

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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2555/April 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of

JOHN BRINER, ESQ., DIANE DALMY, ESQ.,
DE JOYA GRIFFITH, LLC, ARTHUR DE JOYA, CPA,
JASON GRIFFITH, CPA, CHRIS WHETMAN, CPA,
PHILIP ZHANG, CPA, M&K CPAS, PLLC,
MATT MANIS, CPA, JON RIDENOUR, CPA, and
BEN ORTEGO, CPA

ORDER ON MOTION
FOR SUMMARY
DISPOSITION

The Securities and Exchange Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on January 15, 2015. A hearing is scheduled to begin on May 26, 2015, in Denver, Colorado.

Respondents De Joya Griffith, LLC, Arthur De Joya, Jason Griffith, Chris Whetman, and Philip Zhang (collectively, Movants) have moved for summary disposition with respect to the allegations that they violated Section 17(a) of the Securities Act of 1933. For the reasons stated below, I DENY Movants' motion.

1. Background

The Division's allegations concern audit reports Movants prepared for nine Form S-1 registration statements. *See* OIP at 7-9. Form S-1 is a form used to register sales of securities under the Securities Act. *See* 17 C.F.R. § 239.11. The Division believes Movants violated Securities Act Section 17(a) because Movants falsely stated that (1) they conducted each of their audits in accordance with the standards of the Public Company Accounting Oversight Board; and (2) the nine issuers' financial statements conformed with generally accepted accounting principles. *See* OIP at 27.

2. Legal Principles

A. Securities Act Section 17(a)

Securities Act Section 17(a) provides:

It shall be unlawful for any person in the offer or sale of any securities (including security-based swaps) or any security-based swap agreement (as defined in section 3(a)(78) of the Securities Exchange Act of 1934) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly--

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

15 U.S.C. § 77q(a).

In *John P. Flannery*, the Commission explained the interplay among paragraphs (1), (2), and (3).¹ Securities Act Release No. 9689, 2014 SEC LEXIS 4981 (Dec. 15, 2014). First, the Commission reaffirmed that “[a] showing of scienter is required under Section 17(a)(1), but a showing of negligence suffices under subsections (a)(2) and (a)(3).” *Id.* at *31. It also explained that Section 17(a) does not require that the conduct at issue “itself be ‘manipulative or deceptive’” in order to violate the Section’s proscription. *Id.* at *53. It then explained that the paragraphs in subsection (a) are “are ‘mutually supporting rather than mutually exclusive.’” *Id.* at *60 (quoting *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 1961 SEC LEXIS 385, at *14 (Nov. 8, 1961)). The paragraphs in subsection (a), therefore, do not “limit[]” or “narrow” the reach of their neighboring paragraphs. *Id.* at *59-60.

The Commission held that because Section 17(a)(1) prohibits the employment of “any device, scheme, or artifice to defraud,” it covers “all scienter-based, misstatement-related misconduct.” *John P. Flannery*, 2014 SEC LEXIS 4981, at *58. Because a single misstatement qualifies as “a ‘device’ or ‘artifice’ to defraud,” *id.* at *58, *62, anyone “who (with scienter)

¹ “Congress ordinarily adheres to [the] hierarchical scheme” found the House and Senate legislative drafting manuals. *Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 60 (2004). In the manuals, statutory sections are subdivided into subsections (beginning with small letters), paragraphs (beginning with arabic numbers), subparagraphs (beginning with capital letters), and clauses (beginning with romanette numerals). *Id.* at 60-61.

‘makes,’” “drafts[,] or devises” “a material misstatement in the offer or sale of a security has violated Section 17(a)(1),” *id.* at *58-59.

The Commission also clarified in *John P. Flannery* the similarities and differences between the requirements of Section 17(a) and Exchange Act Rule 10b-5. The Commission held that the reasoning in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), does not apply to Section 17(a)(2). *John P. Flannery*, 2014 SEC LEXIS 4981, at *32-36. In *Janus*, the Supreme Court interpreted Exchange Act Rule 10b-5(b), which makes it unlawful to “*make* any untrue statement of a material fact” in “connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b-5(b) (emphasis added). The Court held that because Rule 10b-5(b) used the word “make,” only a person with “ultimate authority” over an alleged false statement could be liable for violations of the Rule. 131 S. Ct. at 2302. Having reviewed the Court’s holding in *Janus*, the Commission clarified that in contrast to Rule 10b-5(b), liability under Section 17(a)(2) does not turn on whether a person “has ‘made’ a false statement.” *John P. Flannery*, 2014 SEC LEXIS 4981, at *33. “[L]iability instead turns on whether one has obtained money or property ‘by means of’ an untrue statement.” *Id.* As a result, liability under subsection (a)(2) may be premised on the *use* of a misstatement even if the user “‘has not himself made a false statement in connection with the offer or sale of a security.’” *Id.* at *33-34 (quoting *SEC v. Tambone*, 550 F.3d 106, 127-28 (1st Cir. 2008)).

With respect to Section 17(a)(3), the Commission found significant that, whereas Exchange Act Rule 10b-5(c) premises liability on “any *act*, practice, or course of business,” 17 C.F.R. § 240.10b-5(c) (emphasis added), Section 17(a)(3) premises liability on “any *transaction*, practice, or course of business,” 15 U.S.C. § 77q(a)(3) (emphasis added). *John P. Flannery*, 2014 SEC LEXIS 4981, at *61-62. According to the Commission, “while a misstatement (or misstatement-related activity) may fairly be characterized as an ‘act,’ a misstatement is not a ‘transaction.’” *Id.* at *61. As a result, subsection (a)(3) does not apply to “‘acts’ . . . that are not ‘transactions,’ ‘practices’ or ‘courses of business.’” *Id.* at *61-62.

B. Summary disposition standard

Motions for summary disposition are governed by Rule of Practice 250. *See* 17 C.F.R. § 201.250. An administrative law judge “may grant [a] motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law.” 17 C.F.R. § 201.250(b). “The facts of the pleadings of the party against whom the motion is made shall be taken as true, except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noticed pursuant to [Rule 323].” 17 C.F.R. § 201.250(a). In order “to survive a motion for summary disposition, the non-moving party must do more than ‘simply show that there is some metaphysical doubt as to the material facts.’” *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *21 n.24 (Feb. 13, 2009) (citation omitted), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010). The party opposing summary disposition “must set forth specific facts showing a genuine issue for a hearing and may not rest upon mere allegations or denials in its submissions to the judge to create a genuine issue.” *Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 SEC LEXIS 236, at *22 n.26 (Feb. 4, 2008).

3. Discussion

A. Section 17(a)(1)

As discussed above, the decision in *John P. Flannery* makes clear that any single misstatement made with scienter may suffice to establish liability under Section 17(a)(1). *See* 2014 SEC LEXIS 4981 at *58-59, *62. The Division has alleged a series of misstatements in nine audit reports prepared by Movants. Taking as true for purposes of this Order the allegations in the OIP, there are genuine issues of material fact as to whether Movants made material misstatements in the offer or sale of securities and in so doing, employed a device, scheme, or artifice to defraud.

In their motion, Movants present the following syllogism. Liability under subsection (a)(1) is called “scheme” liability; scheme liability must be based on something more than a misstatement or omission; because the Division’s allegations are based merely on misstatements, the allegations fail. Summary Disp. Mot. at 9-11 (principally relying on *SEC v. St. Anselm Exploration Co.*, 936 F. Supp. 2d 1281 (D. Colo. 2013)). Movants’ premise is flawed, however; liability under subsection (a)(1) can be based on a single misstatement, assuming the other requirements of subsection (a)(1) are met. *John P. Flannery*, 2014 SEC LEXIS 4981, at *58-61. Movants’ argument that scheme liability requires “inherently deceptive” conduct is similarly foreclosed by *John P. Flannery*. *See id.* at *53.

Movants also argue that no reasonable fact finder could find that they acted with scienter. Summary Disp. Mot. at 11-15. Scienter refers to “a mental state embracing intent to deceive, manipulate, or defraud.” *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1323 (2011) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007)). “‘Scienter includes recklessness,’” which is “conduct that is ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it.’” *Anthony Fields*, Securities Act Release No. 9727, 2015 SEC LEXIS 662, at *44 (Feb. 20, 2015) (citations omitted). Scienter may be shown through circumstantial evidence. *Id.* at *44 & n.62.

Issues of a respondent’s intent or state of mind are often not amenable to resolution by summary disposition, *see Justofin v. Metropolitan Life Ins. Co.*, 372 F.3d 517, 523-24 (3d Cir. 2004), “unless no reasonable inference supports the adverse party’s claim,” *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 739 F.2d 1434, 1436 (9th Cir. 1984).² This is the case because a person’s state of mind is often proven through circumstantial evidence and inferences, matters about which reasonable people might disagree. *Justofin*, 372 F.3d. at 524; *see Herman & MacLean v. Huddleston*, 459 U.S. 375, 391 n.30 (1983) (noting the observation that “proof of scienter . . . is often a matter of inference from circumstantial evidence”). Courts thus exercise caution in deciding whether to grant summary disposition where the issue at stake concerns a person’s state of mind. *See Corrugated Paper Products, Inc. v. Longview Fibre Co.*, 868 F.2d 908, 914 & n.6 (7th Cir. 1989).

² Although Rule 56 of the Federal Rules of Civil Procedure does not apply in this proceeding, cases applying it are instructive. *See Jeffrey L. Gibson*, 2008 SEC LEXIS 236, at *22 n.26.

Caution is appropriate here where the Division has submitted a declaration prepared by its expert, Sally Hoffman. If true, Ms. Hoffman's testimony is sufficient to support at least an inference that Movants knew their statements about their audits and the issuers' financial statements were untrue or that Movants acted recklessly as to the truth or falsity of those statements. Because I cannot say that "no reasonable inference supports the [Division's] claim," *Vucinich*, 739 F.2d at 1436, there are genuine issues of material fact with respect to the allegations under Section 17(a)(1).

Movants also make a number of factual assertions that go to the merits of their defense. Summary Disp. Mot. at 12-15. The disputes to which these assertions relate cannot be resolved through summary disposition. Movants' motion for summary disposition as to the allegations under Section 17(a)(1) of the Securities Act is therefore denied.

B. Section 17(a)(2)

To establish liability under Section 17(a)(2), the Division must show that Movants "obtain[ed] money or property *by means of* any untrue statement of a material fact or any omission to state a material fact." 15 U.S.C. § 77q(a)(2) (emphasis added). In other words, the Division must show that the untrue statement or omission was the means by which Movants obtained money. *See John P. Flannery*, 2014 SEC LEXIS 4981, at *33-34 & n.38 (quoting *Tambone*, 550 F.3d at 127-28, for the proposition that "[l]iability attaches so long as the statement is *used* 'to obtain money or property'"); *cf. Loughrin v. United States*, 134 S. Ct. 2384 (2014) (construing the phrase "by means of" in 18 U.S.C. § 1344(2)).

Here, there is no dispute that Movants obtained money. Instead, even assuming there were false statements in their audit reports, Movants dispute whether they obtained the money "by means of" those allegedly false statements. Summary Disp. Mot. at 6-8. Movants argue that the OIP does not allege that Mr. Briner engaged Movants to conduct sham audits or that Mr. Briner and Movants reached an understanding that they would be paid for audits that would essentially amount to no audits at all. *Id.* at 7. Movants conclude that they received their fees not because of the allegedly false statements, but because they had provided the requested auditing services. *Id.* at 8.

In response, the Division begins by misconstruing Movants' argument. *See Div. Opp.* at 2 (stating that Movants' "sole contention is that they did not 'obtain money or property' within the meaning of" Section 17(a)(2)). The Division argues that Movants' "admitted receipt of audit fees for their false audits is sufficient to satisfy [the] ['money or property'] element of Section 17(a)(2)." *Id.* at 11. But Movants do not dispute that they received money; they dispute whether false statements led to their receipt of that money.

Continuing, the Division says the issuers, through Briner, "essentially were purchasing false audit reports" and "the fees that the [Movants] received were their motivation for repeatedly providing Briner with false audit reports." *Div. Opp.* at 11. But the Division cites neither the OIP nor supporting evidence and the Commission has made clear that "mere allegations or denials in" a pleading are not enough to defeat summary disposition. *Jeffrey L. Gibson*, 2008 SEC LEXIS 236, at *22 n.26; *Conrad P. Seghers*, Advisers Act Release No. 2656,

2007 SEC LEXIS 2238, at *17 n.25 (Sept. 26, 2007); see *Frank P. Quattrone*, Exchange Act Release No. 53547, 2006 SEC LEXIS 703, at *20 n.26 (Mar. 24, 2006).

Nonetheless, in paragraph 183 of the OIP, the Division alleged that Movants:

knew, or were reckless in not knowing, that each of the Issuers for which they provided audit reports was a device, scheme, or artifice to defraud in violation of Section 17(a)(1) of the Securities Act. Further, by providing such reports, [Movants] acted unreasonably and caused the Issuers' violations of Sections 17(a)(1), (2), and (3) of the Securities Act. [Movants] also violated Sections 17(a)(2) and (3) of the Securities Act by falsely claiming that their audits complied with PCAOB standards.

OIP at 27. Under Rule 250, I must take these allegations as true. 17 C.F.R. § 201.250(a). Although the first sentence of paragraph 183 is tied to subsection (a)(1) instead of (a)(2), in combination with the facts alleged in the OIP, paragraph 183 is sufficient, if barely so, to support the inference that Movants understood that they were to provide sham audits in return for money. Cf. *John P. Flannery*, 2014 SEC LEXIS 4981 at *130 (finding that the OIP provided adequate notice where it contained "allegations sufficient to inform Flannery 'of the charges in enough detail to allow [him] to prepare a defense'") (citation omitted). Given this fact, I deny Movants' motion as to subsection (a)(2).

C. Section 17(a)(3)

Movants' argument regarding Section 17(a)(3) is the same as its argument regarding subsection (a)(1). Movants argue that liability under subsection (a)(3) is called "scheme" liability; scheme liability must be based on something more than a misstatement or omission; because the Division's allegations are based merely on misstatements, the allegations fail. Summary Disp. Mot. at 9-11 (principally relying on *St. Anselm Exploration Co.*, 936 F.Supp.2d 1281). Movants also argue that scheme liability requires proof that they engaged in "inherently deceptive" conduct. *Id.* at 10.

As noted above, the Commission has rejected the argument that scheme liability cannot be premised on misstatements and has stated that liability under Section 17(a) does not require a showing of deceptive conduct. However, Movants' argument has more traction with respect to subsection (a)(3) because the Commission in *John P. Flannery* said that a single act does not qualify as a "transaction, practice, or course of business." *John P. Flannery*, 2014 SEC LEXIS 4981 at *61-62. The OIP, however, alleges that Movants issued *a series* of false audit reports. OIP at 8-9. Taken together, these allegations suffice to allege a "transaction, practice, or course of business."³ See *id.* at *61-63 ("one who *repeatedly* makes or drafts such misstatements over a

³ According to Appendix A to the OIP, Respondent Whetman's involvement in the audits at issue was limited to the first audit. Movants, however, do not allege that Mr. Whetman's participation in the preparation of the first audit report was not a "transaction, practice, or course of business" with respect to subsection (a)(3). Instead, Movants suggest that Respondent

period of time may well have engaged in a fraudulent “practice” or “course of business,” but not every isolated act will qualify”). I therefore deny Movants’ motion as it relates to subsection (a)(3).

James E. Grimes
Administrative Law Judge

Whetman could not have acted with scienter with respect to subsection (a)(1), because his alleged failure to heed warnings occurred before the warning signs arose. Summary Disp. Mot. at 12. Though the argument with respect to Whetman and subsection (a)(3) is not raised by the Movants, the Division alleges in its opposition that Whetman “participated in the firm’s broader improper auditing ‘practices’ and ‘course of business.’” Div. Opp. at 14.