INITIAL DECISION RELEASE NO. 1090
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15764

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

In the Matter of GARY L. McDUFF	INITIAL DECISION December 16, 2016

APPEARANCES: Janie L. Frank for the Division of Enforcement, Securities and Exchange Commission

Gary L. McDuff, *pro se*

BEFORE: Cameron Elliot, Administrative Law Judge

Respondent Gary L. McDuff is a recidivist money launderer currently serving a 300-month prison sentence. Despite otherwise impressive efforts to meet its burden of proof, including putting on its case inside a federal prison, the Division of Enforcement did not prove that McDuff was acting as a broker at the time he engaged in the misconduct underlying this follow-on proceeding. I therefore find that McDuff does not meet the statutory prerequisite for sanctions under Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act) and order this proceeding dismissed.

Procedural History

On February 21, 2014, the Securities and Exchange Commission issued an order instituting proceedings (OIP) against McDuff, pursuant to Section 15(b) of the Exchange Act. The OIP alleges that in *SEC v. McDuff*, No. 3:08-cv-526 (N.D. Tex. Feb. 22, 2013) (*McDuff*), a federal district court enjoined McDuff in a default judgment from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 (Securities Act), as well as Exchange Act Sections 10(b) and 15(a) and Rule 10b-5 (collectively, federal securities laws). OIP at 1-2.

On September 5, 2014, I issued an initial decision that granted summary disposition to the Division. *See Gary L. McDuff*, Initial Decision Release No. 663, 2014 SEC LEXIS 3207. On April 23, 2015, the Commission vacated the initial decision and remanded the proceeding for further development of the record. *See Gary L. McDuff*, Exchange Act Release No. 74803, 2015 SEC LEXIS 1657. I thereafter denied a second round of dispositive motions. *See Gary L. McDuff*, Admin. Proc. Rulings Release No. 3482, 2016 SEC LEXIS 82, at *1-2, *5 (Jan. 11, 2016). On June 14, 2016, the Commission issued an Opinion and Order that denied McDuff's

request for interlocutory review but directed me to reconsider certain procedural rulings. *See Gary L. McDuff*, Exchange Act Release No. 78066, 2016 SEC LEXIS 2121, at *27-33 (June 14, 2016).

I presided over a hearing on June 15 and 16, 2016, at FCI Beaumont, Texas, where the Division presented four witnesses, McDuff presented two witnesses, including himself, and I admitted several dozen exhibits from both parties. *See Gary L. McDuff*, Admin. Proc. Rulings Release No. 3934, 2016 SEC LEXIS 2191, at *1-3 (June 22, 2016); Tr. 3, 233. The Division filed an opening post-hearing brief (Div. Br.) and reply post-hearing brief (Div. Reply). McDuff filed an opening post-hearing brief, and later amended it (Resp. Br.), and also filed a reply post-hearing brief (Resp. Reply). Both parties briefed the issues raised in the Commission's June 14, 2016, Opinion and Order, as well as several issues raised in my post-hearing order. *See Gary L. McDuff*, 2016 SEC LEXIS 2191.

I previously took official notice of the docket sheet, superseding indictment, jury verdict, and criminal judgment in *United States v. Reese*, No. 4:09-cr-90 (E.D. Tex.) (*Reese*). *See Gary L. McDuff*, Admin. Proc. Rulings Release No. 1400, 2014 SEC LEXIS 1445 (Apr. 28, 2014). Pursuant to Rule 323, I take official notice of all the proceedings and record in *Reese* and *McDuff*. I also take official notice of all the proceedings and record in *SEC v. McDuff*, No. 4:06-mc-011 (N.D. Tex.) (*McDuff miscellaneous*).

Findings of Fact

A. Civil Proceeding: *McDuff*

In 2008, the Commission filed a civil complaint against McDuff, Gary Lancaster, and Robert Reese, in *SEC v. McDuff*, No. 3:08-cv-526 (N.D. Tex.), alleging that McDuff was the "mastermind behind the fraud" the three defendants committed, involving the Lancorp Financial Fund Business Trust (Lancorp Fund) and its investment with the Megafund Corporation (Megafund) Ponzi scheme. DX 20 at 1-2. As a result of the misconduct described in the complaint, McDuff allegedly violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, Exchange Act Section 15(a)(1), Sections 5 and 17(a) of the Securities Act, and aided and abetted Lancaster's violations of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. *Id.* at 8-13.

In February 2013, the district court in *McDuff* granted the Commission's motion for default judgment against McDuff, enjoined him from violating the pertinent federal securities laws and from aiding and abetting violations of Advisers Act Sections 206(1) and 206(2), ordered him to disgorge $136,336 plus $65,004 in prejudgment interest and pay a civil penalty of $125,000, and entered final judgment. DX 26, 28. McDuff has since filed various appeals and post-judgment motions, without success. *See generally* Docket Sheet, *McDuff*. Most recently, the district court denied McDuff's motion to set aside the judgment for what McDuff claimed to be improper service of process. *SEC v. McDuff*, No. 3:08-cv-526, 2016 WL 6093368 (N.D. Tex. Oct. 17, 2016).

B. Criminal Proceeding: *United States v. Reese*

McDuff was criminally charged with money laundering and conspiracy to commit wire fraud in *Reese* based on the same misconduct alleged in *McDuff*. *Compare* DX 20 (*McDuff* complaint), *with* DX 32 (*Reese* superseding indictment). Following a trial at which he represented himself, with court-appointed standby counsel, the jury found him guilty on both counts. *See* DX 14 at 3; 33. In April 2014, the district court sentenced McDuff to 300 months in prison and a three-year term of supervised release, and ordered him to pay $6,563,179 in restitution. *See* DX 35 at 2-3, 5. In February 2016, the United States Court of Appeals for the Fifth Circuit affirmed the district court judgment. *See* 639 F. App'x 978.

C. Witnesses and Credibility

The Division called as witnesses Frances Benyo and Jay Biles, two investors in the Lancorp Fund; Michael Quilling, the receiver for Megafund and the Lancorp Fund; and Ronald Loecker, an IRS supervisory special agent. Tr. 21-22, 26, 114, 242, 288. Benyo is a retired high school guidance counselor who met McDuff in the early 2000s at a business presentation. Tr. 22. Biles is a computer analyst for Hewlett Packard and met McDuff in August 2003 through a relative. Tr. 242-43. Quilling is an attorney in Dallas, Texas, who has specialized in acting as a court-appointed receiver, both state and federal, for thirty-five years. Tr. 114, 153-54. Loecker has been a criminal investigator for approximately fifteen years and led the investigation of Megafund and the Lancorp Fund. *See* Tr. 288-89.

McDuff called as witnesses himself and his son, Shiloh McDuff (S. McDuff). Tr. 365, 370, 401. S. McDuff has a high school education with a few months of college, and works in healthcare marketing. Tr. 385-89. He authenticated and explained certain exhibits, provided details about properties and businesses owned by McDuff, his family, and his friends, corroborated the fact of his father's 1993 money laundering conviction, and described a family friend who is retired from law enforcement. *See generally* Tr. 365-94. S. McDuff's testimony was otherwise immaterial.

These witnesses generally had straightforward and credible demeanors. One exception was Quilling, who sometimes gave facetious, unduly informal, or vague answers. *E.g.*, Tr. 153 (referring to details of the Lancorp Fund as "cheap stereo instructions"); Tr. 209 (referring to certain legal filings as "Republic of Texas garbage"). Nonetheless, all these witnesses, including Quilling and S. McDuff, on the whole were consistent with each other and with the documentary evidence. I therefore credit all their testimony except where specifically noted.

The same is not true for McDuff, however. Although McDuff's demeanor was generally unremarkable, and I credit his testimony where it is not inconsistent with other witnesses or with the Division's exhibits, much of McDuff's testimony and many of his exhibits were not believable. Indeed, the record is replete with reasons for doubting McDuff's testimony and questioning the truth and authenticity of his allegedly exculpatory exhibits:

- McDuff was convicted in 1993 of engaging in monetary transactions in criminally derived property, in violation of 18 U.S.C. § 1957, and was convicted in 2013 of

money laundering and conspiracy to commit wire fraud. Tr. 391-93, 482-83; DX 33, 74.

- McDuff nonetheless maintains that both convictions were wrongful. *See* Tr. 482-83; *see also* RX 17.

- McDuff defrauded his own parents. *See* DX 11 at 6 (of 8 pdf pages); DX 13 at 66; RX 42-43. Indeed, he was ordered to pay $16,747 in restitution to his mother, Vivian McDuff. DX 35 at 6.

- McDuff laundered the proceeds of his fraud through a complex series of transactions using multiple companies, at least one of which was domiciled outside the United States. *See* Tr. 213, 299-303; DX 65 at 2.

- In his Answer, McDuff asserted that he "had been unaware of the activities of [co-defendants in *McDuff*] [Robert] Reese and [Gary] Lancaster, which caused the Commission Division of Enforcement to file the Complaint." Answer at 6. He continued to make similar claims throughout this proceeding. *E.g.*, Tr. 454. In fact, McDuff was associated with Lancaster and Reese no later than 2001. *See* DX 12 at 12-14 (of 29 pdf pages); DX 15 at 1-2; DX 16 at 1-2; DX 36 at 13.

- McDuff filed multiple fraudulent documents in this proceeding and related proceedings. *E.g.*, Tr. 485-86; DX 13 at 75-76 (McDuff forged signature of U.S. Attorney General Eric Holder on court document); DX 18 (forged document in question); DX 75-77; *see generally* Answer, Ex. 1 (collecting various illegitimate documents, including Notice of Filing Foreign Judgment, multiple liens, and false Form 1099-A).

- Some documents filed by McDuff and purporting to be affidavits or declarations are inconsistent with conclusively proven facts, which suggests that they are unreliable or inauthentic. For instance, McDuff offered in evidence a "Robert T. Reese Statement," dated November 1, 2005, in which Reese essentially disclaimed any participation in the Lancorp Fund fraud or association with McDuff; in fact, Reese pled guilty in 2009. *Compare* DX 15, *with* RX 31. McDuff also offered in evidence multiple declarations that provide historical accounts inconsistent with the findings of the criminal jury, two of which were from persons now serving prison sentences. *See* RX 32-35; Tr. 480.

Additionally, a considerable portion of McDuff's evidence is either irrelevant or constitutes a challenge to the underlying judgments. *E.g.*, Tr. 401-80. Therefore, except where otherwise noted, I do not credit either McDuff's testimony or his exhibits to the extent they are inconsistent with the Division's evidence.

D. McDuff's Background

McDuff is 61 years old and completed high school. *See* Tr. 490. He went into "business" in the early 1970s. Tr. 490. He is currently married to Shannon McDuff. *See* Tr. 383. He formerly lived at a home in Deer Park, Texas. *See* Tr. 372, 388.

In 1985, while working as a homebuilder, McDuff co-founded a business that bought and sold mortgage notes. *See United States v. McDuff*, No. 94-20076, 1996 WL 167090, at *1 (5th Cir. Mar. 12, 1996); *see also* Tr. 490 (McDuff testified he was "a mortgage developer and investment banker"). By 1988 McDuff's business had filed for bankruptcy and McDuff concocted a scheme to keep it operating, involving a sale/leaseback arrangement on McDuff's home and on a home under construction, financed by loans obtained by false representations. *See United States v. McDuff*, 1996 WL 167090, at *1-2, *6; *see also* Tr. 393 (S. McDuff testified that the home buyer, "an attorney down the street," lied on his loan application). One such false representation pertained to the solvency of the borrower, a holding company in financial trouble that was controlled by a confederate. *See United States v. McDuff*, 1996 WL 167090, at *1. McDuff wrote a $15,000 check to the borrower, drawn on an account with insufficient funds, to inflate the borrower's apparent cash holdings. *See id*. Most of the loan proceeds resulting from the scheme went to McDuff or his company, and much of the remainder went to McDuff's confederates. *See id*. at *2, *6. The borrower ultimately made no loan payments, and the lender foreclosed on both homes. *See id*. at *2.

According to McDuff, in approximately 1988 or 1989 – that is, at or shortly after the completion of his fraudulent loan scheme – he moved to England to study "asset protection and trust law." Tr. 481, 490. In 1993 he was indicted in the Southern District of Texas on two counts of engaging in monetary transactions in property derived from specified unlawful activity, based on the fraudulently obtained home loans. *United States v. McDuff*, 1996 WL 167090, at *1; DX 74 at 1. He represented himself at trial, with a public defender as standby counsel, was convicted on both counts, and was sentenced in 1994 to 37 months' imprisonment. *United States v. McDuff*, 1996 WL 167090, at *1; DX 74 at 1-2.

In 2001 and 2002, McDuff was involved in two new, apparently distinct fraudulent schemes: the scheme underlying the present proceeding, which involved Secured Clearing Corporation (SCC), among other companies; and a Ponzi scheme involving Overseas Development Bank and Trust (Overseas), a company at which McDuff was supposedly a senior trust officer. *See* DX 12 at 13, 15 (of 29 pdf pages); DX 65 at 2; RX 23 at 14-40780.876. McDuff later ran yet another fraudulent scheme in Mexico involving a company called MexBank. *See* Tr. 134, 142-43, 321-24, 348; DX 75 at 9 (of 9 pdf pages). He was charged in *Reese* in 2009, and he "remained abroad for some time after learning of his indictment," until he was apprehended in 2012. *McDuff*, 639 F. App'x at 979-80; DX 32.

E. McDuff Solicited Investments in Overseas

McDuff and Benyo first met at a business presentation in the early 2000s. *See* Tr. 22, 41-42. At that presentation, McDuff pitched to multiple people a separate, "100 percent safe" investment involving Overseas, in which Overseas bought other banks' debt. *See* Tr. 22-23, 43. After eight or ten phone calls with McDuff, Benyo invested approximately $18,000 in Overseas,

and earned approximately $1,500 per month. *See* Tr. 24, 54-55. At some time in 2002 or 2003, McDuff called Benyo to tell her Overseas was closing, and that her investment was "going down." Tr. 25-26. However, McDuff returned her principal, plus an extra $1,000. *See* Tr. 25.

As noted, during this same period, Overseas was part of a Ponzi scheme involving Reese and McDuff, among other persons. *See* DX 12 at 13, 15 (of 29 pdf pages). In August 2004 the California Corporations Commissioner ordered Reese to desist and refrain from, among other things, selling securities. *See id*. at 5, 7 (of 29 pdf pages).

F. McDuff Created the Lancorp Fund

The Lancorp Fund was McDuff's "brain child." Tr. 120. McDuff wished to form an investment company, but could not have his name associated with it because of his criminal record. *See* Tr. 121; DX 53 at 199. He approached Lancaster, a banker who became a registered representative of a broker-dealer in March 2004, to form the investment company and be the "point man." Tr. 121; *see* DX 36 at 70; RX 67; *O.N. Equity Sales Co. v. Steinke*, 504 F. Supp. 2d 913, 914-17 (C.D. Cal. 2007) (granting an investor's motion to compel arbitration against Lancaster's broker-dealer over the Lancorp Fund). He further arranged for Norman Reynolds, a securities attorney whom he had previously retained in connection with a purported Regulation D offering of SCC, to prepare a private placement memorandum (PPM), based on information supplied by McDuff. *See* Tr. 121, 124; DX 36 at 76-77; DX 53 at 86-88, 93-94; RX 23 at 14-40780.876, .879. He again worked with Reese, who brought in investors. Tr. 124. McDuff acted as the "middleman that stuck everybody else together." Tr. 291-92.

The Lancorp Fund was formed in March 2003. *See* DX 73 at 7 (of 87 pdf pages). Its PPM asserted that it was an "unregistered closed-end non-diversified management investment company," with an investment objective "involv[ing] the issuance of Forward Commitments . . . to large financial institutions relating to debt securities." *Id*. at 1 (of 87 pdf pages). McDuff saw to the creation of the Lancorp Fund's offering documents before Lancaster became involved. *See* DX 36 at 103-107. SCC supplied initial funding of an estimated $30,000. *See* DX 36 at 71-72; DX 45; DX 53 at 86. Beginning in early 2003, and continuing through late 2005, the Lancorp Fund sold "shares" to individual and corporate investors. *See* DX 73 at 1 (of 87 pdf pages); DX 11. Ultimately, the Lancorp Fund raised over $11 million from approximately 100 distinct investors. *See* Tr. 125; DX 11 at 8 (of 8 pdf pages).

Most of the investors were solicited by Reese, who was supplied with the relevant Lancorp Fund sales information by McDuff. *See* Tr. 291-93; RX 31-A at 2. McDuff provided Reese with whatever records he needed, answered an unspecified number of prospective investors' follow-up phone calls and questions (especially insurance-related questions), and on at least one occasion "acted as though he was an attorney working for Lancorp to provide the insurance through AIG." Tr. 291. A "handful" of investors, who were not identified by name and whose investment amounts are unknown, received calls from McDuff "[o]ut of the blue" as their initial contact. Tr. 292. The subscription forms for three investors list McDuff as the "referring party." *See* DX 39 at 329; DX 40 at 343; DX 41 at 357. McDuff conducted background checks on investors and forwarded them to Lancaster, although the background checks did not reveal the investors' financial wherewithal. *See* DX 37 at 240-41. Two investors, Benyo and Biles, testified about their solicitation by McDuff. *See* Tr. 26-27, 242-45.

After Benyo's Overseas investment ended, McDuff informed her that the Lancorp Fund was "in the beginning stages." Tr. 26. McDuff pitched the Lancorp Fund at another business presentation, attended by Benyo and others, approximately one year after the presentation where he pitched Overseas. Tr. 26-27. McDuff falsely represented that an investment in the Lancorp Fund would be "absolutely safe" and would have "an insurance policy on it," or something similar. Tr. 27. Benyo thereafter had twenty or thirty phone calls with McDuff regarding the Lancorp Fund, on numerous topics, including: the credit rating of its investments; the fact that she did not qualify as an accredited investor but that her status was nonetheless permissible; her desire for insurance on her investment; the fact that her husband had recently died and her investment was "the only money [she] had in the world"; and the mechanics of transferring her money, which was in an individual retirement account. Tr. 27, 29-32. McDuff sent Benyo the Lancorp Fund's PPM, and she asked him questions about it. Tr. 28; DX 73. At no time did McDuff mention that he had a felony conviction, or that Reese had been barred from selling securities in California. Tr. 33.

In April 2003, Benyo invested $175,000 in the Lancorp Fund, representing the entirety of her and her late husband's retirement account. *See* Tr. 32; DX 56. At McDuff's urging, Benyo listed on her subscription form Levoy Dewey, a colleague of McDuff's father, as the person who referred her to the Lancorp Fund, so that Dewey would be compensated. *See* Tr. 33-36, 42, 473; DX 55 at 887. Dewey had been at the business presentation where McDuff pitched Overseas. Tr. 35. McDuff did not handle the funds, which were transmitted to a retirement account management company and then forwarded to the Lancorp Fund. *See* Tr. 32.

Biles was introduced to McDuff by his wife's cousin, Kevin Herring, who had invested in the Lancorp Fund. *See* Tr. 242-43; DX 40. Biles met McDuff at a restaurant in August 2003, and Biles assumed McDuff was the sales representative for the Lancorp Fund in the Houston area. Tr. 243-44; RX 47 at 3 (McDuff represented himself as the local representative of the Lancorp Fund). McDuff told Biles that the Lancorp Fund provided bridge loans in "big deals," such as Disney building a new theme park. Tr. 244-45. McDuff explained that the person running the investment was experienced, and that although there was no guarantee of a return on investment, the investment itself had optional insurance. Tr. 245-47. McDuff told him the minimum investment was five shares at $5,000 per share, and he may have provided Biles the PPM. *See* Tr. 247-48, 279. McDuff asserted that the Lancorp Fund offered returns of up to eighteen percent per year, or slightly less if the investor opted for insurance on the investment. RX 47 at 3-4. At no time did McDuff mention that he had a felony conviction, or that Reese had been barred from selling securities in California. Tr. 249.

Biles invested a total of $160,000 in the Lancorp Fund, in two separate payments in January and February 2004. *See* Tr. 242, 250; DX 57-60. On his subscription form, Biles listed Herring and his wife as the referring parties, because they recommended he talk to McDuff. *See* Tr. 251-52; DX 62 at 921. As with Benyo's investment, McDuff did not handle the funds, which were transmitted to a retirement account management company and then forwarded to the Lancorp Fund. *See* Tr. 250, 253. Biles never met with McDuff again. Tr. 279-80.

G. McDuff Caused the Lancorp Fund to Invest in, and Receive Ponzi Payments From, Megafund

Megafund was a Ponzi scheme which purported to pay a ten percent monthly return, and which bore indicia of a religion-based affinity fraud. *See* Tr. 136-37, 299-300, 473-74; DX 52; RX 42; RX 44 at 1. Megafund was run by Stan Leitner, who met McDuff through McDuff's father. Tr. 295. McDuff made the decision to have the Lancorp Fund invest in Megafund. Tr. at 124-25, 295. By doing so, the Lancorp Fund's investors would receive their "promised 10 percent or something like that per year," the Lancorp Fund itself would receive ten percent per month, and McDuff and Lancaster would pocket the difference, with McDuff paying Reese separately. *See* Tr. 130-31, 140-41, 145-46; DX 30 at 22 (of 59 pdf pages); DX 45. Investing in Megafund was not consistent with the representations in the Lancorp Fund's PPM. *See* DX 53 at 204-06; DX 73 at 8 (of 87 pdf pages). Investors in the Lancorp Fund were not told of the Megafund investment; not told that McDuff, Lancaster, and Reese would take the Lancorp Fund's excess returns; and were not told that McDuff, rather than Lancaster, had made the decision to invest in Megafund. *See* Tr. 263-64, 343-44; DX 53 at 213.

The Lancorp Fund invested a total of $9,365,000 in Megafund, in three separate payments. *See* DX 11 at 8 (of 8 pdf pages); DX 65 at 1; DX 66. The first payment, of $5 million, was transmitted to Megafund on February 8, 2005. DX 66. That payment was used to calculate the Ponzi payments back to the Lancorp Fund; specifically, Megafund transmitted ten percent "monthly returns" to the Lancorp Fund on March 23, 2005, totaling $500,000, and in April 2005, again totaling $500,000. *See* Tr. 136-38, 300, 302, 319-20; DX 30 at 22 (of 59 pdf pages); DX 66. The Lancorp Fund's second and third investments in Megafund were completed on April 5 and May 4, 2005, but Megafund made no further Ponzi payments to the Lancorp Fund. *See* Tr. 319-20; DX 66.

Megafund sent its first $500,000 payment directly to the Lancorp Fund. *See* Tr. 300-01; DX 30 at 22 (of 59 pdf pages). McDuff took $128,437.58, using multiple intermediary accounts and companies – including MexBank, which essentially "operat[ed] as a bank account for" McDuff, and SCC – and out of that McDuff paid Reese $45,792.89. *See* Tr. 140-42, 301-02, 312; DX 65 at 2-3. Megafund divided its second $500,000 payment between the Lancorp Fund, which received $324,165, and a MexBank account, which received $175,835. *See* Tr. 148, 302, 313; DX 65 at 2. McDuff's share of the second payment was based on an agreement that MexBank would receive 35.166% ($175,835) of Megafund's Ponzi payment directly from Megafund. *See* Tr. 145-47, 305; DX 44. Except as outlined below, the mechanics of these payments, their supporting documentation, and the ultimate recipients of them – issues the Division addresses at length – are otherwise immaterial. *Cf.* Div. Br. at 11-16.

H. McDuff Fled to Mexico After his Scheme Collapsed

Megafund made no further Ponzi payments to the Lancorp Fund after April 2005, even though McDuff had contemplated such payments and given instructions to a Megafund staff member on how to apportion them. *See* Tr. 318-20; DX 19 at 1. The Commission began an investigation of Megafund on June 1, 2005, and the firm was placed in receivership in July 2005. *See McDuff miscellaneous*, Doc. 3-2 at 2 (of 26 pdf pages); Tr. 151. On February 2, 2006, McDuff failed to appear for his scheduled investigative testimony, and instead had his father

tender to Commission investigators a variety of inauthentic documents. *See McDuff miscellaneous*, Doc. 3-1 at 3-5; *see also* DX 51. At some point in 2006, McDuff fled to Mexico. *See McDuff miscellaneous*, Doc. 34 at 2.

In Mexico McDuff used MexBank to commit more fraud. *See* Tr. 321-24. The MexBank scheme raised $40 million from hundreds of investors, and no investor received any money back. *See* Tr. 321. McDuff and Reese, and at least one other person, sold investments in MexBank and "wined and dined and talked to" them about the firm. *See* Tr. 322-24.

Discussion

A. McDuff was not a Broker

Exchange Act Section 15(b) authorizes the Commission to impose a collateral bar on McDuff if: (1) at the time of the alleged misconduct, he acted as or was associated with a broker or dealer; (2) he has been enjoined "from engaging in or continuing any conduct . . . in connection with the purchase or sale of any security"; and (3) the sanction is in the public interest. 15 U.S.C. § 78*o*(b)(4)(C), (b)(6)(A)(iii); *Gary L. McDuff*, Exchange Act Release No. 74803, 2015 SEC LEXIS 1657, at *2 n.2 ("A person who acts as an unregistered broker-dealer is 'associated' with a broker-dealer for purposes of Section 15(b)."). McDuff does not dispute that he has been enjoined from future violations of federal securities laws, i.e., "conduct . . . in connection with the purchase or sale of any security.". 15 U.S.C. § 78*o*(b)(4)(C); *see* Answer at 3-4; DX 28. During the time of his misconduct, McDuff was not associated with a registered broker or dealer. *See* Answer at 3, 19; OIP at 1.

The question, then, is whether McDuff was himself "acting as a broker or dealer" to qualify for sanctions under Section 15(b). *See Gary L. McDuff*, Exchange Act Release No. 74803, 2015 SEC LEXIS 1657, at *11; *see also David F. Bandimere*, Securities Act Release No. 9972, 2015 SEC LEXIS 4472, at *98 (Oct. 29, 2015) (Section 15(b) applies to persons acting as brokers or dealers, regardless of whether they are registered as such), *appeal pending*, No. 15-9586 (10th Cir.); *Vladislav Steven Zubkis*, Exchange Act Release No. 52876, 2005 SEC LEXIS 3125, at *20 (Dec. 2, 2005) (Section 15(b) applies to natural persons who act as a broker or dealer). A broker is defined as "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A). The law regarding dealers is similar, except that dealers buy and sell securities for their own account. *See id*. at § 78c(a)(5). However, there is no evidence that McDuff traded in securities for his own account, and the Division does not contend that he did.

Although holding oneself out as being a broker is alone sufficient to qualify as one, McDuff did not hold himself out as a broker. *See Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *18 & n.112 (Feb. 20, 2015). Therefore, "[i]n determining whether a person is 'engaged in the business' of effecting transactions for others' accounts," a number of factors should be evaluated. *David F. Bandimere*, 2015 SEC LEXIS 4472, at *26-27. "A primary consideration is whether there has been regular participation in securities transactions at key points in the chain of distribution," as indicated by "[t]he number of customers at issue, the dollar amount of transactions, and the number of transactions effected." *Id.* at *27. Additional factors include whether a person: (1) actively solicits or recruits investors;

(2) advises investors as to the merits of an investment, or opines on its merits; (3) receives commissions, transaction based compensation, or payment other than a salary for selling the investments; (4) is an employee of the issuer of the securities; (5) sells, or previously sold, the securities of other issuers; (6) is involved in negotiations between the issuer and the investor; and (7) handles investor funds and securities. *Id.* at *28-29; *see SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005). Receiving "transaction-based compensation" is "one of the hallmarks of being a broker-dealer." *SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011) (internal citations and quotation marks omitted); *see David F. Bandimere*, 2015 SEC LEXIS 4472, at *31-32.

1. The Interests in the Lancorp Fund Were Securities

Investors in the Lancorp Fund provided the capital and shared in its purported earnings and profits, while its promoters – McDuff, Lancaster, and Reese – managed, controlled, and operated it. Its shares were therefore investment contracts and securities. *See David F. Bandimere*, 2015 SEC LEXIS 4472 at *15. Inasmuch as McDuff argues or suggests that Lancorp Fund shares were not "sold" prior to early 2004, and therefore were not securities until that time, his argument is rejected. *See* Resp. Br. at 23-27; Resp. Reply at 57-67.

2. There is Some Evidence of Brokering

As noted above, a "primary consideration" in determining broker status is whether there has been regular participation in securities transactions at key points in the chain of distribution, as demonstrated by "[t]he number of customers at issue, the dollar amount of transactions, and the number of transactions effected." *David F. Bandimere*, 2015 SEC LEXIS 4472, at *27. McDuff definitely persuaded two investors, Benyo and Biles, to purchase shares of the Lancorp Fund. *See* Tr. 27, 29-32, 83-84, 243-48, 275, 278-80. Benyo's purchase was a single transaction involving $175,000, and Biles' purchase involved two transactions totaling $160,000. *See* Tr. 32, 242, 250; DX 56-60. Also, McDuff previously sold the securities of Overseas Bank, and may have later sold the securities of MexBank. *See* Tr. 22-23, 43, 321-22.

3. Most Brokering Factors are Largely Unproven

Beyond that, however, the pertinent evidence is foggy at best. The Division's two non-investor witnesses had somewhat different accounts of how many investors McDuff brought into the Lancorp Fund. *Compare* Tr. 124-26 (Quilling testified that "the vast majority" of the approximately 100 investors "came through" McDuff and Reese), *with* Tr. 292 (Loecker testified that Reese found "the vast majority" of investors, i.e., at least 90 percent of them, and McDuff the remainder). Lancaster testified during the investigation that 80 percent of investors were "referred" by Reese, that McDuff referred a "[d]ozen, maybe," a Mr. Winkler referred "[a] few," and one or two other persons referred single investors. DX 36 at 66, 74; *see also* Tr. 124 (Quilling testified that "there may have been [a] couple of [other solicitors] whose names escape me").

Although it stands to reason, given the nature of the Lancorp Fund investment, that most investors had only one or a few transactions, there is literally no evidence of the total number of transactions solicited by McDuff (other than those of Benyo and Biles). *See* Tr. at 125 (Quilling testified that he approved 130 claims from 100 people who put money into the Lancorp Fund);

DX 11 (listing investors but without associating them with McDuff, Reese, or any other point of contact). The record contains subscription agreements suggesting that three other investors were "informed" of the Lancorp Fund by McDuff, but the precise nature of McDuff's interactions with these investors is unclear, and the context suggests that McDuff may not have been the Lancorp Fund salesman for those investors. *See* DX 39 at 329; DX 40 at 343; DX 41 at 357. Indeed, the evidence suggests that the subscription agreements are generally not reliable indicators of who actually sold the investments. For instance, Biles explained that he put down the Herrings as having "informed" him of the Lancorp Fund rather than McDuff, the "salesperson." *See* Tr. 251-52; DX 62 at 921; *see also* Tr. 35 (Benyo explaining that she listed Levoy Dewey as the referring party at McDuff's request so that Dewey would be compensated). Nor is there evidence of the total dollar amount of the transactions negotiated by McDuff or the precise nature of McDuff's activities with respect to any particular investor (other than Benyo and Biles).

It is similarly unclear whether McDuff actively solicited investors, advised them as to the merits of the Lancorp Fund, or was involved in negotiations between the Lancorp Fund and investors, beyond McDuff's solicitation of Benyo and Biles. He had a significant role in creating the Lancorp Fund PPM, although there is little particularized evidence that the PPM went to investors other than Benyo and Biles. *See* Tr. 121, 124. And he explained the Lancorp Fund investment, its purported insurance coverage, and the mechanics of transferring funds to a qualified retirement account, but, again, it is not clear to what extent he did so for investors other than Benyo and Biles. *See* Tr. 27, 29-32, 244-48.

McDuff was associated with the Lancorp Fund in some capacity, because he orchestrated its creation and directed disbursement of its funds, but it is undisputed that he was not an employee of it. *See* Div. Reply at 3 n.5. And in contrast to Lancaster, who eventually became an associated person of a registered broker-dealer, McDuff never held himself out as being a broker or an associated person of a broker. *See O.N. Equity Sales Co.*, 504 F. Supp. 2d at 915.

There is no evidence that McDuff handled investor funds or securities, and indeed, it appears that that was Lancaster's role. *See* Tr. 124; DX 37 at 192, 220-21; *see also* RX 31-A at 2 (Reese stated that he "never took receipt of any funds"). Both Benyo and Biles testified that their funds were sent to the Lancorp Fund via a retirement account management company. *See* Tr. 32, 36, 250, 253; DX 56, 57, 59.

4. McDuff did not Receive Transaction-Based Compensation

The record does not show that McDuff received transaction-based compensation. This is the most significant factor, both because such compensation is strongly indicative of brokering, and because evidence of it is conspicuously absent from the record. *See Kramer*, 778 F. Supp. 2d at 1334. Transaction-based compensation means "compensation tied to the successful completion of a securities transaction." *Order Exempting the Fed. Reserve Bank of NY, Maiden Lane LLC and the Maiden Lane Commercial Mortg. Backed Sec. Trust 2008-1 from Broker-Dealer Registration*, Exchange Act Release No. 61884, 2010 WL 1419216, at *2 (Apr. 9, 2010).

The evidence shows that Megafund made two $500,000 payments to the Lancorp Fund in March and April 2005, representing two monthly "returns" of ten percent of the Lancorp Fund's

$5 million investment in Megafund. *See* Tr. 299-302; DX 52. The March 2005 payment went to the Lancorp Fund; a portion, $128,437.58, was then sent to an account controlled by McDuff; and out of that portion $45,792.89 went to an account controlled by Reese. *See* Tr. 300-02; DX 65 at 2-3; RX 31-A at 2. The April 2005 payment was divided from the beginning, with most going directly to the Lancorp Fund and $175,835 going to an account controlled by McDuff. *See* Tr. 141-42; 302; DX 65 at 2-3. There is no evidence of other relevant funds paid to McDuff.

There is no evidence McDuff received commissions, that is, a percentage value of the transactions he solicited. Lancaster said during the investigation – that is, before admitting that he had committed fraud – that although SCC and MexBank were purportedly compensated for bringing in investors, commissions were not paid. *See* Tr. 304; *see* DX 37 at 211. The record does not contain a sales commission percentage received by McDuff, and does not even show the total value of McDuff's sales transactions from which the percentage might be calculated. The share he ultimately received, calculated as a percentage of the Lancorp Fund's purported returns, changed between his two payments, for no legitimate reason evident from the record. Specifically, in March 2005 he received $82,644.69 ($128,437.58 less $45,792.89), or approximately 16.5% from the March 2005 Megafund payment, and in April 2005 he received $175,835, or 35.166% from the April 2005 Megafund payment. *See* Tr. 148, 302; DX 65 at 2. And the only transactions proven to be attributable to McDuff, the purchases by Benyo and Biles, were completed long before McDuff was compensated in early 2005, making it unlikely that McDuff was actually being compensated for bringing in those investors. *See* DX 56 (Benyo invested in April 2003); DX 59 (Biles completed his investment in February 2004).

Nor is the basis for McDuff's actual share of the Megafund Ponzi payments clear from the record. There is some documentation indicating that MexBank's share of Megafund's April 2005 Ponzi payment was a percentage McDuff communicated to Megafund's office manager, but the documentation simply recites a percentage amount and largely concerns a contemplated May 2005 payment that was never made, rather than the April 2005 payment specifically. *See* Tr. 295, 304-05, 319 (noting that May 2005 instructions "were "indicative of the type" the office manager would receive from McDuff); DX 19 (May 2005 instructions, 35.166% of $500,000 equals $175,835); DX 44. There is no legitimate explanation in that documentation for the percentage amount; although the relevant documents recite various facts, purportedly to elucidate why different persons and entities received the shares they did, the documents are inconsistent with each other and appear to have been generated out of thin air to provide a semblance of authenticity and legality. *See* Tr. 340 (Loecker characterized the documentation as "gobbledygook"); DX 37 at 214-16, 314-15; *see generally* DX 42-45. And the record contains no reliable evidence to explain McDuff's share of Megafund's March 2005 Ponzi payment. *See* Tr. 303-04.

The record does contain a "Joint Venture" agreement (JVA) purportedly between Lancorp Financial Group LLC, owner of the Lancorp Fund, and MexBank, pursuant to which MexBank "shall direct all of its investors" to invest in the Lancorp Fund. DX 44 at 1. The JVA was signed six days before Megafund transmitted its March 23, 2005, Ponzi payment, and suggests that McDuff, Lancaster, and Leitner (who ran Megafund) had agreed that MexBank would receive $175,835 (35.166%) of that payment directly from Megafund. *See id*. at 2. The Division argues that the JVA, and the other "gobbledygook" exhibits, establish that "McDuff was compensated for bringing investors to Lancorp." Div. Br. at 29. Again, though, these

exhibits are inconsistent with each other and do not recite true facts, and their form and pseudo-legalistic language are consistent with McDuff's history of cloaking his activities in the appearance of legitimacy through forgery and document fraud. *Compare* DX 18 (fraudulent motion to dismiss *Reese*), *with* DX 44 (JVA). Nor was McDuff's March 2005 payment even consistent with the JVA; it should have been $175,835 – like the April 2005 payment – instead of $128,437.58. *See* DX 44 at 2. Moreover, if the JVA actually documented an agreement to provide compensation for the solicitation of investments, Reese, who solicited most of the investors, should have been a party to it and should have received the bulk of such compensation, but instead he received a relative pittance. *See* Tr. 291-93; DX 65 at 2-3. Reese admitted that his own compensation was in consideration of his solicitation efforts, but his compensation was seemingly based on whatever McDuff felt like paying him, and bore no clear indicia of being transaction-based. *See* RX 31-A at 2-3. Neither the JVA nor any other supposed documentation of the purported agreements between the fraudfeasors are reliable evidence that McDuff received compensation for bringing in investors.

Even assuming that both of McDuff's payments were calculated as some percentage of returns on the Lancorp Fund's investment in Megafund, there is insufficient evidence to establish that McDuff's share of the ill-gotten gains was tied to the successful completion of securities transactions. Although the record contains hearsay to the effect that Lancaster maintained "a listing of investors and who brought them in," that listing is not in evidence and Loecker candidly admitted that he could "only surmise" that the listing was used to calculate each fraudfeasor's cut of the Lancorp Fund's earnings. Tr. 304. And again, McDuff's percentage changed over time for no apparent reason, suggesting that McDuff's percentage was not determined by how much money he brought into the Lancorp Fund, or by how much money it earned. There is simply no reliable evidence that McDuff's proceeds depended in any way on the number of investors he brought in, or on the amount of their investment.

In contrast to *Frederick W. Wall*, 58 S.E.C. 758, 761 (2005), in which the respondent admitted that he had received "a percentage of the unregistered brokers' commissions," the record here contains no clear explanation of how McDuff's shares of the Megafund Ponzi payments were determined. *See* Div. Br. at 29-30 (citing *Frederick W. Wall*). Even assuming that McDuff was personally responsible for obtaining ten percent of investments in the Lancorp Fund and indirectly responsible for the rest – a conclusion that is plausible but not proven by a preponderance of the evidence, *see* Tr. at 292 – his share of Lancorp Fund returns bore no rational relationship to his efforts. Indeed, it may as well have been a random percentage of the Lancorp Fund's cash flow. McDuff's "compensation" was "transaction-based" only in the sense that he stole it from the proceeds of the Lancorp Fund's transactions. *See* Div. Br. at 29.

5. Analysis

The Division's evidence of brokering is unconvincing. The Division does not argue that McDuff handled investor funds and securities, and in any event the record shows that he did not. *See* Div. Br. at 27-29; Div. Reply at 10. Nor was he an employee of the Lancorp Fund, a point the Division apparently concedes. *See* Div. Reply at 2-3 & n.5. Employment is a minor factor in any event, as there is not even consensus about whether it weighs in favor of or against broker status. *Compare, e.g., SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005) (defendant's argument that he was "not employed by the issuer" considered as a possible "counter" to evidence of

brokering), *with SEC v. Collyard*, 154 F. Supp. 3d 781, 789 (D. Minn. 2015) (stating that courts "typically construe" lack of employment with the issuer as "supporting a finding" of brokering). I consider each of the Division's other points in turn.

The Division argues that McDuff "actively solicited investors." Div. Br. at 27. This is true, but only as to Benyo and Biles. There is generalized evidence that he solicited others, but the precise number is unclear, and it is also unclear whether his solicitations were active or passive. *E.g.*, Tr. 124-26; DX 37 at 205-06 (Lancaster testified that he expected McDuff's entity, SCC, to be compensated for bringing clients to the Lancorp Fund). And although soliciting two investors might qualify someone as a broker when the other indicia of brokering are sufficiently proven, that is not the case here. *Contra* Div. Reply at 4 n.6.

The Division argues that McDuff was "involved in negotiations between the issuer and the investor." Div. Br. at 28. Beyond his solicitation of Benyo and Biles, the evidence of this is anemic. On the one hand, McDuff helped Benyo and Biles transfer their funds to a special retirement fund custodian (but not to the Lancorp Fund itself), caused an attorney to draft the PPM, provided Reese with whatever records he needed, answered prospective investors' follow-up phone calls and questions, especially insurance-related questions, and on at least one occasion "acted as though he was an attorney working for Lancorp to provide the insurance through AIG," Tr. 291. On the other hand, the evidence that he assisted Reese, answered follow-up phone calls and questions from investors other than Benyo, and conducted investor background checks is conspicuously non-specific, and there is no evidence that he participated in the order-routing or order-taking process. Admittedly, McDuff's recruitment of Reese and assistance to him in closing sales and providing investors information, and possibly his control over Reese's cut of the ill-gotten gains, are all indicative of brokering. *See, e.g.*, *Frederick W. Wall*, 58 S.E.C. at 763 (stating "the recruitment of salespersons" was indicative of respondent's status as an associated person of a broker); *Kenneth C. Meissner*, Initial Decision Release No. 850, 2015 WL 4624707, at *9 (Aug. 4, 2015) (finding that respondent acted as a broker by, among other activities, providing guidance "on the procedures for submitting funds" and "fielding questions"), *finality notice as to one respondent*, Exchange Act Release No. 76001, 2015 WL 5693090 (Sept. 28, 2015); Div. Br. at 28. But the particulars of his oversight and his role are lacking. It is not clear how many persons sold Lancorp Fund shares, what fraction of Lancorp Fund investments was attributable to each seller, whether McDuff supervised any seller other than Reese, or much else about McDuff's supervision of these sales efforts. Nor is there clarity concerning the total number of investors that McDuff provided information to or helped close the transactions of. On balance, the evidence of McDuff's involvement, as measured by the number of investors, the dollar amount of their transactions, and the number of the transactions for which he was responsible or involved, is cloudy except as to Benyo and Biles. Moreover, the background checks McDuff conducted did not reveal whether investors were accredited or otherwise wealthy. *See* Div. Br. at 28; DX 37 at 240-41.

The Division argues that McDuff previously "sold" the securities of Overseas and MexBank. Div. Br. at 28. This is true as to Overseas, and possibly as to MexBank, but the evidence is flimsy. The strongest evidence that McDuff sold Overseas securities comes from a single investor, Benyo. Tr. 22-23, 43. Although Loecker testified that the findings of the California Department of Corporations "mentioned how Mr. McDuff was raising money through that entity," the findings barely addressed McDuff's actions and do not state that McDuff sold

securities in Overseas. Tr. 322; DX 12. McDuff's scheme involving MexBank was not fleshed out, and whether the scheme even involved the sale of securities was not established. *See* Tr. 321-24.

As for Megafund, the Division argues that McDuff sold its securities, "recommended the Megafund investment to Lancaster as an investment for Lancorp," and, through the JVA, "ordered Lancorp to invest in Megafund." Div. Br. at 28-29 (emphasis omitted). The evidence the Division cites shows that McDuff caused the Lancorp Fund to purchase Megafund securities, but it does not show that McDuff sold Megafund securities. *See id*. The fact that McDuff recommended Megafund to Lancaster and caused the Lancorp Fund to invest in Megafund suggests more that McDuff acted as an unregistered investment adviser to the Lancorp Fund than that he brokered Megafund securities. *See Anthony Fields, CPA*, 2015 WL 728005, at *14. McDuff's receipt of a percentage of the Lancorp Fund's purported return on Megafund securities, his association with and control over Lancaster, and the fact that he was enjoined in *McDuff* from aiding and abetting violations of the Investment Advisers Act of 1940, further suggest that he was compensated for acting as an unregistered investment adviser. *See id*.; DX 28 at 4. But the OIP does not so allege, nor does it seek a sanction under Section 203 of that Act. *See* OIP at 1-2.

The Division argues that McDuff "admitted responsibility for soliciting investors" in a March 17, 2005, letter to Lancaster that represented that SCC "direct[ed] investors" to the Lancorp Fund. Div. Br. at 29 (quoting DX 45); *see also* Div. Reply at 4-5 & n.8. In fact, there is no evidence (beyond the "gobbledygook" documents, which I do not credit) showing that either SCC or MexBank directed any investors to the Lancorp Fund or Megafund. *See* Div. Br. at 29. The record instead shows that the investors in the Lancorp Fund were solicited by Reese, perhaps unknown others, and, to a lesser but ultimately unclear extent, McDuff.

The Division argues that "McDuff received transaction-based, or at the very least transaction-*related* compensation." Div. Br. at 29; *see also* Div. Reply at 8-9. True, McDuff received a share of Megafund's Ponzi payments, but his share appears to have been determined arbitrarily, and there is no reliable evidence that it bore any relationship to securities transactions. The JVA, an illegitimate and unreliable document, did not "acknowledge that the funds were intended as compensation for McDuff's solicitation efforts," as the Division asserts. Div. Br. at 29. It instead recited a number of falsehoods, including that MexBank had an investor base at the time and that MexBank "shall direct all of its investors . . . to place their monies into the [Lancorp Fund]." DX 44 at 1; Tr. 321 (Loecker testified that, at the time, MexBank "was simply a couple of accounts that Mr. McDuff named").

More to the point, McDuff's receipts were not tied to the successful completion of securities transactions. *See Order Exempting the Fed. Reserve Bank*, 2010 WL 1419216, at *2. The policy basis for emphasis on this factor is that commission-based incentives "can induce high pressure sales tactics and other problems of investor protection" which necessitate broker registration under the Exchange Act. *Persons Deemed Not To Be Brokers*, Exchange Act Release No. 22172, 1985 WL 634795, at *4 (June 27, 1985). The definition of transaction-based compensation is broad, and includes compensation that is a percentage share of the "return" on investment, where the supposed return is actually a percentage of the dollar amount invested;

that is, compensation that is proportional to the dollar amount invested. *See David F. Bandimere*, 2015 SEC LEXIS 4472 at *32.

But the definition of transaction-based compensation cannot be so broad as to include any and all compensation out of investor funds. McDuff's "compensation" was simply what he looted from the Lancorp Fund's investment in Megafund. McDuff was not "compensated" for his sales efforts in any meaningful sense, and even if he had been, such compensation was not proportional to or based on the amounts contributed by the investors he solicited. Even assuming that McDuff engaged in high pressure sales tactics – and there is no evidence of that – his incentive to do so was his desire to steal investors' money, not his desire to maximize his own brokerage commissions. McDuff could have held himself out as an investment adviser, that is, someone who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. *See* 15 U.S.C. § 80b-2(a)(11). McDuff would then have been just as capable of stealing the "returns" on clients' investments; but had he done so, that would not by itself have made him a recipient of transaction-based compensation. McDuff's plundering of the Lancorp Fund's so-called returns is thus more consistent with garden-variety theft than it is with brokering.

Frederick W. Wall, on which the Division relies, is not to the contrary. Wall received "a percentage of the . . . commissions" paid to unregistered brokers he had recruited, which is by definition transaction-based compensation. 58 S.E.C. at 761; *see also Kenneth C. Meissner*, 2015 WL 4624707, at *5, *9. Although the Commission noted that Wall "shared in [his] scheme's profit" in return for "furthering the scheme's success," that observation was made in the context of analyzing his status as an associated person generally, not in analyzing whether he received transaction-based compensation. 58 S.E.C. at 763. To the extent the other authority on which the Division relies suggests that the compensation need only be paid out of investor funds or returns, such authority is inconsistent with Commission precedent and a meaningfully limited definition of transaction-based compensation. *See* Div. Br. at 26-27, 29-30 (citing *SEC v. George*, 426 F.3d 786, 793 (6th Cir. 2005) (repeating district court's finding that defendant received "transaction-related compensation in the form of investors' money"), and *United States v. Elliot*, 62 F.3d 1304, 1310-11 (11th Cir. 1995) (defendant investment adviser received "transaction-based compensation" by receiving his clients' investment principal)).

6. Summary

On balance, the evidence of McDuff's brokering is not established by a preponderance of the evidence. Certainly the evidence as to Benyo and Biles is concrete and specific. But selling securities to two investors is not especially powerful evidence of brokering because it only weakly shows that McDuff was "engaged in the business" of brokering. 15 U.S.C. § 78c(a)(4)(A). The other evidence is unpersuasive, largely because there are so many unknowns: the unknown number of investors he personally solicited, the unknown number of the transactions for which he was responsible, the unknown dollar amount of the transactions for which he was responsible, and the unknown number of other salespersons he supervised or recruited. Most significantly, McDuff's lack of transaction-based compensation even as to Benyo and Biles, although not dispositive, is particularly weighty because such compensation is "one of the hallmarks of being a broker-dealer." *Kramer*, 778 F. Supp. 2d at 1334 (internal citations and quotation marks omitted). McDuff stole other people's money, but he did not

receive compensation for engaging in the business of effecting securities transactions, which strongly suggests that he was not, in fact, so engaged.

Further comparison with *Frederick W. Wall* illustrates the shortcomings of the Division's evidence. *See* Div. Br. at 28-29. In *Wall*, the respondent pleaded guilty to one count of conspiracy to commit securities fraud, mail fraud, and wire fraud. *See* 58 S.E.C. at 759. In addition to receiving a percentage of commissions paid to unregistered brokers as noted above, 58 S.E.C. at 761, Wall admitted that: he ran the company used in the scheme; he helped a co-conspirator set up a salesforce and the operations of one of the issuers, a purported broker-dealer; he attempted to acquire a broker-dealer; he helped establish a series of boiler rooms and recruited unregistered salespersons to staff them; and he made fraudulent representations and omissions to induce prospective investors to purchase securities in sham private placement offerings. *See id*. at 760-61 & n.4, 767. Wall also admitted at his plea allocution that he initiated efforts to register a company as a broker-dealer and filed its incorporation papers, and that the salespersons he helped recruit sold securities illegally. *See id*. at 761. The evidence was specific enough that the district court was able to set a restitution amount ($500,000) based on the customer losses caused by the three salespersons recruited by Wall. *See id*. at 759, 761 n.5. Here, by contrast, McDuff has admitted virtually nothing, and it is not clear how many persons sold Lancorp Fund shares, what fraction of Lancorp Fund investments was attributable to each seller, or much else about McDuff's sales efforts, other than as to Benyo and Biles.

I therefore conclude that the Division has not proven by a preponderance of the evidence that McDuff acted as a broker at the time of his misconduct. This proceeding must be dismissed. *See* 15 U.S.C. § 78*o*(b)(4), (b)(6)(A).

B. Other Issues

I previously reserved ruling on the admissibility of RX 45, and I now order it admitted in evidence. *See Gary L. McDuff*, Admin. Proc. Rulings Release No. 3934, 2016 SEC LEXIS 2191,at *3 (June 22, 2016). McDuff submitted additional proposed hearing exhibits (up to RX 86) in connection with post-hearing briefing. *See* Resp. Br. at 83-86; Resp. Reply (attaching exhibits up through RX 86). This initial decision relies on and cites to four such exhibits: RX 31-A, RX 47, RX 67, and RX 73. These four exhibits are admitted in evidence; McDuff's other proposed exhibits are not admitted in evidence.

On June 14, 2016, the Commission issued an Opinion and Order of the Commission Denying Interlocutory Review. *See Gary L. McDuff*, Exchange Act Release No. 78066, 2016 WL 3254513 (June 14, 2016). The Commission directed me to determine whether and to what extent certain considerations apply in this proceeding. *See id.* at *7. These considerations include the preclusive effect of McDuff's sentencing proceedings, what weight to accord prior testimony where cross-examination was not available, and, presumably, what weight to accord prior testimony where cross-examination was available but McDuff voluntarily elected not to conduct it. *See id.* Because McDuff has prevailed, he has not been prejudiced by consideration of his criminal sentencing transcript, and I have therefore considered it in its entirety. As for prior testimony, McDuff has not been prejudiced by its introduction, its introduction was very convenient to the parties because it eliminated the need to call live witnesses to testify in prison, and McDuff himself offered in evidence a large quantity of prior testimony. I therefore find that

it is in the interests of justice to place significant weight on such prior testimony, regardless of whether McDuff had an opportunity for cross-examination.

Because this proceeding is dismissed, the many affirmative defenses raised by McDuff are immaterial. Nonetheless, two points merit discussion. First, as with most incarcerated respondents, McDuff's access to evidence was complicated by his imprisonment. *See generally* McDuff Decl. (defined and discussed below) at 17-37. In theory, the Division is only required to make the investigative file "available to the respondent for inspection and copying at the Commission office" where it is maintained. 17 C.F.R. § 201.230(e). In practice, the rule is interpreted somewhat differently when the respondent is incarcerated. *See Byron S. Rainner*, Exchange Act Release No. 59040, 2008 WL 5100855, at *2 (Dec. 2, 2008) (directing that the incarcerated respondent be given a "reasonable amount of time to review the investigative file" and noting that he could "obtain" a photocopy of the investigative file at his own expense under 17 C.F.R. § 201.230(f)); *Jose P. Zollino*, Exchange Act Release No. 51632, 2005 WL 1006826, at *3 (Apr. 29, 2005). In particular, it is sufficient if the investigative file is made reasonably available to an incarcerated respondent's "representative." *Joseph P. Galluzzi*, Exchange Act Release No. 46405, 2002 WL 1941502, at *4 & n.27 (Aug. 23, 2002).

The parties filed lengthy declarations regarding their interactions and activities in litigating this proceeding, much of which dealt with the handling of the investigative file. Specifically: (1) on August 12, 2016, the Division filed the Declaration of Janie L. Frank (Frank Decl.) with nine exhibits (Frank Exs. A-I); (2) on August 26, 2016, McDuff filed the Declaration of Gary L. McDuff (McDuff Decl.) with twenty-eight exhibits (GLM 1-28); (3) on September 23, 2016, the Division filed the Supplemental Declaration of Janie L. Frank (Frank Supp. Decl.) with one exhibit; and (4) on September 23, 2016, McDuff submitted McDuff's Reply to Janie Frank's Declaration (McDuff Supp. Decl.) with two exhibits (GLM 29 and 30). Even accepting McDuff's version of events as true, and viewing the evidence in the light most favorable to McDuff, it is undisputed that McDuff's multiple representatives received access to the investigative file weeks in advance of the hearing. *See* McDuff Decl. at 18, 22-23; *see generally* Frank Decl. at 4-13, 18-22. Indeed, Division counsel's hard work in this regard is laudable, and went far beyond what would normally be expected in a follow-on proceeding. *See generally id*.

Second, the hearing was required to have been "public unless otherwise ordered by the Commission on its own motion or the motion of a party." 17 C.F.R. § 201.301. The meaning of "public" in this context is not entirely clear. Administrative hearings at Commission headquarters are considered public, even though Respondents and members of the public are subject to the same security protocols applicable to other visitors, including showing identification, passing through a metal detector, and being accompanied by an escort while in most sections of the building. Until about twenty years ago, when summary disposition first became available, Commission administrative law judges held hearings in prisons from time to time. *E.g.*, *Daniel L. Zessinger*, Initial Decision Release No. 94, 1996 WL 464154, at *1 (Aug. 2, 1996), *finality notice*, Exchange Act Release No. 37796, 1996 WL 580141 (Oct. 8, 1996); *see* Rules of Practice, 60 Fed. Reg. 32738, 32741 (June 23, 1995). I am aware of no Commission precedent holding that a hearing in a prison violates Rule 301.

Presumably, therefore, a hearing is not considered non-public merely because it takes place in a facility that places some conditions on public access. The question is whether the

conditions in this proceeding were non-public within the meaning of Rule 301. Commission opinions and initial decisions pertaining to incarcerated respondents generally do not describe the case-specific security protocols in any detail. *E.g.*, *Daniel L. Zessinger*, 1996 WL 464154. Different prisons may impose different security requirements. *See* GLM 29 at 42-43, 50 (describing visitation rules at the different facilities within the Federal Correctional Complex, Beaumont).

For this proceeding, hearing attendees had to be pre-cleared, a process which took several weeks and involved submission of personal information so that prison staff could conduct a background check. *See* GLM 29 at 44-46; Frank Decl. at 5, 26-27; Frank Ex. H. A few of McDuff's family members, including his mother, were not permitted to attend the hearing, although it is unclear whether they were on McDuff's list of approved visitors. *Compare* Frank Supp. Decl. at 6, Frank Decl. at 28-29 *and* Frank Ex. H, *with* McDuff Decl. at 29 *and* RX 73. An attendee who did not arrive on time would not have been allowed to attend. *See* Frank Ex. I at 1-2. Once admitted to the prison, attendees were not free to leave. *See id*. Such barriers to public access were high, to be sure, but they were not insurmountable. In principle, members of the public could have attended the hearing had they been especially determined and diligent.

Rule 301 cannot fairly be read to create an unqualified right to a public hearing in any case. In criminal proceedings where, unlike here, there is a clear constitutional right to a public trial, that right is not absolute and, on occasion, may give way to other rights and interests. *See Waller v. Georgia*, 467 U.S. 39, 45 (1984). And in non-criminal proceedings, even total bars on public access to proceedings in prison have been upheld. *See N.J. Media Grp., Inc. v. Ashcroft*, 308 F.3d 198, 212 (3d Cir. 2002) ("the government has continued to hold thousands of deportation hearings each year in federal and state prisons"); *Stewart v. Buchkoe*, 283 F. Supp. 1021, 1022-23 (W.D. Mich. 1968) (neither U.S. Constitution nor Michigan law created right to public parole hearing).

In short, the right to a public proceeding must be balanced against competing interests. The Commission authorized this proceeding and later remanded it for the taking of additional evidence, knowing full well that McDuff was incarcerated. *See* OIP at 1-2; *Gary L. McDuff*, 2015 SEC LEXIS 1657. Faced with the option of holding the hearing at FCI Beaumont with some public-access restrictions versus the alternative options of a substantial delay in resolving this proceeding unless and until McDuff could be transferred to another facility (which was entirely uncertain), or holding no hearing at all, McDuff's right to a hearing and the government interest in a prompt resolution of this proceeding took precedence. McDuff had a hearing at his prison facility that resulted in a public record, I granted many of McDuff's proposed transcript corrections, and the transcript (which is publicly available via the Freedom of Information Act) is a reasonably accurate reflection of what took place. There is no evidence that the barriers to public access prejudiced McDuff. On balance, although the restrictions on public access at the hearing in this matter were significant, any deviation from Rule 301 does not warrant dismissal on that basis or a new hearing.

Record Certification

Pursuant to 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the index issued by the Commission's Office of the Secretary on September 30, 2016, and

corrected on October 28, 2016, and includes four additional exhibits filed on August 26, 2016, after the conclusion of the hearing: RX 31-A, RX 47, RX 67, and RX 73.

Order

It is ORDERED that this proceeding is DISMISSED.

This initial decision shall become effective in accordance with and subject to the provisions of Rule 360. *See* 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this initial decision within twenty-one days after service of the initial decision. A party may also file a motion to correct a manifest error of fact within ten days of the initial decision, pursuant to Rule 111. *See* 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then any party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the initial decision as to a party. If any of these events occurs, the initial decision shall not become final as to that party.

_____
Cameron Elliot
Administrative Law Judge