

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70708 / October 17, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14720

In the Matter of

ALCHEMY VENTURES, INC.,
KM CAPITAL MANAGEMENT, LLC,
ZANSHIN ENTERPRISES, LLC,
MARK H. ROGERS,
STEVEN D. HOTOVEC,
JOSHUA A. KLEIN,
YISROEL M. WACHS,
FRANK K. McDONALD,
and
DOUGLAS G. FREDERICK

NOTICE THAT INITIAL DECISION
HAS BECOME FINAL

On January 26, 2012, the Commission instituted administrative proceedings¹ against the above-named respondents pursuant to Sections 15(b)(4), 15(b)(6), and 21C of the Securities Exchange Act of 1934.² On April 12, 2012, pursuant to Commission Rule of Practice 155(a),³ the administrative law judge issued an Order Making Findings and Imposing Sanctions by Default as to respondents KM Capital Management, LLC, and Joshua A. Klein.⁴ The law judge found that respondents had acted as unregistered brokers and ordered that they cease and desist from violating Section 15(a) of the Exchange Act, jointly and severally disgorge illegal profits of \$102,802 plus prejudgment interest, and pay civil money penalties. KM Capital Management was ordered to pay a penalty of \$150,000, and Klein a penalty of \$50,000.

¹ *Alchemy Ventures, Inc.*, Securities Exchange Act Release No. 66249, 2012 SEC LEXIS 339 (Jan. 26, 2012).

² 15 U.S.C. §§ 78o(b)(4), 78o(b)(6), 78u-3.

³ 17 C.F.R. § 201.155(a).

⁴ *Alchemy Ventures, Inc.*, Exchange Act Release No. 66801, 2012 SEC LEXIS 1197 (Apr. 12, 2012).

After settling with the other respondents,⁵ the Division of Enforcement moved the law judge to issue an initial decision as to the two defaulted respondents, asking the law judge to make the same findings and impose the same sanctions as in his default order. In making this request, the Division represented that it would be "unable to seek judicial enforcement of the Default Order without a final order of the Commission, and the issuance of an initial decision will permit the Commission to either issue a finality order or review the initial decision."⁶ The law judge granted the Division's motion and issued an initial decision, making the same findings of violation and imposing the same sanctions as he did in the default order.⁷

I.

On January 28, 2013, we ordered the parties to file briefs to discuss, among other things, whether and on what basis the law judge had authority to issue an initial decision and whether a district court would have jurisdiction under Exchange Act Section 21(e) to enforce the law judge's default order without the Commission's issuing a finality order.⁸ In doing so, we noted that law judges have expressed some uncertainty about whether they have the authority to issue an initial decision in lieu of a default order.⁹ We also observed that the law judge here had not provided any analysis or authority supporting the Division's claim that it would be unable to obtain judicial enforcement of the default without first obtaining a finality order. We concluded, therefore, that further examination of these topics was necessary before deciding whether to issue a finality order or to call up the law judge's initial decision for review.

The defaulting respondents did not file a response, but the Division filed a brief on February 22, 2013. The Division argued that, although our rules are unclear about whether a law judge may issue an initial decision in the event of a default, those rules "could be read . . . to

⁵ See *Alchemy Ventures, Inc.*, Exchange Act Release No. 67889, 2012 SEC LEXIS 2961 (Sept. 19, 2012) (Yisroel M. Wachs); *Alchemy Ventures, Inc.*, Exchange Act Release No. 67206, 2012 SEC LEXIS 1866 (June 15, 2012) (*Alchemy Ventures, Inc.*, Mark H. Rogers, and Steven D. Hotovec); *Alchemy Ventures, Inc.*, Exchange Act Release No. 67029, 2012 SEC LEXIS 1563 (May 18, 2012) (Douglas G. Frederick); *Alchemy Ventures, Inc.*, Exchange Act Release No. 67028, 2012 SEC LEXIS 1561 (May 18, 2012) (*Zanshin Enterprises, LLC and Frank K. McDonald*).

⁶ *Alchemy Ventures, Inc.*, 2012 SEC LEXIS 3648, at *2 (summarizing the Division's representations).

⁷ *Alchemy Ventures, Inc.*, Initial Dec. Release No. 476, 2012 SEC LEXIS 3658 (Nov. 28, 2012).

⁸ *Alchemy Ventures, Inc.*, Admin. Proc. File No. 3-14720 (Jan. 28, 2013).

⁹ *Id.* at 2 (citing *Brian M. Campbell*, Admin. Proc. Rulings Release No. 734, 2012 SEC LEXIS 3688, at *2-4 (Nov. 30, 2012) (concluding that a law judge could not issue an initial decision in a case where the respondent is in default)).

require an initial decision in cases in which one or more parties is deemed in default."¹⁰ The Division contends that such an interpretation is appropriate because, without an initial decision and resulting finality order, there would be "uncertainty regarding the judicial enforceability of a hearing officer's order on default."¹¹ The Division adds that issuing an initial decision in cases of default would "enable the Division and respondents to use the review and finality procedures applicable to initial decisions under Rule 410."¹²

II.

Under our Rules of Practice, law judges have delegated authority to issue default orders and initial decisions in administrative proceedings.¹³ But what has not been clear, as shown by several recent, conflicting law judge decisions, is whether a law judge can issue both a default order and an initial decision in the same proceeding, or whether those two procedural devices are mutually exclusive.¹⁴ To resolve this uncertainty, we interpret our rules as requiring that law judges issue initial decisions as to respondents who are also in default (with only a few, narrow exceptions not applicable here). Although we find this to be the better reading of our rules and the proper approach going forward, we also explain that existing default orders are valid and judicially enforceable, regardless of whether the law judge ever issued an initial decision in those cases. We further explain that, because the law judge appropriately issued the initial decision in this case, and because the time for filing a petition for review of that decision has expired, the initial decision has become the final decision of the Commission.

A.

As noted above, our Rules of Practice do not explicitly address whether a law judge may issue an initial decision in cases in which a default order has already been issued. Nevertheless, we conclude that those rules are best read to require law judges to issue initial decisions in cases

¹⁰ Div. of Enforcement's Br. Regarding Initial Decision on Default as to KM Capital Mgmt., LLC and Joshua A. Klein at 6 (Feb. 22, 2013).

¹¹ *Id.* at 1.

¹² *Id.* at 1 (citing 17 C.F.R. § 201.410).

¹³ Compare generally Rule of Practice 155(a), 17 C.F.R. § 201.155(a) (delegating to law judges the authority "to determine the proceeding against that [defaulting] party"), with Rule of Practice 360(a), 17 C.F.R. § 201.360(a) (delegating to law judges the authority to issue an initial decision "[u]nless the Commission otherwise directs") and 17 C.F.R. § 200.30–9 (a) (delegating to law judges the authority to "make an initial decision in any proceeding at which the Judge presides in which a hearing is required to be conducted").

¹⁴ Compare, e.g., *Alchemy Ventures*, 2012 SEC LEXIS 3648 (granting Division's motion for issuance of an initial decision in case of a default), with *Campbell*, 2012 SEC LEXIS 3688, at *1 (concluding that a law judge could not grant the Division's motion for issuance of an initial decision in case of a default).

of default. This interpretation is consistent with Rule 360(a)(1), which states that law judges must prepare an initial decision in any proceeding in which the Commission directs the law judge to preside at a hearing. Rule 360 lists only two exceptions to this requirement: (a) where the Commission directs that an initial decision not be issued or (b) where the parties, with the consent of the hearing officer, waive the issuance of an initial decision pursuant to Rule 202.¹⁵ Rule 360(a)(1) does not exclude proceedings in which a party has defaulted, and we decline to interpret the rule as excluding such proceedings. Therefore, in cases such as this one—where the OIP directs the law judge to preside at a hearing, neither exception to the initial decision requirement is present, and the respondent defaults—we conclude that a law judge must issue an initial decision, as was done here.

In reaching this conclusion, we note that, although the law judge issued the initial decision in this case in response to the Division's motion, such a motion is not required. Rule 360(a)(2) specifies that law judges must issue initial decisions within the period directed by the OIP (which, in this case, was 300 days from the issuance of the OIP).¹⁶ Therefore, although the Division is free to move for the law judge to issue an initial decision in an attempt to expedite the proceeding, the law judge will be required to issue an initial decision within the required time regardless of such motion.

Under this interpretation of our rules, default orders serve as one means by which law judges make the determinations underlying their initial decisions. As Rule 360(b) states, an initial decision shall include findings of fact, conclusions of law, and relief, if any.¹⁷ The traditional means for reaching these determinations is by conducting a hearing, during which parties are provided the opportunity to present evidence, submit rebuttal evidence, and cross-examine witnesses.¹⁸ A second means is by considering a motion for summary disposition, which allows parties to obtain a ruling as to any, or all, of the allegations in the OIP without the need for a hearing (provided that the party can establish that there is no genuine issue with regard

¹⁵ 17 C.F.R. § 201.360(a) (requiring law judges to issue an initial decision "[u]nless the Commission otherwise directs"); 17 C.F.R. § 200.30–9 (a) (requiring law judges to "make an initial decision in any proceeding at which the Judge presides in which a hearing is required to be conducted"); Rule of Practice 202, 17 C.F.R. § 201.202 (stating that, in certain proceedings, a party may make a motion to, among other things, determine whether there should be an initial decision by the hearing officer).

¹⁶ 17 C.F.R. § 201.360(a)(2). *But see id.* § 201.360(a)(3) (setting forth the procedure by which a law judge may seek an extension of time to issue an initial decision).

¹⁷ *Id.* § 201.360(b) (stating that an initial decision "shall include: Findings and conclusions, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof"); 5 U.S.C. § 557(c) (same).

¹⁸ *See, e.g.,* Rule of Practice 326, 17 C.F.R. § 201.326 (entitling a party in any proceeding in which a hearing is required to present evidence, submit rebuttal evidence, and conduct cross-examinations).

to any material fact as to the allegation that the party is seeking to have decided by summary disposition).¹⁹ A third means is through default.²⁰

Here, the law judge found that KM Capital Management and Klein were in default because they failed to file an answer to the OIP, which was due twenty days after service of the OIP, and because they failed to participate in a prehearing conference.²¹ By declaring the parties to be in default, the law judge could then determine the proceedings against the defaulted respondents upon consideration of the record, including deeming the allegations in the OIP to be true.²² The law judge did that here by making findings based on the allegations in the OIP and statements made in a declaration filed in connection with the Division's Motion for Findings of Sanctions Based on Entry of Default. Those findings then properly became the basis for the law judge's findings of fact and conclusions of law in the subsequent initial decision.²³

We also note that, until an initial decision is issued, either the Commission or the law judge has the authority to set aside the default "for good cause shown."²⁴ But once the initial decision is issued, our rules largely divest the law judge of authority over the proceedings (including the authority to set aside the default).²⁵ The Commission, by comparison, retains the authority to set aside a default "at any time."²⁶ It can do so, "for good cause shown," even after

¹⁹ Rule of Practice 250, 17 C.F.R. § 201.250 (setting forth the procedures of summary disposition).

²⁰ These means are not mutually exclusive. Depending on the circumstances of a particular proceeding, a law judge could conceivably use a combination of these procedures to develop the record and make the necessary findings.

²¹ See Rule of Practice 155(a), 17 C.F.R. § 201.155(a) (stating that a party may be deemed to be in default for failing "to answer, to respond to a dispositive motion within the time provided, or otherwise to defend the proceeding"); Rule of Practice 220(f), 17 C.F.R. § 201.220(f) (stating that a party may be deemed in default if such person fails to file answer to an OIP); Rule of Practice 221(f), 17 C.F.R. § 201.221(f) (stating that a party may be deemed in default if such person fails to appear at a prehearing conference).

²² Rule of Practice 155(a), 17 C.F.R. § 201.155(a) (stating that "the hearing officer may determine the proceeding against [the defaulting] party upon consideration of the record, including the order instituting proceedings, the allegations of which may be deemed to be true").

²³ As the law judge did in this case, the issuance of an initial decision will, in most cases, likely require little more than importing the findings and conclusions of the default order into the initial decision with few, if any, changes.

²⁴ Rule of Practice 155(b), 17 C.F.R. § 201.155(b).

²⁵ *Id.* (limiting a law judge's authority to set aside a default to "any time prior to the filing of an initial decision"). *But see* Rule of Practice 111(h), 17 C.F.R. § 201.111(h) (providing that law judges may consider a motion to correct a manifest error of fact in the initial decision and setting forth procedure for a party to file, and the law judge to consider, such motions).

²⁶ Rule of Practice 155(b), 17 C.F.R. § 201.155(b) (stating that the Commission may set aside a default "at any time . . . for good cause shown").

the Commission has affirmed the initial decision or declared the decision final.²⁷ It may even do so in the event that the Division obtains an order from a U.S. district court to enforce the initial decision.²⁸

Here, the defaulted respondents have not challenged the default order or sought review of the initial decision. Because the time for filing a petition for review has expired, and because the Commission has not chosen to review the decision on its own initiative, we therefore declare the initial decision to be the final decision of the Commission.

B.

Although we find that issuing initial decisions in cases of default is the proper approach going forward, we emphasize that this conclusion does not mean that prior default orders are invalid or judicially unenforceable if an initial decision was not issued in those cases. Our rules expressly authorize law judges to determine sanctions and to impose cease-and-desist orders via default by authorizing them in such cases to "determine the proceeding against that party upon consideration of the record."²⁹ The foregoing determination that the initial decision requirement applies in cases of default does not rest on our judgment that an initial decision is required to make the default order enforceable. Rather, it is based on our resolution of an ambiguity in our rules and a desire to ensure procedural uniformity. Law judges have long exercised the authority to enter default orders that make findings, order payment of penalties and disgorgement, and order a party to cease and desist.³⁰ And we have long understood such orders to be enforceable.

²⁷ *Id.*

²⁸ To provide a defaulting respondent with notice of the implications of defaulting and how to seek to set aside a default, the order declaring the party to be in default should reference the means for challenging the default as set forth in Rule 155(b). *Cf. SEC v. Gallardo*, No. 12-mc-00223 (S.D.N.Y. Aug. 22, 2012) (noting that the Commission had not provided information to Gallardo on how to seek judicial review of a default order or how to set aside the default order).

The Commission also has the authority, within certain deadlines, to (a) consider a petition by a party for review of the initial decision, (b) order review of the decision on the Commission's own initiative, or (c) declare the initial decision to be final. Rule of Practice 360(d), 17 C.F.R. § 201.360(d) (stating that, "[i]f a party or aggrieved person entitled to review fails to file timely a petition for review or a motion to correct a manifest error of fact in the initial decision, and if the Commission does not order review of a decision on its own initiative, the Commission will issue an order that the decision has become final as to that party"); Rule of Practice 410, 17 C.F.R. § 201.410 (setting forth procedure for filing with the Commission a petition for review of an initial decision); Rule of Practice 411, 17 C.F.R. § 201.411 (setting forth procedure for the Commission to order review of an initial decision).

²⁹ Rule of Practice 155(a), 17 C.F.R. § 201.155(a).

³⁰ *See, e.g., Peak Wealth Opportunities, LLC*, Exchange Act Release No. 69036, 2013 SEC LEXIS 664, at *19 (Mar. 5, 2013) (imposing order by default to cease and desist, impose a bar, deny respondent the privilege of appearing or practicing before the Commission, and pay civil penalties); *Gary J. Martel*, Exchange Act Release

The Exchange Act (under which the current proceeding was brought) specifies that U.S. district courts have "jurisdiction to issue writs of mandamus, injunctions, and orders commanding any person to comply with the provisions of this title, the rules, regulations, *and orders thereunder*."³¹ The Exchange Act authorizes the Commission "to delegate, by published order or rule, any of its functions to . . . an administrative law judge, . . . including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to *any* work, business, or matter."³² The Exchange Act further specifies that, once any deadlines for Commission review have elapsed, any order or other delegated action by a law judge "shall, *for all purposes*, be deemed the action of the Commission."³³ The Exchange Act thus contemplates that district courts have jurisdiction to enforce law judge-issued default orders, including those involving cease-and-desist orders.³⁴ Therefore, although we have concluded that law judges should issue initial decisions in case of default going forward, that conclusion does not disturb existing default orders, nor limit the Division's ability to seek judicial enforcement of those orders.

* * *

No. 68866, 2013 SEC LEXIS 454, at *4–5 (Feb. 7, 2013) (ordering bar from association by default); *Jethro J. Barlow, CPA*, Exchange Act Release No. 42420, 2000 SEC LEXIS 327, at *12 (Feb. 14, 2000) (imposing order by default to cease and desist and deny privilege of appearing or practicing before the Commission).

³¹ 15 U.S.C. § 78u(e) (emphasis added).

³² *Id.* § 78d-1(a) (emphasis added).

³³ *Id.* § 78d-1(c) (emphasis added). More specifically, the Exchange Act states that a delegated action becomes "the action of the Commission" when "the right to exercise such review is declined, or if no such review is sought within the time stated in the rules promulgated by the Commission." *Id.* The Exchange Act, however, is silent on what happens in situations where, as with Rule 155, the Commission's rules do not contain a specific time by which one must seek review of the action at issue. We believe the most reasonable construction of the Exchange Act for such purposes is that, where the relevant Commission rule contains no specific deadline for review, any order issued pursuant to that rule shall immediately be deemed "the action of the Commission." See *Nat'l Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005) (stating that, when a statute is silent on an issue, it is within an agency's authority "to fill the statutory gap in reasonable fashion" (citing *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 865–66 (1984))).

³⁴ *Cf. SEC v. McCarthy*, 322 F.3d 650, 655 (9th Cir. 2003) (holding that the Exchange Act "does not limit or restrict what types of Commission orders may be enforced through § 21(e) [15 U.S.C. § 78u(e)] other than to state that the Commission's order must have been issued pursuant to the Exchange Act or the rules and regulations promulgated thereunder").

For the reasons cited in this order, notice is hereby given, pursuant to Rule 360(d) of Commission's Rules of Practice,³⁵ that the initial decision of the administrative law judge has become the final decision of the Commission with respect to respondents KM Capital Management, LLC, and Joshua A. Klein. The order contained in that decision is hereby declared effective.

By the Commission.

Elizabeth M. Murphy
Secretary

³⁵ 17 C.F.R. § 201.360(d).