Valerie Szczepanik
Alexander Janghorbani
Gwen A. Licardo
Securities and Exchange Commission
New York Regional Office
200 Vesey Street, Suite 400
New York, New York 10281-1022
(212) 336-0177 (Janghorbani)
JanghorbaniA@sec.gov

14 MISC 257

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Applicant,	:	
- against -	:	**Case No. _____**
	:	
JOSEPH D. STILWELL,	:	**ECF CASE**
	:	
Respondent.	:	

SECURITIES AND EXCHANGE COMMISSION'S APPLICATION FOR AN ORDER TO SHOW CAUSE AND FOR AN ORDER REQUIRING JOSEPH D. STILWELL'S COMPLIANCE WITH ITS SUBPOENA

The Securities and Exchange Commission ("Commission"), by its undersigned counsel, respectfully submits this Application for an Order to Show Cause and for an Order Requiring Compliance with a Subpoena ("Application"), together with the supporting Memorandum of Law and Declaration of Gwen A. Licardo ("Licardo Decl.") and exhibit thereto, based on the following:

1. Joseph D. Stilwell ("Respondent") has refused to comply with a lawful Commission investigative subpoena, seeking his testimony ("Subpoena"). The Subpoena requires Respondent to provide sworn testimony to the Commission in the Commission's

investigation titled In the Matter of Stilwell Value, LLC (NY-8850) (the "Stilwell Investigation").

2. On November 27, 2012, the Commission issued an Order Directing Private Investigation and Designating Officers to Take Testimony (the "Formal Order") pursuant to Section 20(a) of the Securities Act of 1933 ("Securities Act"), Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 209(a) of the Investment Advisers Act of 1940 ("Advisers Act").

3. The Formal Order designates certain individuals as officers of the Commission empowered to subpoena witnesses, to take evidence, and to require the production of any records deemed relevant or material to the investigation, pursuant to Section 19(c) of the Securities Act, Section 21(b) of the Exchange Act, and Section 209(b) of the Advisers Act.

4. On June 18, 2014, one of the designated Commission officers properly issued the Subpoena to Respondent in connection with the Stilwell Investigation. The Commission staff properly served the Subpoena on Respondent, pursuant to the Commission's Rules of Practice.

5. The Subpoena required Respondent to appear for sworn testimony on July 15, 2014. Per agreement with Respondent, the date for his appearance to provide testimony was ultimately set for August 6, 2014.

6. On August 4, 2014, Respondent's counsel informed the Commission staff in writing that Respondent did not intend to provide testimony in response to the Subpoena. To date, Respondent has not provided testimony in response to the Subpoena.

7. The Commission therefore submits this Application for an Order to Show Cause, in the form attached, requiring Respondent to show cause why he should not be ordered to

appear for sworn testimony at the Commission's New York Regional Office, Brookfield Place, 200 Vesey Street, New York, New York 10281.

8. The Commission further requests that, absent just cause for Respondent's failure to comply with the Subpoena, the Court enter an order requiring Respondent to comply with the Subpoena within fifteen (15) days.

9. The Court has jurisdiction over this matter and venue properly lies within the Southern District of New York, pursuant to Section 21(a) of the Exchange Act and Section 209(c) of the Advisers Act, which provide as follows: "In case of . . . refusal to obey a subpoena issued to[] any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on . . . in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records…and any failure to obey such order of the court may be punished by such court as a contempt thereof." 15 U.S.C. § 78u(c); 15 U.S.C § 80b-9(c).

10. The Court also has jurisdiction over this matter and venue also properly lies pursuant to Section 22(b) of the Securities Act, which provides as follows: "In case of . . . refusal to obey a subpoena issued to any person, any of the said United States courts, within the jurisdiction of which said person guilty of . . . refusal to obey is found or resides, upon application by the Commission . . . ." 15 U.S.C. § 77v(b).

WHEREFORE, the Commission respectfully requests that the Court:

I.

Enter an Order to Show Cause, directing Respondent to show cause why this Court should not enter an Order directing Respondent to provide sworn testimony;

II.

Enter an Order requiring Respondent to comply fully with the Subpoena within fifteen (15) days; and

III.

Order such other and further relief as may be necessary and appropriate to achieve compliance with the Subpoena within the time period set forth in the proposed Order to Show Cause.

Dated: August 13, 2014
New York, New York

SECURITIES AND EXCHANGE COMMISSION

By: _____

Alexander Janghorbani
Valerie Szczepanik
Gwen A. Licardo
ATTORNEYS FOR THE APPLICANT
New York Regional Office
Brookfield Place, 200 Vesey St., Room 400
New York, New York 10281
(212) 336-077 (Janghorbani)
JanghorbaniA@sec.gov

Of Counsel: Julie M. Riewe
(Admitted only in the District of Columbia)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Applicant,	:	
- against -	:	**Case No. _____**
	:	
JOSEPH D. STILWELL,	:	**ECF CASE**
	:	
Respondent.	:	

[PROPOSED] ORDER TO SHOW CAUSE

WHEREAS, the Securities and Exchange Commission ("Commission") has applied for an order directing Joseph D. Stilwell ("Respondent") to show cause why he should not be ordered to appear and provide sworn testimony at the Commission's New York Regional Office, Brookfield Place, 200 Vesey Street, New York, New York 10281 as called for by the Commission's investigative subpoena, dated June 18, 2014 (the "Subpoena");

WHEREAS, the Court has considered the application filed by the Commission and the memorandum of law and declaration, with exhibits, filed in support of the application;

WHEREAS, based upon these documents, the Court is satisfied that the Commission has made a sufficient and proper showing in support of the relief sought in its application, and therefore:

I.

IT IS HEREBY ORDERED that Respondent shall appear before this Court at _____m. on _____ ____, 2014 in Room _____ of the United States Courthouse, 40 Foley Square, New York, New York 10007, to show cause why the Court should not issue an Order:

(a) directing Respondent to appear for sworn testimony no later than _____ ____, 2014

(b) directing that, in the event that Respondent does not appear for sworn testimony:

(i) the Commission will have established a prima facie case of civil contempt against Respondent for his failure to comply with the Order;

(ii) that Respondent may be held in civil contempt for failure to comply with that Order without further notice or hearing; and

(c) granting the relief in paragraphs (a) and (b) in the event that Respondent fails to appear before this Court at the date and time set forth above.

II.

IT IS FURTHER ORDERED that a copy of this Order and the papers supporting the Commission's application be served upon Respondent by mailing the papers on or before _____ ____, 2014 using United Parcel Service overnight delivery or any other overnight delivery service.

III.

IT IS FURTHER ORDERED that Respondent shall file and serve any opposing papers in response to the application no later than _____ ____, 2014. Service shall be made by delivering the papers by that date to Alexander Janghorbani, Esq., at the Commission's New

York Regional Office via email at JanghorbaniA@sec.gov. The Commission shall have until _____ ____, 2014 to serve any reply papers on Respondent by mailing the papers on or before that date using United Parcel Service overnight delivery or any other overnight delivery service.

SO ORDERED.

Dated: _____, 2014
New York, New York

_____
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Applicant,	:	14MISC257
- against -	:	Case No.
JOSEPH D. STILWELL,	:	ECF CASE
Respondent.	:	

MEMORANDUM OF LAW IN SUPPORT OF SECURITIES AND EXCHANGE COMMISSION'S APPLICATION FOR AN ORDER TO SHOW CAUSE AND FOR AN ORDER REQUIRING JOSEPH D. STILWELL'S COMPLIANCE WITH ITS SUBPOENA

Valerie A. Szczepanik
Alexander Janghorbani
Gwen Licardo
Securities and Exchange Commission
Brookfield Place
New York Regional Office
200 Vesey Street, Suite 400
New York, New York 10281-1022
(212) 336-0177 (Janghorbani)
JanghorbaniA@sec.gov

Of Counsel: Julie M. Riewe
(Admitted only in the District of Columbia)

August 13, 2014

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Other Authorities

The Securities and Exchange Commission (the "Commission") respectfully submits this memorandum of law in support of its Application for an Order to Show Cause and for an Order Requiring Joseph D. Stilwell's Compliance with its Subpoena. For the reasons discussed below and in the accompanying Declaration of Gwen A. Licardo ("Licardo Decl."), the Commission respectfully requests that the Court enter an order directing Joseph D. Stilwell ("Respondent") to comply with the investigative subpoena the Commission has lawfully issued.[1]

PRELIMINARY STATEMENT

The Commission is investigating whether Respondent and Stilwell Value, LLC ("Stilwell Value")—the registered investment adviser and fund manager that Respondent owns and operates—violated the federal securities laws. Specifically, the Commission is investigating whether Respondent, Stilwell Value, and possibly others, made materially false and misleading statements and omissions to their investors, the funds they managed (the "Stilwell Funds" or "Funds"), and the Commission concerning a host of undisclosed or improperly disclosed inter-fund loans. The Commission staff initially took investigative testimony from Respondent in July 2013. Respondent testified about seven inter-fund loans, but disclaimed knowledge of any others. Nearly a year later—in approximately Spring 2014—the Commission staff discovered evidence of approximately 13 additional inter-fund and related-party loans, dating back to approximately 2003. The Commission staff subsequently issued a new subpoena for Respondent's testimony.

---

[1] The Commission may proceed by order to show cause in a subpoena enforcement action. Motions to enforce administrative subpoenas "may be summary in nature." SEC v. Knopfler, 658 F.2d 25, 26 (2d Cir. 1981). "Summary proceedings may be 'conducted without formal pleadings, on short notice, without summons and complaints, generally on affidavits, and sometimes even ex parte.'" SEC v. Vindman, 06 Civ. 14233 (LTS) (THK), 2007 WL 1074941, at *1 (S.D.N.Y. Apr. 5, 2007).

Respondent has refused to comply with that subpoena. He contends that because "all of the relevant charging decisions have been made" against him, the Commission no longer has "any investigative purpose" in taking his testimony. (Licardo Decl., Ex. 14 at 2.) This argument is meritless. First, as Respondent knows, (1) the Commission has not made any charging determinations; and (2) while the Commission's staff notified Respondent of its intention to recommend that the Commission institute a suit, it has not yet done so because it is still investigating. Second, there is no authority for the proposition that staff's mere intention to recommend suit divests the Commission of its authority to carry on a properly-authorized investigation into potential violations of the federal securities law. To the contrary, that the authority to conduct investigations lies with the Commission (and not its staff) is plain from the face of the empowering statutes and the case law. Indeed, the Commission's investigations are "not fully carried out until every available clue has been run down and all witnesses examined in every proper way to find out" if there has been a violation of the federal securities law. SEC v. Kaplan, 397 F. Supp. 564, 570-71 (E.D.N.Y. 1975) (quoting United States v. Stone, 429 F.2d 138, 140 (2nd Cir. 1970)).

Here, that investigation cannot be fully carried out precisely because of Respondent's refusal to appear. The Court should, therefore, issue an order compelling Respondent to provide testimony before the Commission staff.

STATEMENT OF FACTS

I. RESPONDENT

Joseph D. Stilwell is the principal owner and managing member of Stilwell Value, an investment adviser to the Stilwell Funds, a series of investment funds. (Licardo Decl. ¶ 4.) Stilwell founded his investment advisory business in 1993. (Id.) Stilwell Value registered as an

investment adviser with the Commission in February 2012. (Id.) According its Form ADV filed with the Commission on January 15, 2014, Stilwell Value manages over $210 million in assets in the various Stilwell Funds. (Id., Ex. 2 at 9.)

II. THE COMMISSION'S EXAMINATION OF STILWELL VALUE

On July 24, 2012, the Commission's Office of Compliance Inspections and Examinations ("OCIE") commenced an examination of Stilwell Value.[2] (Id. ¶ 6.) During the course of its examination, the OCIE staff identified four inter-fund loans between various Stilwell Funds. (Id. ¶ 7.)

III. THE COMMISSION'S INVESTIGATION

On November 27, 2012, the Commission issued an Order Directing Private Investigation and Designating Officers to Take Testimony (the "Formal Order"), pursuant to Section 20(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(a)], Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78u(a)], and Section 209(a) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. § 80b-9(a)]. (Id. ¶ 8.) The Formal Order designates certain individuals as officers of the Commission empowered to, among other things, subpoena witnesses and require the production of any records deemed relevant or material to the investigation.[3] (Id.)

To date, the Commission staff has obtained information that tends to shows that Respondent, Stilwell Value, and others may have, among other things, (1) failed to disclose the

---

[2] OCIE is responsible the Commission's "nationwide examination and inspection program" and "conduct[s] examinations of the nation's registered entities, including . . . investment advisers . . . ." About the Office of Compliance Inspections and Examinations, available at http://www.sec.gov/ocie (cite last visited on Aug. 10, 2014).

[3] See Securities Act, § 19(c) [15 U.S.C. § 77s(c)]; Exchange Act, § 21(b) [15 U.S.C. § 78u(b)], and Advisers Act, § 209(b) [15 U.S.C. § 80b-9(b)] (authorizing Commission to designate officers for investigations).

existence of—and conflicts of interest created by—the inter-fund loans; (2) failed to disclose that Respondent allowed one of the borrower Funds to default repeatedly on interest and principal due under certain of the loans; and (3) failed to disclose that Respondent repeatedly failed to make good on his written personal guarantee of the defaulted loans. (Id. ¶ 5.)

IV. THE INVESTIGATIVE SUBPOENAS

A. The Initial Investigative Subpoenas

On December 18, 2012, the Commission served a subpoena on Stilwell Value, calling for documents relating to the inter-fund loans. (Id. ¶ 14, Ex. 6.) Stilwell Value produced documents in response to the subpoena. One of those documents, produced on February 15, 2013, was entitled "Stilwell Funds Intercompany Loans November 2008 to December 2012," and contained a schedule of five inter-fund loans exceeding $8 million ("February 2013 Loan Schedule"). (Id. ¶ 14; Ex.7 at 3-4.)

The staff initially took testimony from Respondent on July 2, 2013, pursuant to a subpoena, dated May 31, 2013. (Id. ¶ 15; Ex. 8.) Respondent testified about the inter-fund loans between the Stilwell Funds. He indicated that he believed the February 2013 Loan Schedule reflected "a summary of all the loans, interfund loans . . . from the beginning of our time through the present." (Id. ¶ 16; Ex. 1 at 75-76.) The staff also asked Respondent whether he made *any* transfers between the Stilwell Funds:

> Q. Did you ever from time to time transfer funds between -- transfer money between the accounts of the different funds, even for a short period of time?
> A. Not that I recall. I mean, I just don't see what the point would be even.

(Id. ¶ 17; Ex. 1 at 171.)

B. The Staff Notifies Respondent and Stilwell Value of its Preliminary Determination to Recommend that the Commission Institute an Action Against Them

On October 23, 2013, the Commission staff notified Respondent's counsel that it had made a preliminary determination to recommend that the Commission file an enforcement action against Respondent and Stilwell Value, including for violations of certain antifraud provisions of the Advisers Act (later supplemented to include the Exchange Act).[4] (Id. ¶¶ 19, 20; Exs. 10, 11.) Such a notification is known as a "Wells Notice," and

> identifies the securities law violations that the staff has preliminarily determined to include in the recommendation and . . . provides notice that the person may make a submission to the Division [of Enforcement] and the Commission concerning the proposed recommendation.

(Id. ¶ 18; Ex. 9 at 22 (Division of Enforcement, Enforcement Manual, § 2.4). The staff's preliminary determination was based on the seven inter-fund loans that it was then aware of. (Id. ¶ 22.)

Respondent made a submission ("Wells Submission") to the Commission staff setting forth their view of why such charges would be inappropriate on December 4, 2013. (Id. ¶ 23.)

C. The Staff Learns of Additional Inter-fund Loans and Transfers

Following the issuance of the Wells Notices, the Commission staff continued to investigate the inter-fund loans. (Id. ¶ 24.) In approximately Spring 2014, the staff learned—from another source—of the possible existence of additional inter-fund loans. (Id.) On April 15, 2014, the staff served an additional subpoena duces tecum on Stilwell Value calling for

[4] Specifically, the staff notified Respondent that it had preliminarily determined that he and Stilwell Value violated Advisers Act Sections 206(1), 206(2), 206(4), and 207 and Rules 206(4)-2, 206(4)-7, and 206(4)-8, thereunder. (Id. ¶ 19; Ex. 10.) On April 3, 2014, the staff supplemented the Wells Notices to include potential violations of Exchange Act Section 10(b) and Rule 10b-5. (Id. ¶ 20; Ex. 11.)

documents concerning inter-fund loans, in addition to the seven of which the staff was already aware. (Id. ¶ 26; Ex. 12.)

From May 16 through June 5, 2014, Stilwell Value produced documents responsive to the new subpoena. (Id. ¶ 28.) One such document—entitled "Schedule of Potential Loan Activity"—included what appeared to be an additional 13 inter-fund and related-party loans in excess of $13 million. The Commission staff was unaware of these loans prior to receipt of this document. (Id. ¶ 28; Ex. 13 at 2.) The staff has also developed additional evidence concerning, for example, Respondent's scienter in failing to disclose the inter-fund loans accurately. (Id. ¶ 27.)

D. The Investigative Subpoena at Issue Here

On June 18, 2014, the Commission staff served a subpoena ad testificandum (the "Subpoena") calling for Respondent's testimony in light of the newly-produced evidence of additional inter-fund loans and other documents. (Id., Ex. 4.) By agreement with Respondent, the staff adjourned Respondent's testimony to August 6, 2014. (Id. ¶ 34.) At no time before August 4, 2014 (see infra) did Respondent raise any objection to the Subpoena. (Id. ¶ 35.)

E. Settlement Negotiations

Respondent requested that—prior to the staff's making any recommendation to the Commission—the staff meet with Respondent's counsel to discuss the legal and evidentiary theories of the case and possible settlement. (Id. ¶ 30.) The staff afforded Respondent two such in-person meetings. The first meeting, held on July 8, 2014, included the investigative staff and the Co-Chief of the Division of Enforcement's Asset Management Unit. (Id. ¶ 31.) At that meeting, the staff made a presentation to counsel concerning its evidentiary and legal theories. (Id.) At the beginning of that meeting, the staff notified counsel that it was still investigating the

newly-discovered loans, was unprepared to make detailed conclusions concerning those loans, and intended to continue its investigation (which included taking testimony from Respondent pursuant to the Subpoena). (Id. ¶ 32.) Respondent's counsel made no objection. (Id.) At counsel's request, the second meeting, on July 11, 2014, was attended by the Director of the Division of Enforcement. (Id. ¶¶ 32, 33.) Again, at no point in time did Respondent indicate that he viewed his appearance for testimony as somehow conditional upon satisfactory settlement negotiations with the staff or the Commission. (Id. ¶ 35.) By July 24, 2014, the staff and Respondent's counsel agreed that further settlement talks would not be productive. (Id. ¶ 36.)

To date, the staff has not made any recommendation to the Commission concerning Respondent. (Id. ¶ 43.) Moreover, the Commission has not made any determination as to whether to initiate an action, and no such action has been instituted. (Id. ¶ 44.)

F. Respondent Refuses to Appear for Testimony Pursuant to the Subpoena

On August 4—two days before his testimony was scheduled to take place—Respondent's counsel notified the staff that Respondent would not appear for testimony. (Id. ¶ 37; Ex. 14.) Counsel's letter stated that it was their belief that the staff "intended to file charges against Mr. Stilwell" and that:

> [w]here all of the relevant charging decisions have been made, we fail to see how Mr. Stilwell's testimony serves any investigative purpose.

(Id., Ex. 14 at 2.)

On August 5, the staff informed Respondent's counsel, both by telephone and email, that Respondent's refusal to appear was unjustified. (Id. ¶¶ 38, 39; Ex. 15 at 2.) The staff reiterated to counsel (1) that the staff has no authority to file charges, as only the Commission may do so; (2) that the Commission had made no determination whether to file charges; and (3) that Respondent was free to recommend his own settlement offer directly to the Commission for its

consideration. (Id. ¶ 39; Ex. 15 at 2.) The staff also informed Respondent's counsel that it intended to proceed with Respondent's testimony as scheduled. (Id., Ex. 15 at 2.) Respondent's counsel again confirmed that Respondent would not appear and noted that, in their view, there was no equitable reason for him to obey the Subpoena because "we are now in a litigation posture in the wake of the breakdown of our negotiations." (Id. ¶ 40, Ex. 15 at 1.)

Respondent failed to appear for testimony as scheduled on August 6, 2014. (Id. ¶ 41.) As a result, the Commission staff has been unable to complete its investigation. (Id. ¶ 42.)

ARGUMENT

The Commission properly served the Subpoena on Respondent in order to investigate numerous indications of potential securities fraud, including potential conduct that the Commission's staff learned of only recently. The Court should order Respondent to comply promptly with the Subpoena. Respondent's excuse for failing to comply—that the Commission has divested itself of its power to issue the Subpoena because "all of the relevant charging decisions have been made" (Licardo Decl., Ex. 15 at 2)—is contradicted by both the facts and law.

I. THE SUBPOENA IS WELL WITHIN THE COMMISSION'S BROAD INVESTIGATIVE AUTHORITY

The Commission has "broad authority to conduct investigations into possible violations of the federal securities and to demand the production of evidence relevant to such investigations." SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735, 741 (1984); see also Gabelli v. SEC, 133 S.Ct. 1216, 1222 (2013) ("[e]ven without filing suit, [the Commission] can subpoena any documents and witnesses it deems relevant or material to an investigation."). The statutes

authorizing the Commission's investigation are "not narrow, but extremely broad."[5] SEC v. F.N. Wolf & Co., Inc., 93 Civ. 0379 (LLS), 1993 WL 568717, at *1 (S.D.N.Y. Dec. 14, 1993). As the Court observed in SEC v. Kaplan,

> [The Commission's] investigation is not fully carried out until every available clue has been run down and all witnesses examined in every proper way . . . .

397 F. Supp. 564, 570-71 (E.D.N.Y. 1975) (quoting United States v. Stone, 429 F.2d 138, 140 (2nd Cir. 1970)).

In a proceeding to enforce an administrative subpoena, the Court's role "is extremely limited." RNR Enters., Inc. v. SEC, 122 F.3d 93, 96 (2d Cir. 1997) (citation omitted). To obtain enforcement of the Subpoena, the Commission need only demonstrate:

> [1] that the investigation will be conducted pursuant to a legitimate purpose, [2] that the inquiry may be relevant to the purpose, [3] that the information sought is not already within the Commission['s] possession, and [4] that the administrative steps required . . . have been followed.

Id. at 96-97 (quoting United States v. Powell, 379 U.S. 48, 57-58 (1964)). Moreover, "[a]n affidavit from a governmental official is sufficient to establish a prima facie showing that these requirements have been met." Id. at 97 (citation omitted). Once the Commission has made a prima facie showing, Respondent can defeat the enforcement of the Subpoena only by demonstrating that the Subpoena is "unreasonabl[e] or was issued in bad faith or for an improper purpose or that compliance would be unnecessarily burdensome." Id. (quoting SEC v. Brigadoon Scotch Distrib. Co., 480 F.2d 1047, 1056 (2d Cir. 1973)) (internal quotation marks

[5] Here, the Commission's investigation is undertaken pursuant to Section 20(a) of the Securities Act, Section 21(a) of the Exchange Act, and Section 209(a) of the Advisers Act. (See Licardo Decl., ¶ 8.)

omitted and emphasis in original). Here, the Commission easily satisfies each of the four requirements for enforcement of the Subpoena.

First, the investigation is being conducted pursuant to a legitimate purpose—namely, to determine whether any violations of the antifraud and other provisions of the federal securities laws have occurred. The Stilwell Investigation concerns possible false and misleading statements about approximately 20 inter-fund loans—approximately 13 of which the Commission learned of only in Summer 2014—months after Respondent initially testified in this investigation. The evidence collected to date suggests that Respondent (1) failed to disclose the existence of the inter-fund loans to investors and others; (2) inaccurately disclosed that he had allowed other loans to default; and (3) repeatedly stated that he had personally guaranteed some of the loans, while at the same time failing to act under those guarantees when he caused the borrower Fund to default. (Licardo Decl. ¶¶ 5, 12-13.) As investment advisers, and so, fiduciaries, Respondent and Stilwell Value had a duty of "[p]erfect candor, full disclosure, good faith, in fact, the utmost good faith, and the strictest honesty." In re Parmalat Sec.'s Litig., 684 F. Supp. 2d 453, 478 (S.D.N.Y. 2010). Thus, failure to fully and accurately disclose all potential and actual conflicts of interest may constitute violations of Advisers Act Sections 206(2), 206(4), 207, and Rule 206(4)-8 thereunder—and if done knowingly or recklessly, of Advisers Act Section 206(1) and Exchange Act Section 10(b) and Rule 10b-5 thereunder.[6]

[6] See Vernazza v. SEC, 327 F.3d 851, 859-60 (9th Cir. 2003) (upholding Commission's finding that "petitioners had a duty to disclose potential conflicts of interest accurately . . . ." and finding that "[i]t is indisputable that potential conflicts of interest are 'material' facts with respect to clients and the Commission.") (citation omitted); Steadman v. SEC, 603 F.2d 1126, 1130 (5th Cir. 1979) (potential conflicts can be material facts that advisers must disclose); SEC v. Slocum, Gordon & Co., 334 F. Supp. 2d 144, 183 (D.R.I. 2004) (even an innocent failure to disclose "potential conflict of interest" constitutes a violation of Section 206(2)).

Second, the information sought by the Subpoena—Respondent's testimony about these events—is highly relevant to the Commission's investigation. When asked by Commission staff during testimony, Respondent acknowledged the existence of only the inter-fund loans the Commission's staff had already discovered. (Licardo Decl. ¶¶ 16-17.) Indeed, when asked, Stilwell disclaimed knowledge of any other inter-fund loans or transfers. (See Id.; Ex. 1 at 75-76, 171.) In Spring 2014, the Commission staff learned, from another source, of the possible existence of many more loans.[7] (Id. ¶ 24.) In response to an additional administrative subpoena, Stilwell's counsel, on June 5, 2014, furnished the Commission staff with a "Schedule of Potential Loan Activity," showing more than 13 additional "Potential" inter-fund and related-party loans. (Id., Ex. 28; Ex. 13.) Respondent's testimony as the sole engineer of these transactions is needed to establish (1) the loans' true nature; and (2) the existence and degree of his scienter in engaging in (and not disclosing) these inter-fund transactions. At the very least, Respondent's testimony is needed to assess whether his original sworn statement that no other loans existed was merely mistaken or an intentional obfuscation. Such inquiries easily pass the minimal relevancy showing that is required of the Commission in a subpoena enforcement action.[8]

---

[7] While the Commission can provide greater detail on the new evidence to the Court in camera, it is not required to provide any greater detail to Respondent concerning its sources or evidence to prevail in its application to enforce the Subpoena. As the Supreme Court has stated, the Commission need not "lay[] bare the state of the Commission's knowledge and intentions midway through investigations" and "such exposure could significantly hamper the Commission's efforts to police violations of the securities laws." Jerry T. O'Brien, Inc., 467 U.S. at 750 n.23; see also Exchange Point LLC v. SEC, 100 F. Supp. 2d 172, 177 (S.D.N.Y. 1999) ("Further, identifying to Exchange Point by names or other indicia the entities or transactions specifically targeted by the investigation could result in advanced warning to potential targets and jeopardize the efficacy of the SEC's investigation").

[8] See Knopfler, 658 F.2d at 26 ("For the purpose of such an investigation the Commission may subpoena witnesses and require the production of such books and papers as it deems relevant or material to the inquiry") (emphasis added); Kaplan, 397 F. Supp. at 570 ("Where a

Third, the information sought is not already in the Commission's possession, as only Respondent can testify about his knowledge of events. Fourth, the Subpoena was issued in accordance with the required administrative steps. The Subpoena was issued by Commission staff authorized by the Formal Order to issue subpoenas in the Stilwell Investigation. See Exchange Action, § 21(b) [15 U.S.C. § 78u(b)]; Advisers Act, § 209(b) [15 U.S.C. § 80b-9(b)]; Securities Act, § 19(c) [15 U.S.C. § 77s(c)]. In addition, the Commission staff served the Subpoena on Respondent's counsel by overnight delivery using UPS. (Licardo Decl. ¶ 10; Ex. 5 (showing receipt of service).) The staff, therefore, properly served the Subpoena pursuant to the Commission's Rules. See 17 C.F.R. § 201.232(c) (allowing for services in SEC investigations pursuant to Rule 150); 17 C.F.R. §§ 201.150(b)-(c) (allowing for service on witness' counsel by commercial courier service).

II. RESPONDENT'S PROFFERED EXCUSE IS MERITLESS

Respondent's stated justification for refusing to appear—that because "all the relevant charging decisions have been made, we fail to see how Mr. Stilwell's testimony serves any investigative purpose" (Licardo Decl., Ex. 14 at 2)—is entirely without merit. Courts enforce administrative subpoenas "unless jurisdiction is plainly lacking." EEOC v. Federal Express Corp., 558 F.3d 842, 848 (9th Cir. 2009) (citation and quotation marks omitted). Moreover, the scope of the Commission's inquiry "is not to be limited narrowly by . . . forecasts of the probable result of the investigation." Kaplan, 397 F. Supp. at 569.

Here, the Commission has done nothing to divest itself of its jurisdiction to investigate potential violations of the federal securities law. Respondent's arguments to the contrary—

United States District Court is confronted with the necessity of making a determination of relevancy or materiality, it need only find that the documents sought are not plainly immaterial or irrelevant to the investigation") (citing Endicott Johnson Corp. v. Perkins, 317 U.S. 501, 509 (1943)) (other citations omitted).

which focus on just such an improper forecast of the investigation—have no foundation in the facts, the Commission's statutory authority and its practices, or the case law. Indeed, given the timing of his refusal to appear, Respondent's true motive seems to be his disappointment that the staff would not accede to recommend his settlement demands to the Commission, following settlement talks.[9]

First, Respondent's contention that charging decisions have been made is false. Only the Commission has the authority to determine whether to institute an action and what charges to bring. It has not done so here.[10] See Knopfler, 658 F.2d at 26 (to defeat an administrative subpoena, Respondent "must prove that the improper purpose is that of the Commission, not merely that of one of its investigators"). Rather, it was the Commission staff—which has the ability only to *recommend* charges to the Commission—that gave Respondent Wells Notices on October 10, 2013 and April 3, 2014 concerning the seven loans of which it was then aware.[11] (Licardo Decl. ¶¶ 18-22.) But even as to that preliminary determination, the staff has not yet recommended any action to the Commission. Thus, the Commission's investigation properly continues.

---

[9] See Section IV.E supra; see also Licardo Decl., Ex. 14 at 2 (Respondent informed the staff that he would not appear only after "[t]hose negotiations broke down . . . ."); Ex. 15 at 1 ("we have a good faith belief that the June 18 subpoena is no longer valid, and because we are now in a litigation posture in the wake of the breakdown of our negotiations" there are no equitable reasons to appear for the scheduled testimony).

[10] See Licardo Decl., Ex. 9, Securities and Exchange Commission Division of Enforcement, Enforcement Manual, Oct. 9, 2013 ("Enforcement Manual"), § 2.5.1 ("The filing or institution of any enforcement action must be authorized by the Commission"). The Enforcement Manual is a publicly-available document, "designed to be a reference for the staff of the U.S. Securities and Exchange Commission's . . . Division of Enforcement . . . in the investigation of potential violations of the federal securities laws." Id., § 1.1.

[11] The staff also informed Respondent that it has not completed its investigation concerning the newly-discovered transactions and evidence. (Licardo Decl. ¶ 32.) Thus, Respondent is aware that the staff has made no determination, preliminary or otherwise, as to any newly-discovered transactions and evidence.

In addition, the Commission's institution of an action (and, indeed, the parameters of any such action) is not a foregone conclusion. As the staff notified Respondent on multiple occasions, he may submit (1) his Well Submission, a document explaining why the Commission (not the staff) should not institute charges, and (2) any written offer of settlement for the Commission's consideration.[12] (Id., Ex. 15 at 2.) The objective of allowing a Wells Notice recipient such direct access to the Commission:

> is, as the Commission stated in the original Wells Release, for the Commission "not only to be informed of the findings made by its staff but also, where practicable and appropriate, to have before it the position of persons under investigation at the time it is asked to consider enforcement action."

(Id., Ex. 9 (Enforcement Manual, § 2.4 (quoting Securities Act of 1933 Rel. No. 5310, Sept. 27, 1972) (emphasis added).) Thus—while the staff remains unconvinced by Respondent's arguments against recommending charges—no recommendation has yet been made and the Commission may, in any event, choose not to authorize the institution of an action.

Second, the power to compel testimony pursuant to administrative subpoena likewise emanates from the Commission, not the staff. Thus, the staff's determination to recommend charges cannot divest the Commission of its power to issue administrative subpoenas or to investigate wrongdoing. That the power to investigate lies with the Commission is plain from the face of the relevant statutes:

---

[12] The Commission's Rules on Informal and Other Procedures set out the practice to direct any such submissions directly to the Commission on receipt. See Licardo Decl., Ex. 9, Enforcement Manual, § 2.4 ("[p]ersons who become involved in . . . investigations may . . . submit a written statement to the Commission setting forth their interests and position in regard to the subject matter of the investigation.") (quoting 17 C.F.R. § 202.5(c)); see also id., 15 at 2 (Email from Alexander Janghorbani to Steven Glaser, Aug. 5, 2014 ("[a]s we informed you two weeks ago, you may present a written settlement offer to the Commission for its consideration"); Exs. 10-11 (Wells notices).

> The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this title, the rules or regulations thereunder . . . .
>
> [. . .]
>
> For the purpose of any such investigation . . . any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance . . . .

Exchange Act, §§ 21(a)(1)&(b) [15 U.S.C. §§ 78u(a)(1) & (b)) (emphasis added).

Third, the courts have also determined that the Commission's investigative power survives, not only the Wells Notice, but also, in this Circuit, the Commission's actual determination to file suit. Thus, in SEC v. Sears, the court rejected a virtually identical argument to the one raised here. There, respondents argued they were excused from complying with a testimonial subpoena because, upon the staff's issuance of a Wells notice, the Commission "no longer has a valid basis for enforcing these subpoenas." 05 Civ. 728 (JE), 2005 WL 5885548, at *1 (D. Or. July 28, 2005) (Jelderks, M.J.). The court easily rejected that contention:

> A Wells notice is issued by SEC staff. It informs a person that the staff intends to recommend that the Commission charge that person with one or more violations of the securities laws. The person is thereby given an opportunity to submit responsive evidence or argument to the SEC-in the form of a "Wells submission"-before the Commission decides whether to accept the staff recommendation.
>
> The Sears point to no regulation that precludes the SEC from continuing with or reopening its investigation following issuance of a Wells notice. On the contrary, the information submitted in response to a Wells notice may prompt further inquiry by the agency staff before making a final recommendation. A Wells notice is more appropriately viewed as a preliminary recommendation that is being circulated for comment. Even when no Wells submission is made in response to the Wells notice, the agency may thereafter learn of additional facts that warrant investigation, or seek additional documents or testimony to confirm its preliminary understanding of the facts or to clarify any

lingering confusion.

Id., 2005 WL 5885548, at *2 (emphasis added).

The Second Circuit has reached the same conclusion in a similar context. In United States v. Frowein, the Customs Services sought to enforce its administrative summonses despite having already referred the case to the Department of Justice, which, in turn, had instituted a civil prosecution. 727 F.2d 227 (2d Cir. 1984). The subpoena recipients argued that "the district court was stripped of its jurisdiction to enforce the administrative summonses once the matter was referred to the Department of Justice for civil prosecution." Id. at 231. In rejecting that argument, the Second Circuit noted that the Customs Service's "investigatory stage" was not so "isolated" and that it could, thus, continue to investigate even after DOJ's implementation of suit. Id.; see also F.N. Wolf & Co., 1993 WL 568717, at *2 (finding that Commission could continue to issue investigative subpoenas even after it has instituted a civil action); Licardo Decl., Ex. 16 (SEC v. Badian, 06 Civ. 2621 (LTS) (JLC) (May 11, 2010), DE 144 (opinion upholding Magistrate Judge's determination that the Commission was authorized to use its investigative powers to obtain information from a foreign regulatory authority even after the Commission instituted litigation); Id., Ex. 17 (SEC v. Loyd, 8:02-cv-1613-T-26EAJ (RAL) (M.D. Fla. Dec. 2, 2002), DE 71 (opinion confirming that "even though [the Commission] has instituted this action against Defendants, it continues to enjoy the absolute right . . . to issue investigative subpoenas. . . ."); In re Stanley Plating Co., 637 F. Supp. 71, 73 (D. Conn. 1986) (EPA's administrative investigation was not foreclosed by the pendency of its civil suit).[13] It

[13] There is no dispute that the Commission has not instituted an action here. However—even where the issuance of an administrative subpoena is intended to aid inappropriately an already-filed litigation—the remedy is not to bar enforcement of the administrative subpoena, but to allow the trial court to address preclusion in that underlying action. See NLRB v. Bacchi, 04 MC 28 (ARR), 2004 WL 2290736, at *4 (June 17, 2004 E.D.N.Y.) (adopting Report and Recommendation stating that "[t]o the extent information is wrongfully obtained through an

would be highly incongruous if the Commission's ability to issue investigative subpoenas survived the filing of a civil suit, but could not be exercised to fully investigate transactions because the staff and Respondent failed to reach an early settlement after a Wells Notice was issued.[14] Thus, the Commission is plainly within its authority to continue its investigation where, as here, (1) the staff has made no recommendation to institute suit; (2) the Commission has not filed (or decided to file) an action; and (3) the staff is still investigating newly-discovered evidence.

Finally, the position Respondent urges would yield absurd results. First, under Respondent's logic, he is now entirely free to commit new violations of the federal securities laws safe in the knowledge that the Commission could not investigate those.

Second, Respondent's argument would only serve to reward gamesmanship. Here, Respondent received extensive process, including multiple meetings with Senior Officers of the staff to discuss the Commission's legal and evidentiary theories. At no point during this process did Respondent indicate that he would refuse to appear for his long-schedule testimony—which was, in fact, rescheduled until after these meetings with Respondents' agreement—or that he would argue that those meetings precluded the Commission from taking his testimony. However, it is exactly such preclusion that he now seeks. Indeed, should Respondent's view

---

investigative subpoena and used in a subsequent proceeding, 'the subpoenaed party remains free to challenge the use of that information in the appeal from that proceeding'" and "[t]hus, any concerns that enforcement of the subpoenas would result in improper discovery in the administrative proceeding should be address in that proceeding) (quoting Office of Thrift Supervision v. Dobbs, 931 F.2d 956, 959 (D.C. Cir. 1991)) (emphasis in originals).

[14] Respondent would apparently agree. After he received the staff's Wells Notice, he nonetheless produced numerous documents in response to subpoenas issued months after the staff gave him a Wells Notice. He, thus, plainly understands that merely informing Respondent of the staff's view of his conduct does not divest the Commission of its investigative powers. It was only after the staff indicated that it would not recommend Respondent's proposed settlement to the Commission that Respondent refused to comply with the Subpoena.

prevail, the Commission's staff would be blocked from exploring good-faith settlement talks until after an action was filed for fear that doing so would limit its ability to investigate fraud. This is an absurd result, as demonstrated by the fact that many of the Commission's investigations settle before litigation is ever commenced.[15] See SEC v. Everest Mgmt. Corp., 475 F.2d 1236, 1240 (2d Cir. 1972) ("The SEC can bring the large number of enforcement actions it does only because in all but a few cases consent decrees are entered.").

Third, Respondent's argument may incentivize witnesses in Commission investigations to hold back potentially-relevant information—as may have happened here—in the hopes that the Commission staff would not uncover additional evidence until after a preliminary recommendation was made on the already-discovered conduct. This outcome is hardly conducive to a just or efficient program of enforcement.

[15] One imagines that Respondent would simply be making the opposite complaint had the staff refused to give him extensive process in an effort to settle this investigation *before* recommending that the Commission institute a litigated action. His current argument would actually discourage just such open dialogue with the Commission staff. Compare Licardo Decl., Ex. 9, Enforcement Manual, § 2.5 at 25 (in deciding whether to provide evidence to a Wells recipient for review the staff is to consider "[w]hether access to portions of the file would be a productive way for both the staff and the recipient of the Wells notice to assess the strength of the evidence that forms the basis for the staff's proposed recommendations.") with Id. (limiting such dialogue where "[t]he prospective defendant or respondent failed to cooperate . . . or otherwise refused to provide information during the investigation").

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the Court (1) order Respondent to show cause why he should not comply with the Subpoena; and (2) order him to appear pursuant to the Subpoena to give full testimony about all matters relevant to this Investigation.

Dated: August 13, 2014
New York, New York

SECURITIES AND EXCHANGE COMMISSION

By: _____

Alexander Janghorbani
Valerie A. Szczepanik
Gwen Licardo
Attorneys for Applicant
Securities and Exchange Commission
New York Regional Office
Brookfield Place
200 Vesey Street, Suite 400
New York, New York 10281-1022
(212) 336-0177 (Janghorbani)
(703) 813-9504 (fax)
JanghorbaniA@sec.gov

Of Counsel: Julie M. Riewe
(Admitted only in the District of Columbia)