allow the largest of the life settlement policies (Paul Evert) to lapse because the costs associated with that policy were greater than the benefits due to the change in life expectancies. The PPM for Fund I that was used to sell interests in 2010 did not disclose that America West and Amber Ready/Galaxy were in default on loan obligations. The PPM did not disclose that the Funds, in fact, had been unable to sell much of the stock that was received in connection with the bridge loans because there was no market for that stock. In *SEC v. Meltzer*, 440 F. Supp.2d 179, 191 (E.D.N.Y. 2006) the court explained that the "bespeaks caution" doctrine is not applicable in such a case:

> It must be remembered that the "cautionary language associated with the 'bespeaks caution' doctrine is aimed at warning investors that bad things may come to pass in dealing with the contingent or unforeseen future." Thus, the doctrine does not apply to "historical or present fact-knowledge within the grasp

> of the offeror." "Such facts exist and are known; they are not unforeseen or contingent. It would be perverse indeed if an offeror could knowingly misrepresent historical facts but at the same time disclaim those misrepresented facts with cautionary language." In sum, the "bespeaks caution" doctrine does not apply "where a defendant knew that its statement was false when made."

Consequently, any argument Respondents raise based on warnings should fail.

C. Respondents Had the Requisite Scienter

Scienter is a "mental state embracing intent to deceive, manipulate or defraud" and is also considered present when one acts with a reckless disregard for the truth. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976). "[K]nowledge . . . is sufficient to satisfy [the scienter] requirement." *Graham v. SEC*, 222 F.3d 994, 1004 (D.C. Cir. 2000); *see also SEC v. U.S. Env'tl., Inc.*, 155 F.3d 107, 111 (2d Cir. 1998) ("It is well-settled that knowledge of the proscribed activity is sufficient scienter under § 10(b)"), *cert. den.*, 526 U.S. 1111 (U.S. 2000). The Division, however, does not have to demonstrate that Respondents intended "to do something fraudulent." *SEC v. Stanard*, 06 Civ. 7736, 2009 U.S. Dist. LEXIS 6068 *79 (S.D.N.Y. Jan. 27, 2009). Reckless conduct also suffices to violate the antifraud provisions. *Id.*

Reckless conduct is conduct that is highly unreasonable and 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. Recklessness may be established through Respondents' knowledge of or access to contradictory information. Recklessness may also be established where Respondents failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud. *See Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47 (2d Cir.), *cert. den.*, 439 U.S. 1039 (U.S. 1978); *U.S. Envt'l, Inc.*, 155 F.3d at 111; *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir.), *cert. den.*, 525 U.S. 931 (U.S. 1996); *SEC v. Biovail Corp.*, No. 08 Civ. 2979, 2009 U.S. Dist. LEXIS 15546 (S.D.N.Y. Feb. 10, 2009). Representations and opinions given without basis and in reckless disregard of

their truth or falsity establish scienter. *SEC v. Bremont*, 954 F. Supp. 726 (S.D.N.Y. 1997); *Rolf* 570 F.2d at 47.

Jarkesy had the requisite scienter. He knew that KPMG did not audit either Fund. He knew that Deutsche Bank was not the prime broker for the Funds, but he continued to represent that Deutsche Bank was the prime broker even after Deutsche Bank demanded that its name be removed from Fund II's PPM. The fact that Respondents may have engaged KPMG and Deutsche Bank for the International Master Fund and/or the International Feeder Fund did not give them license to tell investors and prospective investors that these well-known, respected, and trusted entities were engaged by Fund I or Fund II, particularly when KPMG never performed any audit and no Deutsche Bank account was ever funded. In sum, Respondents used the good names of KPMG and Deutsche Bank to lend legitimacy to their fraudulent operations.

Jarkesy controlled all operations of JTCM and made all investment decisions for the Funds. He either knew that he was concentrating more than five percent of investor capital into several of the portfolio companies or he was reckless in doing so. Indeed, the total investment in America West in Fund I was well in excess of $2 million when Fund I investor capital was approximately $20 million. In *Leaddog Capital Markets*, 2012 SEC LEXIS 2918 at *43-44, this Hearing Officer held that such representations were fraudulent:

> The representation that Leaddog would "try to limit investments to 5% per issuer maximum" was manifestly false, given that the Fund's portfolio was concentrated in four issuers, with United EcoEnergy at 26.64%. Messalas's answers show at least a reckless degree of scienter – highly unreasonable and an extreme departure from the standards of ordinary care – and a clear violation of the fiduciary duty owed by an investment adviser. These representations were so far from the truth that LaRocco also, even absent special knowledge of trading the type of securities that Leaddog held, had to have known that they were misrepresentations.

Notably, in Leaddog, the representation was that the hedge fund would "**try** to limit its investment to 5% per issuer ...." *Id.* (emphasis added). In the instant case, the PPM for Fund I

stated that "[t]he total investment of the Partnership in any one company at any one time **will not exceed** 5% of the aggregate Capital Commitments." (emphasis added).

Jarkesy purchased the insurance policies for the Fund. He either knew or recklessly disregarded that he was not purchasing policies with 117% face value of investor capital. He also knew or recklessly disregarded that he was not putting aside the money that he represented would be set aside and segregated to pay the insurance premiums. Furthermore, Jarkesy negotiated the terms of the loans that the Funds provided to the portfolio companies. He either knew or recklessly disregarded that many of the bridge loans were not "collateralized," creating great risk to the Funds in the event of default.

With respect to the valuations, Jarkesy knew that the appropriate discount rate for the life insurance policies was not 12%. He told the brokers who were looking for policies that he was seeking policies with yields of 15%. He told investors that the Fund had purchased policies with average yields of 15%. Jarkesy knew that his representations concerning the independent relationship between the Funds and JTF were misleading because, even as he made them, he was directly negotiating investment banking agreements that often were in conflict with the interests of the Funds. Jarkesy's intent is best expressed by his email to Belesis that "we will always try to get you as much as possible. Every time without exception." Jarkesy negotiated the investment banking agreement between America West and JTF but did not attempt to reduce JTF's fees – even though it was in the interest of the Funds to have JTF's fees be as low as possible.

[5] The Division does not claim that the promotional campaigns were, in and of themselves, fraudulent or illegal. The Division's claim is that the stock prices in December were not "real" because they reflected the promotional activity. Jarkesy knew this and used those prices anyway.

Jarkesy also knew or recklessly disregarded that JTF was not going to raise sufficient money for Radiant and Galaxy. As such, his recommendation that the portfolio companies hire JTF was unreasonable and hurt the Funds. Jarkesy knew this because JTF failed to raise sufficient interest in the Funds to meet the Funds' target investments of $25 million and $250 million respectively. JTF failed to raise sufficient funds for America West, resulting in America West being unable to repay many of its debt obligations. Moreover, Belesis sought unreasonable compensation, including demanding that one of the America West directors give Belesis stock that the director's family owned. Notwithstanding all of this, Jarkesy approved an investment banking agreement between Radiant and JTF that, in addition to the customary fees, made JTF the second largest shareholder in the company – even greater than the Funds.

Finally, Jarkesy ceded control over the Funds' investment in Galaxy to Tommy Belesis who made decisions about how the Fund's money would be used. As one example, when Belesis promised Galaxy's lawyer that he would be paid $49,000 from the Funds, the Funds that supposedly Respondents controlled paid as Belesis ordered. Belesis also ordered Fund money to be used for other Galaxy expenses and directed who would be Galaxy officers and directors. Jarkesy participated in this and allowed it to happen.

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.), *cert. den.*, 434 U.S. 969 (U.S. 1977)). A company's scienter is imputed from that of the individuals controlling it. *See SEC v. Blinder, Robinson & Co.*, 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)). Thus, Jarkesy's conduct and scienter are attributed to JTCM.

1. Reliance on Accountants and Experts is not a Sufficient Defense

Respondents may argue that because they relied on the opinions of outside valuation experts as well as the Funds' outside accountants and auditors, the Division cannot demonstrate that they had the required scienter. This argument is contrary to the evidence. First, the outside accountants and auditors did not actually value any of the positions. Instead, they relied on Respondents' valuations and merely sought support from Respondents for those valuations. Moreover, because Respondents did not provide full and complete information to their accountants and their auditors (and knew that the accountants and auditors were relying on the incomplete information), Respondents cannot argue that their reliance on the accountants and auditors was in good faith. Similarly, Respondents cannot assert a defense based upon their "expert" insurance valuations because they did not, in fact, rely on those valuations and ultimately had those experts create spreadsheets using Respondents' own baseless discounrt rate assumptions. Furthermore, two of three valuation "experts" were not independent.

To establish a reliance-on-professional-advice defense, Respondents must show that they (1) sought professional advice; (2) completely disclosed the issue to the professional; (3) received advice; and (4) relied on that advice in good faith. *SEC v. Bankatlantic Bancorp., Inc.*, No. 12-60082, 2013 U.S. Dist. LEXIS 146699 *59 (S.D. Fla. Oct. 10, 2013); *SEC v. Huff*, 758 F. Supp.2d1288, 1349 (S.D. Fla. 2010); *Markowski v. SEC*, 34 F.3d 99, 104-05 (2d Cir. 1994); *In the Matter of David F. Bandimere*, 2013 SEC LEXIS 3142 *146-47 (Initial Decision Oct. 8, 2013). It is Respondents burden to establish that they made full and fair disclosures to the professionals of all facts known and that they relied in good faith on that advice. *Stokes v. S. States Coop., Inc.*, 651 F.3d 911, 920 (8th Cir. 2011); *U.S. v. Scott*, 37 F.3d 1564, 1583 (10th Cir. 1994), *cert. den.*, 513 U.S. 1100 (U.S. 1995) ("reliance upon advice of counsel is a defense that

the defendant must establish"); *SEC v. AIC, Inc.*, 3:11-CV-176, 2013 U.S. Dist. LEXIS 130249 *22 (E.D. Tenn. Sept. 12 2013) (burden on defendant); *In the Matter of the Application of Louis Feldman*, 1994 SEC LEXIS 3428 *6 (Commission Opinion Nov. 3, 1994) ("Feldman has fallen far short of the meeting the threshold requirement for invocation on the defense of reliance on counsel").

With respect to the third-party accountants, Spectrum did not actually value any of the portfolio positions. Instead, it relied on Respondents' valuations for the non-publicly traded stock, the restricted stock, the notes, the warrants, and the insurance policies, Spectrum. Even when Spectrum elevated concerns over Galaxy's share value in September 2010, its role was limited to obtaining information supporting Respondents' valuation. Spectrum did not opine on whether such valuation was correct or whether such valuation was in accordance with GAAP.

Respondents also cannot demonstrate their lack of scienter by relying on the fact that the auditors at MFR issued a clean opinion on the Funds' financial statements. First, MFR did not review any of the monthly financial statements for the Funds. Consequently, Respondents cannot claim reliance on their auditors with respect to the monthly valuations. Second, in order to invoke the principle of reliance on their auditors, Respondents must show "that [they] made complete disclosure ...." *In re Bank of Am. Corp. Sec. Deriv. & ERISA Litig.*, No. 09 MD 2058, 2011 U.S. Dist. LEXIS 84831 *15 (S.D.N.Y. July 29, 2011) (failure to update counsel about growing losses impeded counsel's ability to make a fully informed analysis and, as such, court rejects reliance on counsel defense). Therefore, in *SEC v. Johnson*, No. 04-4114, 2006 U.S. App. LEXIS 8230 (3d Cir. April 5, 2006), the Third Circuit Court of Appeals rejected a reliance on advice defense where the defendant "did not tell the auditors about a state court injunction and security agreement that effectively prevented MERL from exercising control over Essex. In

addition, [defendant] supplied to the auditors various baseless assumptions about a customer list acquired from the Hanold entites, which resulted in their giving the list an inflated value."[6]

Respondents here have not demonstrated that they made complete disclosure to their auditors. There is no evidence in the record that Respondents disclosed to MFR, as examples, (a) that the America West and Galaxy notes were in default, (b) that the valuations from the purported experts were based on Respondents' own 12% NPV assumption and that the consultants had valued the policies based upon a 15% NPV assumption with much lower resulting values, (c) all of the facts concerning the lawsuits brought by Ohio National Life Assurance Corp., or (d) all of the facts about Galaxy's financial condition. Given the amount of information that they failed to disclose to their auditors, Respondents cannot rely on the audit opinions that MFR rendered.

Moreover, while Respondents received valuations for the insurance policies, they did not actually follow the valuations that they originally received. Instead, Jarkesy repeatedly requested new valuations using his own 12% NPV assumption, which he knew did not reflect the market price. By using the 12% NPV values instead of the 15% NPV values originally received from their purported experts, Respondents grossly and unreasonably inflated the value of the insurance policy portfolio. As such, Respondents cannot argue that they relied on experts.

The valuation opinions from Abacus and Life Settlement Solutions were also not independent as Respondents had purchased the policies from those companies. Clearly, the companies that sold the policies to the Funds had an interest in giving Respondents high

[6] *See also SEC v. Melzer*, 440 F. Supp.2d 179, 190 (E.D.N.Y. 2006) (no reliance on counsel defense where defendant did not make a complete disclosure, including failure to discuss specific disclosures with counsel); *Renner v. Townsend Fin. Servs. Corp.*, 98 Civ. 926, 2002 U.S. Dist. LEXIS 8898 *22 and n.8 (S.D.N.Y. May 20, 2002) (defendant's selective disclosure would render unavailable the defense of advice of counsel); *Leaddog Capital Markets,* 2012 SEC LEXIS at *45 ("[a]ny claim analogous to a reliance on advice of counsel claim must fail because Respondents did not disclose the related-party transactions to [the auditors]").

valuations because they wanted additional business. Professional opinions must be disinterested and independent. *S.E.C. v. O'Meally*. No. 06 Civ 6483, 2010 U.S. Dist. LEXIS 107696, *4 (S.D.N.Y. Sept. 29, 2010) (citing *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988)); *Illes v. Commissioner*, 983 F.2d 163, 166 (6th Cir.), *cert. den.*, 982 F.3d 163 (U.S. 1992) (Reliance on a professional is not reasonable where the professional is not disinterested). The only "independent" consultant hired by Respondents to value the policies was Steve Boger. Respondents, however, did not use Boger's valuation at 14-16% NPV, and did not seek values from him for any of the policies purchased in 2009.

Finally, professionals cannot sanction something that Respondents should have known was wrong. *FTC v. Commerce Planet, Inc.*, 878 F. Supp.2d 1048, 1084 (C.D. Cal. 2012). Thus, in *United States v. Smith*, 523 F.2d 771, 778 (5th Cir. 1975), *cert. den.*, 429 U.S. 817 (U.S. 1976), the court held that the defendant's reliance on a CPA could not be in good faith if he had knowledge contrary to the conclusions of the CPA. Moreover, the court held that "[t]he fact that material is not intentionally hidden fails to meet the requirement that it be fully disclosed." *Id.* In *In the Matter of the Application of Harold B. Hayes*, 1994 SEC LEXIS 2870 *13 (Commission Opinion Sept. 13, 1994), the Commission similarly held that where the impropriety of the Respondent's actions should have been obvious, Respondent could not excuse his activities even if he had received advice that his actions were proper." Respondents knew that their valuations did not have a reasonable basis. Consequently, even the receipt of professional opinions supporting those valuations (or not contradicting those valuations) does not eliminate their fraudulent intent.

D. Respondents are Separately Liable for their Participation in the Scheme

In addition to liability for misrepresentations, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act also generally prohibit any wrongdoing by any person that rises to the level of a deceptive practice. *See Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6, 10 (1971). For the purposes of the securities laws, a "'scheme to defraud' is merely a plan or means to obtain something of value by trick or deceit." *SEC v. Kimmes*, 799 F. Supp. 852, 858 (N.D. Ill. 1992), *aff'd*, 997 F.2d 287 (7th Cir. 1993). Thus, scheme liability is established where a defendant "engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Middlesex Retirement Sys. v. Quest Software Inc.*, 527 F. Supp.2d1164, 1191 (C.D. Cal. 2007).[7] The case for scheme liability against Jarkesy and JTCM is predicated on the same facts that form the basis of their liability under Section 17(a)(2) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder. While the misrepresentations and failures to disclose were parts of the scheme, and in and of themselves violative of the statutes, the overall scheme involved a multi-year campaign to falsely induce investments in the Funds, to routinely inflate the valuation of the Funds' holdings, and to steadily divert the Funds' assets to Belesis and JTF. Thus, scheme liability is appropriate for Jarkesy and JTCM.

E. Respondents Violated the Advisers Act

Respondents, through the same conduct described above, also violated Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. JTCM and Jarkesy, as the

[7] *See also SEC v. Fraser*, 2009 U.S. Dist. LEXIS 70198, *25 (D. Ariz. Aug. 11, 2009); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 158 (2008) (holding that "[c]onduct itself can be deceptive" and, as such, liability under Section 10(b) or Rule 10b-5 does not require "a specific oral or written statement"); *SEC v. Dorozhko*, 574 F.3d 42, 50 (2d Cir. 2009); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp.2d319, 335-36 (S.D.N.Y. 2004) ("a cause of action exists under [Rule 10b-5] subsections (a) and (c) for behavior that constitutes participation in a fraudulent scheme, even absent a fraudulent statement by the defendant

alter ego of JTCM, can be charged directly as investment advisers because they meet the definition under the Advisers Act. *See* Advisers Act Section 202(a)(11). As defined in Section 202(a)(11) of the Advisers Act, Respondents, for compensation, engaged 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. In addition, as part of their work, Respondents, for compensation and as a part of their regular business, issued or promulgated analyses or reports concerning securities.

There is ample evidence of misconduct establishing violations of Sections 206(1), 206(2) and 206(4) and Rule 206(4)-8. Primarily, the violative conduct was Respondents' fraudulent valuation of the Funds' holdings, which deceived investors and inflated the management fees, resulting in a misuse of Fund assets that directly defrauded the Funds. Moreover, Respondents knowingly solicited investments in the Funds on the basis of false and misleading misrepresentations about (1) the insurance component of the portfolio; (2) the identity of the Funds' service providers; (3) the manner in which Respondents would value the portfolio positions; and (4) the concentration of the Funds' assets. In similar circumstances, investment advisers and fund managers have been found in violation of the antifraud provisions of the Advisers Act based on misrepresentations regarding, among other things, valuations of funds' portfolios, concentrations of assets, and manipulation of assets in the portfolio. *See e.g., Lauer*, 2008 U.S. Dist. LEXIS 73026 at *77-78; *Seghers*, 2006 U.S. Dist. LEXIS 69293 at *3-5 *Evergreen,* 2009 SEC LEXIS 1853 *31-32.

Finally, by repeatedly favoring Belesis's and JTF's pecuniary interests over those of the Funds (including by negotiating and/or approving investment banking agreements that paid JTF excessive fees and fees for performing no services), Respondents breached their fiduciary

obligations to the Funds. By allowing Belesis and JTF to influence certain decisions on behalf of the Funds as to the disposition of certain Funds' assets, Respondents further violated their fiduciary duty to the Funds. The fact that Jarkesy actively sought to maximize Belesis's and JTF's fees was never disclosed in the offering documents. Nor did Jarkesy and JTCM disclose that they would permit Belesis to drive utilization of the Funds' assets, a decision that was directly contrary to Jarkesy's supposedly exclusive role as manager of the Funds. Based on the foregoing Respondents are liable under the Advisers Act. *See Tambone*, 550 F.3d at 146; *Batterman*, 2002 U.S. Dist. LEXIS 18556 at *23.

III. Respondents Should Receive Maximum Sanctions

The Division seeks the following relief against Respondents: (i) censure pursuant to Section 203(e) of the Advisers Act; (ii) an order directing Respondents to cease and desist from committing or causing violations and any 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, pursuant to Section 8A of the Securities Act, Section 21C(a) of the Exchange Act, and Section 203(k) of the Advisers Act; (iii) disgorgement, pre-judgment interest, and third-tier penalties on a joint and several basis, pursuant to Section 21B(a) and (e) and 21C(e) of the Exchange Act, Section 8A(e), (g) of the Securities Act, and Section 203(i)-(j) of the Advisers Act; (iv) permanent officer and director bars against Jarkesy pursuant to Section 20(d)(2) of the Exchange Act and Section 20(e) of the Securities Act; (v) permanent collateral bars against Jarkesy pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), Section 15(b) of the Exchange Act, and Section 203(f) of the Advisers Act; (vi) permanent penny stock bars against

Jarkesy pursuant to Section 21(d) of the Exchange Act and Section 20(g) of the Securities Act; and (vii) an accounting of all JTCM operations and investments.

In *In the Matter of Daniel Bogar*, 2013 SEC LEXIS 2235 (Initial Decision, Aug. 2, 2013) (Foelak, ALJ), this Hearing Officer stated that "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." *Id.* at *79 (*citing Steadman v. SEC*, 450 U.S. 91, 97-104 (1981). "The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation." *Id.* at *80 (*citing Marshall E. Melton*, 56 S.E.C. 695, 698 (2003).) "Additionally, the Commission considers the extent to which the sanction will have a deterrent effect." *Id.* (*citing Schield Mgmt. Co.*, Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & 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." *Id.* (*citing Christopher A. Lowry*, 55 S.E.C. 1133, 1145 (2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, 46 S.E.C. 78, 100 (1975)).

Based on these factors, Respondents should receive the most severe sanctions available. Their conduct was egregious and they had a high degree of scienter. Their conduct took place starting in 2007 and continues through today. Respondents have not accepted or recognized the wrongful nature of their conduct. Indeed, at no point during the hearing, did Jarkesy even suggest that he did anything wrong. To the contrary, Jarkesy blamed investor losses on the financial meltdown and credit crunch and on the failure of JTF to raise sufficient capital for

portfolio companies. Jarkesy also sought to blame others by repeatedly stating during the hearing that he did not value the positions – that the values came from others – and that he was not responsible for the financial statements or their notes. Jarkesy's attempt to place the blame on others underscores his culpability. *Leaddog Capital Markets*, 2012 SEC LEXIS 2918 at *45.

In addition, the fraudulent conduct was recent and the harm to investors was significant. Millions of dollars of investor funds were squandered and lost. Jarkesy cannot even quantify the amount of the loss even though he continues to claim that the Funds are still in existence. Moreover, Jarkesy's occupation presents further opportunity for future violations. He is highly engaged in the securities industry. In addition to the Funds, he provides investment advice through his syndicated radio show and through the National Eagles and Angels Association, which he chairs. As such, he has ample opportunity to commit future violations even though he claimed at the hearing that he has no present intention to manage any funds in the future.

A. Respondents Should Receive a Cease and Desist Order

The showing required to obtain a cease and desist order is "significantly less than that required for an injunction." *In the Matter of Fields*, 2012 SEC LEXIS 3747 *43 (Initial Decision, Dec. 5, 2012) (Foelak, ALJ). As described above, based on the *Steadman* factors, a cease and desist order is warranted. *See In the Matter of Koch*, 2012 SEC LEXIS 1645 * 43-44 (Initial Decision, May 24, 2012) (Foelak, ALJ) (Respondents' conduct was egregious and recurrent over a period of three months. 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. Koch's chosen occupation in the financial industry will present opportunities for future violations).

B. Respondents Should Pay Disgorgement, Interest, and Penalties

In addition to the censure and the cease and desist order, the Division seeks disgorgement, penalties, and prejudgment interest. In *In the Matter of Gerasimowicz*, 2013 SEC LEXIS 2019 *6 (Initial Decision July 12, 2013) (Foelak, ALJ), this Hearing Officer described the standard for ordering monetary relief. "Sections 8A(e) of the Securities Act, 21B(e) of the Exchange 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." With respect to advisors such as Respondents, "[m]anagement and incentive fees are appropriately disgorged where they constitute ill-gotten gains earned during the course of fraudulent activities. However, the Commission distinguishes between amounts earned through legitimate activities and those connected to violative activities, and it falls on the Division to show what a reasonable approximation of the fees constituted unjust enrichment." *Id* at *6-7 (internal citations omitted). "The amount of the disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation." Id. at *7 (internal citations omitted). After the Division meets its burden, "the burden shift[s] to Respondents to demonstrate that a lesser amount was appropriate." *Id.* at *11. Once disgorgement is ordered, prejudgment interest shall be paid. *Id.* at *14. Pursuant to 17 C.F.R. § 201.600(a), interest shall be due from the first day of the month following the violation . . . through the last day of the month preceding the month in which payment of disgorgement is made." *Id.* at *15 n.7.

In this case, the Division is seeking an order for Respondents to disgorge all of the incentive fees Respondents paid themselves (approximately $260,000) plus the $1.3 million in management fees that Respondents received for "managing" a fraudulent operation. The

incentive fees would not have been earned by Respondents had they accurately valued the positions. Moreover, Respondents would not have been able to attract investors (and obtain the management fees) had their disclosures (including concerning the risk associated with the investment) not been fraudulent. *Leaddog Capital Markets*, 2012 SEC LEXIS 2918 *51-52 (ordering disgorgement of management fees).

With respect to penalties, "Sections 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 violations of the Securities, Exchange, Advisers, or Investment Company Acts or rules thereunder. Six factors are to be considered when determining whether a penalty is in the public interest: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require." *Gerasimowicz*, 2013 SEC LEXIS 2019 at *16. In this case, multiple units of third-tier penalties should be ordered, particularly in light of the nature of the conduct, the number of Funds harmed, the number of investors harmed, and the amount of the loss. Units of third-tier penalties are $150,000 for natural persons (including Jarkesy) and $725,000 for other persons (including JTCM). 17 C.F.R. § 201.1004.

In *Gerasimowicz*, penalties were determined by multiplying the statutory third-tier penalty by the number of fund investors harmed by the conduct. *Id.* at *18 (*citing Steven E. Muth*, 58 S.E.C. 770, 813 (2005) ("we believe that a civil money penalty based on the number of customers that [the respondent] defrauded . . . is appropriate."); *see also SEC v. Glantz*, 94 CV 5737, 2009 U.S. Dist. LEXIS 95350 *17 (S.D.N.Y. Oct. 13, 2009) (multiplying the penalty by the number of victims); *SEC v. Milan Capital Group, Inc.*, 00 Civ. 0108, 2001 U.S. Dist. LEXIS 11804 (SDNY 2001) (multiplying the penalty by each of the 200 defrauded investors, resulting in a $10 million penalty); *SEC v. Kenton Capital Ltd.*, 69 F. Supp.2d1, 17 & n.15 (D.D.C. 1998)

(assessing a $1.2 million penalty calculated by "multiplying the maximum third tier penalty for natural persons ($100,000) by the number of investors who actually sent money to [defendant] (12)"). In this case, Jarkesy testified that there were more than ninety investors in Fund I and a document produced by Respondents and offered into evidence by the Division (but not admitted) shows that there were at least 103 investors harmed by the conduct. Thus, it would be appropriate for the Hearing Officer to issue a penalty equaling ninety times the statutory amount and up to 103 times the statutory amount.

Alternatively, the Hearing Officer might calculate the penalty by multiplying the statutory amount by the number of false statements. Because each monthly account statement starting in March 2009 was fraudulently inflated (based upon the first use of the 15% NPV calculation), it would be appropriate to multiply the statutory penalty by a large number. In addition to the false account statements there were numerous additional false and misleading marketing materials and periodic investor communications. *SEC v. Pentagon Capital Mgmt., PLC*, 725 F.3d 279, 288 n. 7 (2d Cir. 2013) ("although we vacate the civil penalty award, we find no error in the district court's methodology for calculating the maximum penalty be counting each trade as a separate violation"); *SEC v. Coates*, 137 F. Supp.2d413, 430 (S.D.N.Y. 2001) (multiplying the penalty amount by the number of violations); *In the Matter of Gualario & Co.*, LLC, 2012 SEC LEXIS 497, *55-56 (Feb. 14, 2012) (multiplying the statutory penalty by three (representing the operation of the fund, and the sale of two notes)).

C. Jarkesy Should Receive Collateral Bars

The Division also seeks bars against Jarkesy from association with brokers, dealers, investment advisers, municipal securities dealers, municipal advisors, transfer agents, nationally recognized statistical rating organizations, and investment companies. Such collateral bars are authorized under Sections 15(b) of the Exchange Act and 203(f) of the Advisers Act.

Respondents may argue that the Division cannot obtain collateral bars because most of their conduct pre-dates the effective date of the Dodd-Frank Act. This argument was specifically rejected in *Bogar*, where this Hearing Officer ruled:

> While Respondents' misconduct antedates the July 22, 2010, effective date of the Dodd-Frank Act, the Commission has determined that sanctioning a respondent with a collateral bar for pre-Dodd-Frank wrongdoing is not impermissibly retroactive, but rather provides prospective relief from harm to investors and the markets. *John W. Lawton*, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722; *see also Alfred Clay Ludlum, III*, Advisers Act Release No. 3628 (July 11, 2013); *Johnny Clifton*, Securities Act Release No. 9417 (July 12, 2013); *Tzemach David Netzer Korem*, Exchange Act Release No. 70044 (July 26, 2013).

2013 SEC LEXIS 2235 at *89 n.40; *see also In the Matter of Siris*, 2012 SEC LEXIS 4075 *13 n.3 (Initial Decision, Dec. 31, 2012) (Foelak, ALJ); *In the Matter of Seeley*, 2013 SEC LEXIS 3156 * 34-35 (Initial Decision, Oct. 9, 2013); *In the Matter of Constantin*, 2013 SEC LEXIS 3134 *5 n.3 (Initial Decision, Oct. 4, 2013).

The fact that Respondents were not engaged in all of these activities during the time that they engaged in the fraud is also not a barrier to imposing the collateral bars. *See LeadDog Capital Markets*, 2012 SEC LEXIS at *57 n.22. Indeed, the collateral bars are particularly appropriate where, as here, the violators are fiduciaries and "their abuse of the trust placed in them is particularly reprehensible." *Id.* at *57.

D. Jarkesy Should Receive Penny Stock and Officer and Director Bars

The Division also seeks orders barring Jarkesy from engaging in penny stock activity and from serving as an officer or director of a public company. Since the fraud at issue concerned numerous "penny stocks," including America West and Radiant, a penny stock bar is particularly appropriate. Likewise, since Jarkesy was an officer and director of several of the portfolio companies that were fraudulently overvalued and used his power as an officer and director of these companies to inappropriately direct money to Belesis and JTF, he should be barred from serving as an officer and director.

Section 21(d)(2) of the Exchange Act provides that officer and director bars are appropriate where "the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer." Even if Jarkesy's fraudulent conduct was unrelated to his activities as an officer and director, his conduct to his fiduciaries and investors demonstrates "unfitness." Jarkesy's securities laws violations were egregious. And he was not a low-level employee taking directions from higher ranking individuals. As Jarkesy stated in his Answer to the OIP, "Jarkesy does not 'purportedly' control all operations and activities of JTCM and the Funds because, in fact, he does control all operations, etc." Jarkesy had an economic stake in the violations receiving fees, he directed the fraud, and he had a high degree of scienter.

CONCLUSION

For the reasons set forth in this memorandum, the Division respectfully requests that the Hearing Officer find that Respondents violated 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. The Division also respectfully requests that the Hearing Officer grant all of the requested relief against Respondents.

Dated: April 7, 2014

Respectfully Submitted,

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